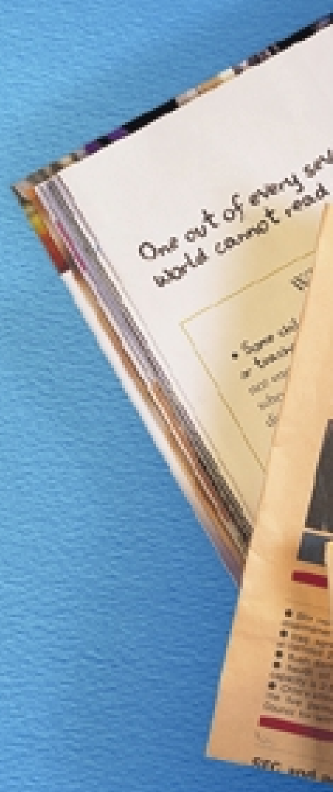
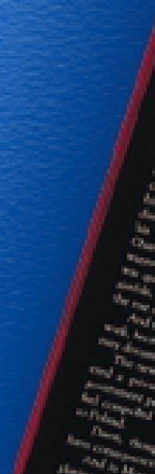
a little knowledge is never enough





PEARSON ANNUAL REPORT 2002

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A little knowledge is never enough. So we try to provide a little more. We educate , entertain and inform millions around the world every day. Through our publishing and our services, we help people live and learn.

Financial highlights	2002		2001		headline % change	underlying % change
Sales*	**£4,320m**	*$6,955m*	£4,225m	*$6,802m*	2	6
Business performance						
Operating profit*	**£493m**	*$794m*	£426m	*$686m*	16	18
Profit before tax*	**£399m**	*$642m*	£294m	*$473m*	36	
Adjusted earnings per share	**30.3p**	*48.8¢*	21.4p	*34.5¢*	42	
Operating free cash flow	**£305m**	*$491m*	£236m	*$380m*	29	
Statutory results						
Operating profit/(loss)	**£143m**	*$230m*	£(47)m	*$(76)m*	–	
Loss before tax	**£(25)m**	*$(40)m*	£(436)m	*$(702)m*	–	
Loss per share	**(13.9)p**	*(22.4)¢*	(53.2)p	*(85.7)¢*	–	
Dividend per share	**23.4p**	*37.7¢*	22.3p	*35.9¢*	5	
Net borrowings	**£1,408m**	*$2,267m*	£2,379m	*$3,830m*	41	

* continuing operations before goodwill, integration costs and non-operating items. Profit before tax includes discontinued operations.

Contents

notes ▸ Throughout this report (unless otherwise stated):

1. Growth rates are given on an underlying basis, excluding the impact of acquisitions, disposals and currency movements. In 2002, portfolio changes increased revenues by £10m and reduced profits by £26m;
2. Adjusted figures are presented as additional measures, to provide a better indicator of business performance. They are stated before goodwill, integration costs and non-operating items. Goodwill is amortised over no more than 20 years;
3. Figures are reported after internet enterprises;
4. 2001 numbers and all prior year numbers have been restated for FRS 19, the new accounting standard for deferred tax;
5. The value of the dollar has been translated at the year-end rate; $1.61: £1 sterling.

Dear fellow shareholders,

A year ago today, I wrote to you about my confidence that you would see a strong earnings recovery from Pearson in 2002, even in uncertain times.

I am pleased to say that we have kept that promise – in spite of the fact that the drought in business advertising has proved more severe and more enduring than any of us could have imagined. However, as a shareholder in Pearson myself, I am painfully aware that our share price has dropped dramatically over the past 24 months. It is little consolation that most of our media peers have experienced similar declines.

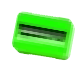
As I write this, the newspapers are full of headlines about prolonged economic and political uncertainty, stock market falls and international terrorism. Why, therefore, am I still confident about Pearson's future?

1. We are now in three fundamentally strong long-term businesses.

As you read this annual report, you will see that each of our businesses provides 'education' in the broadest sense of the word. The judgement we made a few years ago was that in economies dependent more than ever on knowledge and knowledge-based services, governments, companies and individuals would spend more time and money on education and information.

In the past two years we have seen many signs that that was the right judgement: more people going to college or learning English around the world than ever before; a US President who has made education reform the cornerstone of his domestic policy; all of us needing to take a more active interest in managing our pensions and investments. Pearson's businesses will prosper in this brain-powered world.

If we have to be in very treacherous economic waters, it is reassuring that we get the majority of our profits from education and consumer publishing. These areas are not immune to the recession – no sector is – but they do have some fundamental characteristics that are well suited for the times we are in. Stock markets may have plunged and, as I write this, we may be on the verge of a war, but children are still going to school, governments are still spending on education and bookworms are still feeding their excellent habit. As a result, Pearson Education and Penguin had record performances in 2002.



PAMELA WALKER * PEARSON GOVERNMENT SOLUTIONS

Despite the very fine results at those businesses, Pearson's overall performance was muted by a precipitous advertising-led decline in revenues in the business publications of the FT Group.
The financial institutions, the technology companies and the other major corporations that have accounted for most of the advertising in our newspapers have been battered by falling earnings, plunging stock markets and the crisis of confidence in the corporate world.

Despite the appalling economic conditions, the *FT* and its sister titles continue to provide some of the best business and financial information and insight in the world. Their management and journalists deserve all our congratulations for the way they have produced news, comment and analysis of the highest quality. Your board is confident that the FT Group is blessed with people, products and brands of huge value, whose time will come again when advertising recovers, as it always has.

2. The governance of Pearson is in good health.

Pearson practised good corporate governance long before it became fashionable – based on some common sense rules but more fundamentally on the integrity and the values of the board and everyone working in Pearson. We have never slavishly followed the various codes on corporate governance but have always endeavoured to explain where and why we have not ticked the boxes. In that spirit, we welcome Derek Higgs' invitation for companies to 'comply or explain' their attitude to the new UK combined code recommendations.

We already comply with the majority of the proposals made in the Higgs and Smith reports in the UK and the Sarbanes-Oxley Act in the US. We have carried out a complete review of all our corporate governance procedures and we will implement several changes which we believe will improve our governance. There are several recommendations on which we will seek to explain why we believe they will not make us better or serve our shareholders well.

The revised Combined Code will not be finalised until July this year, and we will report on our compliance with it in the annual report next year. However, the board outlines its initial thinking about the implications of new governance proposals in the directors' report.

Over the next few years the US federal government will transfer 850,000 jobs to private companies and our government solutions business is making the most of that opportunity. In 2002 we worked with the new Transportation and Security Administration to help it recruit, qualify and hire more than 64,000 security personnel for US airports – the largest peace time recruitment drive in US history.

3. Pearson’s work is done by many, many bright, energetic and totally committed people.

There are outstanding people all around Pearson. All of them have the admiration and gratitude of me and of the board – whether they are celebrating a record year in 2002 or hoping that their markets will begin to recover in 2003. I would like to extend the same gratitude to our independent directors. We have a small number of independent directors who are a strength in themselves and have been a source of support, constructive criticism and sanity.

Marjorie and the team have continued to do a wonderful job of protecting the company from the worst effects of the downturn while doing nothing in the short term that could prejudice Pearson’s long-term growth. At a time when there is much debate about the appropriate relationship between non-executive and executive directors it is worth saying that they feel enormously fortunate to have a board of non-executives who are supportive and challenging in equal measure.

We have set about 2003 with confidence and determination. We tried not to be distracted by irrational exuberance as the markets boomed, and we won’t be deflected by irrational pessimism on the way down. We’re keeping our eyes firmly fixed on the big picture – which is that we have three world-class businesses, better managed than ever before, with leading positions in long-term attractive markets. That’s a powerful combination that will ensure that Pearson will continue to make good progress this year and for many years to come.

DENNIS STEVENSON ★ CHAIRMAN, PEARSON

Chief executive's review

If you're reading this, you're a Pearson shareholder, and you may be wondering how things *really* are in your company.

Our share price is at a low ebb; one of our finest brands, the *Financial Times*, is becalmed in the advertising doldrums; and the political and economic atmosphere we're working in doesn't look as if it's going to fill with sunshine any time soon.

But Pearson is, in the midst of this gloom, in fine shape. There is every reason for you to be very proud of your connection to the company and confident about your investment. Let me give you just ten:

1 ▸ **Our profits took a turn for the better in 2002 and we can make yearly progress hereafter.** From 1997 to 2000 we produced record sales, profits and cash, and a rising dividend. In 2001, the advertising slump began to be an advertising collapse, and our business newspapers' profits collapsed as well. We still made a profit and still maintained a rising dividend; but it wasn't anywhere near what we'd been used to.

So 2002 was a year when we had to fight back. And we did. We kept our promise of an earnings recovery in spite of a global economy and business climate that just got worse and worse.

2 ▸ **Each of our businesses is a leader in its field.** All of them have sustainable, best-in-class positions in their markets. They are not only leaders in size; they also have strong brands and franchises – something special in the products they make or the way they do things that sets them apart from their competitors.

3 ▸ **We are in 'knowledge' markets, good markets to be in when the world is moving from relying mostly on muscle power to relying mostly on brain power.** Those markets require news and information to run businesses or countries; education – cradle to grave, pre-school to professional; entertainment and elucidation – at least what can be found in books, one of the most cost-effective ways there is to have a good time. Our businesses use two methods to appeal to people's intellects: great publishing and the ability to mix that publishing with services to help customers use the words and data and ideas.

4 ▸ **Pearson is now an operating company rather than a holding company.** That means our businesses have enough in common that we can all work on the business at hand, not on *overseeing* disparate enterprises. Including management. We go out with salesmen and dig for new product ideas and talk to customers. We look for ways to do new things, or to do old things differently. We look for ways for the parts of the company to share talents and assets and costs inside the company.

Of course, you can only share things if you have a set of businesses that work together and help each other. And that's what we finally have. Our businesses all make sense together, and so they can work toward the same goals together. Collaboration is an everyday occurrence at Pearson.

5 ▸ **We are entirely reliant on the inventiveness and character of our people.** If tomorrow we didn't have offices, or warehouses, or we lost all our manuscripts

MARJORIE SCARDINO • CHIEF EXECUTIVE, PEARSON

and all our software code, we’d still be in business. We’d still have our major stock in trade – our people’s ability to reinvent the business and their willingness to confront tough chores.

We’ve set our sights on being a great place to work, a place everyone *can* leave because they’re in such demand, but no one *does* because this place is better. We do everything we can to make sure that we recruit the best people and then give them the training and career development they need to do their job... and the next job they’re going to have. When they join us, they can expect to be paid fairly for doing their job and to receive rewards for extraordinary work. They can also expect to have a safe place to work, free from any kind of bullying or unfair pressures. And they can, on most days, expect to enjoy their work.

6 ▸ **We have a board of directors who understand that their job is to help the enterprise prosper, and who do just that.** These days boards face more rules to ensure they act responsibly and check up on management regularly. Our board has an informal and intimate frankness that ensures they do both without pulling any punches. They know management needs their help, and they give it generously. They know the shareholders count on them to make sure their investment is being well taken care of, and they do that uncompromisingly.

7 ▸ **We try to make it as easy as possible for people to understand our business and our performance.** In a world where companies have lost their way through a confusion of accounting rules and special purpose vehicles, and where business stories are told in jargon and pension details are covered with caveats, we try to tell our stories – including our strengths and weaknesses – in plain English and plain data. We think that will protect our shareholders and give us advantages.

8 ▸ **We believe corporations are risk-taking organisations whose aim is to become more valuable over time because they produce valuable products and services at a profit.** Our company doesn’t discover miracle drugs or miracle technology. But we do discover and publish new ideas; make information available and understandable; strive to provide truly ‘universal’ education – that teaches *each* child. We in Pearson work because of that possibility, and believe that if we’re able to change the world, our shareholders will profit as well.

9 ▸ **We count on the fact that culture and conduct – what beliefs we share and how we conduct business – have a great deal to do with success.** Like all companies, we say we are ethical and try to do our duty to society and our employees. But we’ve been saying our aims were to be ‘brave, imaginative, and decent’ so long now we’ve all begun to know what that means. And when we don’t act that way, we know it and try to make sure that it doesn’t happen again.

10 ▸ **We have a clear goal and a strategy for achieving it.** Our goal is outlined in the theme of this report. It is to add to people’s knowledge to help them live and learn.

Pearson Education and Penguin US have partnered to create a new college book series: Penguin Academics. Ranging from anthologies of literature to history books, the series makes Penguin’s unique backlist available in new forms to professors and students of literature.

KIYARA ALS * PENGUIN
LATOYA SIMS * PENGUIN

To entertain and enlighten them; to teach them new skills and inform them about their professions. We believe it's a good goal, and we've now got the company that can accomplish it. But the measure of whether we're accomplishing it is our financial performance.

So now our strategy for achieving it is not just getting the right pieces, as it has been for the last five or six years. It is having annual improvement in sales, profits and cash; and increasing our return on invested capital. It is exerting what Thomas Edison once said genius required: **1% inspiration and 99% perspiration.**

2002

Last year, to achieve the earnings rebound, we relied on all those attributes of Pearson to get the job done.

We were helped in our profit improvement by cost reductions, lower internet losses and lower interest charges (because we paid off some debt when we sold our television business). We were hurt by the weaker dollar, and, of course, by the advertising environment.

Since 1997 we have measured our success three ways – sales, margins and cash. In 2002, we began to work even harder on cash and, with a special emphasis on managing our working capital, we were able to increase our operating free cash flow by 29%.

Good competitive performances ▸ We gained significant shares in four of our biggest markets: higher education, consumer publishing, asset valuation and government services. We made modest gains in most of our other markets, too. The only market where we lost share slightly was in US schools, and that was because we decided to sit out of bidding for some school book opportunities we thought would be unprofitable for us.

Aggressive cost management and asset allocation ▸ We had to reduce spending across Pearson, especially in our business newspapers and in technology publishing, areas hit hard by the recession in advertising and in technology. We also began to see the early investment costs of new businesses come down, particularly those reliant on the internet. As we managed costs, we tried to balance the risks and the rewards. We did not treat people as sacrifices to be made for financial markets that wanted the short-term to be better.

Continued investment ▸ At the same time we cut costs, we invested. We put more than £250m into new product development, which will sustain our top-line in the future. And we spent £30m integrating our businesses and their shared functions in ways that will add to our bottom line in the years to come.

2003

For this year, we're confident that, except in the most extreme political and economic conditions, we can deliver further significant earnings growth, even at current exchange rates, and also further cash and an increasing return on capital. And we're confident we can go on to sustain annual progress on all three measures, working hard, task by task, day by day. Where will we be exerting our 99% perspiration?

More investing ▸ We'll allocate our resources first to our markets that are growing the fastest: higher education, English language teaching, children's publishing, testing, governments as customers, investors who need our data and pricing help in an unpredictable market.

We'll also invest to take advantage of our franchise and market share where we see our competitors are weakened by the environment. This is especially true in our business newspapers. Of course we'll make these investments carefully, but no franchise can continue – even one a century old – without nourishment.

Growing our own ▸ Now that we have all the right parts in our company, we plan to rely more on our ingenuity than on acquisitions for new products and services. So we'll be working to create some for existing brands and to customise some. Customisation is already booming in our education business, where professors want their own unique books. It also works for FT.com subscribers who want their investments monitored, or their data fed to them their way. Organic investment means we will also have to be even more disciplined in our allocation of assets – not shying away from taking risks, but taking those with the most reliable and enduring returns.

Streamlining operations ▸ We started on this last year. We've been pretty good at getting integration benefits from our acquisitions – we've always done better, faster than planned. Now we do that with our existing companies as well, sharing processes and back offices and efficiencies of all kinds; improving sales efforts and marketing ideas thanks to the expertise of one part of the company teaching another.

BEYOND 2003

Pearson was started by an entrepreneurial contractor in Yorkshire in 1844. Over the last century and a half its assets and its businesses have been built up by descendants of that adventurer and then by others they brought in as the enterprise grew. It has had its high periods and its low periods. It has gone through digging railroad tunnels and drilling for oil and starting airlines and providing lighting for the public monuments of Athens. It has made wine and fine china and amusements in wax. And for nearly a century it has been a devoted and courageous publisher.

But whatever it has done, its owners and managers have always prided themselves in the thought that the assets of the company were to be improved in value and passed on to the shareholders of the next day. And that is still our aim today.

We know that, in order to do our part for the enterprise, we have to make the decisions that will make the company more valuable as it passes down the line than it was when we took it over. That means we have to invest our capital in ventures that will bring in more value than they cost and that will endure. And that is what we aim to do in 2003 and well beyond.

Marjorie Scardino

In a year of tough commercial conditions, the FT set out to treat its readers and customers better than ever. In the UK and US, the FT conducted extensive market research, held an internal customer awareness seminar and put a customer service ranking system in place to raise the quality of customer service. As a result, overall satisfaction with the FT is now consistently 9 out of 10.

CHARLOTTE HOARE * FINANCIAL TIMES
OLIVIER FLEUROT * MANAGING DIRECTOR, FT GROUP
MARK RUBIN * FINANCIAL TIMES
SASA SAVIC * FT CUSTOMER
JACK BRABIN * FINANCIAL TIMES
CHRIS COTNOIR * FINANCIAL TIMES

The Pearson goals

For the past five years, Pearson's performance measures have been central to the way we manage our business. With our portfolio transformation now largely complete, we have refined our approach.

Our six measures provide clarity, internally and externally, about the most tangible and relevant measures of our financial performance. We use our operating goals – sales growth, margins and cash conversion – to set targets for our businesses and as the basis of incentive plans across Pearson. We use our financial benchmarks – free cash flow, EBITDA and adjusted earnings per share – to align management with the interests of our shareholders. These financial benchmarks, and increasingly our share price itself, form the basis of our senior management incentive plans.

While these performance measures have served us well, with our portfolio transformation largely complete we have taken the opportunity to refine our approach. We think it's important that we continue to look at a range of measures that give a balanced view of our business, rather than an excessive focus on any single one. We also believe that our current operating goals meet our objective of being simple, measurable, stretching and consistent, and that our financial benchmarks do align our actions with the interests of our owners.

However, we are making some modest adjustments to our goals as Pearson enters this new phase in its evolution. A key objective will be to deliver returns above our cost of capital. We are therefore introducing return on invested capital as one of our financial benchmarks in place of EBITDA. (EBITDA is largely covered by our targets on cash conversion and free cash flow. For the record, EBITDA was £615m in 2002, up from £588m in 2001.)

Our operating goals already largely focus on the levers we have to improve ROIC. We will continue to measure our performance against the goals which drive operating profit: sales growth (at constant exchange rates) and operating margins. We are also retaining our cash focus and continue to aim to convert at least 80% of our operating profits into cash in any one year. We are adding a through-the-year measure of capital efficiency – an annual improvement in the average ratio of working capital to sales. We introduced this measure in 2002 at Penguin and Pearson Education, where we currently tie up an average of some £1bn in stock, debtors and creditors. The FT Group is a net contributor of working capital.

Naturally, we alter the weighting of these metrics across our company depending on the nature of the business involved and its operating environment. It is also important to note that the goals set out here do not reflect the full range of measures, both financial and non-financial, that we use to drive performance in our operating companies.

Finally, although we have always striven to communicate our financial performance openly and clearly, the radical changes in our portfolio have not made it easy to compare our performance year-on-year. Many of these complexities – which were explained in the notes to our accounts – will naturally fall away as our portfolio becomes more settled. However, we will seek to provide additional reconciliation in our accounts wherever they aid a better understanding of our business.

In 2002 we reduced the average working capital tied up in our book publishing businesses by £53m – even as we increased investment in new authors, titles and programmes – by being more efficient with our inventory.

RONA FAIRHEAD * CHIEF FINANCIAL OFFICER, PEARSON

UNDERLYING SALES GROWTH

Pearson's underlying sales grew 6% in 2002. We calculate underlying sales growth by excluding the effect of acquisitions or disposals on the one hand and currency movements on the other. As our business portfolio is now more stable, the 'underlying' impact in 2002 is primarily currency movements.

We believe that we now have a mix of companies that can deliver long-term through-the-cycle growth. However, in 2001, our book publishing businesses were unable to protect us from the downturn in our more cyclical newspaper publishing operations. In 2002 we delivered a return to growth even though sales in our newspaper and technology businesses continued to decline.

In 2003, with the outlook for our advertising-related and technology publishing businesses still difficult, we expect only modest sales growth. Looking further ahead, we expect sales growth to pick up again.

TRADING MARGIN

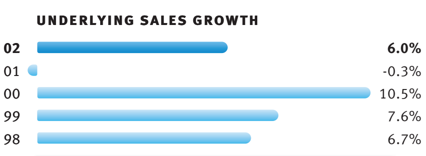
Trading margin represents our ability to turn our sales into profit. Our aim is to ensure that all our businesses generate 'best-in-class' margins, relative to their industries.

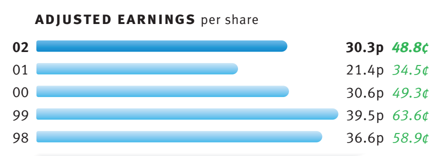
In 2002, our trading margins improved to 11.4% (from 10.5% in 2001). We benefited from lower internet losses and actions taken in 2001 to reduce our cost base. This more than offset the continued business advertising and technology publishing downturn and a change in the revenue mix at Pearson Education (where we saw a very big increase in the sales contribution from our lower-margin professional operations). Throughout 2002 we continued to take cost actions, which we expect to help improve margins in future years. These included ongoing business restructuring costs (which we expense as operating costs) and a £30m investment in back office integration and systems rationalisations.

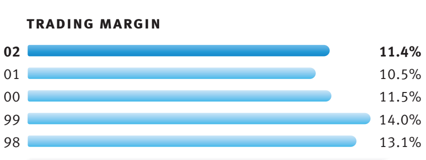
Looking ahead to 2003, we expect to reduce internet losses and the costs of our business integration investment to fall to £20m. This investment spend will disappear in 2004 and we aim to generate some £20m of annual cost savings from 2005 onwards.

ADJUSTED EARNINGS PER SHARE

We report our adjusted earnings after normal business restructuring costs, which we treat as operating expenses, but before specific non-recurring costs, primarily the integration costs relating to significant acquisitions and before







TAMMY MAN * PEARSON EDUCATION, HONG KONG
ANDREA CROZIER * PENGUIN, CANADA
JULIE GIBBS * PENGUIN, AUSTRALIA

We are the world's biggest book publisher and we are beginning to make that scale count in our favour. We have combined our book businesses in Australia and Canada and we are moving to share back office operations such as warehousing and distribution in the UK and New Zealand.

JEFFREY ATKINSON * PENGUIN, NEW ZEALAND
SAUL MATTHEW IRELAND * PENGUIN, NEW ZEALAND
MICHAEL CAMPBELL * PEARSON EDUCATION, CANADA

UDI KORE * ZEDDRICK WHITE * PEARSON

certain non-cash items – principally goodwill amortisation. Non-recurring costs were integration charges of £10m in 2002 (against £74m in 2001) and a £37m charge for the cancellation of certain swap contracts following the RTL disposal. The total goodwill charge was £340m down from £436m in 2001 with an average remaining life of goodwill of 15 years.

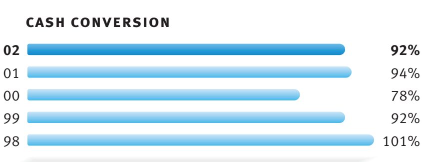
Our adjusted earnings per share fell back in 2001, driven by the sharp cyclical downturn in business advertising. In 2002, despite the continued advertising downturn and a weaker dollar exchange rate, we delivered earnings growth of 42%.

In 2003, we expect to continue to grow earnings in double-digits at constant exchange rates, as we benefit from a further steep decline in internet losses and some modest improvements from our business integrations.

Looking further out, we should benefit from our leading positions in growth markets and our ability to harness the benefits of sharing our assets and our processes. Our aim will be to deliver strong annual earnings improvement at constant exchange rates.

CASH CONVERSION

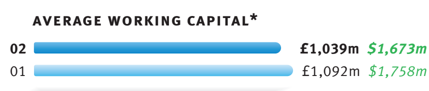
Our newspaper businesses typically convert almost all their operating profit into operating cash flow,

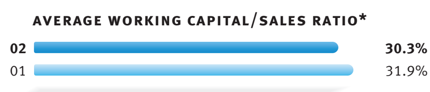


but, if they are to grow, our book publishing businesses need to absorb capital – in the form of authors' advances, pre-publication costs, inventory and receivables. We do not as a result, seek to convert 100% of our operating profit into cash, although we set ourselves a minimum target of 80% cash conversion for any year.

We achieved that target again last year with a strong performance in both cash collection and inventory management.

working capital ▸ Of our £1bn of working capital in 2002, 53% represents our investment in future growth – the advances that Penguin pays its authors before they deliver their manuscripts; and the new product development (or 'pre-publication costs') at Dorling Kindersley and Pearson Education.





* *Pearson Education and Penguin only*

We'll continue to make these investments, so long as we can see adequate returns. The rest of our working capital represents cash tied up in our processes, and here we see potential to become more efficient.

In our book publishing businesses we targeted and delivered a 5% improvement – some £53m – in the absolute level of average working capital, based on constant sales.

Marca, Spain's leading sports newspaper, has raised its game in the face of tough competition. A successful redesign and an aggressive marketing campaign helped *Marca* bounce back to growth.

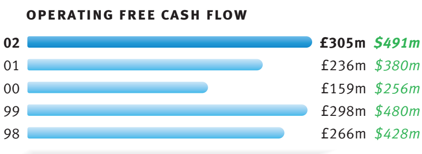
PILAR TRUCIOS * RECOLETOS

GASPAR GONZALEZ PALENZUELA * RECOLETOS
JOSE MARIA PAJARES * RECOLETOS

Improving our average working capital to sales in 2003 and 2004 will be extremely challenging as, at our education business in particular, we'll be ramping up new product investment ahead of very strong expected sales in 2005. However, we will seek to deliver continued efficiency gains and yearly progress on this measure.

FREE CASH FLOW

Free cash flow is the measure of the cash that is available from our business operations, after the payment of interest and tax, for distribution in the form of dividends or for re-investment in our business. The proceeds of disposals and the cost of acquisitions, together with any substantial integration costs associated with them, are excluded from the calculation.



Pearson's total free cash flow has been depressed in recent years by a high level of investment, particularly in the internet operations, but also in our print businesses. We believe that these investments will generate future growth, but we also need to ensure that dividends to shareholders can be paid from the cash generated by our businesses. In 2002, our focus on working capital and capital expenditure helped us to deliver a 29% improvement in free cash flow – even as we continued to invest in our businesses.

Looking ahead, we expect to deliver steady progress in cash generation, although we recognise that free cash flow in any one year may be affected by individual investment programmes. In the short term, we expect cash flow generation to be strongly positive.

RETURN ON INVESTED CAPITAL

Over the last few years, the transformation of Pearson has significantly increased the capital invested in the business (in the form of goodwill associated with the acquisitions necessary to build our market-leading businesses) and required substantial cash investment to integrate those acquisitions and to deliver an increasing proportion of our publishing and services online. With that transformation now largely complete, we are in a strong position to improve, each year, our return on invested capital.

We define ROIC as operating profit less cash tax as a percentage of our net operating assets plus total goodwill (that is, before goodwill amortisation). In 2002, our ROIC was 6%, up from 4.6% in 2001. Our cost of capital is a little lower than 8%. Our goal is to generate returns on invested capital above the cost of our capital as soon as possible.

RETURN ON INVESTED CAPITAL	2002		2001	
RETURN (OPERATING PROFIT LESS CASH TAX)	£419m	$675m	£394m	$634m
TOTAL INVESTED CAPITAL	£6,976m	$11,231m	£8,584m	$13,820m
RETURN ON INVESTED CAPITAL	6.0%		4.6%	

Going forward, we have two main levers to improve returns: increasing operating profit and reducing the level of operating assets. How quickly we can generate returns above our cost of capital will be dependent on a number of factors such as the business advertising environment.

ELISE SEE TAI * SIÂN WILLIAMS * CATHERINE GOLDSMITH * RACHAEL FOSTER * DK DESIGNS LYNN TREPICCHIO * BETSY NILES * SUZANNE KEEZER * CELIA ARGIRIOU * PEARSON EDUCATION

For the first time, children in the US, UK, Australia and Canada will learn to read from the same series of books thanks to an ambitious collaboration between Pearson Education and Dorling Kindersley. The Four Corners reading programme consists of 140 books which combine Pearson Education's mastery of content with DK's design magic.

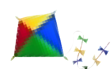
From business to education to books, our products last a lifetime.

In a world where the prosperity of individuals and countries increasingly depends on their knowledge and skills, our products matter more than ever.

1 **We're a publishing company:** whether data or images on paper or screens; whether in real time or from another century. Our customers trust us to make the right calls on which authors to sign up, which news stories to put up front, or how best to illustrate a science experiment. That takes good judgement in thousands of decisions about what's true, what's important, what's entertaining and what's inspiring.

2 **We mix services with our publishing to make the content more valuable and introduce us to new markets.** We combine textbooks with tests, so a teacher can diagnose how a child is learning, and prescribe an individual programme to help him along. We blend today's company news and analysis with historic data, so an investor has the information he needs to manage his money.

3 **We're one company.** Our special mix of assets is generating some wonderful opportunities – both to save costs and to grow revenues. We're realising the scale advantages of being the world's biggest book publisher, and we're creating new products that are more useful and more appealing because our businesses are working together.



4 **Our most important advantage is our people.** Everything we create – ideas, stories, newspapers, images, books, websites – is only as good as their minds and imaginations. They're responsible for helping children learn and for testing them to check that they have; for helping business people to make the right choices; for telling stories that help people understand the world or bring a smile to their face. So our company extends beyond newsrooms, design studios and warehouses and into classrooms, colleges, businesses, trading floors and homes.

Pearson is one of the world's great publishers. We publish more books than any other company and our news and analysis reach millions of people every day, in print and online. Over many years our publishing brands – Penguin, the Financial Times, Scott Foresman, Dorling Kindersley, Prentice Hall, Longman and many others – have earned the trust of readers because of their commitment to accuracy, integrity, and independence of thought. Our journalists, authors and editors are constantly seeking out the next scoop, blockbuster author, compelling story, innovative format or distinctive design.

Penguin's best Christmas: In a year when the global consumer publishing industry was flat, Penguin grew its underlying revenues by 5%. Much of that performance was down to our strongest publishing schedule yet. Penguin topped the Christmas bestseller lists on both sides of the Atlantic, thanks to authors like Jamie Oliver, Roy Keane, Zadie Smith, William Trevor, Tom Clancy, Patricia Cornwell, Nora Roberts and Jan Karon.

A publishing revolution: For many years, Dorling Kindersley's unique style of illustrated reference books has brought learning to life. Acquired by Pearson in 2000, DK has been working hard to turn around its commercial performance and unlock its creative magic. Those efforts paid off in 2002, as DK returned to profit and to its publishing best with a new generation of beautiful books including Bill Wyman's *Rolling with the Stones* and Judith Miller's *Antiques Guide*. DK's progress is set to continue in 2003 as it strengthens its partnerships with world-renowned institutions including The Smithsonian and The Royal Horticultural Society and prepares to publish new titles from leading experts such as Peter Ackroyd in history, Monty Don in gardening and Tom Peters in business.

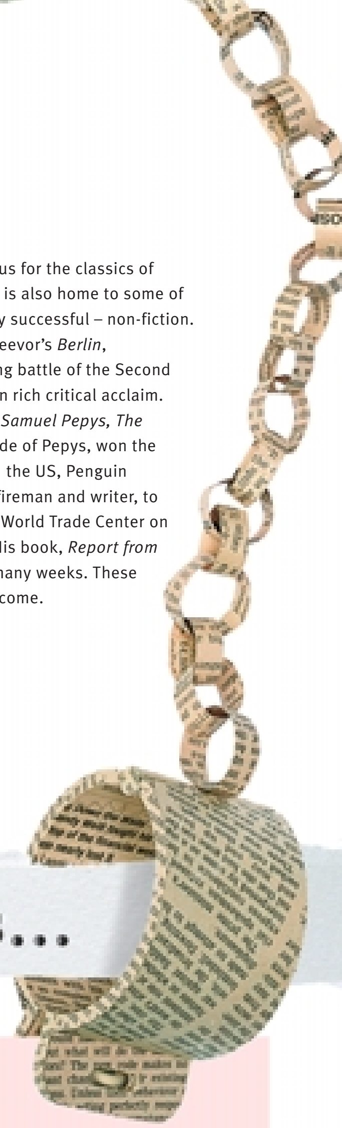
Rethinking the Classics: For more than 50 years, the Penguin Classics have provided the most authoritative and informative editions of classic literature for students and general readers. Launched in 1946 with a paperback translation of Homer's *The Odyssey*, the Classics were described as 'the greatest educative force of the Twentieth Century'. This year we're relaunching the entire list of 1,000 Classics, with new introductions and prefaces, up-to-date suggestions for further reading and a fresh new design.

The web of life: In colleges and schools across the US, we are moving our teaching materials from pure textbooks to a blend of printed and online content. Working with leading biology expert, Neil Campbell, Pearson Education applied content and technology from its college business to develop a slimmed-down core school textbook. We moved much of the detailed content online, enhancing lessons with tests, simulations, experiments and rich data.

Barons of Bankruptcy: Corporate greed was among the biggest business stories of 2002, and executives being led away in handcuffs provided the defining images. The *FT* looked behind the headlines and analysed how much money company directors made as their companies went bankrupt. After a six-week investigation, the *FT* revealed that executives who presided over the 25 largest bankruptcies in the US amassed personal fortunes totalling $3.3bn. The story touched a popular nerve in the US and helped set the agenda for the debate on corporate governance that followed.

Head of the class: It's statistically impossible to graduate from college in the US without studying one of our textbooks. Our college authors define the way future generations view the world, and many are the world's leading authorities on their subjects. They include Philip Kotler in marketing, Neil Campbell in biology, James Watson in microbiology, Robin Bade and Michael Parkin in economics, X J Kennedy in literature and Donald Knuth in computer programming.

Making history: Though Penguin is famous for the classics of literature and for contemporary fiction, it is also home to some of the most critically acclaimed – and commercially successful – non-fiction. Three history titles stood out in 2002. Antony Beevor's *Berlin*, with its story of the human misery of the defining battle of the Second World War, topped the bestseller charts and won rich critical acclaim. Claire Tomalin's funny and irreverent biography *Samuel Pepys, The Unequalled Self,* which revealed the personal side of Pepys, won the prestigious Whitbread Book of the Year prize. In the US, Penguin editors approached Dennis Smith, a retired NY fireman and writer, to tell the story of his colleagues who ran into the World Trade Center on September 11, when others were running out. His book, *Report from Ground Zero*, stayed on the bestsellers list for many weeks. These books will inform and inspire for a long time to come.



entertains and informs...

Playing to win: When *Marca,* Spain's leading sports newspaper, was faced with a tough competitor who began to reduce its cover price sharply, it was faced with a dilemma: fight a price war, as many newspapers have in Europe, or compete on the quality of the product. It opted for publishing quality – supporting the editorial team, investing in the brand and expanding into new media formats. As a result *Marca* gained share during the year, despite the price competition, with its circulation bouncing back to growth.

English lessons: There are more than a billion people worldwide learning English as a second language. Through the world-famous Longman imprint, we teach more than 40 million of them every year.

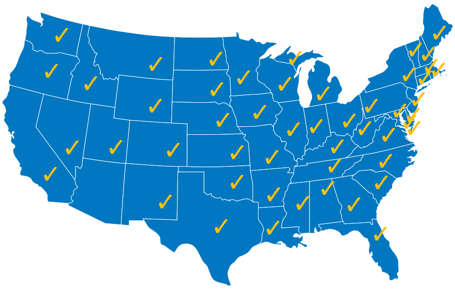
Award-winning journalism: The *Financial Times* stole the show at the World Leadership Forum's Business Journalist of the Year Awards:

- Decade of Excellence Award: Martin Wolf.
- Business Journalist of the Year Award: Richard Tomkins.
- Management and Business Education Award: John-Paul Flintoff.
- Service Industry Award: Juliette Jowitt.

Great publishing isn't just about great ideas and stories. It's also about making them available in the way customers want them and making the content special and useful. Much of our future depends upon being able to customise the things we make. Our books, newspapers and websites all have mass audiences, but our customers often want something unique, too.

Our customer may be a teacher who wants to give one student special practice to get his reading skills up to speed with the rest of the class. He may be a college professor who wants to build an economics course out of his own notes, lectures, assignments and tests, and deliver them online to his students. She may be an investor who wants to track the news and share price performance of her own unique portfolio of stocks.

Making its mark: Millions of students depend on Pearson as they sit their school tests and exams. In 2002, our educational testing business renewed two of its largest statewide contracts – California and Ohio – and won six new state contracts and the Department of Education's nationwide test of student progress. This business is poised to benefit further as the US Government has passed a law requiring all 50 states to test every 8-13 year-old in reading and maths every year.



Adding up: Pearson's Higher Education publishing business took the emergence of the internet as an opportunity to extend its leadership and attack one of its big competitors – the market for second-hand textbooks. *My Math Lab,* an online learning environment dedicated to improving student performance in mathematics, is a good example. It provides homework in multi-media instructions for 66 of our Higher Education maths titles and we're adding more. Students are able to log on using access codes, which they only receive when they buy a new textbook. Professors use the site to tailor material to their particular teaching needs. This leading-edge technology helped the Higher Education publishing business to grow well ahead of its market. We're launching similar products in economics, psychology, anatomy and physiology in 2003.

A fair deal for investors: The *FT*'s asset pricing business, IDC, is set to benefit from one of its most exciting new products. IDC discovered that a structural inefficiency within US mutual funds was costing the funds $4bn a year. Their investments in overseas markets like Japan were valued at the end-of-day prices – even though there were circumstances in which, if stock markets elsewhere in the world rose sharply while Japan was sleeping, it was a statistical certainty that Japan would re-open higher too. Arbitrageurs were taking advantage of these 'stale' prices and making significant profits.

So IDC created a service called Fair Value Pricing – to come up with more accurate values for overseas securities. The product is being trialled with 50 of the world's largest financial institutions and we're helping the industry solve a problem that they weren't even aware of. We're now developing a range of follow-on products and ideas that our methodology can be applied to.

Working for the government: NCS Pearson's Government Solutions business was Pearson's fastest-growing division in 2002, winning more than $500m of new US Government contracts. The US federal Government is keen to outsource non-core operations to private companies, and NCS is using its expertise in testing, training, HR support and data management to take advantage of the opportunity.

In March NCS Pearson was hired by the Transportation Security Administration to help it recruit and train 64,000 security personnel for US airports, in the biggest recruitment drive in US peacetime history.

We're also providing an online college education for US Navy personnel onboard ships and submarines; processing student grant applications for the Department of Education; helping the US Army, Navy and Air Force to administer their HR systems; and operating a national customer service centre for the US Department of Justice.

The fourth edition: FT.com, the online expression of the *Financial Times*, is the world's most popular audited business website. Since its launch in 2000, we've been steadily growing its audience – now a record 3.5 million users every month – and earning revenues through the sale of advertising and content. In 2002 FT.com took another big step forward as it launched a new range of services and began to convert those users into paying customers.

We re-designed the site and added new content, making the most of the *FT*'s unique comment and analysis. Paid-for services such as Lex Live and the Brussels Briefing are among the most popular areas of the site. By the end of 2002 we had 45,000 paying subscribers, helping FT.com to break even. It's now well established as the leader in online business journalism and is set fair to pay its way as the newspaper's fourth edition.

Testing the professionals: This year, 200 Pearson professional testing centres opened for business across the US. Each year 150,000 aspiring nurses will take their professional examinations in our centres, which provide an accessible and secure environment for online testing. Now the centres are open, we're aiming to make them the testing home for many other professions.

Made-to-order: In colleges up and down America, we're helping professors to create their own unique textbooks. We custom-build books and online programmes for a professor's individual course – taking in his own course plan and lecture notes, chapters from our books, newspaper articles, and tests and assignments he wants his students to take along the way.

So now we can make a curriculum that teaches his course the way he wants it. This business has trebled in size over the past three years, and is a model of personalised publishing that many other parts of Pearson can follow.

Over the past few years we've spent a lot of time and effort transforming Pearson from a disparate group into a more coherent company. We are a large family of businesses that are a lot alike and all share the same aim – to help our customers get on in, and make the most of, their lives. Pearson is the world's leading publisher and we want to make the most of it. Where it makes sense to share assets – such as intellectual property, content, design, brands and back offices – we are doing it more and more. Collaboration across Pearson isn't just about reducing costs, it's also helping us to create new products with some fantastic results.

...A FAMILY OF BUSINESSES THAT SHARES BRANDS.

Four corners: For the first time, children in the world's largest English-language markets – Australia, Canada, the US and UK – will learn to read from the same series of books in a new collaborative production between Pearson Education and Dorling Kindersley. An international team of researchers, designers and editors from across the two companies have been working since 2001 to create 2,400 pages and 140 books to be launched at the end of 2003.

Each book has been compiled to match curriculum standards in each of the four countries and written locally to reflect cultural differences. They will look dramatically different from any other reading book with beautiful DK designs that bring the pages to life. This collaboration is one of a number of cross-Pearson projects spearheaded by a new division, DK Designs, created specifically to spread DK's design magic across the company.

Painting campuses pink: Our college publisher Prentice Hall has sales teams on the campus of every business school and every college across America. With the *FT*, we're now offering business, finance and economics professors a weekly online service from the *FT*'s top writers. They report and analyse the major business and economics stories, and highlight the big issues to look out for in the week ahead. Professors use this commentary to prepare topical lessons and assignments. The partnership is helping our college business sell more books, and introducing the *FT* to its next generation of readers.

Sharing assets: As the world's largest publisher, we own millions of digital assets. We've pooled these resources to create the Pearson Asset Library. Not only is this saving costs on image licensing fees but it is also streamlining our production processes across the company. In 2002 we combined our two biggest libraries – 2.7 million images from our commercial DK image library and more than 800,000 from Pearson Education. The *Financial Times* photo library, a vast collection of news photographs and images, will be added in 2003.

The power of one: Together, Pearson Education and Penguin are the world's largest book publisher. We are starting to make that scale count in our favour.

Last year, we combined these book publishing businesses into single companies in Australia and Canada. They already shared many customers in the form of the major bookstores, and they now share warehouses, distribution centres, technology, salesforces and back office functions, too. In the UK, we are combining Penguin's and Pearson Education's warehousing and distribution into a new centre.

These are big investments – we plan to spend a total of £50m in 2002 and 2003 combined – but we expect to save £20m a year from 2005 and provide a better service to our customers.

The books business: The *FT* is trusted the world over for its authoritative business news and analysis. Now it's our brand for business books, too.

The FT and Prentice Hall, one of our imprints for college students and business people, have joined forces to publish the best titles in management, finance and business.

Recent titles include the history of telecommunications giant Nokia; a biography of Bernard Arnault, head of the LVMH luxury goods empire; and the *Financial Times* guides to marketing, investment and strategy.

A Texas-sized opportunity: In 2003 the state of Texas plans to buy new social studies textbooks for all its school children. Pearson Education expects to take a decent share of that opportunity as it launches a new social studies programme.

The new programme consists of 27 books, some in English, some in Spanish and some for advanced study, all aligned to the state's specific standards. The elementary texts feature specially designed spreads from Dorling Kindersley that radically transform the traditional look and feel of a social studies textbook. And scanners from our education testing business will enable teachers, for the first time, to test their students on-the-spot to see if they've learned the lessons the state requires them to.

We publish educational programmes that help teachers teach and students learn; news and analysis that help business people, politicians and investors make decisions; and fiction and non-fiction books that entertain and inform.

In all that publishing, we are unusually dependent on our people: the reporters, authors, designers, editors, educators and sales people who create our products and make them successful. Our work is underpinned by some basic principles. They are about being a company that is brave, imaginative and decent; about being committed to education in the broadest sense of the word; and about having a fundamental commitment to editorial integrity and freedom of speech.

…a company that is entirely reliant on our people and counts on the

a great place to work

Everything we create – ideas, stories, newspapers, images, books, websites – depends on the minds and imagination of our people. We're home to some of the best in the business, and we've set ourselves the goal of being the best place to work in the world. Of course we're nowhere near there yet, but that's where we're aiming.

Employee survey: This year we completed our first company-wide employee survey, and compared our results with 6,000 other companies. Pearson scored reasonably well as a place to work. We enjoy our work, we're happy with our working conditions, we think we have good benefits, we like to think we help each other. More than 60% of us think that being part of Pearson is important, and more than 80% think we're doing a good job of communicating what Pearson is about. But there are also real concerns over job security, stress and lack of opportunity for promotion. These are concerns that you expect at this stage in the economic cycle and we take them seriously. We're making a big effort to improve the feedback and career planning we provide to everyone at Pearson, and to improve the information we give people about their benefits. We'll repeat the survey this year, too, so we can see how we're doing.

Code of conduct: One of our basic principles is to be a decent company, that does the right thing by its people, its customers, its shareholders and everyone we do business with. This year we published a code of business conduct, setting out what that means to us – and really putting down on paper the standards of what we already believe and do.

Pearson careers: Across Pearson, we run a series of programmes to develop our people at all stages of their careers. Each of our businesses runs training programmes for graduates, exposing them to various roles across different functions and countries. Every year, we hold forums for managers from around the world to focus on company strategy and generating new ideas. And in 2002 we introduced a Pearson-wide placement programme to give people the chance to work for a short period with colleagues in other businesses or another country.

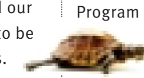
Diversity: We aim to be a diverse and inclusive company. We've appointed people in each of our businesses to spearhead our diversity programme and this is going to be a priority for us over the next few years.

our products

We provide education in the broadest sense of the word. Our products help children to succeed at school or adults to succeed at work; they help politicians consider different points of view or business people to divine markets; they inspire people to take a fresh look at the world. In 2002, we invested some £250m on new products and services.

Learning to read at your own speed: A great deal of scientific research suggests that very young children who aren't read to at home enter school at a significant disadvantage.

After nearly a decade of intensive study by top educators and researchers, the Waterford Early Reading Program was developed by the Waterford Institute, a non-profit organisation whose mission is to deliver superior education through technology.



The programme, sold across the US by Pearson Education, has a unique computer-based instruction that adapts to an individual user's learning pace, regardless of primary language or pre-literacy exposure. It gives each child 15 minutes of individual attention and assistance each day, with a rich multi-media mix of books, poems, songs and other literacy activities.

The programme has been formally assessed, comparing the achievements of students who used the programme with those who did not. The research shows the programme to be very effective in preparing young children to read, with particular strength in bringing the lowest performers in a class to

DAVID BELL * DIRECTOR FOR PEOPLE, PEARSON

fact that culture and conduct have a great deal to do with success…

reading competency and helping non-English speaking children to assimilate English language skills more quickly.

We've recently launched the Waterford Early Maths and Science programmes, using the same innovative self-paced software to provide students with a solid foundation in basic maths skills, science content and creative problem-solving.

MORE ABOUT THE WATERFORD PROGRAMME AND THE RESEARCH FINDINGS AT ***www.pearsondigital.com***

Leaving no child behind: Teachers and schools getting ready for America's most sweeping education reforms for 25 years now have a helping hand. Concert, a new online application, will allow teachers to tailor learning for each student and help schools to monitor and report their students' performance. These are new requirements for schools as part of President Bush's 'No Child Left Behind' education act.

MORE INFORMATION AT ***www.pearsonedtech.com***

Putting reading first: The US federal Government has created a $1bn annual budget to boost literacy levels for young children. The money can only be spent on programmes that are scientifically proven to boost language and literacy skills.

Pearson Education has partnered with eminent researchers to bring their work in scientifically-based reading instruction to benefit young children across America. Teaming up with the National Center for Learning Disabilities, Pearson Early Learning published their research-based screening tool, *Get Ready to Read!*, which helps parents and teachers know if a child is ready to learn how to read. To engage parent, child, and teacher in the active development of reading skills, we published their scientifically-based programme *Read Together, Talk Together*. It is founded on the principle that children gain dramatic growth in reading and language skills when there is an integrated dialogue between the adult and the child who is learning to read. The programme includes new picture books designed by Dorling Kindersley, classic children's books from Penguin, and support materials for teachers and parents designed to stimulate conversations with children about books.

publishing power

Our editorial judgements – what authors we publish, the stories we feature, the comment we make – can have a big impact on both broad social issues and specific community organisations. That's why we employ the best authors, editors and journalists, and vigorously protect their editorial integrity and freedom.

Editorial integrity: Freedom of speech and editorial independence are fundamental principles of our publishing. Penguin has long championed these causes. Over the years, it has been the publisher (and defender in the courts) of controversial titles and the *Financial Times* has an equally strong reputation for incisive and objective news and analysis.

Corporate ethics and responsibility: While our newspapers have helped to shape the debate on corporate ethics and responsibility, our book publishers are creating the leading practical guides for business schools and companies.

Our higher education imprint Prentice Hall leads the publishing market in business ethics – a market which is growing rapidly as more college and MBA students choose business ethics courses as one of their electives towards a degree in business.

Everybody's Business: For the past ten years, the *FT* has been lending its publishing skills to campaigning organisations such as Business in the Community and The Prince of Wales Business Leaders Forum, bringing their publications to a much wider audience of business leaders and publishing indices of corporate responsibility and environmental management. Last year the *FT* teamed up with Dorling Kindersley to publish *Everybody's Business*, a handbook for companies who are trying to meet changing expectations from customers, employees, communities and investors.

A life like mine: In 2002 Dorling Kindersley and the United Nations Childrens Fund (UNICEF) extended a long-term publishing partnership that gives a unique insight into the lives children lead around the world. Nearly 11 million children under five die each year, mostly from preventable diseases, and more than 100 million children aged 5-14 are in full-time or dangerous work. The UN's Convention on the Rights of the Child sets out what every child needs, from the basics of food, water and shelter, through education and health care and protection from wars, abuse and exploitation. To celebrate the anniversary of the UN Convention, DK and UNICEF published *A life like mine*, exploring the Rights of the Child through the eyes of twenty children from all corners of the world.

…in everything we do, we aspire to be brave, imaginative and decent.

community programmes

We've focused our business on helping people of all ages get on in their lives and we've focused our community support around organisations that help them do that too.

In 2002, we invested some £2.8m in community programmes. That investment is centred on two things. We want to support our employees who are active in their communities, providing them with time, money and products that encourage and extend their commitment. And we want to forge long-term partnerships with a small number of not-for-profit organisations that make a sustainable difference to education, teachers and literacy.

A jump-start for pre-schoolers: In 2001 we made a $2.5m, three-year commitment to Jumpstart, a US non-profit organisation. Jumpstart recruits and trains college students to work one-to-one with disadvantaged pre-school children. The process can measurably improve the children's performance, and often inspires the college students to take up careers as pre-school teachers. This year, the Pearson Teacher Fellowship is sponsoring 28 Jumpstart alumni to become full-time early education teachers. Pearson Teacher Fellows receive stipends, on-going training, plus individual mentoring from our employees to support them in the first two years of their teaching careers. Our US businesses are using their expertise and resources creatively to further assist the Jumpstart programme with books, technology and staff time. We plan to launch a flagship UK community programme during 2003.

MORE INFORMATION AT
www.jstart.org

Employee volunteering: We encourage employees to offer their services as volunteers – to read to children in local primary schools, paint classrooms or tidy up playgrounds.

We run a matching scheme for employee fundraising so that they can double the money they raise for their chosen organisations. Our payroll-giving schemes make it easier for employees to make tax-free donations to their favourite causes.

Spreading the word: We partner with various organisations which promote literacy and increase access to books. Our children's publisher Puffin works with Bookstart in the UK, which provides every baby in the country with a pack of free books and learning materials for parents. In the US, Penguin has partnered with Literacy Partners, which focuses on adult and family literacy programmes.

We also work closely with Book Aid International, which helps schools and libraries in the developing world to make books and educational materials available where they are most needed.

our policies

Environment: Every day, our people travel to work and for business, use electricity to keep warm or cool and to power their computers and consume water. Our books and newspapers use paper and ink and are packaged around the world. While most of our products are based on intellectual property, we recognise that our day to day operations have an effect on the world around us and that we have a responsibility to manage and measure this impact.

Efficiency is not just about capital. It is also about making sure that we and our supplier partners do not use up more natural resources than we really need to.

Pearson has had an environmental policy since 1992. We reviewed this policy in 2000 and put a benchmarking procedure in place in 2001 to measure our progress. We have now surveyed all of our wholly owned businesses. We have set targets and report on our performance on our website. There is more to do, but we are committed to continue this work.

MORE INFORMATION AT
www.pearson.com/community/envr.htm

Labour standards and human rights: A commitment to labour standards and human rights is one of the basic building blocks on what being a good corporate citizen means to us.

We realise that these are not always easy issues. One practical way to make real our concern for labour standards and human rights was by becoming a founder signatory to the United Nations Global Compact. The Compact sets out nine principles in the areas of human rights, labour standards and the environment. Its purpose is to provide a framework for companies to consider and manage their impact on global society and the environment – ideal for an international company with customers all over the world.

In our 2000 Annual Report and Accounts, we codified the UN principles into a series of guidelines that formed the key commitments against which we would judge ourselves. Each year, we report in our Annual Report and Accounts and on our website on the progress made against our guidelines.

In 2001 we began a process to ensure that we live up to these commitments by surveying our workforce. We completed this process in 2002 and the survey now covers 82 business operations in 41 countries. We are confident that for all the businesses that we own we meet or exceed the standards we have set ourselves on equal employment opportunities and conditions. In 2003 we plan to extend our survey to include our major sub-contractors.

MORE INFORMATION AT
www.pearson.com/community/ethics.htm

BILL BARKE * CHAIRMAN AND CEO ADDISON WESLEY HIGHER EDUCATION GROUP, JUMPSTART BOARD MEMBER

JOSÉ LUIS MORALES * PAULO ROVAI * PEARSON EDUCATION

Operating review

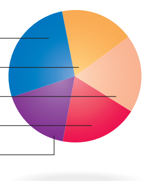
In 2002, sales increased by 6% to £4,320m and operating profit from continuing operations improved by £67m to £493m, an increase of 18%. Adjusted earnings per share grew to 30.3p, a headline increase of 42%. Operating free cash flow improved by £69m to £305m. Average use of working capital improved by £53m in our book publishing businesses, even as we increased investment in new authors, titles and programmes.

On a statutory basis, Pearson reported a loss before tax for the year of £25m (a £436m loss in 2001) and generated a loss per share of 13.9p (a loss per share of 53.2p in 2001). The loss includes a (non-cash) goodwill charge of £340m. Net borrowings fell by £971m to end the year at £1,408m. The board is recommending a 5% increase in the dividend to 23.4p per share.

SALES total £4,320m *$6,955m*

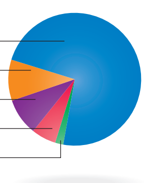
sector analysis

27% SCHOOL EDUCATION £1,151m *$1,853m*
18% HIGHER EDUCATION £775m *$1,248m*
19% PROFESSIONAL EDUCATION £830m *$1,336m*
19% THE PENGUIN GROUP £838m *$1,349m*
17% THE FT GROUP £726m *$1,169m*



geographical analysis

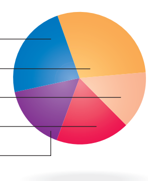
73% NORTH AMERICA £3,139m *$5,054m*
10% CONTINENTAL EUROPE £419m *$675m*
9% UNITED KINGDOM £411m *$661m*
6% ASIA PACIFIC £249m *$401m*
2% REST OF WORLD £102m *$164m*



OPERATING PROFIT* total £493m *$794m*

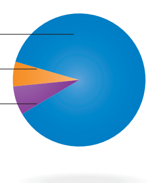
sector analysis

23% SCHOOL EDUCATION £115m *$185m*
29% HIGHER EDUCATION £142m *$229m*
14% PROFESSIONAL EDUCATION £69m *$111m*
18% THE PENGUIN GROUP £87m *$140m*
16% THE FT GROUP £80m *$129m*



geographical analysis

87% NORTH AMERICA £495m *$797m*
7% CONTINENTAL EUROPE £40m *$64m*
6% ASIA PACIFIC £31m *$50m*
REST OF WORLD £(1)m *$(2)m*
UNITED KINGDOM £(72)m *$(116)m*



* continuing operations before goodwill and exceptional items.

In 2002, Pearson launched its first ever corporate advertising campaign. While our publishing imprints are known the world over, research suggests that there is little awareness that names like Scott Foresman, Prentice Hall, Penguin and The Financial Times are all part of the Pearson family. The campaign – which only runs in our own publications – aims to show how all of our businesses help people 'live and learn'.

JOHN FALLON * CEO, PEARSON EDUCATION, EUROPE, MIDDLE EAST AND AFRICA
PAMELA MUSICK * PEARSON EDUCATION

The Financial Times Group

The Financial Times Group is a network of some of the world's finest newspapers and a fast-growing web of online services. Built around the *Financial Times* newspaper – a unique voice on the key financial, economic and business issues of the day – we are the most international source of business news and analysis in the world.

- *The Financial Times* is the most international business newspaper in the world. It is printed in 20 cities across the globe with a daily circulation of over 470,000 and a readership of more than 1.6m people in 140 countries.
- FT.com, the newspaper's internet partner, combines agenda-setting editorial and financial data with a broad range of business tools, including the most extensive business news search function on the internet. FT.com attracts 3.5m unique monthly visitors and has a growing subscriber base of 45,000.
- Our pan-European network includes the leading business newspapers and websites in France (*Les Echos* and lesechos.fr) and Spain (*Expansión* and expansiondirecto.es). In 2000 we launched a new German language newspaper, *FT Deutschland*, a joint venture with Gruner + Jahr, which has built a circulation of 90,000 in just three years.
- Our Interactive Data Corporation (NYSE: IDC) is a leading provider of financial data to institutional and retail investors. IDC collects, maintains and models data on more than 3.5m securities for its customers which include 49 of the world's top 50 financial institutions.
- FT Business produces specialist information on the retail, personal and institutional finance industries including *Investors Chronicle* and the UK's premier finance magazine, *The Banker*.
- The FT Group has a 50% stake in the Economist Group, which publishes the world's leading weekly business and current affairs journal.
- The FT also has a stake in a number of joint ventures, including FTSE International, a joint venture with the London Stock Exchange; *Vedomosti*, Russia's leading business newspaper and a partnership venture with Dow Jones and Independent Media; and a 50% stake in BDFM, publishers of South Africa's leading financial newspapers and websites.

FT YEAR END CIRCULATION

02	**473,587**
01	501,258
00	485,103
99	440,381
98	385,578

source: ABC

In 2002 FT.com launched a new range of services and began to convert loyal users into paying customers. The entire site was redesigned, offering an improved user experience and new value-added services. Subscribers enjoy complete access to specialist FT comment and analysis including Lex Live and in-depth data on over 18,000 listed companies worldwide. This helped FT.com reach its target of break-even in the fourth quarter of 2002. And it added a new revenue stream (alongside advertising & content sales) with 45,000 subscribers signing up by the end of the year.

The FT Group saw revenues fall £75m (8%) as the global economic downturn continued to hit advertising revenues and, to a much lesser extent, newsstand sales. Despite the revenue decline, operating profits increased 8% to £80m due to double digit profit growth at IDC and Recoletos (the FT Group's two businesses least affected by the downturn), successful cost reduction programmes across the Group, and sharply lower internet losses of £34m (down from £60m in 2001).

The ***Financial Times*** newspaper and its internet partner, **FT.com**, are now fully integrated. A 14% reduction in their combined cost base mitigated – but could not offset – a sharp reduction in advertising revenues at the newspaper. A further advertising deterioration in the second half, together with some one-off costs, meant that, although the newspaper remained in profit for the full year, it operated at a loss in the second half. Industry conditions remained tough for the *FT*'s major advertising categories,

SALES

02	**£726m**	***$1,169m***
01	£801m	*$1,290m*
00	£844m	*$1,359m*

OPERATING PROFIT

02	**£80m**	***$129m***
01	£72m	*$116m*
00	£98m	*$158m*

CLARE PAYNE * FINANCIAL TIMES

including financial services, technology and business-to-business. Advertising volumes fell by 24% (on top of a 29% fall in 2001) and advertising revenues by 23% (after a 20% decline in 2001). The newspaper ended the year with average daily circulation of 473,587, a decline of 6% on the previous year primarily due to lower sales in the UK.

FT.com broke even in the fourth quarter of 2002. Revenues were up 9% to £25m. Despite the introduction of paid-for elements of the site, FT.com's popularity continued to grow, up 30% to a record 3.5m unique monthly users in January 2003.

Les Echos made a profit of £7m (down 34% on 2001) as advertising revenues fell sharply. Average daily circulation was 121,000, a 6% decline, but well ahead of its market. **FT Business** delivered double digit margins as its major titles – *Investors Chronicle, The Banker* and *Financial Adviser* – all strengthened their market positions.

Losses from the FT's **associates and joint ventures** were less than half the level of the previous year due to continued progress at ***FT Deutschland***, our joint venture with Gruner + Jahr. Despite the tough German advertising market, *FT Deutschland* grew its advertising revenues slightly and increased its circulation by 14% to 89,000 at the end of the year. **The Economist Group** also contributed to the improvement, offsetting falling advertising revenues with tight cost controls. *The Economist's* worldwide weekly circulation grew by 6% to 881,259.

Recoletos (Bolsa Madrid: REC), our Spanish media group, increased profits by 21%, benefiting from actions taken in 2001 to reduce costs. After a successful re-launch *Marca*, Spain's leading sports newspaper, grew its circulation by 2% to 382,000 and increased advertising revenues and profits. Circulation at business newspaper *Expansion* was 9% lower and advertising revenues 25% lower.

Interactive Data Corporation (NYSE: IDC), our 60%-owned asset pricing business, increased revenues by 7% as contract renewal rates in its institutional business – which accounts for 90% of revenues – continued to run at 95%. IDC also benefited from the launch of several new products and the integration of Merrill Lynch's Securities Pricing business, the latest in a series of successful bolt-on acquisitions. In January 2003, IDC announced the acquisition of S&P Comstock, which adds real-time pricing to IDC's existing end-of-day services.

SALES	2002		2001		UNDERLYING % CHANGE
FT NEWSPAPER	£202m	*$326m*	£250m	*$403m*	(19)
OTHER FT PUBLISHING*	£102m	*$164m*	£138m	*$222m*	(14)
INTERNET ENTERPRISES**	£48m	*$77m*	£51m	*$82m*	(5)
RECOLETOS	£148m	*$238m*	£150m	*$242m*	(4)
IDC	£226m	*$364m*	£212m	*$341m*	7
TOTAL	**£726m**	***$1,169m***	**£801m**	***$1,290m***	**(8)**

OPERATING PROFIT	2002		2001		UNDERLYING % CHANGE
FT NEWSPAPER	£1m	*$2m*	£31m	*$50m*	(92)
OTHER FT PUBLISHING*	£13m	*$21m*	£21m	*$34m*	(39)
ASSOCIATES AND JOINT VENTURES	£(3)m	*$(5)m*	£(10)m	*$(16)m*	65
INTERNET ENTERPRISES**	£(34)m	*$(55)m*	£(60)m	*$(97)m*	46
RECOLETOS	£29m	*$47m*	£23m	*$37m*	21
IDC	£74m	*$119m*	£67m	*$108m*	12
TOTAL	**£80m**	***$129m***	**£72m**	***$116m***	**8**

* *Les Echos and FT Business*

** *The FT Group's internet enterprises include online businesses related to the FT, Les Echos, Recoletos, FT Deutschland, The Economist, IDC and CBSMarketWatch.*

JON MCMANUS * FINANCIAL TIMES

The Penguin Group

CELESTE BROWN * PENGUIN

Penguin is one of the world's great names in consumer publishing. From literary prize winners to commercial blockbusters; from a child's first picture book to the classics of literature; from fantastic fiction to beautiful reference works, Penguin publishes an unrivalled range of books in 100 countries. Penguin is the world's pre-eminent English language publisher – number one or two in the US, UK, Australia, New Zealand, India and Canada.

› Over the last four years, Penguin has doubled its presence on the bestseller lists in the US and UK thanks to writers such as Tom Clancy, Patricia Cornwell, Jan Karon, Nora Roberts, Nick Hornby and Jamie Oliver.

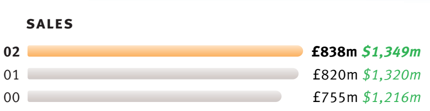
› We are the world's leading children's publisher, helping characters such as Peter Rabbit, The Little Engine That Could and Spot capture the imagination of children all over the world through imprints such as Puffin, Grosset & Dunlap and Ladybird.

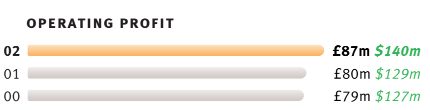
› Dorling Kindersley's beautifully illustrated reference books help children and adults of all ages to learn about the world around them in more than 90 countries and 40 languages.

› Penguin is working hard to discover the writing stars of tomorrow. In 2002 our debut authors included Hari Kunzru and Jonathan Safran Foer, winner of the *Guardian* First Book Award, in the UK, and Gary Shteyngart, winner of the Stephen Crane First Fiction Award, and Sue Monk Kidd in the US.

› In 2003 we relaunched the Penguin Classics range which includes more than 1,000 titles from Homer's *The Odyssey* to George Orwell's *Nineteen Eighty Four*.

› People discover the world using our travel guides. Together, our Rough Guides and Dorling Kindersley's *Eyewitness* Guides, have sold more than 15 million copies worldwide.





The Penguin Group increased sales by 5% and operating profits by 11%, in spite of Penguin's £10m share of our £30m investment in new back office systems and processes.

In the US, Penguin published 24 titles that became *New York Times* number one bestsellers, more than any other publisher and a 25% increase on 2001. In the UK, Penguin posted its best performance on the bestseller lists for a decade as 45 titles reached the Neilsen Bookscan top 15, a 10% increase on 2001. This strong performance enabled Penguin to gain share in both the US and the UK.

Dorling Kindersley increased sales by 8% and profits by £15m as it benefited from its integration within Penguin, the revitalisation of DK's creative style and our investment in a stronger frontlist of key titles.

Pearson is now, by some distance, the world's largest book publisher and Pearson Education and Penguin are working on a number of initiatives to maximise the scale advantages that this brings.

	2002		2001		UNDERLYING % CHANGE
SALES	£838m	*$1,349m*	£820m	*$1,320m*	5
OPERATING PROFIT	£87m	*$140m*	£80m	*$129m*	11

JOHN MAKINSON * CHAIRMAN AND CHIEF EXECUTIVE, PENGUIN GROUP

Pearson Education

JOE SMALL * PEARSON EDUCATION

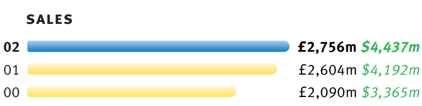
Pearson Education is the world's leading education company. We serve every age and level of student from early learning right through to professional life. We offer the broadest range of publishing and services from the most comprehensive list of textbooks, to leadership in testing, assessment and enterprise software and the very best in online consumer and professional learning.

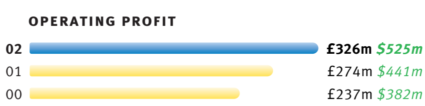
- Through our Scott Foresman and Prentice Hall School imprints, one in three American schoolchildren studies English or Maths with one of our textbooks.
- We are America's leading test scoring and reporting company, scoring and processing 40 million student tests across the US every year.
- More than 40,000 schools in the US use at least one of our online programmes and more than 14 million parents, students and teachers connect to our learning tools from home using the internet.
- We are the largest college publisher in the world, with imprints such as Prentice Hall, Addison Wesley, Longman, Allyn & Bacon and Benjamin Cummings. These publishers represent around one in three of all the text and online programmes studied on US campuses.
- Our professional and technology group publishes leading computer and business titles through imprints such as Addison-Wesley Professional, Peachpit Press, Prentice Hall PTR and Cisco Press.
- Pearson Government Solutions is our fastest-growing business providing data management information and education-related services to the US federal Government.
- We teach more people English as a second language than any other company in the world – 40 million of them. We're also the leading education company outside the US, operating in 55 countries and 17 languages.

Underlying sales at Pearson Education increased 11% and profits 22%. Profits were helped by a £52m reduction in internet losses but offset by Pearson Education's £20m share of investment in new back-office systems and processes and an £11m increase in pension contributions. **NCS Pearson** is now an integral part of Pearson Education. On a standalone basis, revenues increased 42% to £843m and profits increased 46% to £92m.

In our **School** business sales were down 5% and operating profits down 15%. In the US, our School business includes publishing, testing and software operations. School publishing revenues were down 6% due to the slower adoption cycle* and our decision to compete for just 65% of the available new adoption dollars. Our school imprints, Scott Foresman and Prentice Hall, took a 23% share of the total new adoption market and a 36% share of the adoptions in which we participated. Overall, our share of the US School publishing market was 24% (24.5% in 2001).

* In the US, 21 'adoption' states buy textbooks and related programmes to a planned contract schedule, which means the level of spending varies from year to year according to this schedule. The 'open territory' states are those that buy textbooks on an as-needed basis rather than on a published adoption schedule.





SALES	2002		2001		UNDERLYING % CHANGE
SCHOOL	£1,151m	*$1,853m*	£1,266m	*$2,038m*	(5)
HIGHER EDUCATION	£775m	*$1,248m*	£721m	*$1,161m*	13
PROFESSIONAL	£784m	*$1,262m*	£558m	*$898m*	48
FT KNOWLEDGE	£46m	*$74m*	£59m	*$95m*	(18)
TOTAL	**£2,756m**	***$4,437m***	**£2,604m**	*$4,192m*	**11**

OPERATING PROFIT	2002		2001		UNDERLYING % CHANGE
SCHOOL	£140m	*$225m*	£167m	*$269m*	(15)
HIGHER EDUCATION	£142m	*$229m*	£127m	*$204m*	17
PROFESSIONAL	£81m	*$130m*	£80m	*$129m*	8
INTERNET	£(25)m	*$(40)m*	£(77)m	*$(124)m*	–
FT KNOWLEDGE	£(12)m	*$(19)m*	£(23)m	*$(37)m*	–
TOTAL	**£326m**	***$525m***	**£274m**	***$441m***	**22**

We are the number one educational testing company in the US, and in 2002 we extended that lead as we won several new state testing contracts. We plan to use that experience to build our testing business outside the US.

MICHAEL KAYSER * NCS PEARSON
CLAUDINE O'LEARY * NCS PEARSON

After 13% growth in 2001, our school testing business grew by a further 3%. It renewed and expanded two of its largest multi-year statewide contracts – California and Ohio – as well as the National Assessment of Educational Progress contract from the US Department of Education. It won new contracts in California and six other states that will start to contribute to revenues in 2003. Revenues were down at our school software business, primarily due to the deferral of a number of contracts into 2003, but losses fell as we outsourced more of our software development needs.

Outside the US, our school publishing businesses performed strongly in Hong Kong, Japan, Singapore and Spain. Strong growth in English Language Teaching sales in Europe and Asia was partially offset by some weakness in US and Latin American markets.

Our **Higher Education** business increased revenues by 13% and operating profits by 17%. In the US the Higher Education publishing business grew its revenues by 14%, ahead of market growth of 10% (8% excluding Pearson). The business benefited from a booming college population, its publishing and salesforce strength and its lead in making online services an integral part of its products. Our custom publishing business, which produces text books and course materials custom-made for individual college professors, continued its rapid growth, with sales up 50% in the year (and 300% over the past three years). Around the world, our Higher Education operations benefited from the same trends we saw in the US, with a particularly strong performance in Europe where revenues were up in double digits.

The **Professional** business increased sales by 48% and profits by 8%. A major investment in 200 professional certification centres across the US, along with a change in business mix and a further decline in our higher-margin technology publishing businesses, and double digit growth in the lower margin Government Solutions division, meant that profits grew considerably slower than revenues. In the US, we helped the newly-formed Transportation Security Administration to recruit 64,000 security personnel for US airports, a one-year contract worth more than $300m in revenues to our Government Solutions business. A series of smaller, longer-term contract wins – with the Immigration and Naturalization Service, the Department of Health and Human Services and the US Department of Defense – gives the business a strong pipeline for 2003 and future years. With IT and technology markets continuing to be bleak, sales at our technology publishing arm were down 12% in the US (following a 20% fall in 2001) and margins declined, although due to further cost actions they were still in double digits. In Europe, where technology publishing sales were down more than 20% in 2002, we have taken similar actions to reduce costs.

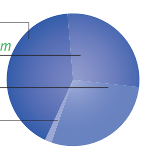
SALES ANALYSIS total £2,756m *$4,437m* **2002**

42% SCHOOL £1,151m *$1,853m*

28% HIGHER EDUCATION £775m *$1,248m*

28% PROFESSIONAL £784m *$1,262m*

2% FT KNOWLEDGE £46m *$74m*



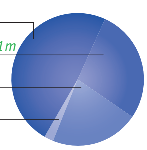
SALES ANALYSIS total £2,604m *$4,192m* 2001

49% SCHOOL £1,266m *$2,038m*

28% HIGHER EDUCATION £721m *$1,161m*

21% PROFESSIONAL £558m *$898m*

2% FT KNOWLEDGE £59m *$95m*



Pearson Broadband has partnered with Pearson Education to develop KnowledgeBox, a digital learning system that helps teachers create multimedia lessons in reading, maths, science and social studies. It contains over 1,500 digital resources and material from leading publishers including Longman, Puffin, Penguin and Dorling Kindersley. KnowledgeBox is being used by schools in 21 states across the US and was launched in the UK in early 2003.

KELLIE LANE * **LAURA JONES** * **WENDY KERR** * **ROBIN GAY** * PEARSON BROADBAND

Financial review

EMMA JAMES * DK, PENGUIN

	2002		2001	
OPERATING PROFIT FROM CONTINUING OPERATIONS	**£493m**	*$794m*	**£426m**	*$686m*
OPERATING PROFIT FROM DISCONTINUED OPERATIONS (RTL)	–	–	£37m	*$59m*
GOODWILL AMORTISATION	£(330)m	*$(531)m*	£(375)m	*$(604)m*
GOODWILL IMPAIRMENT	£(10)m	*$(16)m*	£(61)m	*$(98)m*
INTEGRATION COSTS	£(10)m	*$(16)m*	£(74)m	*$(119)m*
NON OPERATING ITEMS	£(37)m	*$(60)m*	£(128)m	*$(206)m*
AMOUNTS WRITTEN OFF INVESTMENTS	–	–	£(92)m	*$(148)m*
NET INTEREST PAYABLE	£(94)m	*$(151)m*	£(169)m	*$(272)m*
EARLY REPAYMENT OF DEBT AND TERMINATION OF SWAP CONTRACTS	£(37)m	*$(60)m*	–	–
LOSS BEFORE TAXATION	**£(25)m**	***$(40)m***	**£(436)m**	***$(702)m***
TAXATION	£(64)m	*$(103)m*	£33m	*$53m*
LOSS AFTER TAXATION	**£(89)m**	***$(143)m***	**£(403)m**	***$(649)m***
MINORITY INTERESTS	£(22)m	*$(35)m*	£(20)m	*$(32)m*
LOSS FOR THE FINANCIAL YEAR	**£(111)m**	***$(178)m***	**£(423)m**	***$(681)m***
DIVIDENDS	£(187)m	*$(301)m*	£(177)m	*$(285)m*
RETAINED LOSS FOR THE YEAR	**£(298)m**	***$(479)m***	**£(600)m**	***$(966)m***

The sale of our 22% share in RTL was concluded at the end of January 2002 allowing us to pay down our debt to under £1.5bn and marking the beginning of a period of portfolio stability. This also results in the Pearson profit and loss account becoming more straightforward as our significant acquisition and disposal activity and our start-up internet investments are largely behind us. 2002 also marks the end of the integration charges on our major acquisitions. Moreover, the goodwill amortisation arising from those acquisitions will be more predictable.

Our operating profits from continuing operations in 2002 increased from 2001 by 18% to £493m. However, almost entirely as a result of our (non-cash) goodwill amortisation charge, we still show an overall loss for the financial year.

FINANCIAL STATEMENTS

goodwill amortisation ▸ Goodwill is a balance sheet item which represents the difference between the price paid for acquisitions and the fair value of the assets acquired. Pearson amortises goodwill to the profit and loss account over the estimated useful life of the acquisition, or a period of 20 years whichever is the shorter. The goodwill amortisation charge fell by £45m last year to £330m mainly due to the disposal of the RTL Group.

goodwill impairment ▸ Goodwill is subject to an impairment review at the end of the first full year following an acquisition and at any other time if events or changes in circumstances indicate that the carrying value may not be recoverable. In 2002 we took a £10m impairment charge, relating to a subsidiary of Recoletos in Argentina.

We're combining forces to grow our bilingual publishing programme. In just four years we've become the leading publisher of bilingual materials for the US elementary school market. We've taken the market-leading position in elementary Spanish reading and we hope to do the same in social studies.

JOANNE DRESNER * PRESIDENT, ELT, PEARSON EDUCATION
DEBRA HOPKINS * BILINGUAL PRODUCT MANAGER, PEARSON EDUCATION
MERCEDES MURATORIO * SPANISH PUBLISHING CO-ORDINATOR, PEARSON EDUCATION

integration costs ▸ Integration costs are the one-off costs of integrating significant recent acquisitions into our existing businesses. In 2002 £3m was incurred in integrating Dorling Kindersley into the Penguin Group (compared to £45m in 2001) and £7m related to the integration of NCS into Pearson Education (compared to £29m in 2001). This expenditure was in line with our forecasts at the time of the transactions and there will be no further charges in respect of these acquisitions in 2003. All other restructuring and related costs are expensed through the profit and loss account as part of the ongoing operations of our businesses.

non-operating items ▸ In 2002, we took a charge of £37m for non-operating items relating to losses on the sale or closure of businesses and fixed assets. The principal items are a profit of £18m relating to the completion of the sale of RTL in January 2002 and a provision of £40m for the loss on sale of our Forum business, which completed in January 2003. This provision largely relates to unamortised goodwill at the balance sheet date. Other items include a loss on sale of PH Direct of £8m, a profit of £3m on finalisation of the sale of *Journal of Commerce* by the Economist and various smaller losses on investments and property.

amounts written off investments ▸ In 2002, we continued to review our fixed asset investments and concluded that there have been no further material impairments. This compares to a charge of £92m taken in 2001 relating to the carrying value of Pearson shares held to secure employee share option plans and equity investments in a number of internet businesses.

interest ▸ Net interest fell by £75m to £94m, with average net debt decreasing by £748m following the receipt of proceeds from the RTL disposal. Interest was further reduced by the effect of a general fall in interest rates during the year. The weighted average three month LIBOR rate, reflecting the Group's borrowings in US dollars, euros, and sterling, fell by 160 basis points, or 1.6%. The effect of these falls was mitigated by our existing portfolio of interest rate swaps, which converted over half our variable rate commercial paper and bank debt to a fixed rate basis. As a result, the Group's net interest rate payable averaged approximately 5.0%, falling 1.4% from the previous year. During 2002 we took an additional one-off charge of £37m for cancellation of certain swap contracts and the early repayment of debt following re-balancing of the group's debt portfolio on the receipt of the RTL proceeds.

INTEGRATION COSTS	2002		2001		2000		1999	
SIMON & SCHUSTER	–	–	–	–	£9m	*$14m*	£95m	*$153m*
NCS	£7m	*$11m*	£29m	*$47m*	£4m	*$6m*	–	–
DK	£3m	*$5m*	£45m	*$72m*	£27m	*$44m*	–	–
TOTAL	**£10m**	***$16m***	**£74m**	***$119m***	**£40m**	***$64m***	**£95m**	***$153m***

Reading is fundamental to Pearson. We help more people learn to read – and enjoy doing it – than any other company. Our programmes cover every stage of learning from Dorling Kindersley's pre-school picture books to basic school literacy programmes, to customised electronic reading software to Longman's world-famous English language teaching resources.

SHANE BREAUX * PEARSON EDUCATION

JULIE SAUSEN * PEARSON EDUCATION

ALEX KIRKHAM ★ DK, PENGUIN

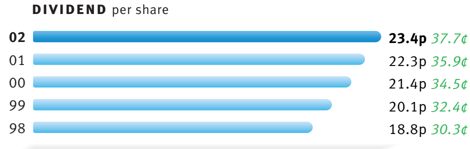
taxation ▸ The Group recorded a total pre-tax loss of £25m in 2002 but there was a tax charge for the year of £64m. This situation reflects the fact that there is only limited tax relief available for the goodwill amortisation charged in the accounts. The total tax charge was in fact reduced by a non-operating credit of £45m attributable to the resolution of the tax position on the disposal of the group's remaining interest in BSkyB.

The tax charge reflects the adoption of FRS 19 'Deferred Tax'. FRS 19 requires full provisioning for deferred tax and this has had a significant effect on Pearson's effective tax rate. This is mainly because Pearson has recognised a deferred tax asset in respect of US tax losses and other timing differences. Previously the tax benefit of US tax losses was accounted for as the losses were utilised.

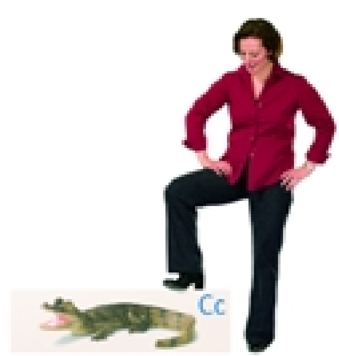
The tax rate on adjusted earnings, after restating for FRS 19, decreased from 34.0% to 32.8%. The decrease was attributable to two main factors. There was a more favourable mix of profits between higher and lower tax regimes than in 2001; in addition there was a benefit from prior year adjustments.

minority interests ▸ Minority Interests include a 40% minority share in IDC and a 21% minority share in Recoletos.

dividends ▸ The dividend payment of £187m which we are recommending in respect of 2002 represents 23.4p per share – a 5% increase on 2001. The dividend is covered 1.3 times by adjusted earnings, and 1.6 times by operating free cash flow. The company seeks to maintain a balance between the requirements of our shareholders, including our many private shareholders, for a rising stream of dividend income and the re-investment opportunities that we see across the Group. This balance has been expressed in recent years as a commitment to increase our annual dividend faster than the prevailing rate of inflation while progressively reinvesting a higher proportion of our distributable earnings in our business. While this commitment remains unchanged, we believe that the income requirements of our shareholders should take priority over reinvestment this year.



PETER JOVANOVICH ★ CHIEF EXECUTIVE, PEARSON EDUCATION



JOAN MAZZEO ★ PEARSON EDUCATION

OTHER FINANCIAL ITEMS

pensions ▸ Pearson operates a variety of pension schemes. Our UK fund is by far the largest and we also have some smaller defined benefit funds in the US and Canada. Outside the UK, most of our people operate 401K (essentially defined contribution) plans. In 2001, after a full actuarial valuation, the company resumed cash contributions to its UK Pension Fund (a £1bn fund) following a prolonged 'holiday' period. At that time, this resulted in the scheme having a small surplus of £40m. Although the next full actuarial valuation is not due until 2004, the funding level is kept under regular review by the company and the Fund trustees. After an informal indication in 2002, and taking account of current stock market conditions, the company agreed to increase contributions by £5m to £25m in 2003, ahead of the full valuation in 2004. This was designed to keep the scheme fully funded.

In this report we have included additional disclosure in respect of FRS 17 'Retirement Benefits' for pensions and other post retirement benefits. FRS 17 approaches pension cost accounting from a balance sheet perspective with the net surplus or deficit in Pearson's pension schemes being incorporated into the balance sheet. Changes in this surplus or deficit will flow through the profit and loss account and the statement of total recognised gains and losses. In this report we have disclosed the effect on the profit & loss account and balance sheet in the notes to the accounts (see note 10).

accounting disclosures and policies ▸ As described above we have included additional disclosure in respect of FRS 17 for pensions and other post retirement benefits in accordance with that standard. The mandatory implementation of FRS 17 has been postponed and is now not required to be implemented before adoption of International Accounting Standards in 2005. FRS 19 'Deferred Tax', has been adopted in these accounts and the comparative figures have been restated. The effect of FRS 19 is discussed above and in note 21 to the accounts.

NET TRADING ASSETS		
INTANGIBLE ASSETS	£3,610m	*$5,812m*
TANGIBLE ASSETS	£503m	*$810m*
OPERATING WORKING CAPITAL	£811m	*$1,306m*
OTHER NET ASSETS	£5m	*$8m*
TOTAL	**£4,929m**	***$7,936m***

CAPITAL EMPLOYED		
SHAREHOLDERS' FUNDS	£3,338m	*$5,374m*
DEFERRED TAX, PROVISIONS AND MINORITIES	£183m	*$295m*
NET DEBT	£1,408m	*$2,267m*
TOTAL	**£4,929m**	***$7,936m***

Every Monday, 80,000 business, economic and finance professors across the US receive a briefing, the *Week Ahead*, from the *Financial Times* US managing editor, Andrew Hill. The professors, customers of our college imprint Prentice Hall, use the *FT*'s analysis of the key events to enliven their teaching. The *FT* benefits from the scale and reach of Prentice Hall's large sales and marketing team and from its experience in managing online curriculum content.

ANDREW HILL * FINANCIAL TIMES
ANNIE TODD * PEARSON EDUCATION

TODD FRIES * KIM HIGHLAND * JAY HENRY * THERESE BURKE * LORI BURKE * DK, PENGUIN

MANAGING OUR FINANCIAL RISKS

This section explains the Group's approach to the management of financial risk.

treasury policy ▸ The Group holds financial instruments for two principal purposes: to finance its operations and to manage the interest rate and currency risks arising from its operations and its sources of finance. The Group finances its operations by a mixture of cash flows from operations, short-term borrowings from banks and commercial paper markets, and longer-term loans from banks and capital markets. The Group borrows principally in US dollars, euros and sterling, at both floating and fixed rates of interest, using derivatives, where appropriate, to generate the desired effective currency profile and interest rate basis. The derivatives used for this purpose are principally interest rate swaps, interest rate caps and collars, currency swaps and forward foreign exchange contracts. The main risks arising from the Group's financial instruments are interest rate risk, liquidity and refinancing risk, counterparty risk and foreign currency risk. These risks are managed by the chief financial officer under policies approved by the Board which are summarised below. These policies have remained unchanged, except as disclosed, since the beginning of 2002. A treasury committee of the board receives reports on the Group's treasury activities, policies and procedures, which are reviewed periodically by a group of external professional advisers. The treasury department is not a profit centre and its activities are subject to internal audit.

OPENING NET DEBT	£(2,379)m	$(3,830)m
CASH INFLOW		
OPERATING CASH FLOW	£455m	$733m
DISPOSALS	£930m	$1,497m
NET EQUITY	£6m	$10m
CASH OUTFLOW		
INTEGRATION COSTS	£(44)m	$(71)m
INTEREST, TAX, DIVIDENDS AND OTHER	£(252)m	$(406)m
ACQUISITIONS	£(124)m	$(200)m
CLOSING NET DEBT	**£(1,408)m**	**$(2,267)m**

interest rate risk ▸ The Group's exposure to interest rate fluctuations on its borrowings is managed by borrowing on a fixed rate basis and by entering into interest rate swaps, interest rate caps and forward rate agreements. Since October 2002 the Group's policy objective has been to set a target proportion of its forecast borrowings (taken at the year end, with cash netted against floating rate debt) to be hedged (i.e. fixed or capped) over the next four years of 40% to 65%. At the end of 2002 that ratio was 56%. On that basis, a 1% change in the Group's variable rate US dollar, euro and sterling interest rates have a £6m effect on profit before tax. The disposal of Pearson's interest in RTL has resulted in a significant reduction in floating rate debt. We have cancelled a number of swap contracts in order to bring the balance of fixed and floating rate debt back within our policy parameters.

liquidity and refinancing risk ▸ The Group's objective is to procure continuity of funding at a reasonable cost. To do this it seeks to arrange committed funding for a variety of maturities from a diversity of sources. The Group's policy objective has been that the weighted average maturity of its core gross borrowings (treating short-term advances as having the final maturity of the facilities available to refinance them) should be between three and ten years. Since January 2002, reflecting the impact of the RTL disposal, the Group's policy for non-bank sources has continued to be they should provide at least £250m of core gross borrowings, but for bank sources no such minimum is required (previously £250m). At the end of 2002 the average maturity of gross

As well as sharing technology resources and expertise for product development across the company, we're also improving all of our information systems to bring us big benefits in terms of customer service and our ability to manage our working capital.

DAVID JESKA * PEARSON TECHNOLOGY

CAROL KENNEDY * PEARSON BROADBAND
BILL GAULD * CHIEF INFORMATION OFFICER, PEARSON

JASON KINCADE * PENGUIN
JESSICA GOLDSTEIN * PEARSON EDUCATION

MICK MCGALE * PENGUIN

borrowings was 4.8 years and non-banks provided £1,790m (90%) of them (down from 5.3 years and up from 75% respectively at the beginning of the year). The proceeds of the RTL sale were used to repay debt, including part of the Group's syndicated bank facility, and to provide seasonal working capital. The Group believes that ready access to different funding markets also helps to reduce its liquidity risk, and that published credit ratings and published financial policies improve such access. The Group manages the amount of its net debt, and the level of its net interest cover, principally by the use of a target range for its interest cover ratio. All of the Group's credit ratings remained unchanged during the year. The long-term ratings are Baa1 from Moody's and BBB+ from Standard & Poor's, and the short-term ratings are P2 and A2 respectively. The Group continues to operate on the basis that the Board will take such action as is necessary to support and protect its current credit ratings. The Group also maintains undrawn committed borrowing facilities. At the end of 2002 these amounted to £1,059m, and their weighted average maturity was 2.5 years.

counterparty risk ▸ The Group's risk of loss on deposits or derivative contracts with individual banks is managed in part through the use of counterparty limits. These limits, which take published credit limits (among other things) into account, are approved by the chief financial officer. In addition, for certain longer dated higher value derivative contracts the Group has entered into mark to market agreements whose effect is to reduce significantly the counterparty risk of the relevant transactions.

currency risk ▸ Although the Group is based in the UK, it has a significant investment in overseas operations. The most significant currency for the Group is the US dollar, followed by the euro and sterling. The Group's policy during the year on routine transactional conversions between currencies (for example, the collection of receivables, and the settlement of payables or interest) remained that these should be effected at the relevant spot exchange rate. As in previous years, no unremitted profits were hedged with foreign exchange contracts. The Group's policy is to align approximately the currency composition of its core borrowings in US dollars, euros and sterling with the split between those currencies of its forecast operating profit. This policy aims to dampen the impact of changes in foreign exchange rates on consolidated interest cover and earnings. Long-term core borrowing is limited to these three major currencies. However, the Group still borrows small amounts in other currencies, typically for seasonal working capital needs. At the year end the split of aggregate net borrowings in its three core currencies was US dollar 72%, euro 13% and sterling 15%.

NET BORROWINGS FIXED AND FLOATING RATE	2002		2001	
FIXED RATE	£753m	*$1,212m*	£1,398m	*$2,251m*
FLOATING RATE	£655m	*$1,055m*	£981m	*$1,579m*
TOTAL	**£1,408m**	***$2,267m***	**£2,379m**	***$3,830m***
GROSS BORROWINGS				
BANK DEBT	£193m	*$311m*	£694m	*$1,117m*
BONDS	£1,790m	*$2,882m*	£2,078m	*$3,346m*
TOTAL	**£1,983m**	***$3,193m***	**£2,772m**	***$4,463m***
GROSS BORROWINGS BY CURRENCY				
US DOLLARS	£1,350m	*$2,174m*	£1,829m	*$2,945m*
STERLING	£241m	*$388m*	£520m	*$837m*
EURO	£380m	*$612m*	£404m	*$650m*
OTHER	£12m	*$19m*	£19m	*$30m*
TOTAL	**£1,983m**	***$3,193m***	**£2,772m**	***$4,463m***

STEVE TIMEWELL * SIMON BLACKMORE * ALICE PARTRIDGE * PARVEEN BANSAL * ANTON TSAVKILOVL * FT BUSINESS, FINANCIAL TIMES

In the worst financial advertising market for decades, FT Business' international monthly magazine *The Banker,* has had its best year ever. Advertising revenue has grown by 500% in three years.

Board of Directors

CHAIRMAN

Dennis Stevenson ‣ chairman, aged 57, has been a non-executive director of Pearson since 1986 and became chairman in 1997. He is also chairman of HBOS plc and a non-executive director of Manpower Inc. in the US.

EXECUTIVE DIRECTORS

Marjorie Scardino ‣ chief executive, aged 56, joined the Pearson board in January 1997. She trained and practised as a lawyer, and published a weekly newspaper in the US. In 1985 she joined The Economist Group as president of its North American operations and was its chief executive from 1993 until joining Pearson. She is also a non-executive director of Nokia Corporation.

David Bell ‣ director for people, aged 56, became a director of Pearson in March 1996. He is chairman of the Financial Times Group, having been chief executive of the Financial Times from 1993 to 1998. In July 1998 he was appointed Pearson's director for people with responsibility for the recruitment, motivation, development and reward of employees across the Pearson Group. He is also a non-executive director of VITEC Group plc and chairman of the International Youth Foundation.

John Makinson ‣ chairman and chief executive officer of the Penguin Group, aged 48, joined the Pearson board in March 1996 and was finance director until June 2002. From 1994 to 1996 he was managing director of the Financial Times, and prior to that he founded and managed the investor relations firm Makinson Cowell. He was appointed chairman of The Penguin Group in May 2001. He is also a non-executive director of George Weston Limited in Canada.

Rona Fairhead ‣ chief financial officer, aged 41, joined the Pearson board and became chief financial officer in June 2002. Prior to this she served as deputy finance director from October 2001. From 1996 until 2001, she worked at ICI, where she served as executive vice president, group control and strategy. Prior to that, she worked for Bombardier Inc. in finance, strategy and operational roles.

Peter Jovanovich ‣ chief executive of Pearson Education, aged 54, joined the Pearson board in June 2002. He became chief executive of Pearson Education in 1998. Prior to this he was chairman and chief executive of Addison Wesley Longman. He also serves on the boards of the Association of American Publishers and the Alfred Harcourt Foundation.

NON-EXECUTIVE DIRECTORS

Terry Burns*† ‣ aged 58, was the government's chief economic adviser from 1980 until 1991 and Permanent Secretary of HM Treasury from 1991 until 1998. He is non-executive chairman of Abbey National plc and Glas Cymru Limited, and a non-executive director of The British Land Company PLC. He was appointed a non-executive director of Pearson in May 1999.

Reuben Mark*† ‣ aged 64, is chairman and chief executive of the Colgate-Palmolive Company and a director of AOL Time Warner Inc. He became a non-executive director of Pearson in 1988.

Vernon Sankey* ‣ aged 53, was previously chief executive of Reckitt & Colman plc and is deputy chairman of Photo-Me International plc and Beltpacker plc. He is also a non-executive director of Zurich Financial Services AG and a board member of the UK's Food Standards Agency. He became a non-executive director of Pearson in 1993.

Rana Talwar† ‣ aged 54, was previously group chief executive of Standard Chartered plc. He became a non-executive director of Pearson in March 2000.

Patrick Cescau ‣ aged 54, is a director of Unilever plc and Unilever NV. He became a non-executive director of Pearson in April 2002.

* a member of the audit committee.
† a member of the personnel committee.

Directors' Report

The directors are pleased to present their report to shareholders, together with the financial statements for the year ended 31 December 2002 on pages 61 to 64 and 67 to 102. Details of the businesses, the development of the Group and its subsidiaries and likely future developments are given on pages 9 to 12 and 23 to 28 of this annual report. Sales and profits of the different sectors and geographical markets are given on pages 69 and 70.

Results and dividend ▸ The loss for the financial year ended 31 December 2002 was £111m (2001: £423m loss). The loss retained for the year was £298m (2001: £600m loss) and has been transferred to reserves. A final dividend of 14.3p per share is recommended for the year ended 31 December 2002. This, together with the interim dividend already paid, makes a total for the year of 23.4p (2001: 22.3p). The final dividend will be paid on 9 May 2003 to shareholders on the register at the close of business on 14 March 2003, the record date.

Significant acquisitions and disposals ▸ Details of these transactions can be found in notes 25 and 26 to the accounts on pages 96 to 97.

Transactions with related parties ▸ Details of transactions with related parties, which are reportable under FRS 8, are given in note 30 to the accounts on page 100.

Capital expenditure ▸ The analysis of capital expenditure and details of capital commitments are shown in note 12 to the accounts on page 83.

Directors ▸ The present members of the board, together with their biographical details, are shown on page 35. Patrick Cescau was appointed a non-executive director on 1 April 2002, and both Rona Fairhead and Peter Jovanovich were appointed directors on 1 June 2002. Details of directors' remuneration and interests in ordinary shares and options of the company are contained in the report on directors' remuneration on pages 46 to 60. Three directors, David Bell, Terry Burns and Rana Talwar will retire by rotation at the forthcoming Annual General Meeting (AGM) on 25 April 2003. All three, being eligible, will offer themselves for re-election. Rona Fairhead and Peter Jovanovich who were appointed to the board after the last AGM, retire from office in accordance with the company's articles of association and, being eligible, will offer themselves for reappointment. Details of directors' service contracts can be found on pages 49 and 50. No director was materially interested in any contract of significance to the company's business.

Corporate governance ▸ We have carried out a comprehensive internal review of the implications of the Sarbanes-Oxley Act and the Higgs recommendations on corporate governance. The review was conducted with the help of our external advisers and the board has discussed the matter in full. Most of their recommendations – whether they are mandatory, optional, or considered to be best practice – are already part of our governance and audit procedures.

The key issues the board has been discussing are:

1. Pearson supports the principles of good governance and code of best practice expressed in the Combined Code published in June 1998. We have complied with the Combined Code with only two main exceptions. The first is that we have not had a separate Nominations Committee, but instead used the entire board as the Nominations Committee. This has been because we have a small board and have seen a contradiction between on the one hand asking executive directors to be legally responsible under the Companies Act yet on the other hand effectively disenfranchising them from decisions on the addition of non-executives to the board. The Higgs report deals with this concern by firmly establishing that the Nominations Committee should have a majority of non-executive directors (rather than consist entirely of them). We welcome this approach and will now set up a Nominations Committee.

2. Our second non-compliance with the Combined Code is that we have not named a senior independent director (SID). To date we have been satisfied with the practice that if any shareholder raises a concern or makes a complaint to the chairman, he is obliged to share it with the other directors. Pearson has also for some time been happy for non-executives to meet shareholders. However, recognising the appetite to formalise these processes, we do now intend to appoint a SID.

3. Until recently the board has had a majority of non-executive directors. In 2002 we added two more executive directors to the board and as a result we now have the same number of executive and non-executive directors. (This excludes the chairman who, under the definition set out in the Higgs report is not an executive director – as his is a part time role – but, as chairman, is not considered "independent".) We determined some time ago to seek to appoint up to two additional independent directors. When one is appointed, non-executive directors will be in the majority and we will comply – albeit for good business reasons – with this general principle.

4. Under some definitions, however, not all of these non-executive directors are "independent". The Higgs report recommends that, non-executive directors should not serve on the board for more than ten years. However, Higgs acknowledges that boards must be free to make their own judgements on this issue. Two of our non-executive directors have been on the board for more than ten years and both would not wish to continue to serve as directors unless they are regarded as "independent". The unanimous view of their colleagues on the board is that, by virtue of their personalities, their experience and their knowledge of the business, they are robustly independent. There are many examples of board debates and decisions that support this view. Therefore, we believe it would be in the interests of shareholders to consider them as fully "independent", and we intend to do so.

5. Higgs has said no-one should hold more than one chairmanship of a FTSE100 company. Although Higgs has made it clear that this principle should be applied to future appointments rather than current incumbents, we felt it right to consider it. Our chairman, Dennis Stevenson, is also chairman of HBOS plc and has been chairman of both companies for nearly five years. Dennis' chairmanship will be routinely considered as part of high level succession planning by the Nominations Committee. However, all the other members of the board have made it clear to Dennis that they do not wish him to step down from the chairmanship. Before Dennis became chairman of Halifax plc (now HBOS plc), the Pearson board was consulted and agreed to his taking on this additional chairmanship. Since then, there has never been the slightest conflict of time or interest.

6. We welcome the Higgs recommendations that boards should evaluate themselves and their work annually. We will report on what we have done and what the outcomes are in our next annual report.

7. The board has not yet formally considered the detailed audit-related recommendations of both the Sarbanes-Oxley Act and the Smith report on audit committees. The audit committee has of course been studying these and it will report shortly to the board.

The board ‣ The board currently comprises the chairman, who is part-time, five executive directors and five non-executive directors. All of the non-executive directors are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.

The board schedules six meetings each year and arranges to meet at other times as appropriate. There is a formal schedule of matters specifically reserved to the board for decision and approval, and the board is supplied in a timely manner with the necessary information to discharge its duties. A procedure exists for directors to seek independent professional advice in the furtherance of their duties, and all directors have access to the advice and services of the company secretary.

Board committees ‣ The board of directors has established the following committees all of which have written terms of reference setting out their authority and duties:

i Audit committee ‣ This committee is chaired by Vernon Sankey and its other members are Terry Burns and Reuben Mark. All are non-executive directors. The committee provides the board with the means to appraise Pearson's financial management and reporting, and to assess the integrity of the Group's accounting procedures and financial controls. The Group's 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. The committee reports to the full board of Pearson.

ii Personnel committee ‣ This committee is chaired by Reuben Mark and its other member during 2002 was Terry Burns. Rana Talwar joined the committee in 2003. All three are non-executive directors. The committee meets regularly to decide the remuneration and benefits packages of the executive directors and the chief executives of the main operating companies, as well as recommending the chairman's remuneration to the board for its decision. It also reviews the Group's management development and succession plans. The committee reports to the full board and its report on directors' remuneration, which has been considered and adopted by the board, is set out on pages 46 to 60.

iii Treasury committee ‣ This committee comprises Dennis Stevenson, Rona Fairhead, Vernon Sankey and Rana Talwar. The committee sets the policies for the company's treasury department and reviews its procedures on a regular basis.

Internal control ‣ The directors have reviewed the effectiveness of the Group's internal control process in accordance with provision D.2.1 of the Combined Code.

The directors are responsible for the Group's system of internal control and reviewing its effectiveness. They consider that the system of internal control is appropriately designed to manage the risk environment facing the Group and to provide reasonable, but not absolute, assurance against material misstatement or loss.

They confirm that there is an ongoing process, embedded within the Group's integrated internal control system which allows for the identification, evaluation and management of significant business risks, together with a reporting process to the board. The directors require operating companies to undertake at least annual reviews to identify new or potentially under-managed risks. The results of these reviews are reported annually to the board via the audit committee. This process has been in place throughout 2002 and up to the date of the approval of this annual report and accords with the Turnbull guidance.

The main elements of the Group's internal control system including risk identification are as follows:

i Board ‣ The board of directors, which has overall responsibility for the Group's system of internal control, exercises control through an organisational structure with clearly defined levels of responsibility, authority and appropriate reporting procedures. The board meets regularly and has a regular schedule of matters that are brought to it or its duly authorised committees for decision, aimed at maintaining effective control over strategic, financial, operational and compliance issues. This structure includes the audit committee, which with the chief financial officer, reviews the effectiveness of the internal financial and operating control environment of the Group. The audit committee meets regularly, at least three times per annum, and considers, inter alia, reports from internal and external auditors covering such matters.

ii Operating company controls ‣ The identification and mitigation of major business risks is the responsibility of operating management. Each operating company maintains controls and procedures appropriate to its own business environment whilst conforming to Group standards and guidelines, including procedures to identify and then mitigate all types of risk. To this end operating companies are required to undertake at least annual risk reviews to identify new or potentially under-managed risks, the results of which are reported to the board.

iii Financial reporting ‣ There is a comprehensive budgeting and forecasting system with an annual budget approved by the board of directors. Monthly financial information, including balance sheets, cash flow statements, trading results and indebtedness, are reported against the corresponding figures for the budget and the previous year, with corrective action being taken by the directors as appropriate. Quarterly, group senior management meet with operating company management to review their business and financial performance against budget and forecast. Major business risks relevant to each operating company are reviewed in these meetings.

iv Treasury management ‣ The treasury department operates within policies approved by the board, and its procedures are reviewed regularly by the treasury committee. Major transactions are authorised outside the department at the requisite level and there is an appropriate segregation of duties. Frequent reports are made to the chief financial officer and regular reports are prepared for the treasury committee.

v Group control ‣ The group control department has the central responsibility for risk control and internal audit, which it exercises through teams located both in the UK and the US. The department reviews business risks, processes and procedures in all the main operating companies, agrees with operating companies their plans to eliminate or mitigate risks where possible, and to improve controls and processes. It monitors operating companies' progress and reports the results of its work regularly to executive management and, via the audit committee, to the board. Annually, via the audit committee, the group control department specifically reports on business risk to executive management and the board.

vi Insurance ‣ Insurance cover is provided either through Pearson's captive insurance subsidiary or externally, depending on the scale of the risk in question and the availability of cover in the external market. The insurance market remains difficult and the Group continues to review its insurance coverage to ensure that it has the most cost effective balance between insured and uninsured risks.

Going concern ‣ Having reviewed the Group's liquid resources and borrowing facilities, and the 2003 and 2004 cash flow forecasts contained in the Group budget for 2003, the directors believe that the Group and the company have adequate resources to continue as a going concern for the foreseeable future. For this reason, the financial statements have, as usual, been prepared on a going concern basis.

ABI guidelines on socially responsible investment ‣ The board has taken steps during the year to implement procedures to facilitate the company's compliance with the ABI guidelines on socially responsible investment. We are now reporting for the first time on our level of compliance with the guidelines.

During February of this year, the monitoring of social, environmental and ethical (SEE) risk was carried out by the group control department, in addition to their work on the Turnbull risk management process. A report from the group control department on SEE risk management is now tabled at each meeting of the audit committee and of the board. This enables the board to take regular account of the significance of SEE matters to the business of the company.

Pearson is proud to have been a founding signatory to the UN 'Global Compact'. As part of our compliance process in support of this, we have reviewed our risks relating to labour standards, human rights and the environment. No significant issues arose out of these reviews. Our progress in reviewing our risks is described in the sections to follow on labour standards, human rights and the environment. During 2003, we will work with more of our key suppliers to optimise compliance with the principles of the 'Global Compact'.

In February 2003, operating companies were asked to report specifically on SEE risks for the first time and no significant risks to shareholder value were identified. It is anticipated that more information about actual and potential SEE risks will be gathered over time as the monitoring process continues and that this will enable action to be taken to manage such risks as appropriate.

Shareholder communication ‣ Pearson has an extensive programme of communication with all our shareholders – large and small, institutional and private. We also make a particular effort to communicate regularly with Pearson's employees, a large majority of whom are shareholders in the company.

During the year, we completed a major revamp of our website, www.pearson.com. We post all company announcements on the website as soon as they are released, and major shareholder presentations are made accessible via webcast or conference call. It contains a dedicated investor relations section with an extensive archive of past announcements and presentations, historical financial performance, share price data and a calendar of events. It also includes background information about all of our businesses, links to their websites, and details of our corporate responsibility policies and activities.

Each year our AGM – which will be held on 25 April this year – includes information about Pearson's businesses and the previous year's results as well as general AGM business.

People ‣ Pearson wants to be the best employer in the world. We know this is an ambitious goal and that we need continually to review the way we hire and promote people and how we train, develop and reward them.

There are approximately 30,000 people in Pearson spread throughout 60 countries. We have two main aims: to make sure that we are 'best in class' wherever we operate and to be consistent in the way we treat our people in every part of the world. Each business has detailed employment policies for recruitment, remuneration, employee relations, health and safety, and terms and conditions designed for the different sectors and countries in which they operate.

Pearson has a number of specific and discrete responsibilities across all its operating companies. These include overseeing the compensation, benefits, staffing, succession planning, development and training of our most senior executives. We also work hard to identify individuals with the potential to be future leaders in the business and to make sure they get development opportunities which match their aspirations with the needs of our businesses.

i Employment ▸ We are committed to equal opportunity for all, regardless of gender, race or other status. This philosophy applies equally to recruitment and to the promotion, development and training of people who are already part of Pearson. The company takes seriously its statutory obligations to the disabled and seeks not to discriminate against current or prospective employees because of any disability. We are always willing to make reasonable adjustments to premises or employment arrangements if these substantially disadvantage a disabled employee or prospective employee.

Last autumn we launched a new initiative to make sure that the company properly reflects the communities and markets in which we operate. We are developing a number of programmes to ensure that we hire, promote and develop our people in a way which is consistent with our commitment to diversity.

Pearson's core values are simple: we want to be a company which is brave, imaginative and decent in everything we do. This means that we treat our people as we wish to be treated. This is also true when we have to reduce staff and, here too, we seek to set a high standard.

ii Training and development ▸ The development of our people is an integral part of the management agenda within each operating unit of Pearson as well as a key responsibility of the top leaders across the company. It is championed by Pearson's director for people. We believe that we have two main aims in our training and development activities: firstly, to ensure that our people are trained to do their current job to the best of their abilities; and secondly, to ensure that we have a strong pipeline of future managers for our businesses.

Each company has people dedicated to training who carry out regular, thorough analyses of training needs, and create programmes and activities to meet these needs.

In addition to the attention to training within each operating unit, we have a number of discrete professional groups across the Pearson companies – editors, designers, sales and marketing people, finance experts and so on. We have created programmes which address the specific skills of each of these groups and last year we held forums for professionals in finance, HR, marketing and design. Each of these was designed to help develop their professional skills and to create opportunities to share ideas, resources and expertise. We have also created opportunities for job swaps, mentoring and other programmes within each functional group. We intend to extend this formula to other functional groups in due course.

In 2002, we again held our leadership forum which brought together over 100 managers from each part of Pearson. This forum, which is also attended by the top management of our company, provides an opportunity to understand our key business challenges and learn more about our many Pearson interests. This forum remains a key initiative in the way that we identify and develop leaders for Pearson's future.

In 2002, we also implemented a new company-wide performance and career review specifically targeted at the most senior leaders of our business units. This enables us to take a snapshot on an annual basis of the performance and career aspirations of these key people. It is enabling us to develop individual plans which match their current and future development with where the business wants to be.

But our emphasis on career development goes beyond senior management. In 2002, we set a goal to ensure that everyone in Pearson had a chance to discuss their own aspirations and career prospects if they wished. With this as an overall objective, we then explored how each operating unit might implement activities to deliver this goal by mid-2003. In some instances, we enhanced the performance appraisal process to include career discussions, and in other instances, we created discrete career discussion meetings. By the end of 2002, we had created pilot programmes in most of our business units and by the end of 2003 will involve everyone in the company.

Many of our people also want to learn more about other parts of Pearson and to have direct experience outside their typical business responsibilities. We set up the Pearson placement programme which enabled people to do an exchange between operating units for a week at a time. This increased individuals' exposure to wider Pearson issues and enhanced their understanding of the business.

The Pearson placement programme was an intense learning and development initiative for a focused group of individuals. We have extended our effort to cross-pollinate learning between the operating units through larger scale activities. During the year, we held a Getting to Know You day in our book publishing units in the US. This comprised a market stall exhibition of products and services and a number of productive business ideas were produced as a result. Following on from this, we intend to hold more such learning and development events in 2003.

iii Employee participation ▸ We continue strongly to encourage share ownership in a number of ways across Pearson and operate profit sharing and share acquisition plans in over 60 countries.

Last year Pearson won the ProShare award for best performance in fostering employee share ownership. This was awarded to recognise Pearson's serious and long-term commitment to employee share ownership. The judges applauded a number of ways in which Pearson used technology, communication and its co-ordinator network to encourage people to respond to the launch of its Sharesave plan.

iv Employee communication ▸ Each operating unit has its own communications plan which cascades the key goals and challenges through line management and encourages feedback to inform future decision making. Across the whole company, activities include our Pearson-wide magazine, *InPearson*, as well as our company-wide website, *Pearson to Pearson*. This year, we have enhanced the company website with the addition of job posting and CV posting through *PearsonPartners*. This aims to connect people from all parts of Pearson to learn about other parts of our business and to explore opportunities for development and networking.

The chief executive continues to communicate her messages to all colleagues worldwide, on a semi-annual basis and as events require, to ensure that people are informed of key developments and goals in a timely and relevant fashion.

v European employee forum ▸ Once again, two meetings were held during the year of the European Employee Forum which brings together representatives from across our European business units where we have a significant number of colleagues. These forums debated key issues relating to employment and business challenges and remain a key conduit of information to and from business units to ensure that colleagues have access to the planning and decision-making made on their behalf.

Labour standards and human rights ▸ During 2000, Pearson, along with other companies, signed a 'global compact' at the United Nations (UN) which set out a series of principles on labour standards, human rights and the environment. At that time, we set a series of key commitments to reflect the UN principles against which we would monitor and report our performance. We describe our progress below.

In 2001, taking independent advice, we put in place a process to ensure we live up to those commitments covering approximately 80% of our workforce, primarily focusing in the UK and the US. In 2002, we surveyed the remaining 20% of our workforce as well as revisiting areas covered earlier. The survey now covers 82 business operations in 41 countries. The survey does not cover sales offices or joint ventures where Pearson does not have management control.

Some of the UN principles concern the environment and are covered by our environmental policy. Others refer to labour standards and human rights. They are:

Labour standards

- Freedom of association and the right to collective bargaining.
- The elimination of all forms of compulsory labour.
- The abolition of child labour.
- The elimination of discrimination in employment and occupation.

Human rights

- To support and respect international human rights within our sphere of influence.
- To ensure that we are not complicit in human rights abuses.

i Labour standards ‣ The commitments shown below reflect the UN principles. As a result of our survey, we are confident that, for all the businesses we own, we meet or exceed the following:

- We offer equal employment opportunities to all. The people we recruit and promote are selected on merit and suitability, and are not discriminated against because of gender, race, origin, background, religion, marital status, sexual orientation, disability or age. In 2001, we identified the need to establish a group-wide diversity policy and last year, we committed ourselves at a meeting of our most senior managers to a five-year programme to progress this.
- We comply with the relevant laws relating to employment and employment conditions in each country and business surveyed. Subject to relevant laws in the countries where we operate, we fully respect the right of our people to freedom of association and representation either through trades unions, works councils, or any other appropriate forum.
- We are satisfied that we have systems in place to deal with physical and verbal abuse, or the threat of it, and any other form of intimidation within our workforce. In 2003, we plan to review these systems.
- We recognise that labour standards and conditions may vary from country to country. Pearson companies conduct business in countries of the world where living standards are low. Where Pearson companies directly control their activities in a country, we ensure that our people have satisfactory wages and working conditions, and that there is no exploitation of labour.

Following our survey in 2001, we set ourselves targets relating to the two supply chain commitments below:

- We expect those who provide us with goods and services to assure, and if necessary, demonstrate to us that their businesses at least comply with the UN standards set out above. We also expect third-party suppliers to provide satisfactory working conditions for their employees.
- We will advise third-party suppliers that we will positively support their efforts to comply with our guidelines to enable them broadly to adhere to our commitments made under the UN 'Global Compact', and we expect them to do so within an agreed time frame.

The targets we set ourselves were to contact all key suppliers in writing to communicate our expectations and to provide guidance for our professional buyers on incorporating our commitments into operational practice.

In 2002, in order to meet these targets, we focused attention first on the UK and the US as these countries account for around 80% of our business. During the year we wrote to over 16,000 of our suppliers managed from the UK or US advising them of our commitment to the UN 'Global Compact' and outlining our expectations of them. We also briefed and provided guidance for our key professional buyers in the UK and US so that our commitments can routinely be included in discussions and arrangements with our suppliers, whenever appropriate. As relationships with our key suppliers came up for renewal in 2002, we introduced a contractual requirement to meet our commitments. In light of the replies we have received from our original mailing, we have identified certain major sectors including printing, distribution and paper supply on which we will concentrate this year.

In each country, our local subsidiary continues to be responsible for monitoring activity annually. Their reports are submitted to the director for people at Pearson.

ii Human rights ▸ Pearson companies and people operate globally. Our products are produced and manufactured across the world and sold in many countries, often by companies we do not own which are operating on our behalf. In the course of conducting business in 'high risk areas', we are committed to ensure that we are not complicit in human rights abuses and continue to monitor this. If we were to find ourselves inadvertently implicated in abuses of human rights, we would take immediate steps to rectify such a situation. Our survey revealed no such situations which cause us concern.

iii Board responsibility ▸ David Bell, as director for people, is the board director with overall responsibility for labour standards, human rights and environmental issues.

Environmental policy ▸ Pearson does not directly operate in industries where there is a potential for serious industrial pollution. Our main products are based on intellectual property. However, in our normal operations we do things that have an impact on the environment in many ways.

Pearson has had an environmental policy since 1992. In an ever-changing world, environmental issues concern the company and its shareholders, customers, staff and the general public alike. During 2000, we reviewed our policy and concluded that, although most of the original principles were still valid, we needed to enhance our efforts and measure them better. During 2001 we worked with independent consultants to put in place a benchmarking procedure to allow us to measure our progress. The procedure has been introduced into all our businesses involving buildings that house over 100 people or are over 25,000 sq ft in size. The data collected from our surveys allows us to set benchmarks and targets to report against.

For the buildings and companies involved we confirm we meet the principal commitments we set ourselves:

- We comply with the relevant environmental laws and regulations applicable in each country in which we operate.
- We work with regulatory agencies and advisers as necessary in the implementation of effective environmental policies.
- We take account of environmental issues when placing contracts with our top suppliers of goods and services. In 2002, we wrote to our principal suppliers, managed from the UK and the US, outlining our commitments and our expectations of them.
- We continue to introduce energy efficient systems into our buildings and to manage sensibly our energy requirements.
- A senior executive, Alan Miller, has the responsibility for ensuring that our environmental principles are followed and we progress towards the targets we set ourselves. The board takes an active interest in our progress, and each of our operating companies has nominated a senior person to take responsibility for implementing our policy in those businesses. The board reviews progress annually.
- Our environmental policy and our annual environmental review are available to everyone in Pearson through our website, and we have encouraged people to participate and contribute to the development of environmental initiatives as they affect our business.

Health and safety ▸ We continue to be committed to protecting our people, our visitors, our contractors and our customers through our health and safety practices in the workplace. As an aid to further progress, we recognised that a group-wide health and safety policy would be a useful supplement to those adopted by our businesses.

We reviewed our policy on health and safety in 2002 and will communicate this around the Group in 2003.

Our commitments are:

- We comply with health and safety laws and regulations applicable in each of the countries in which we operate.
- Each of our operating companies has appropriate guidelines and procedures in place for the people working in these businesses.

- We ensure that our people are made aware of health and safety issues and good practice in their workplace and that suitable training, supervision and instruction are provided as necessary.
- We actively encourage safe systems of work, policies and procedures from external contractors to ensure the safety of all those working at any time in any one of our operating company locations.
- We review our procedures regularly.
- We accurately record 'incidents' that take place and action any changes necessary following such incidents.
- We have measures to monitor our progress and report annually. This forms part of our environmental review.

Supplier payment policy ‣ Operating companies are responsible for agreeing the terms and conditions, including terms of payment, under which business transactions with their suppliers are conducted. It is Group policy that suppliers are made aware of such terms of payment and that payments to suppliers are made in accordance with these terms, provided that the supplier is also complying with all relevant terms and conditions. Group trade creditors at 31 December 2002 were equivalent to 32 days of purchases during the year ended on that date. The company does not have any significant trade creditors enabling it to produce creditor information for this purpose.

External giving ‣ In 2002, Pearson's external giving totalled £2.8m (£2.39m in 2001). This was split between the UK (£868,000; £745,000 in 2001), and the rest of the world (£1,929,000; £1,648,000 in 2001). In addition to cash donations, Pearson provides in-kind support such as books, publishing expertise, advertising space and staff time. We encourage our employees to support their personal charities by matching fundraising and through payroll giving.

We have conducted a major review of our community involvement, with the aim of focusing our support on a cause where Pearson could make a unique contribution. As the world's leading education company, we decided to focus our charitable giving on projects related to education, and have concentrated on larger projects in our main markets in the UK and US.

We embarked on our first step in 2001 when we made a $2.5m, three-year commitment to Jumpstart, a non-profit organisation that connects college students who aim to become teachers with low-income pre-school children across the US. From September 2002, Pearson is supporting 28 teacher fellows and connecting them with mentors from across the company. Our US businesses are using their expertise and resources creatively to further assist the Jumpstart programme with books, technology and staff time.

We hope to develop a flagship community programme in the UK during 2003.

Pearson businesses have a proud history of corporate giving and supporting projects in the local community. We support Book Aid International, which works with schools and libraries to distribute books and educational materials in Africa. The Financial Times Group in the UK supports schools and colleges in its local borough of Southwark including reading and mentoring schemes. Penguin US has worked with the National Book Foundation and Literacy Partners, which focuses on adult and family literacy programmes. Pearson Education has a book donation programme which has covered countries such as Belize, Nepal, South Africa and Lithuania in 2002.

Share capital ▸ Details of share issues are given in note 23 to the accounts on pages 94 and 95. At the AGM held on 26 April 2002, the company was authorised, subject to certain conditions, to acquire up to 80 million of its ordinary shares by market purchase. Although circumstances have not merited using this authority and there are no plans at present to do so, shareholders will be asked to renew this authority at the AGM on 25 April 2003.

At 3 March 2003, beneficial interests amounting to 3% or more of the issued ordinary share capital of the company notified to the company comprised:

	NUMBER OF SHARES	PERCENTAGE
Legal and General	24,046,759	3.00%
Telefonica Contenidos, SA	38,853,403	4.85%
The Capital Group Companies Inc.	88,115,107	10.99%

Annual general meeting ▸ The notice convening the AGM to be held at 12 noon on Friday, 25 April 2003 at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE, is contained in a circular to shareholders to be dated 25 March 2003.

Registered auditors ▸ Following the conversion of our auditors PricewaterhouseCoopers to a limited liability partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned on 31 January 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors. A resolution to reappoint PricewaterhouseCoopers LLP as auditors to the company will be proposed at the AGM, at a level of remuneration to be agreed by the directors.

Statement of directors' responsibilities ▸ Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and Group as at the end of the year and of the profit or loss of the Group for that period. The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time, the financial position of the company and the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and the Group, and hence for taking reasonable steps towards preventing and detecting fraud and other irregularities. In preparing the financial statements on pages 61 to 64 and 67 to 102 inclusive, the directors consider that appropriate accounting policies have been used and applied in a consistent manner, supported by reasonable and prudent judgements and estimates, and that all relevant accounting standards have been followed.

JULIA CASSON ▸ SECRETARY ▸ 3 MARCH 2003

Report on Directors' Remuneration

Introduction ‣ The Directors' Remuneration Report is presented to shareholders by the board and contains the following information:

- a description of the role of the personnel committee;
- a summary of the company's remuneration policy, including a statement of the company's policy on directors' remuneration;
- details of the terms of the service contracts and the remuneration of each director for the preceding financial year;
- details of the awards under long-term incentive plans held by the directors;
- details of each director's interest in shares in the company; and
- a graph illustrating the performance of the company relative to the FTSE All-Share index for the last five years.

This report complies with the Directors' Remuneration Report Regulations 2002 that apply to the company for the first time this year. This report also sets out how the principles of the Combined Code relating to directors' remuneration are applied.

A resolution will be put to shareholders at the Annual General Meeting on 25 April 2003 inviting them to consider and approve this report.

The personnel committee ‣ Reuben Mark chairs the personnel committee; the other member of the committee during 2002 was Terry Burns. Rana Talwar joined the committee in 2003. All three members of the committee are non-executive directors.

It is named the 'personnel committee' rather than the more conventional 'remuneration committee' to underline the fact that, while a major part of its responsibility is concerned with remuneration, its overriding brief in an unusually people-dependent company is to help Pearson achieve its goal of being the best employer in the world.

The committee's terms of reference are:

- To approve the remuneration and benefits packages of the executive directors, the chief executives of the principal operating companies and other members of the Pearson Management Committee. This includes base salary, annual and long-term incentive entitlements and awards, and pension arrangements.
- To approve the company's long-term incentive and other share plans, including guidelines for the operation of such plans as a whole and, where relevant, the determination of performance measures and targets.
- To review, when appropriate with external assistance, the remuneration and benefits packages of comparable companies to ensure that the company's senior executives are fairly and competitively remunerated.
- To review the total cost of annual remuneration of the executive directors, the chief executives of the principal operating companies and other members of the Pearson Management Committee.
- To ensure that the board meets its statutory and regulatory obligations to report the company's remuneration policy and directors' remuneration, including the production of the Report on Directors' Remuneration.
- To advise and decide on general and specific arrangements in connection with the termination of employment of executive directors, the chief executives of the principal operating companies and other members of the Pearson Management Committee.
- To review the company's management development, training and succession plans.
- To recommend to the full board for its approval the remuneration and benefits package of the chairman of the board.

Dennis Stevenson, chairman, Marjorie Scardino, chief executive, David Bell, director for people, and Robert Head, compensation and benefits director, provided material assistance to the committee during the year. They attend meetings of the committee, although no director is present when his or her own position is being considered.

To ensure that it received independent advice, the committee appointed Towers Perrin who supplied survey data and advised on market trends, long-term incentives and other general remuneration matters. They did not provide other services to the company.

Other external remuneration and benefits specialists also advised the committee. Watson Wyatt supplied survey data, advised on retirement benefits and tracked the company's relative total shareholder return for the purposes of the incentive share plan. Watson Wyatt were also actuaries for the Pearson Group Pension Plan and advisors to the company on general retirement and benefit matters in the UK and the US. Freshfields Bruckhaus Deringer provided legal advice on long-term incentives. They were the company's main UK legal advisor. Lovells advised the company on the legal aspects of pension arrangements, including those for the executive directors, and were also advisors to the Trustee of the Pearson Group Pension Plan. The committee did not appoint these firms.

Compliance ‣ The committee believes that the company has complied with the provisions regarding remuneration matters of the Combined Code on corporate governance as required by the UK Listing Authority of the Financial Services Authority.

Remuneration policy ‣ This report sets out the company's policy on directors' remuneration. This policy will continue to apply to each director for 2003 and, so far as practicable, for subsequent years. The committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the company's business environment and in remuneration practice. Any changes in policy for years after 2003 will be described in future reports, which will continue to be subject to shareholder approval. All statements in this report in relation to remuneration policy for years after 2003 should be considered in this context.

Pearson seeks to generate a performance culture by developing programmes that support its business goals and rewarding contributions towards their achievement. It is the company's policy that total remuneration (basic compensation plus short-term and long-term incentives) should reward both short- and long-term results, delivering competitive rewards for target performance, but outstanding rewards for exceptional performance.

The company's policy is that base compensation should provide the appropriate rate of remuneration for the job, taking into account relevant recruitment markets and business sectors and geographic regions. Benefit programmes should ensure that Pearson retains a competitive recruiting advantage.

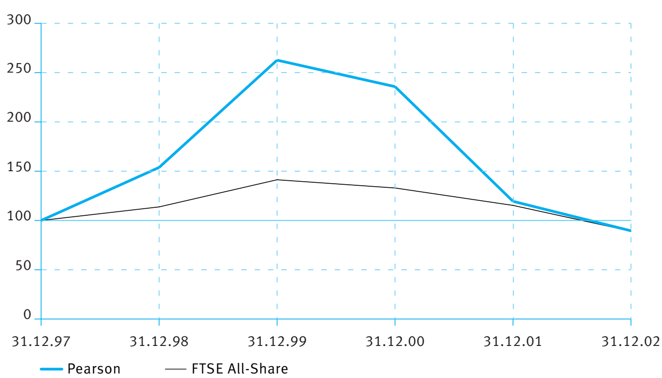
Share ownership is encouraged. Equity-based reward programmes align the interests of directors, and employees in general, with those of shareholders. They also enhance identification with Pearson by linking rewards with Pearson's financial success.

The committee selects performance measures and establishes targets for the company's various performance-related annual or long-term incentive plans based on an assessment of the interests of shareholders and the company and taking into account an appropriate balance of risk and reward for the directors and other participants.

Whether or not targets have been met under the company's various performance-related annual or long-term incentive plans is a matter for the committee to determine based on the relevant information and input from advisors and auditors as appropriate.

Performance ‣ We set out below Pearson's total shareholder return performance relative to the FTSE All-Share index (of which Pearson is a constituent) over the five-year period 1997 to 2002. We have chosen this index on the basis that it is a recognisable reference point and appropriate comparator for the majority of our investors.

TOTAL SHAREHOLDER RETURN



The five-year total shareholder return figures for Pearson, the FTSE All-Share index and the FTSE Media sector (of which Pearson is also a constituent) were as follows:

	PEARSON	FTSE ALL-SHARE	FTSE MEDIA
Dec 97	100.00	100.00	100.00
Dec 02	89.53	89.14	81.00

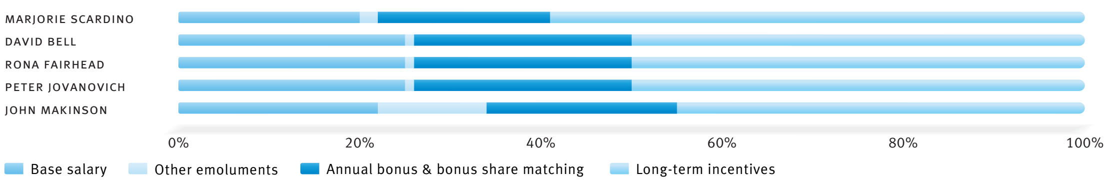
note ‣ Based on data from Bloomberg and FT-SE International.

Main elements of remuneration ‣ We set out below the company's policies for each of the main elements of remuneration as they affect executive directors, namely:

- base salary and other emoluments;
- annual bonus and bonus share matching;
- long-term incentives.

Total remuneration is made up of fixed and performance-linked elements. Consistent with its policy, the committee places considerable emphasis on the performance-linked elements of remuneration that comprise annual bonus, bonus share matching and long-term incentives. As a proportion of total remuneration (not including retirement benefits), the relative importance of fixed and performance-linked remuneration based on the remuneration policy set out in this report for each of the executive directors is broadly as follows:

PROPORTION OF TOTAL COMPENSATION



note ‣ Based on current base salaries and other emoluments, target annual incentives with maximum bonus share matching, and present expected values for 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 ‣ Our aim is that the base salaries of the executive directors should be set at levels that are competitive with those of directors and executives in similar positions in comparable companies. This includes a range of companies of comparable size and global reach in different sectors in the UK and selected media companies in North America.

Our policy is to review salaries annually.

Other emoluments ‣ It is the company's policy that its benefit programmes should be competitive in the context of the local labour market, while recognising the requirements, circumstances and mobility of individual executives.

Annual bonus ‣ The committee establishes the annual bonus plans for the executive directors, chief executives of the company's main operating companies and other members of the Pearson Management Committee, including performance measures and targets and the amount of bonus that can be earned.

The performance targets relate to the company's main drivers of business performance at both the corporate and operating company level. Performance is measured separately for each item.

For 2003, the performance measures for Pearson plc are growth in underlying sales and adjusted earnings per share, operating cash conversion and working capital as a ratio to sales. For subsequent years, the measures will be set at the time.

For 2003, following the committee's review of executive remuneration, the target annual bonus opportunity for executive directors and other members of the Pearson Management Committee will be 75% of salary. Individuals may receive up to twice their target bonus based on performance in excess of target.

The committee will continue to review the bonus plans on an annual basis and to revise the bonus limits and targets in light of the current conditions.

The committee may award individual discretionary bonuses. In the UK, bonuses do not form part of pensionable earnings. In the US, bonuses up to 50% of base salary are pensionable under the supplemental executive retirement plan, consistent with US market practice.

Bonus share matching ‣ The company encourages executive directors and other senior executives to hold Pearson shares.

The annual bonus share matching plan permits executive directors and senior executives around the Group to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the company's adjusted earnings per share increase in real terms by at least 3% per annum, the company will match them on a gross basis of one share for every two held after three years, and another one for two originally held (i.e. a total of one-for-one) after five years.

This measure of performance is consistent with the test of company performance used in the executive option plan at the time the plan was introduced. It is also in line with that adopted by other companies operating deferred bonus or bonus investment plans of this type where the company match is subject to meeting an additional performance condition.

This target is met if the company's adjusted earnings per share as published in the company's annual report and accounts for the financial year ending prior to the end of the three- or five-year period exceed those for the financial year ending prior to the date of the award by the percentage increase in the Index of Retail Prices (All Items) published by the UK Government plus 3% per annum, subject to any adjustment the committee may make in accordance with the plan rules. This method of calculation thus measures the company's financial progress over the period to which the entitlement to matching shares relates.

The long-term incentive plan ▸ Executive directors, senior and other executives and managers are eligible to participate in Pearson's long-term incentive plan introduced in 2001. The plan consists of two parts: stock options and/or restricted stock. The aim is to give the committee a range of tools with which to link corporate performance to management's long-term reward in a flexible way. The principles underlying it are as follows:

- the committee establishes guidelines that set out the maximum expected value of awards each year using an economic valuation methodology for fixing the relative values of both option grants and restricted stock awards;
- the maximum expected value of awards for executive directors is based on assessment of market practice for comparable companies;
- no more than 10% of Pearson equity will be issued, or be capable of being issued, under all Pearson's share plans in any ten-year period commencing in January 1997;
- awards of restricted stock are satisfied using existing shares.

For stock options, within this overall 10% limit, up to 1.5% of new issue equity may be placed under option under the plan in any year, subject to the company's earnings per share performance. No options may be granted unless the company's adjusted earnings per share increase in real terms by at least 3% per annum over the three-year period prior to grant. Performance-linking the grant of options is intended to provide a direct link between the amount of equity allocated to option grants and the company's financial progress. The application of a pre-grant performance condition is consistent with the practice in the markets in which the majority of participants find themselves and is acknowledged by institutional investors as being appropriate for companies like Pearson. Earnings per share growth was chosen as the most appropriate test of the company's financial performance for this purpose. This target is met if the company's adjusted earnings per share as published in the company's annual report and accounts for the last financial year prior to grant exceed those for the last financial year prior to the start of the three-year period by the percentage increase in the Index of Retail Prices (All Items) published by the UK Government plus 3% per annum, subject to any adjustment the committee may make in accordance with the plan rules. This method of calculation was chosen to link the extent to which options may be granted in a single year to financial performance. There are no further performance conditions governing the exercise of options.

The vesting of restricted stock is normally dependent on the satisfaction of a stretching corporate performance target over a three-year period. On the introduction of the plan, the committee said that the performance condition governing the vesting of restricted stock would initially be growth in Pearson's free cash flow but that it might specify a different condition in future years if it thought fit. Details of the performance measures and targets for outstanding awards are set out in the notes to table 4 on page 55 of this report. Restricted stock may be granted without performance conditions to satisfy recruitment and retention objectives.

For 2003, the pre-grant performance condition for the award of stock options based on earnings per share growth over the period 1999 to 2002 was not met. The committee will be able to award restricted stock in accordance with policy, although, at the date of publication of this report, no decisions had been made.

All-employee share plans ▸ Executive directors are eligible to participate in the company's all-employee share plans on the same terms as other employees. These plans comprise share acquisition programmes in the UK and the US. These plans operate within specific tax legislation (including a requirement to finance acquisition of shares using the proceeds of a monthly savings contract) and the acquisition of shares under these plans is not subject to the satisfaction of a performance target.

Shareholding policy ▸ As previously noted, in line with the policy of encouraging widespread employee ownership, the company is keen to encourage executive directors to build up a substantial shareholding in the company. However, in view of the volatility of the stock market, we do not think it is appropriate to specify a particular relationship of shareholding to salary.

Service agreements ▸ Executive directors have rolling service agreements with the company. Other than by termination in accordance with the terms of these agreements, employment continues until retirement.

It is normal policy that the company may terminate these agreements by giving 12 months' notice, although there may be circumstances when a longer notice period may be justified. The agreements also specify the compensation payable by way of liquidated damages in circumstances where the company terminates agreements without notice or cause.

In the case of Peter Jovanovich, his service agreement provides for compensation on termination of employment by the company without cause of 200% of annual salary plus target bonus reflecting US employment practice and the terms agreed with him in October 2000 before his appointment as a director of the company.

We summarise the agreements as follows:

NAME	DATE OF AGREEMENT	NOTICE PERIODS	COMPENSATION ON TERMINATION BY THE COMPANY WITHOUT NOTICE OR CAUSE
Dennis Stevenson	13 May 1997	6 months from the director; 12 months from the company	100% of annual salary at the date of termination
Marjorie Scardino	13 May 1997	6 months from the director; 12 months from the company	100% of annual salary at the date of termination, the annual cost of pension and all other benefits and a proportion of bonus
David Bell	15 March 1996	6 months from the director; 12 months from the company	100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential bonus
Rona Fairhead	24 January 2003	6 months from the director; 12 months from the company	100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential bonus
Peter Jovanovich	9 October 2000	Employment may be terminated by either party at any time, subject to 3 months' notice from the director in the case of voluntary resignation	200% of annual salary and target bonus
John Makinson	24 January 2003	6 months from the director; 12 months from the company	100% of annual salary at the date of termination, the annual cost of pension and all other benefits and 50% of potential bonus

Retirement benefits ▸ We describe in turn the retirement benefits for each of the executive directors.

Marjorie Scardino has both defined benefit and defined contribution pension arrangements in the US. The Pearson Inc. Pension Plan (the US Plan) is an approved defined benefit plan providing a lump sum convertible to a pension on retirement. The lump sum accrued at 6% of capped compensation, but accruals of benefit ceased on 31 December 2001.

The defined contribution arrangements are an approved 401(k) plan and an unfunded, unapproved scheme.

The US Plan has a normal retirement age of 65. Early retirement after age 55 is possible, with company consent and on a reduced pension for early payment. The US Plan also provides a spouse's pension on death in service from age 55 and death in retirement broadly equivalent to 50% of the member's early retirement pension. The US Plan does not guarantee any increases to the pension once it comes into payment.

David Bell is a member of the Final Pay Section of the Pearson Group Pension Plan (the UK Plan), to which he contributes 5% of his pensionable salary.

He is eligible for a pension from the UK Plan of two-thirds of his final base salary at normal retirement age (age 62) due to his previous service with the *Financial Times*. Early retirement after age 50 is possible, with company consent, and on a pension that is scaled down to reflect the shorter period of service completed. If retiring before age 60, the pension will be further reduced by an actuarial factor to reflect the longer period over which it is expected to be paid.

On death before normal retirement age, a pension will be paid to the spouse, or in the absence of a spouse to a financial dependant nominated by the member. The pension will be one-third of annual base salary. On death after leaving service but before retirement, a pension of 50% of the deferred pension will be payable to the spouse or nominated financial dependant. On death in retirement the pension payable is 60% of the director's pension (ignoring any pension commuted for a lump sum at retirement). Children's pensions may also be payable to dependent children. Pensions in payment are guaranteed in the UK Plan to increase each year at 5% or the increase in the Index of Retail Prices, if lower.

Rona Fairhead is also a member of the Final Pay Section of the UK Plan, but her pensionable salary is restricted to the earnings cap introduced by the Finance Act 1989. In addition, the company contributes into a Funded Unapproved Retirement Benefits Scheme (FURBS).

The UK Plan provides her with a pension that accrues at one-thirtieth of the earnings cap for each year of service.

Early retirement after age 50 is possible, with company consent, and on a pension from the plan that is scaled down to reflect the shorter period of service completed. If retiring before age 60, the pension will be further reduced by an actuarial factor to reflect the longer period over which it is expected to be paid. Under the company's FURBS arrangements, early retirement is possible with company consent from age 50 onwards. The benefit payable will be the amount of the member's fund at the relevant date.

On death before normal retirement age, a pension will be paid to the spouse, or in the absence of a spouse to a financial dependant nominated by the member. The pension will be one-third of the earnings cap at the time of death. On death after leaving service but before retirement, a pension of 50% of the deferred pension will be payable to the spouse or nominated financial dependant. On death in retirement the pension payable is 60% of the director's pension (ignoring any pension commuted for a lump sum at retirement). Children's pensions may also be payable to dependent children. Pensions in payment are guaranteed in the UK Plan to increase each year at 5% or the increase in the Index of Retail Prices, if lower. In addition the proceeds of the FURBS will be paid.

Peter Jovanovich has both defined benefit and defined contribution pension arrangements in the US. The Pearson Inc. Pension Plan (the US Plan) is an approved defined benefit plan providing a lump sum convertible to a pension on retirement. The lump sum accrued at 6% of capped compensation, but accruals of benefit ceased on 31 December 2001. In addition, there is an unfunded, unapproved Supplemental Executive Retirement Plan (the US SERP) providing an annual pension accrual of 2% of final average earnings, less benefits accrued in the US Plan and US Social Security.

The defined contribution arrangements are an approved 401(k) plan and a funded, unapproved 401(k) excess plan.

The US Plan has a normal retirement age of 65. Early retirement after age 55 is possible, with company consent and on a reduced pension for early payment. The US Plan also provides a spouse's pension on death in service from age 55 and death in retirement broadly equivalent to 50% of the member's early retirement pension. The US Plan does not guarantee any increases to the pension once it comes into payment.

For 2003, Peter Jovanovich's pension arrangements will include a new unfunded, unapproved, defined contribution plan and his participation in the US SERP will cease.

John Makinson is also a member of the Final Pay Section of the UK Plan, and his pensionable salary is also restricted to the earnings cap. The company has been paying contributions into a FURBS, but the contributions ceased on 31 December 2001. During 2002, the company established an Unfunded Unapproved Retirement Benefits Scheme (UURBS) for John Makinson.

The UURBS tops up the pensions payable from the UK Plan and the closed FURBS to a target pension of two-thirds of Revalued Base Salary on retirement at age 62. Revalued Base Salary is defined as £450,000 indexed in line with the increase in the Index of Retail Prices.

Early retirement after age 50 is possible, with company consent based on a uniform accrual from 1 April 1994. The pension from the UK Plan, the FURBS and the UURBS in aggregate will be scaled down to reflect the shorter period of service completed. If retiring before age 60, the pension will be further reduced by an actuarial factor to reflect the longer period over which it is expected to be paid.

On death before normal retirement age, a pension from the UK Plan, the FURBS and the UURBS in aggregate will be paid to the spouse, or in the absence of a spouse to a financial dependant nominated by the member. The pension will be one-third of Revalued Base Salary. On death after leaving service but before retirement, a pension of 50% of the deferred pension will be payable to the spouse or nominated financial dependant. On death in retirement the pension payable is 60% of the director's pension (ignoring any pension commuted for a lump sum at retirement). Children's pensions may also be payable to dependent children. The pension in payment is guaranteed to increase each year at 5% or the increase in the Index of Retail Prices, if lower.

Details of directors' pension arrangements are set out in table 2 on page 53 of this report.

Chairman's remuneration ‣ The committee recommends to the full board for its approval the remuneration and benefits package of the chairman of the board.

Dennis Stevenson's remuneration comprises a salary that is intended to be competitive with those of chairmen in comparable companies taking into account the role that he performs.

His original remuneration package included an entitlement to long-term incentives. He waived this entitlement in 1999 because he thought there might be a conflict when discussing long-term incentive policy with shareholders. In view of that and the fact that his salary was last revised in 1999, his remuneration is currently under consideration.

He is not entitled to an annual bonus, retirement or other benefits. He is eligible to participate in the company's worldwide save for shares plan.

Non-executive directors ‣ 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. Fees are reviewed annually with the help of outside advice. 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.

Since January 2000, non-executive directors have received an annual fee of £35,000 each. One overseas-based director is paid a supplement of £7,000 per annum. The non-executive directors who chair the personnel and audit committees each receive an additional fee of £5,000 per annum. For those non-executive directors who retain their fees personally, £10,000 of the total fee, or all of the fee in the case of Rana Talwar, is payable in the form of Pearson shares which the non-executive directors have committed to retain for the period of their directorships.

In the case of Patrick Cescau, his fee is paid over to his employer.

Non-executive directors serve Pearson under letters of appointment and do not have service contracts.

They were appointed to the board on the following dates:

Patrick Cescau	1 April 2002
Rana Talwar	20 March 2000
Reuben Mark	6 May 1988
Terry Burns	6 May 1999
Vernon Sankey	8 January 1993

There is no entitlement to compensation on the termination of their directorships.

Remuneration of the directors ‣ Excluding contributions to pension funds and related benefits set out in table 2, directors' remuneration was as follows:

TABLE 1	2002				2001
all figures in £000s	SALARIES/FEES	BONUS	OTHER	TOTAL	TOTAL
Chairman					
Dennis Stevenson	275	—	—	275	275
Executive directors					
Marjorie Scardino	525	273	54	852	583
David Bell	310	161	16	487	325
Rona Fairhead (appointed 1 June 2002)	193	100	8	301	—
Peter Jovanovich (appointed 1 June 2002)	325	240	5	570	—
John Makinson	419	279	157	855	396
Non-executive directors					
Terry Burns	35	—	—	35	35
Patrick Cescau (appointed 1 April 2002)	26	—	—	26	—
Reuben Mark	47	—	—	47	45
Vernon Sankey	40	—	—	40	40
Rana Talwar	35	—	—	35	35
Total	**2,230**	**1,053**	**240**	**3,523**	1,734
Total 2001†	1,653	—	94	—	1,747

† Includes amounts to former directors.

note 1 ‣ John Makinson was the highest paid director in 2002. His total remuneration, including pension contributions, amounted to £859,607.

note 2 ▸ For the full-year, Rona Fairhead's and Peter Jovanovich's remuneration was as follows:

all figures in £000s	SALARIES/FEES	BONUS	OTHER	TOTAL
Rona Fairhead	318	165	13	496
Peter Jovanovich	557	412	9	978

note 3 ▸ Although the salaries of the executive directors were in certain cases below those of their competitors, the executive directors (along with their fellow senior managers) elected not to receive an increase in their base salaries with effect from 1 January 2002.

Rona Fairhead and John Makinson received increases in their base salaries on taking up their appointments as chief financial officer and chairman and chief executive of the Penguin Group respectively with effect from 1 June 2002.

note 4 ▸ For Pearson plc, the 2002 performance measures in the annual bonus plan were growth in underlying sales, growth in adjusted earnings per share, trading cash conversion and average working capital as a ratio to sales.

In the case of Peter Jovanovich and, for part of the year, John Makinson, part of their bonuses also related to the performance of Pearson Education and Penguin Group respectively. For both businesses, the performance measures were growth in underlying sales, trading margin, trading cash conversion and average working capital as a ratio to sales.

No discretionary bonuses were awarded for 2002.

note 5 ▸ Other emoluments include company car and healthcare benefits and, in the case of Marjorie Scardino, include £36,090 in respect of housing costs.

On taking up his appointment as chairman and chief executive of the Penguin Group with effect from 1 June 2002, John Makinson also became entitled to a location and market premium in relation to the management of the business of the Penguin Group in the US. He received £130,640 for 2002.

Marjorie Scardino, Rona Fairhead, David Bell and John Makinson have the use of a chauffeur.

note 6 ▸ No amounts in compensation for loss of office and no expense allowances chargeable to UK income tax were paid during the year.

TABLE 2

	DIRECTORS' REMUNERATION REPORT REGULATIONS 2002[1]					
	AGE AT 31 DEC 02	IN ACCRUED PENSION OVER THE PERIOD £000	INCREASE ACCRUED PENSION AT 31 DEC 02 £000[2]	TRANSFER VALUE AT 31 DEC 01 £000	TRANSFER VALUE AT 31 DEC 02 £000[3]	INCREASE IN TRANSFER VALUE LESS DIRECTORS' CONTRIBUTIONS £000
Directors' pensions						
Marjorie Scardino	55	-0.5	4.5	33.6	32.0	-1.6
David Bell	56	6.9	179.1	2,104.6	1,965.7	-154.4
Rona Fairhead	41	3.2	4.0	4.9	19.9	10.2
Peter Jovanovich	53	0.7	68.4	339.1	392.5	53.4
John Makinson	48	32.1	97.2	559.2	648.0	84.0

	DIRECTORS' REMUNERATION REPORT REGULATIONS 2002[1]		LISTING RULES[1]	
	OTHER PENSION COSTS TO THE COMPANY OVER THE PERIOD £000[4]	OTHER PENSION RELATED BENEFITS £000[5]	INCREASE IN ACCRUED PENSION (NET OF INFLATION) DURING THE PERIOD £000	TRANSFER VALUE OF THE INCREASE IN ACCRUED PENSION (NET OF INFLATION) AT 31 DEC 02, LESS DIRECTORS' CONTRIBUTIONS £000
Directors' pensions				
Marjorie Scardino	439.6	29.1	-0.6	-4.3
David Bell	–	–	4.0	28.0
Rona Fairhead	78.0	–	3.2	11.2
Peter Jovanovich	20.7	2.1	-0.5	-2.9
John Makinson	–	4.5	31.0	202.1

note 1 ▸ In previous years, details of directors' pension benefits have been reported in accordance with the Listing Requirements of the Listing Authority. The Directors' Remuneration Report Regulations 2002 introduced the requirement to disclose additional information for directors' pension benefits under defined benefit plans. The above table provides the information required on both bases.

note 2 ▸ The accrued pension at 31 December 2002 is that which would become payable from normal retirement age if the member left service at 31 December 2002. For Marjorie Scardino, it relates only to the pension from the US Plan and the increase is negative because of exchange rate changes over the year. For David Bell and Rona Fairhead it relates to the pension payable from the UK Plan. For John Makinson it relates to the pension from the UK Plan, the FURBS and the UURBS in aggregate. For Peter Jovanovich it relates to the pension from the US Plan and the US SERP.

note 3 ‣ The UK transfer values at 31 December 2002 are calculated using the assumptions for cash equivalents payable from the UK Plan and are based on the accrued pension at that date. For the US Plan and SERP, transfer values are calculated using a discount rate equivalent to current US government long term bond yields.

note 4 ‣ This column comprises payments to a FURBS arrangement for Rona Fairhead. For Marjorie Scardino and Peter Jovanovich, it includes company contributions to funded defined contribution plans and notional contributions to unfunded defined contribution plans.

note 5 ‣ This column comprises life assurance, group term life cover and long-term disability insurance.

TABLE 3 *at 31 Dec 02*

	ORDINARY SHARES AT 1 JAN 02	ORDINARY SHARES AT 31 DEC 02
Interests of directors were		
Dennis Stevenson	110,017	161,894
Marjorie Scardino	82,225	86,121
David Bell	49,438	50,939
Terry Burns	812	1,712
Patrick Cescau	—	—
Rona Fairhead	—	560
Peter Jovanovich	54,986	54,986
John Makinson	28,620	29,333
Reuben Mark	10,713	11,837
Vernon Sankey	801	1,666
Rana Talwar	3,283	6,848

note 1 ‣ Ordinary shares includes 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 annual bonus share matching plan.

note 2 ‣ On 2 January 2003, Terry Burns acquired 260 shares, Reuben Mark 339, Vernon Sankey 261 and Rana Talwar 1,074. The shares were acquired as part of their directors' fees.

note 3 ‣ Executive directors of the company, as possible beneficiaries, are also deemed to be interested in the Pearson Employee Share Trust and the Pearson Employee Share Ownership Trust, the trustees of which held 175,402 and 850,779 Pearson ordinary shares of 25p each respectively at 31 December 2002 and also at 3 March 2003.

note 4 ‣ At 31 December 2002, Marjorie Scardino, John Makinson and David Bell each held 1,000 shares in Recoletos Grupo de Comunicación S.A. Dennis Stevenson held 8,660 shares.

note 5 ‣ 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 2002 was 574.50p per share and the range during the year was 505.00p to 922.00p.

TABLE 4

Movements in directors' interests in restricted shares

		DATE OF AWARD	01 JAN 02	AWARDED	RELEASED	LAPSED	31 DEC 02	MARKET VALUE AT DATE OF AWARD	LATEST VESTING DATE
Dennis Stevenson	**a**	12/9/97	74,396	1,232	(76,670)			820.64p	N/A
				1,042			—	660.30p	N/A
			74,396	2,274	(76,670)	—	—		
Marjorie Scardino	**b**	8/6/99	54,029				54,029		
	b	3/5/00	33,840			(33,840)	—		
	c	25/6/98	7,803			(3,903)	3,900		
	c	29/4/99	23,476				23,476		
	c	19/5/00	13,676				13,676		
	c	11/5/01	14,181				14,181		
	d	9/5/01	55,400				55,400		
	d	19/11/02		5,869			5,869	672.00p	29/4/04
	d	16/12/02		362,040			362,040	638.50p	28/6/09
			202,405	367,909	—	(37,743)	532,571		
David Bell	**b**	8/6/99	26,890				26,890		
	b	3/5/00	17,097			(17,097)	–		
	c	29/4/99	9,763				9,763		
	c	19/5/00	6,371				6,371		
	c	11/5/01	6,371				6,371		
	d	9/5/01	21,800				21,800		
	d	19/11/02		2,440			2,440	672.00p	29/4/04
	d	16/12/02		159,678			159,678	638.50p	28/6/09
			88,292	162,118	—	(17,097)	233,313		
Rona Fairhead	**c**	19/4/02		933			933	892.00p	19/4/07
	d	8/4/02		5,000			5,000	843.00p	8/10/04
	d	16/12/02		159,678			159,678	638.50p	28/6/09
			—	165,611	—	—	165,611		
Peter Jovanovich	**b**	8/6/99	46,586				46,586		
	b	3/5/00	30,678			(30,678)	—		
	c	29/4/99	8,889				8,889		
	c	19/5/00	9,822				9,822		
	c	3/1/01	58,343				58,343		
	d	9/5/01	41,560				41,560		
	d	19/11/02		2,222			2,222	672.00p	29/4/04
	d	16/12/02		198,396			198,396	638.50p	28/6/09
			195,878	200,618	—	(30,678)	365,818		
John Makinson	**b**	8/6/99	30,874				30,874		
	b	3/5/00	19,539			(19,539)	—		
	c	25/6/98	4,587			(2,294)	2,293		
	c	29/4/99	11,630				11,630		
	c	19/5/00	9,117				9,117		
	c	11/5/01	9,553				9,553		
	d	9/5/01	26,380				26,380		
	d	19/11/02		2,907			2,907	672.00p	29/4/04
	d	16/12/02		206,880			206,880	638.50p	28/6/09
			111,680	209,787	—	(21,833)	299,634		

note 1 ▸ The number of shares shown represents the maximum number of shares that may vest, subject to any performance conditions being met.

note 2 ▸ No variations to the terms and conditions of plan interests were made during the year.

note 3 ▸ Restricted shares designated as: **a** incentive share plan; **b** reward plan; **c** annual bonus share matching plan; and **d** long-term incentive plan.

- Awards released under incentive share plan:
  The incentive share plan was introduced in 1993 to reward executives based on the performance of the company over the medium to longer term. The performance test was Pearson total shareholder return relative to the FTSE 100 total return index so as to reward the small number of senior executives participating in the plan in such a way that their total remuneration reflected the performance of the company and the interests of the shareholders. Dennis Stevenson's was the only outstanding award under this plan covering the five-year performance period May 1997 to April 2002.

  The terms of this award were such that no shares vested if the ratio of Pearson to FTSE 100 total return was less than 100%. 25% of the shares vested if the ratio was 100% and 150% of the shares (the maximum possible) vested if the ratio was 125% or more. In addition, Pearson's adjusted earnings per share for the latest full-year covered by the performance period (2001) needed to be higher than those in the year prior to the award being made (1996). Pearson's total shareholder return was 46.7% over the period and the FTSE 100's was 36.6%, a ratio of 127.6%. Pearson's pre-internet adjusted earnings per share for 2001 were 39.2p against 27.3p in 1996.

  As a consequence, both performance targets were met in full and Dennis Stevenson received 150% of shares comprised in the award together with the rolled-up scrip, dividend re-investment plan or cash dividends. The market value of the shares on the date of release (19 November 2002) was 672.00p. Details of Dennis Stevenson's award under this plan are set out in table 4 itemised as **a** on page 55 of this report.

- Awards lapsed:
  The vesting of Pearson Equity Incentives (PEIs) awarded in 2000 under the reward plan was related to growth in free cash flow per shares over the three-year period 2000 to 2002. On the basis of performance over that period, no PEIs vested and all entitlements lapsed. Marjorie Scardino, David Bell, Peter Jovanovich and John Makinson held PEIs under this plan. Details of these awards are set out in table 4 and itemised as **b** on page 55 of this report.

- Awards outstanding:
  The annual bonus share matching plan permits executive directors and senior executives around the Group to invest up to 50% of any after tax annual bonus in Pearson shares. If these shares are held and the company's adjusted earnings per share increase in real terms by at least 3% per annum, the company will match them on a gross basis of one share for every two held after three years, and another one for two originally held (i.e. a total of one for one) after five years. For the award made in 1998, since the real growth in earnings per share target for the period 1997 to 2002 was not met, participants did not become entitled to the second one-for-two matching shares and these awards lapsed. Participants were, however, already entitled to the first one-for-two matching shares based on 1997 to 2000 performance and these shares will be released in 2003. For the award made in 1999, participants did not become entitled to the one-for-two match in 2002 but remain eligible for the one-for-one match in 2004 subject to the earnings per share target for 1998 to 2003 being met. If this target is not met, the awards lapse. Marjorie Scardino, David Bell, Rona Fairhead, Peter Jovanovich and John Makinson hold awards under this plan. Details of these awards are set out in table 4 and itemised as **c** on page 55 of this report.

  As reported in 2001, Pearson Equity Incentives awarded in 1999 under the reward plan vested on 8 June 2002. Following vesting, the shares remain subject to a two-year retention period and will be released in 2004. Marjorie Scardino, David Bell, Peter Jovanovich and John Makinson hold PEIs under this plan. Details of these awards are set out in table 4 and itemised as **b** on page 55 of this report.

  The vesting of restricted stock awards under the long-term incentive plan made in 2001 is related to free cash flow per share performance over the period 2001 to 2003 consistent with the performance measure used in relation to vesting of restricted stock under the previous reward plan. The committee considered that free cash flow was the most appropriate performance measure to determine the vesting of restricted shares at the time because the cash the businesses generate provides a transparent and accurate measure of Pearson's achievements and was recognised by shareholders as a significant driver of value. This target is met if the company's cumulative free cash flow per share for the three financial years of the performance period exceeds the target set by the committee for growth over the free cash flow per share for the financial year prior to the start of the period (free cash flow being defined as our operating cash flow as stated in each year's accounts less tax liabilities on operating activities and tax paid). Details of the restricted stock awards under this plan for Marjorie Scardino, David Bell, Peter Jovanovich and John Makinson are set out in table 4 and itemised as **d** on page 55 of this report.

- Awards granted:

  The annual bonus share matching plan shares awarded to Rona Fairhead on 19 April 2002 will vest in full on 19 April 2007 if the company's adjusted earnings per share increase in real terms by at least 3% per annum over the period 2001 to 2006. 50% of these shares vest on 19 April 2005 if the company's adjusted earnings per share increase in real terms by at least 3% per annum over the period 2001 to 2004.

  The long-term incentive plan shares awarded to Rona Fairhead on 8 April 2002 will vest on 8 October 2004, being three years from the date of her appointment, in accordance with the terms agreed with her when she joined the company.

  The long-term incentive plan shares awarded on 19 November 2002 will vest on 29 April 2004 providing the company's adjusted earnings per share increase in real terms by an average of 3% per annum over the five-year period 1998 to 2003 by comparing earnings per share for 1998 with those for 2003.

  The long-term incentive plan shares awarded on 16 December 2002 will vest in tranches as follows:

	A	B	C	D	E
Marjorie Scardino	60,340	60,340	60,340	60,340	120,680
David Bell	26,613	26,613	26,613	26,613	53,226
Rona Fairhead	26,613	26,613	26,613	26,613	53,226
Peter Jovanovich	33,066	33,066	33,066	33,066	66,132
John Makinson	34,480	34,480	34,480	34,480	68,960

  The first tranche of shares shown in A will vest on 28 June 2005. The second, third, fourth and fifth tranches shown in B, C, D and E will vest no earlier than 28 June 2005 subject to the Pearson share price reaching £9, £11, £13 and £18 respectively for a period of 20 consecutive business days prior to 28 June 2009. The committee considered that these awards and share price targets, which focus on the restoration of shareholder value, provide meaningful incentives to the executives concerned while recognising the long-term interests of shareholders. Details of the restricted stock awards under this plan for Marjorie Scardino, David Bell, Rona Fairhead, Peter Jovanovich and John Makinson are set out in table 4 and itemised as **d** on page 55 of this report.

TABLE 5

Movements in directors' interests in share options		Date of grant	1 Jan 02	Granted	Exercised/ lapsed	31 Dec 02	Option price	Earliest exercise date	Expiry date
Dennis Stevenson	**b**	15/5/98	2,512	—	—	2,512	687p	1/8/03	1/2/04
Total			2,512	—	—	2,512	—		
Marjorie Scardino	**a***	14/9/98	176,556	—	—	176,556	974p	14/9/01	14/9/08
	a*	14/9/98	5,660	—	—	5,660	1090p	14/9/01	14/9/08
	b	15/5/98	2,839	—	—	2,839	687p	1/8/05	1/2/06
	c	8/6/99	37,583	—	—	37,583	1373p	8/6/02	8/6/09
	c	8/6/99	37,583	—	—	37,583	1648p	8/6/02	8/6/09
	c	8/6/99	37,583	—	—	37,583	1922p	8/6/02	8/6/09
	c	3/5/00	36,983	—	—	36,983	2303p	3/5/03	3/5/10
	c	3/5/00	36,983	—	—	36,983	2764p	3/5/03	3/5/10
	c	3/5/00	36,983	—	—	36,983	3225p	3/5/03	3/5/10
	d*	9/5/01	41,550	—	—	41,550	1421p	9/5/02	9/5/11
	d	9/5/01	41,550	—	—	41,550	1421p	9/5/03	9/5/11
	d	9/5/01	41,550	—	—	41,550	1421p	9/5/04	9/5/11
	d	9/5/01	41,550	—	—	41,550	1421p	9/5/05	9/5/11
Total			574,953	—	—	574,953	—		
David Bell	**a***	14/9/98	20,496	—	—	20,496	974p	14/9/01	14/9/08
	b*	9/5/97	650	—	(650)	—	530p	1/8/02	1/2/03
	b	15/5/98	501	—	—	501	687p	1/8/03	1/2/04
	b	16/5/99	184	—	—	184	913p	1/8/04	1/2/05
	b	13/5/00	202	—	—	202	1428p	1/8/03	1/2/04
	b	9/5/01	202	—	—	202	957p	1/8/04	1/2/05
	b	10/5/02	—	272	—	272	696p	1/8/05	1/2/06
	c	8/6/99	18,705	—	—	18,705	1373p	8/6/02	8/6/09
	c	8/6/99	18,705	—	—	18,705	1648p	8/6/02	8/6/09
	c	8/6/99	18,705	—	—	18,705	1922p	8/6/02	8/6/09
	c	3/5/00	18,686	—	—	18,686	2303p	3/5/03	3/5/10
	c	3/5/00	18,686	—	—	18,686	2764p	3/5/03	3/5/10
	c	3/5/00	18,686	—	—	18,686	3225p	3/5/03	3/5/10
	d*	9/5/01	16,350	—	—	16,350	1421p	9/5/02	9/5/11
	d	9/5/01	16,350	—	—	16,350	1421p	9/5/03	9/5/11
	d	9/5/01	16,350	—	—	16,350	1421p	9/5/04	9/5/11
	d	9/5/01	16,350	—	—	16,350	1421p	9/5/05	9/5/11
Total			199,808	272	(650)	199,430	–		
Rona Fairhead	**d***	1/11/01	19,997	—	—	19,997	822p	1/11/03	1/11/11
	d	1/11/01	19,998	—	—	19,998	822p	1/11/04	1/11/11
	d	1/11/01	20,005	—	—	20,005	822p	1/11/05	1/11/11
Total			60,000	—	—	60,000	—		

TABLE 5 CONTINUED

		Date of grant	1 Jan 02	Granted	Exercised/ lapsed	31 Dec 02	Option price	Earliest exercise date	Expiry date
Peter Jovanovich	**a***	12/9/97	8,250	—	—	8,250	758p	12/9/00	12/9/07
	a*	12/9/97	102,520	—	—	102,520	677p	12/9/00	12/9/07
	c	8/6/99	32,406	—	—	32,406	1373p	8/6/02	8/6/09
	c	8/6/99	32,406	—	—	32,406	1648p	8/6/02	8/6/09
	c	8/6/99	32,406	—	—	32,406	1922p	8/6/02	8/6/09
	c	3/5/00	33,528	—	—	33,528	2303p	3/5/03	3/5/10
	c	3/5/00	33,528	—	—	33,528	2764p	3/5/03	3/5/10
	c	3/5/00	33,528	—	—	33,528	3225p	3/5/03	3/5/10
	d*	9/5/01	31,170	—	—	31,170	$21.00	9/5/02	9/5/11
	d	9/5/01	31,170	—	—	31,170	$21.00	9/5/03	9/5/11
	d	9/5/01	31,170	—	—	31,170	$21.00	9/5/04	9/5/11
	d	9/5/01	31,170	—	—	31,170	$21.00	9/5/05	9/5/11
	d*	1/11/01	19,998	—	—	19,998	$11.97	1/11/03	1/11/11
	d	1/11/01	19,998	—	—	19,998	$11.97	1/11/04	1/11/11
	d	1/11/01	20,004	—	—	20,004	$11.97	1/11/05	1/11/11
Total			493,252	—	—	493,252	–		
John Makinson	**a***	6/5/94	56,000	—	—	56,000	567p	6/5/97	6/5/04
	a*	20/4/95	20,160	—	—	20,160	487p	20/4/98	20/4/05
	a*	8/8/96	36,736	—	—	36,736	584p	8/8/99	8/8/06
	a*	12/9/97	73,920	—	—	73,920	677p	12/9/00	12/9/07
	a*	14/9/98	30,576	—	—	30,576	974p	14/9/01	14/9/98
	b*	23/5/96	3,342	—	(3,342)	—	517p	1/8/01	1/2/02
	b	9/5/01	1,920	—	—	1,920	957p	1/8/08	1/2/09
	c	8/6/99	21,477	—	—	21,477	1373p	8/6/02	8/6/09
	c	8/6/99	21,477	—	—	21,477	1648p	8/6/02	8/6/09
	c	8/6/99	21,477	—	—	21,477	1922p	8/6/02	8/6/09
	c	3/5/00	21,356	—	—	21,356	2303p	3/5/03	3/5/10
	c	3/5/00	21,356	—	—	21,356	2764p	3/5/03	3/5/10
	c	3/5/00	21,356	—	—	21,356	3225p	3/5/03	3/5/10
	d*	9/5/01	19,785	—	—	19,785	1421p	9/5/02	9/5/11
	d	9/5/01	19,785	—	—	19,785	1421p	9/5/03	9/5/11
	d	9/5/01	19,785	—	—	19,785	1421p	9/5/04	9/5/11
	d	9/5/01	19,785	—	—	19,785	1421p	9/5/05	9/5/11
Total			430,293	—	(3,342)	426,951	–		

note 1 • The option prices and market prices have been rounded up to the nearest whole penny.

note 2 • No variations to the terms and conditions of share options were made during the year.

note 3 • Shares under option are designated as: **a** executive; **b** worldwide save for shares; **c** premium priced; and **d** long-term incentive; and * where options are exercisable.

a Executive

Subject to any performance condition being met, executive options become exercisable on the third anniversary of the date of grant and lapse if they remain unexercised at the tenth.

Options granted prior to 1996 are not subject to performance conditions representing market best practice at that time.

The exercise of options granted since 1996 is subject to a real increase in the company's adjusted earnings per share over any three-year period prior to exercise. This measure of performance represented market best practice and was in accordance with institutional investors' guidelines for option plans of that period.

This target is met if the company's adjusted earnings per share as published in the company's annual report and accounts for the last financial year prior to exercise, exceed those for the last financial year prior to the start of the three-year period by the percentage increase in the Index of Retail Prices (All Items) published by the UK Government plus 2% per annum (for options granted in 1996 and 1997) and 3% per annum (for options granted in 1998), subject to any adjustment the committee may make in accordance with the plan rules.

This target was not met for the period 1998 to 2001 and options granted in 1999 did not become exercisable in 2002. This target was also not met for the period 1999 to 2002 and options granted in 2000 will not become exercisable in 2003.

Marjorie Scardino, David Bell, Peter Jovanovich and John Makinson hold options under this plan. Details of these awards are set out in table 5 and itemised as **a** on pages 58 and 59 of this report.

b Worldwide save for shares

The acquisition of shares under the worldwide save for shares plan is not subject to the satisfaction of a performance target. Dennis Stevenson, Marjorie Scardino, David Bell and John Makinson hold options under this plan. Details of these holdings are set out in table 5 and itemised as **b** on page 58 and 59 of this report.

c Premium priced

Subject to the performance conditions being met, Premium Priced Options (PPOs) become exercisable on the third anniversary of the date of grant and lapse if they remain unexercised at the tenth.

PPOs were granted in three tranches. For these to become exercisable, the Pearson share price has to stay above the option price for 20 consecutive days within three, five and seven years respectively. The share price targets for the three- and five-year tranches of PPOs granted in 1999 were met in 2000. In addition, for options to be exercisable, the company's adjusted earnings per share have to increase in real terms by at least 3% per annum over the three-year period prior to exercise. This target is met if the company's adjusted earnings per share, as published in the company's annual report and accounts for the last financial year prior to exercise, exceed those for the last financial year prior to the start of the three-year period by the percentage increase in the Index of Retail Prices (All Items) published by the UK Government plus 3% per annum, subject to any adjustment the committee may make in accordance with the plan rules. These targets for the three-year periods 1998 to 2001 and 1999 to 2002 were not met.

Marjorie Scardino, David Bell, Peter Jovanovich and John Makinson hold PPOs under this plan. Details of these awards are set out in table 5 and itemised as **c** on pages 58 and 59 of this report.

d Long-term incentive

Options granted in 2001 were based on pre-grant earnings per share growth of 75% against a target of 16.6% over the period 1997 to 2000 and are not subject to further performance conditions on exercise.

Long-term incentive options granted on 9 May 2001 become exercisable in tranches on the first, second, third and fourth anniversary of the date of grant and lapse if they remain unexercised at the tenth. The fourth tranche lapses if any of the options in the first, second or third tranche are exercised prior to the fourth anniversary of the date of grant.

Long-term incentive options granted on 1 November 2001 become exercisable in tranches on the first, second and third anniversary of the date of grant and lapse if they remain unexercised at the tenth.

Details of the option grants under this plan for Marjorie Scardino, David Bell, Rona Fairhead, Peter Jovanovich and John Makinson are set out in table 5 itemised as **d** on pages 58 and 59 of this report.

In addition, Marjorie Scardino and Peter Jovanovich both contribute US$1,000 per month (the maximum allowed) to the US employee stock purchase plan. The terms of this plan allow participants to make monthly contributions for one year and to acquire shares at the end of that period at a price that is the lower of the market price at the beginning or the end of the period, both less 15%. Based on the market price at the start of the period, Marjorie Scardino and Peter Jovanovich would have the right to acquire 1,461 American Depositary Receipts.

REUBEN MARK ‣ DIRECTOR ‣ 3 MARCH 2003

Consolidated profit and loss account

year ended 31 Dec 2002

all figures in £ millions	NOTE	2002 RESULTS FROM OPERATIONS	2002 OTHER ITEMS	2002 TOTAL	2001 RESTATED RESULTS FROM OPERATIONS	2001 RESTATED OTHER ITEMS	2001 RESTATED TOTAL
Sales (including share of joint ventures)		4,331	–	4,331	4,240	–	4,240
Less: share of joint ventures		(11)	–	(11)	(15)	–	(15)
Sales	2a	4,320	–	4,320	4,225	–	4,225
Group operating profit		496	(302)	194	444	(424)	20
Share of operating (loss)/profit of joint ventures and associates	2c/d	(3)	(48)	(51)	19	(86)	(67)
Total operating profit/(loss)	2b	493	(350)	143	463	(510)	(47)
Loss on sale of fixed assets and investments	4a	–	(13)	(13)	–	(12)	(12)
Loss on sale of subsidiaries and associates	4b	–	(27)	(27)	–	(63)	(63)
Profit/(loss) on sale of subsidiaries and associates by an associate	4c	–	3	3	–	(53)	(53)
Non operating items		–	(37)	(37)	–	(128)	(128)
Profit/(loss) before interest and taxation		493	(387)	106	463	(638)	(175)
Amounts written off investments		–	–	–	–	(92)	(92)
Net finance costs	5	(94)	(37)	(131)	(169)	–	(169)
(Loss)/profit before taxation		399	(424)	(25)	294	(730)	(436)
Taxation	7	(131)	67	(64)	(100)	133	33
(Loss)/profit after taxation		268	(357)	(89)	194	(597)	(403)
Equity minority interests		(27)	5	(22)	(24)	4	(20)
(Loss)/profit for the financial year		241	(352)	(111)	170	(593)	(423)
Dividends on equity shares	8			(187)			(177)
Loss retained				(298)			(600)
Adjusted earnings per share	9			30.3p			21.4p
Loss per share	9			(13.9)p			(53.2)p
Diluted loss per share	9			(13.9)p			(53.2)p
Dividends per share	8			23.4p			22.3p

There is no difference between the loss before taxation and the retained loss for the year stated above and their historical cost equivalents.

The 2001 comparatives have been restated for the adoption of FRS 19 (see note 21).

Consolidated balance sheet

as at 31 Dec 2002

all figures in £ millions	NOTE	2002	2001 RESTATED
Fixed assets			
Intangible assets	11	3,610	4,193
Tangible assets	12	503	542
Investments: joint ventures	13		
Share of gross assets		7	8
Share of gross liabilities		–	(1)
		7	7
Investments: associates	14	106	893
Investments: other	15	84	84
		4,310	5,719
Current assets			
Stocks	16	734	849
Debtors	17	1,057	1,005
Deferred taxation	21	174	272
Investments		2	3
Cash at bank and in hand	18	575	393
		2,542	2,522
Creditors – amounts falling due within one year			
Short-term borrowing	19	(249)	(165)
Other creditors	20	(1,114)	(1,203)
		(1,363)	(1,368)
Net current assets		1,179	1,154
Total assets less current liabilities		5,489	6,873
Creditors – amounts falling due after more than one year			
Medium and long-term borrowing	19	(1,734)	(2,607)
Other creditors	20	(60)	(54)
		(1,794)	(2,661)
Provisions for liabilities and charges	22	(165)	(239)
Net assets		3,530	3,973
Capital and reserves			
Called up share capital	23	200	200
Share premium account	24	2,465	2,459
Profit and loss account	24	673	1,138
Equity shareholders' funds		3,338	3,797
Equity minority interests		192	176
		3,530	3,973

The 2001 comparatives have been restated for the adoption of FRS 19 (see note 21).

The company balance sheet is shown in note 32.

The financial statements were approved by the board of directors on 3 March 2003 and signed on its behalf by

DENNIS STEVENSON ▸ RONA FAIRHEAD

Consolidated statement of cash flows

year ended 31 Dec 2002

all figures in £ millions	NOTE	2002	2001
Net cash inflow from operating activities	27	**529**	490
Dividends from joint ventures and associates		**6**	25
Interest received		**11**	31
Interest paid		**(151)**	(187)
Debt issue costs		**–**	(1)
Dividends paid to minority interests		**(1)**	(9)
Returns on investments and servicing of finance		**(141)**	(166)
Taxation		**(55)**	(71)
Purchase of tangible fixed assets		**(126)**	(165)
Sale of tangible fixed assets		**7**	36
Purchase of investments		**(21)**	(35)
Sale of investments		**3**	22
Capital expenditure and financial investment		**(137)**	(142)
Purchase of subsidiaries	25	**(87)**	(128)
Net cash acquired with subsidiaries		**1**	83
Purchase of joint ventures and associates		**(40)**	(26)
Sale of subsidiaries	26	**3**	41
Net cash disposed with subsidiaries		**(1)**	–
Sale of associates	14	**920**	1
Acquisitions and disposals		**796**	(29)
Equity dividends paid		**(181)**	(174)
Net cash inflow/(outflow) before management of liquid resources and financing		**817**	(67)
Liquid resources acquired		**(65)**	(48)
Collateral deposit reimbursed		**22**	47
Management of liquid resources	27	**(43)**	(1)
Issue of equity share capital		**6**	20
Capital element of finance leases		**(5)**	(7)
Loan facility repaid		**(507)**	(521)
Bonds (repaid)/advanced		**(167)**	507
Collateral deposit reimbursed		**17**	–
Net movement in other borrowings		**(7)**	3
Financing		**(663)**	2
Increase/(decrease) in cash in the year	27	**111**	(66)

Statement of total recognised gains and losses

year ended 31 Dec 2002

all figures in £ millions	NOTE	2002	2001 RESTATED
Loss for the financial year		**(111)**	(423)
Other net gains and losses recognised in reserves:			
Currency translation differences		**(317)**	26
Taxation on currency translation differences		**5**	(6)
Total recognised gains and losses relating to the year		**(423)**	(403)
Prior year adjustment – FRS 19	21	**209**	
Total recognised gains and losses		**(214)**	

Reconciliation of movements in equity shareholders' funds

year ended 31 Dec 2002

all figures in £ millions	2002	2001 RESTATED
Loss for the financial year	**(111)**	(423)
Dividends on equity shares	**(187)**	(177)
	(298)	(600)
Currency translation differences (net of taxation)	**(312)**	20
Goodwill written back on sale of subsidiaries and associates	**144**	37
Goodwill written back on sale of subsidiaries and associates by an associate	**–**	36
Shares issued	**6**	18
Replacement options granted on acquisition of subsidiary	**1**	2
Net movement for the year	**(459)**	(487)
Equity shareholders' funds at beginning of the year	**3,797**	4,044
Prior period adjustment – FRS 19	**–**	240
Equity shareholders' funds at end of the year	**3,338**	3,797

Independent auditors' report to the members of Pearson plc

We have audited the financial statements which comprise the consolidated profit and loss account, the consolidated balance sheet, the consolidated statement of cash flows, the statement of total recognised gains and losses, the reconciliation of movements in equity shareholders' funds and the related notes. We have also audited the disclosures required by Part 3 of Schedule 7a to the Companies Act 1985, contained in the report on directors' remuneration ('the auditable part').

Respective responsibilities of directors and auditors ‣ The directors' responsibilities for preparing the annual report, the report on directors' remuneration, and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements and the auditable part of the report on directors' remuneration in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, have been prepared for and only for, the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the report on directors' remuneration have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the financial highlights, the chairman's statement, the chief executive's review, the 'Pearson goals' section, the 'business highlights' section, the operating review, the financial review, the board of directors, the directors' report and the unaudited part of the report on directors' remuneration.

We review whether the corporate governance statement within the directors' report reflects the group's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the company's or group's corporate governance procedures or its risk and control procedures.

Basis of audit opinion ‣ We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the auditable part of the report on directors' remuneration. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the auditable part of the report on directors' remuneration are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion ‣ In our opinion

- the financial statements give a true and fair view of the state of affairs of the company and the group at 31 December 2002 and the result and cash flows of the group for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the report on directors' remuneration required by Part 3 of Schedule 7a to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PRICEWATERHOUSECOOPERS LLP ‣ CHARTERED ACCOUNTANTS AND REGISTERED AUDITORS ‣ LONDON 3 MARCH 2003

Notes

The maintenance and integrity of the Pearson Plc website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Index to the financial statements

Notes to the accounts

1 ACCOUNTING POLICIES

Accounting policies have been consistently applied except that FRS 19 'Deferred tax' has been adopted and hence comparative figures have been restated. The effect of this change in accounting policy is disclosed in note 21. The transitional arrangements of FRS 17 'Retirement benefits' have been adopted which require additional disclosures in respect of retirement benefits, as set out in note 10.

a. Basis of accounting ‣ The accounts are prepared under the historical cost convention and in accordance with the Companies Act and applicable accounting standards. A summary of the significant accounting policies is set out below.

b. Basis of consolidation ‣ The consolidated accounts include the accounts of all subsidiaries made up to 31 December. Where companies have become or ceased to be subsidiaries or associates during the year, the Group results include results for the period during which they were subsidiaries or associates.

The results of the Group includes the Group's share of the results of joint ventures and associates, and the consolidated balance sheet includes the Group's interest in joint ventures and associates at the book value of attributable net assets and attributable goodwill.

c. Goodwill ‣ From 1 January 1998 goodwill, being either the net excess of the cost of shares in subsidiaries, joint ventures and associates over the value attributable to their net assets on acquisition or the cost of other goodwill by purchase, is capitalised and amortised through the profit and loss account on a straight-line basis over its estimated useful life not exceeding 20 years. Estimated useful life is determined after taking into account such factors as the nature and age of the business and the stability of the industry in which the acquired business operates, as well as typical life spans of the acquired products to which the goodwill attaches. Goodwill is subject to an impairment review at the end of the first full year following an acquisition, and at any other time if events or changes in circumstances indicate that the carrying value may not be recoverable. Goodwill arising on acquisitions before 1 January 1998 has been deducted from reserves and is charged or credited to the profit and loss account on disposal or closure of the business to which it relates.

d. Sales ‣ Sales represent the amount of goods and services, net of value added tax and other sales taxes, and excluding trade discounts and anticipated returns, provided to external customers and associates.

Revenue from the sale of books is recognised when the goods are shipped. Anticipated returns are based primarily on historical return rates. Circulation and advertising revenue is recognised when the newspaper or other publication is published. Subscription revenue is recognised on a straight-line basis over the life of the subscription.

Revenue from long-term contracts, such as contracts to process qualifying tests for individual professions and government departments, is recognised over the contract term based on the percentage of services provided during the period, compared to the total estimated services to be provided over the entire contract. Losses on contracts are recognised in the period in which the loss first becomes probable and reasonably estimable. Contract losses are determined to be the amount by which estimated direct and indirect costs of the contract exceed the estimated total revenues that will be generated by the contract.

e. Pension costs ‣ The regular pension cost of the Group's defined benefit pension schemes is charged to the profit and loss account in order to apportion the cost of pensions over the service lives of employees in the schemes. Variations arising from a significant reduction in the number of employees are adjusted in the profit and loss account to the extent that the year's regular pension cost, reduced by other variations, exceeds contributions payable for that year. Other variations are apportioned over the expected service lives of current employees in the schemes. The pension cost of the Group's defined contribution schemes is the amount of contributions payable for the year.

f. Post-retirement benefits other than pensions ‣ Post-retirement benefits other than pensions are accounted for on an accruals basis to recognise the obligation over the expected service lives of the employees concerned.

g. Tangible fixed assets ‣ The cost of tangible fixed assets other than freehold land is depreciated over estimated economic lives in equal annual amounts. Generally, freeholds are depreciated at 1% to 5% per annum, leaseholds at 2% per annum, or over the period of the lease if shorter, and plant and equipment at various rates between 5% and 33% per annum.

h. Leases ‣ Finance lease rentals are capitalised at the net present value of the total amount of rentals payable under the leasing agreement (excluding finance charges) and depreciated in accordance with policy g above. Finance charges are written off over the period of the lease in reducing amounts in relation to the written down carrying cost. Operating lease rentals are expensed as incurred.

i. Fixed asset investments ‣ Fixed asset investments are stated at cost less provisions for diminution in value.

j. Share schemes ‣ Shares held by employee share ownership trusts are shown at cost less any provision for permanent diminution in value. The costs of funding and administering the trusts are charged to the profit and loss account in the period to which they relate. The cost of shares acquired by the trusts or the fair market value of the shares at the date of the grant, less any consideration to be received from the employee, is charged to the profit and loss account over the period to which the employee's performance relates. Where awards are contingent upon future events (other than continued employment) an assessment of the likelihood of these conditions being achieved is made at the end of each reporting period and an appropriate provision made.

k. Stocks ‣ Stocks and work in progress are stated at the lower of cost and net realisable value.

l. Pre-publication costs ‣ Pre-publication costs represent direct costs incurred in the development of titles prior to their publication. These costs are carried forward in stock where the title to which they relate has a useful life in excess of one year. These costs are amortised upon publication of the title over estimated economic lives of five years or less, being an estimate of the expected life cycle of the title, with a higher proportion of the amortisation taken in the earlier years.

m. Royalty advances ‣ Advances of royalties to authors are included within debtors when the advance is paid less any provision required to bring the amount down to its net realisable value. The royalty advance is expensed at the contracted royalty rate as the related revenues are earned.

n. Newspaper development costs ‣ Revenue investment in the development of newspaper titles consists of measures to increase the volume and geographical spread of circulation. These measures include additional and enhanced editorial content, extended distribution and remote printing. These extra costs arising are expensed as incurred.

o. Deferred taxation ‣ Provision is made in full for deferred tax that arises from timing differences that have originated but not reversed by the balance sheet date on transactions or events that result in an obligation to pay more tax in the future. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be taxable profits from which the underlying timing differences can be deducted. Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Deferred tax assets and liabilities are not discounted. No deferred tax is provided in respect of any future remittance of earnings of foreign subsidiaries or associates where no commitment has been made to remit such earnings.

p. Financial instruments ‣ The Group uses derivative financial instruments to manage its exposure to interest rate and foreign exchange risks. These include interest rate swaps, currency swaps and forward currency contracts. Amounts payable or receivable in respect of interest rate derivatives are accrued with net interest payable over the period of the contract. Where the derivative instrument is terminated early, the gain or loss is spread over the remaining maturity of the original instrument. Where the underlying exposure ceases to exist, any termination gain or loss is taken to the profit and loss account. Foreign currency borrowings and their related derivatives are carried in the balance sheet at the relevant exchange rates at the balance sheet date. Gains or losses in respect of the hedging of overseas subsidiaries are taken to reserves. Gains or losses arising from foreign exchange contracts are taken to the profit and loss account in line with the transactions which they are hedging. Premiums paid on contracts designed to manage currency exposure on specific acquisitions or disposals are charged to the profit and loss account.

The company participates in offset arrangements with certain banks whereby cash and overdraft amounts are offset against each other.

q. Foreign currencies ‣ Profit and loss accounts in overseas currencies are translated into sterling at average rates. Balance sheets are translated into sterling at the rates ruling at 31 December. Exchange differences arising on consolidation are taken directly to reserves. Other exchange differences are taken to the profit and loss account where they relate to trading transactions and directly to reserves where they relate to investments.

The principal overseas currency for the Group is the US dollar. The average rate for the year against sterling was $1.51 (2001: $1.44) and the year end rate was $1.61 (2001: $1.46).

r. Liquid resources ‣ Liquid resources comprise short-term deposits of less than one year and investments which are readily realisable and held on a short-term basis.

s. Retained profits of overseas subsidiaries and associates ‣ No provision is made for any additional taxation, less double taxation relief, which would arise on the remittance of profits retained where there is no intention to remit such profits.

2a ANALYSIS OF SALES

all figures in £ millions	2002 SALES BEFORE INTERNET ENTERPRISES	2002 INTERNET ENTERPRISES	2002 SALES	2001 SALES BEFORE INTERNET ENTERPRISES	2001 INTERNET ENTERPRISES	2001 SALES
Business sectors						
Pearson Education	2,752	4	2,756	2,596	8	2,604
FT Group	678	48	726	750	51	801
The Penguin Group	838	–	838	820	–	820
Continuing operations	4,268	52	4,320	4,166	59	4,225
Geographical markets supplied						
United Kingdom	395	16	411	423	10	433
Continental Europe	413	6	419	438	8	446
North America	3,110	29	3,139	2,936	39	2,975
Asia Pacific	248	1	249	239	2	241
Rest of world	102	–	102	130	–	130
Continuing operations	4,268	52	4,320	4,166	59	4,225

all figures in £ millions	2002 TOTAL BY SOURCE	2002 INTER-REGIONAL	2002 TOTAL SALES	2001 TOTAL BY SOURCE	2001 INTER-REGIONAL	2001 TOTAL SALES
Geographical source of sales						
United Kingdom	644	(25)	619	686	(20)	666
Continental Europe	304	(4)	300	315	(5)	310
North America	3,144	(36)	3,108	2,976	(35)	2,941
Asia Pacific	226	(2)	224	221	(6)	215
Rest of world	69	–	69	93	–	93
Continuing operations	4,387	(67)	4,320	4,291	(66)	4,225

note ▸ The table above analyses sales by the geographical region from which the products and services originate. Inter-regional sales are those made between Group companies in different regions.

2b ANALYSIS OF TOTAL OPERATING PROFIT/(LOSS)

all figures in £ millions	2002 RESULTS FROM OPERATIONS BEFORE INTERNET ENTERPRISES	INTERNET ENTERPRISES	RESULTS FROM OPERATIONS	INTEGRATION COSTS	GOODWILL AMORTISATION	GOODWILL IMPAIRMENT	OPERATING PROFIT
Business sectors							
Pearson Education	351	(25)	326	(7)	(244)	–	75
FT Group	114	(34)	80	–	(65)	(10)	5
The Penguin Group	87	–	87	(3)	(18)	–	66
Continuing operations	552	(59)	493	(10)	(327)	(10)	146
Discontinued operations	–	–	–	–	(3)	–	(3)
	552	(59)	493	(10)	(330)	(10)	143

2b ANALYSIS OF OPERATING PROFIT/(LOSS) CONTINUED

	2002						
all figures in £ millions	RESULTS FROM OPERATIONS BEFORE INTERNET ENTERPRISES	INTERNET ENTERPRISES	RESULTS FROM OPERATIONS	INTEGRATION COSTS	GOODWILL AMORTISATION	GOODWILL IMPAIRMENT	OPERATING PROFIT
Geographical markets supplied							
United Kingdom	(37)	(35)	(72)	(5)	(25)	–	(102)
Continental Europe	41	(1)	40	–	(8)	–	32
North America	518	(23)	495	(5)	(288)	–	202
Asia Pacific	31	–	31	–	(6)	–	25
Rest of world	(1)	–	(1)	–	–	(10)	(11)
Continuing operations	552	(59)	493	(10)	(327)	(10)	146
Discontinued operations	–	–	–	–	(3)	–	(3)
	552	(59)	493	(10)	(330)	(10)	143

	2001 RESTATED						
all figures in £ millions	RESULTS FROM OPERATIONS BEFORE INTERNET ENTERPRISES	INTERNET ENTERPRISES	RESULTS FROM OPERATIONS	INTEGRATION COSTS	GOODWILL AMORTISATION	GOODWILL IMPAIRMENT	OPERATING LOSS
Business sectors							
Pearson Education	351	(77)	274	(29)	(254)	(8)	(17)
FT Group	132	(60)	72	–	(67)	(3)	2
The Penguin Group	80	–	80	(45)	(19)	(50)	(34)
Continuing operations	563	(137)	426	(74)	(340)	(61)	(49)
Discontinued operations	37	–	37	–	(35)	–	2
	600	(137)	463	(74)	(375)	(61)	(47)
Geographical markets supplied							
United Kingdom	16	(53)	(37)	(33)	(27)	(55)	(152)
Continental Europe	55	(10)	45	–	(6)	–	39
North America	470	(73)	397	(41)	(302)	(3)	51
Asia Pacific	24	–	24	–	(4)	–	20
Rest of world	(2)	(1)	(3)	–	(1)	(3)	(7)
Continuing operations	563	(137)	426	(74)	(340)	(61)	(49)
Discontinued operations	37	–	37	–	(35)	–	2
	600	(137)	463	(74)	(375)	(61)	(47)

note ▸ Internet enterprises consist of the Group's discrete internet operations, including FT.com and Family Education Network. Integration costs in 2002 and 2001 include costs in respect of the Dorling Kindersley and National Computer Systems acquisitions. In 2002, of the goodwill impairment charge, £10m (2001: £58m) relates to the impairment of goodwill arising on acquisition of subsidiaries (see note 11) and £nil (2001: £3m) relates to the impairment of goodwill arising on acquisition of associates. Integration costs, goodwill amortisation and goodwill impairment are included as other items in the profit and loss account. Discontinued operations relate to the withdrawal of the Group from the television business following the disposal of its 22% interest in the RTL Group on 30 January 2002.

2c SHARE OF OPERATING LOSS OF JOINT VENTURES

all figures in £ millions	RESULTS FROM OPERATIONS BEFORE INTERNET ENTERPRISES	INTERNET ENTERPRISES	RESULTS FROM OPERATIONS	INTEGRATION COSTS	GOODWILL AMORTISATION	GOODWILL IMPAIRMENT	OPERATING LOSS
2002							
Pearson Education	(1)	–	(1)	–	–	–	(1)
FT Group	(13)	–	(13)	–	–	–	(13)
The Penguin Group	1	–	1	–	–	–	1
	(13)	–	(13)	–	–	–	(13)

all figures in £ millions	RESULTS FROM OPERATIONS BEFORE INTERNET ENTERPRISES	INTERNET ENTERPRISES	RESULTS FROM OPERATIONS	INTEGRATION COSTS	GOODWILL AMORTISATION	GOODWILL IMPAIRMENT	OPERATING LOSS
2001							
Pearson Education	–	–	–	–	–	–	–
FT Group	(20)	–	(20)	–	–	–	(20)
The Penguin Group	1	–	1	–	–	–	1
	(19)	–	(19)	–	–	–	(19)

2d SHARE OF OPERATING LOSS OF ASSOCIATES

all figures in £ millions	RESULTS FROM OPERATIONS BEFORE INTERNET ENTERPRISES	INTERNET ENTERPRISES	RESULTS FROM OPERATIONS	INTEGRATION COSTS	GOODWILL AMORTISATION	GOODWILL IMPAIRMENT	OPERATING LOSS
2002							
Pearson Education	3	–	3	–	(1)	–	2
FT Group	10	(3)	7	–	(44)	–	(37)
The Penguin Group	–	–	–	–	–	–	–
Continuing operations	13	(3)	10	–	(45)	–	(35)
Discontinued operations	–	–	–	–	(3)	–	(3)
	13	(3)	10	–	(48)	–	(38)

all figures in £ millions	RESULTS FROM OPERATIONS BEFORE INTERNET ENTERPRISES	INTERNET ENTERPRISES	RESULTS FROM OPERATIONS	INTEGRATION COSTS	GOODWILL AMORTISATION	GOODWILL IMPAIRMENT	OPERATING LOSS
2001							
Pearson Education	3	–	3	–	(1)	(3)	(1)
FT Group	8	(10)	(2)	–	(47)	–	(49)
The Penguin Group	–	–	–	–	–	–	–
Continuing operations	11	(10)	1	–	(48)	(3)	(50)
Discontinued operations	37	–	37	–	(35)	–	2
	48	(10)	38	–	(83)	(3)	(48)

2e ANALYSIS OF CAPITAL EMPLOYED

all figures in £ millions	NOTE	2002	2001 RESTATED
Business sectors			
Pearson Education		3,914	4,628
FT Group		410	427
The Penguin Group		605	501
Continuing operations		4,929	5,556
Discontinued operations		–	763
		4,929	6,319
Geographical location			
United Kingdom		557	516
Continental Europe		258	243
North America		3,971	4,628
Asia Pacific		125	139
Rest of world		18	30
Continuing operations		4,929	5,556
Discontinued operations		–	763
		4,929	6,319
Reconciliation of capital employed to net assets			
Capital employed		4,929	6,319
Add: deferred taxation	21	174	272
Less: provisions for liabilities and charges	22	(165)	(239)
Less: net debt excluding finance leases	27	(1,408)	(2,379)
Net assets		3,530	3,973

3 ANALYSIS OF CONSOLIDATED PROFIT AND LOSS ACCOUNT

all figures in £ millions	2002	2001 RESTATED
Cost of sales	(2,064)	(1,902)
Gross profit	2,256	2,323
Distribution costs	(197)	(200)
Administration and other expenses	(1,924)	(2,169)
Other operating income	59	66
Net operating expenses	(2,062)	(2,303)
Analysed as:		
Net operating expenses – before other items	(1,760)	(1,879)
Net operating expenses – other items:		
– Integration costs	(10)	(74)
– Goodwill amortisation	(282)	(292)
– Goodwill impairment	(10)	(58)
Net operating expenses	(2,062)	(2,303)

note ‣ Other items are all included in administration and other expenses.

3 ANALYSIS OF CONSOLIDATED PROFIT AND LOSS ACCOUNT CONTINUED

all figures in £ millions	2002	2001
Other operating income		
Income from other investments:		
Unlisted	2	2
Other operating income (mainly royalties, rights and commission income)	57	64
	59	66
Loss before taxation is stated after charging:		
Amortisation of pre-publication costs	170	161
Depreciation	122	125
Operating lease rentals:		
– Plant and machinery	11	31
– Properties	101	99
– Other	13	17
Auditors' remuneration:		
Audit (Company £20,000; 2001: £20,000)	3	2
Non-audit – UK (Company £231,000; 2001: £nil)	1	2
Non-audit – Overseas	2	3
Non-audit services were as follows:		
US reporting, due diligence and other related work	1	2
Taxation advice	2	1
Acquisition related work	–	2
	3	5

note ‣ There were no fees capitalised in 2002 or 2001.

4a LOSS ON SALE OF FIXED ASSETS AND INVESTMENTS

all figures in £ millions	2002	2001
Net loss on sale of property	(3)	(2)
Net loss on sale of investments	(10)	(10)
Continuing operations	(13)	(12)
Taxation	6	1

4b LOSS ON SALE OF SUBSIDIARIES AND ASSOCIATES

all figures in £ millions	NOTE	2002	2001 RESTATED
Loss on sale of Forum		(40)	–
Loss on sale of PH Direct		(8)	–
Loss on sale of iForum		–	(27)
Net profit/(loss) on sale of other subsidiaries and associates		3	(36)
Continuing operations		(45)	(63)
Profit on sale of the RTL Group – discontinued operations	14	18	–
		(27)	(63)
Taxation		(6)	4

4c PROFIT/(LOSS) ON SALE OF SUBSIDIARIES AND ASSOCIATES BY AN ASSOCIATE

all figures in £ millions	2002	2001
Profit/(loss) on sale of Journal of Commerce by the Economist – continuing operations	3	(36)
Loss on sale of subsidiaries and associates by the RTL Group – discontinued operations	–	(17)
	3	(53)

5 NET FINANCE COSTS

		2002			2001		
all figures in £ millions	NOTE	RESULTS FROM OPERATIONS	OTHER ITEMS	TOTAL	RESULTS FROM OPERATIONS	OTHER ITEMS	TOTAL
Net interest payable							
– Group	6	(94)	–	(94)	(163)	–	(163)
– Associates		–	–	–	(6)	–	(6)
Early repayment of debt and termination of swap contracts		–	(37)	(37)	–	–	–
Total net finance costs		(94)	(37)	(131)	(169)	–	(169)

6 NET INTEREST PAYABLE – GROUP

all figures in £ millions	2002	2001
Interest payable and similar charges:		
Bank loans, overdrafts and commercial paper		
On borrowing repayable wholly within five years not by instalments	(54)	(100)
On borrowing repayable wholly or partly after five years	(51)	(72)
Other borrowings		
On borrowing repayable wholly within five years not by instalments	–	(16)
	(105)	(188)
Interest receivable and similar income:		
On deposits and liquid funds	11	23
Amortisation of swap proceeds	–	2
	11	25
Net interest payable	(94)	(163)

7 TAXATION

all figures in £ millions	NOTE	2002	2001 RESTATED
Analysis of benefit/(charge) in the year:			
Current taxation			
UK corporation tax for the year		**11**	(28)
Adjustments in respect of prior periods		**58**	147
		69	119
Overseas tax for the year		**(63)**	(43)
Joint ventures		**–**	(6)
Associates		**(4)**	(9)
		2	61
Deferred taxation			
Origination and reversal of timing differences:			
UK		**(11)**	4
Overseas		**(56)**	(32)
Adjustments in respect of prior periods		**1**	–
	21	**(66)**	(28)
Taxation		**(64)**	33

The tax for the year is different than the standard rate of corporation tax in the UK (30%). The differences are explained below:

all figures in £ millions	2002	2001 RESTATED
Loss before tax	**(25)**	(436)
Expected benefit at UK corporation tax rate of 30% (2001: 30%)	**8**	131
Effect of overseas tax rates	**11**	37
Effect of tax losses	**(7)**	(1)
Other timing differences	**55**	(98)
Non-deductible goodwill amortisation	**(111)**	(149)
US state taxes	**(10)**	(6)
Adjustments in respect of prior periods	**56**	147
Current tax benefit for the year	**2**	61

all figures in percentages	2002	2001 RESTATED
Tax rate reconciliation		
UK tax rate	**30.0**	30.0
Effect of overseas tax rates	**2.8**	4.5
Other items	**–**	(0.5)
Tax rate reflected in adjusted earnings	**32.8**	34.0

note ▸ Included in the adjustment in respect of prior periods in 2002 is a tax benefit of £45m (2001: £143m) relating to a prior period disposal of a subsidiary and a fixed asset investment.

Both the current and the total tax charge on profit (or loss) before tax will continue to be affected by the fact that there is only very limited tax relief available on the goodwill amortisation charged in the accounts.

The current tax charge will continue to be affected by the utilisation of tax losses and by the impact of other timing differences, in both cases mainly in the United States. Following the adoption of FRS 19 these factors will have only a very limited impact on the total tax rate; as shown in note 21, the Group has recognised a total deferred tax asset of £174m at 31 December 2002 (2001: £272m).

In both 2002 and 2001 the tax charge was materially affected by prior year adjustments; it is not practicable to forecast the possible effect of such items in future years as this will depend on progress in agreeing the Group's tax returns with the tax authorities.

The total charge in future periods will also be affected by any changes to corporation tax rates and/or any other relevant legislative changes in the jurisdictions in which the Group operates. It will also be affected by the mix of profits between the different jurisdictions.

8 DIVIDENDS ON EQUITY SHARES

	2002		2001	
	PENCE PER SHARE	£m	PENCE PER SHARE	£m
Interim paid	9.1	72	8.7	68
Final proposed	14.3	115	13.6	109
Dividends for the year	23.4	187	22.3	177

note ▸ Dividends in respect of the company's shares held by employee share trusts (see note 15) have been waived.

9 EARNINGS/(LOSS) PER SHARE

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

		2002		2001 RESTATED	
	NOTE	£m	EARNINGS/(LOSS) PER SHARE (P)	£m	EARNINGS/(LOSS) PER SHARE (P)
Loss for the financial year		(111)	(13.9)	(423)	(53.2)
Adjustments:					
– Non operating items		37	4.6	128	16.1
– Integration costs	2b	10	1.3	74	9.3
– Goodwill amortisation	2b	330	41.4	375	47.1
– Goodwill impairment	2b	10	1.3	61	7.7
– Amounts written off investments		–	–	92	11.6
– Other net finance costs	5	37	4.6	–	–
Taxation on above items		(67)	(8.4)	(133)	(16.7)
Minority interest share of above items		(5)	(0.6)	(4)	(0.5)
Adjusted earnings		241	30.3	170	21.4
Weighted average number of shares (millions) – for earnings and adjusted earnings		796.3		795.4	
Effect of dilutive share options		–		–	
Weighted average number of shares (millions) – for diluted loss		796.3		795.4	

note ▸ In 2002 and 2001 the Group made a loss for the financial year (after taking into account goodwill amortisation), consequently the effect of share options is anti-dilutive and there is no difference between the loss per share and the diluted loss per share.

10a EMPLOYEE INFORMATION

The details of the emoluments of the directors of Pearson plc are shown on pages 46 to 60 and form part of these audited financial statements.

all figures in £ millions	**2002**	2001
Staff costs		
Wages and salaries	**1,106**	1,090
Social security costs	**106**	104
Post-retirement costs	**59**	39
	1,271	1,233

	UK	US	OTHER	TOTAL
Average number employed 2002				
Pearson Education	**1,326**	**14,459**	**4,250**	**20,035**
FT Group	**1,914**	**1,140**	**2,169**	**5,223**
The Penguin Group	**1,305**	**2,167**	**890**	**4,362**
Other	**204**	**534**	**1**	**739**
	4,749	**18,300**	**7,310**	**30,359**
Average number employed 2001				
Pearson Education	1,505	12,610	4,344	18,459
FT Group	2,075	1,121	2,340	5,536
The Penguin Group	1,333	2,293	768	4,394
Other	193	444	1	638
	5,106	16,468	7,453	29,027

10b PENSIONS

The Group operates a number of pension schemes throughout the world, the principal ones being in the UK and US. The major schemes are self-administered with the schemes' assets being held independently of the Group. Pension costs are assessed in accordance with the advice of independent qualified actuaries. The UK is a hybrid scheme with both defined benefit and defined contribution sections but, predominantly consisting of defined benefit liabilities. There are a number of defined contribution schemes, principally overseas. The cost of the schemes is as follows:

all figures in £ millions	**2002**	2001
UK Group scheme		
Regular pension cost		
– Defined benefit sections	**11**	9
– Defined contribution sections	**7**	6
Amortisation of surplus	**–**	(5)
	18	10
Other schemes		
Defined benefit schemes	**6**	11
Defined contribution schemes	**30**	14
	36	25
	54	35

note ‣ During 2001, the main defined benefit scheme for US employees was closed to the majority of active members. The UK Group scheme will only offer defined contribution benefits to new joiners from 1 January 2003. The changes to these schemes will give rise to a reduction in defined benefit and an increase in defined contribution costs, the impact taking effect in 2002 in the US and 2003 in the UK.

Included in note 22, there is a pension provision of £36m (2001: £61m) as measured in accordance with SSAP 24.

10b PENSIONS CONTINUED

The most recent full actuarial valuation of the UK Group scheme was performed as at 1 January 2001, using the projected unit method of valuation. It is this valuation that Pearson uses to determine its cash contributions with the goal of remaining fully funded. The market value of the assets of the scheme at this date was £1,166m. The major assumptions used to determine the SSAP 24 charge and level of funding are as follows:

all figures in percentages	UK GROUP SCHEME
Inflation	3.0
Rate of increase in salaries	5.0
Rate of increase for pensions in payment and deferred pensions	3.0
Return on investments	7.0
Rate of increase in dividends	4.3
Level of funding	104.0

The funding policy differs from the accounting policy to the extent that more conservative assumptions are used for funding purposes. The SSAP 24 funding level of 104% is based on the last formal valuation of the UK Group scheme at 1 January 2001. However, the UK Group scheme actuaries have estimated that the surplus arising at 1 January 2001 had been substantially eliminated by 1 January 2002, primarily due to adverse market movements in 2001. The Group has therefore not recognised any amortisation of the surplus for the year ended 31 December 2002. The next full triennial valuation is due to take place in January 2004.

The date of the most recent valuation of the US plan was 31 December 2001.

The disclosures required under the transitional arrangements of FRS 17 for the Group's defined benefit schemes and the UK Group hybrid scheme are set out below. The disclosures for the UK Group hybrid scheme are in respect of both the defined benefit and defined contribution sections.

For the purpose of these disclosures, the valuations of the UK Group scheme and other schemes have been updated by independent actuaries to 31 December 2002. The assumptions used are shown below. Weighted average assumptions have been shown for the other schemes.

	2002		2001	
all figures in percentages	UK GROUP SCHEME	OTHER SCHEMES	UK GROUP SCHEME	OTHER SCHEMES
Inflation	2.25	3.00	2.50	3.00
Rate of increase in salaries	4.25	4.50	4.50	4.50
Rate of inflation linked increase for pensions in payment and deferred pensions	2.25	–	2.50	–
Rate used to discount scheme liabilities	5.70	6.75	6.00	7.20

The assets of the UK Group scheme and the expected rate of return on these assets, and the assets of the other defined benefit schemes and the expected rate of return on these assets shown as a weighted average, are as follows:

	UK GROUP SCHEME			
	LONG-TERM RATE OF RETURN EXPECTED AT 31 DEC 2002 %	VALUE AT 31 DEC 2002 £m	LONG-TERM RATE OF RETURN EXPECTED AT 31 DEC 2001 %	VALUE AT 31 DEC 2001 £m
Equities	8.00	472	7.50	657
Bonds	4.75	284	5.30	293
Properties	6.50	112	6.30	102
Other	6.50	108	6.30	42
Total market value of assets		976		1,094
Present value of scheme liabilities		(1,189)		(1,167)
Deficit in the scheme		(213)		(73)
Related deferred tax asset		64		22
Net pension liability		(149)		(51)

10b PENSIONS CONTINUED

	OTHER SCHEMES			
	LONG-TERM RATE OF RETURN EXPECTED AT 31 DEC 2002 %	**VALUE AT 31 DEC 2002 £m**	LONG-TERM RATE OF RETURN EXPECTED AT 31 DEC 2001 %	VALUE AT 31 DEC 2001 RESTATED £m
Equities	**9.75**	**33**	9.50	37
Bonds	**6.00**	**23**	6.50	24
Other	**2.75**	**1**	–	–
Total market value of assets		**57**		61
Present value of scheme liabilities		**(96)**		(95)
Deficit in the schemes		**(39)**		(34)
Related deferred tax asset		**14**		12
Net pension liability		**(25)**		(22)

note ▸ The measurement of the deficit in the scheme for FRS 17 follows a different approach to SSAP 24. The FRS 17 measurement date is 31 December 2002. The fall in stock markets in 2002 reduced the market value of the UK Group scheme assets and the fall in bond yields (the discount rate) has acted to increase the present value of the UK Group scheme liabilities. This has resulted in an increased deficit in the UK Group scheme under FRS 17.

all figures in £ millions	UK GROUP SCHEME	DEFINED BENEFIT OTHER	TOTAL	DEFINED CONTRIBUTION	TOTAL
Operating charge					
Current service cost	(19)	(3)	(22)	(30)	(52)
Past service cost	–	(1)	(1)	–	(1)
Total operating charge	(19)	(4)	(23)	(30)	(53)
Other finance income/(charge)					
Expected return on pension scheme assets	73	5	78	–	78
Interest on pension scheme liabilities	(68)	(6)	(74)	–	(74)
Net income/(charge)	5	(1)	4	–	4
Net profit and loss impact	(14)	(5)	(19)	(30)	(49)
Statement of total recognised gains and losses					
Actual return less expected return on pension scheme assets	(165)	(11)	(176)		
Experience gains and (losses) arising on the scheme liabilities	17	(1)	16		
Changes in assumptions underlying the present value of the scheme liabilities	3	(4)	(1)		
Exchange differences	–	2	2		
Actuarial loss	(145)	(14)	(159)		
Movement in deficit during the year					
Deficit in scheme at beginning of the year	(73)	(34)	(107)		
Current service cost	(19)	(3)	(22)		
Past service cost	–	(1)	(1)		
Contributions	19	14	33		
Other finance income/(charge)	5	(1)	4		
Actuarial loss	(145)	(14)	(159)		
Deficit in scheme at end of the year	(213)	(39)	(252)		
Related deferred tax asset	64	14	78		
Net pension deficit	(149)	(25)	(174)		

The contribution rate for 2002 for the UK Group scheme was 17.1% of pensionable salaries. It has been agreed with the Trustees that the contribution rate for 2003 will be 17.1% of pensionable salaries plus a one-off contribution of £5m. This is designed to ensure that the UK Group scheme is fully funded.

10b PENSIONS CONTINUED

The experience gains and losses of both the UK Group scheme and other schemes are shown below:

History of experience gains and losses	
Difference between the actual and expected return on scheme assets	£(176)m
As a percentage of year end assets	17%
Experience gains and (losses) on scheme liabilities	£16m
As a percentage of year end liabilities	1%
Total amount recognised in statement of total recognised gains and losses	£(159)m
As a percentage of year end liabilities	12%

If the above amounts had been recognised in the financial statements, the Group's net assets and profit and loss reserve at 31 December 2002 would be as follows:

all figures in £ millions	2002	2001 RESTATED
Net assets excluding pension liability (see note below)	3,566	4,034
FRS 17 pension liability	(174)	(73)
Net assets including FRS 17 pension liability	3,392	3,961
Profit and loss reserve excluding pension reserve (see note below)	709	1,199
FRS 17 pension reserve	(174)	(73)
Profit and loss reserve including FRS 17 pension reserves	535	1,126

note ‣ The net assets and profit and loss reserve exclude the pension liability of £36m (2001: £61m) included within provisions (see note 22).

10c OTHER POST-RETIREMENT BENEFITS

The Group provides certain healthcare and life assurance benefits principally for retired US employees and their dependents. These plans are unfunded. Retirees are eligible for participation in the plans if they meet certain age and service requirements. Plans that are available vary depending on the business division in which the retiree worked. Plan choices and retiree contributions are dependent on retirement date, business division, option chosen and length of service. The valuation and costs relating to other post-retirement benefits are assessed in accordance with the advice of independent qualified actuaries.

The cost of the benefits and the major assumptions used, based on a measurement date of 31 December 2001, are as follows:

all figures in £ millions	2002	2001
Other post-retirement benefits	5	4

all figures in percentages	
Inflation	3.0
Rate of increase in healthcare rates	5-10
Rate used to discount scheme liabilities	7.2

Included in note 22, there is a post-retirement medical benefits provision of £56m (2001: £62m). In accordance with UITF 6, the cost of post-retirement benefits, and related provisions, are based on the equivalent US GAAP standard, FAS 106.

The disclosures required under the transitional arrangements of FRS 17 are set out below.

10c OTHER POST-RETIREMENT BENEFITS CONTINUED

For the purpose of these disclosures the valuation of the schemes has been updated to 31 December 2002 using the assumptions listed below.

all figures in percentages	2002	2001
Inflation	**3.00**	3.00
Rate of increase in healthcare rates	**5-12**	5-10
Rate used to discount scheme liabilities	**6.75**	7.20

The value of the unfunded liability is as follows:

all figures in £ millions	2002	2001 RESTATED
Present value of unfunded liabilities	**(63)**	(63)
Related deferred tax asset	**22**	22
Net post-retirement healthcare liability	**(41)**	(41)
Operating charge		
Current service cost	**(1)**	
Past service cost	**–**	
Total operating charge	**(1)**	
Other finance charge		
Interest on pension scheme liabilities	**(4)**	
Net charge	**(4)**	
Net profit and loss impact	**(5)**	
Statement of total recognised gains and losses		
Experience gains arising on the scheme liabilities	**3**	
Changes in assumptions underlying the present value of the scheme liabilities	**(7)**	
Exchange differences	**5**	
Actuarial gain	**1**	
Movement in deficit during the year		
Deficit in scheme at beginning of the year	**(63)**	
Current service cost	**(1)**	
Contributions	**4**	
Other finance charge	**(4)**	
Actuarial gain	**1**	
Deficit in scheme at end of the year	**(63)**	
Related deferred tax asset	**22**	
Net post-retirement deficit	**(41)**	

The experience gains and losses for the schemes are shown below:

History of experience gains and losses	
Experience gains on scheme liabilities	£3m
As a percentage of year end liabilities	4%
Total amount recognised in statement of total recognised gains and losses	£1m
As a percentage of year end liabilities	2%

10c OTHER POST-RETIREMENT BENEFITS CONTINUED

If the above amounts had been recognised in the financial statements, the Group's net assets and profit and loss reserves at 31 December 2002 would be as follows:

all figures in £ millions	2002	2001 RESTATED
Net assets excluding post-retirement healthcare liability (see note below)	3,586	4,035
FRS 17 post-retirement healthcare liability	(41)	(41)
Net assets including FRS 17 post-retirement healthcare liability	3,545	3,994
Profit and loss reserve excluding post-retirement healthcare reserve (see note below)	729	1,200
FRS 17 post-retirement healthcare reserve	(41)	(41)
Profit and loss reserve including FRS 17 post-retirement healthcare reserve	688	1,159

note ▸ The net assets and profit and loss reserve exclude the post-retirement healthcare liability of £56m (2001: £62m) included within provisions (see note 22).

11 INTANGIBLE FIXED ASSETS

all figures in £ millions	GOODWILL RESTATED
Cost	
At 31 December 2001 as previously reported	4,950
Prior year adjustment – FRS 19	(84)
As restated	4,866
Exchange differences	(383)
Additions	63
Disposals	(59)
At 31 December 2002	**4,487**
Amortisation	
At 31 December 2001 as previously reported	(689)
Prior year adjustment – FRS 19	16
As restated	(673)
Exchange differences	70
Disposals	18
Provided in the year	(282)
Provision for impairment (see note below)	(10)
At 31 December 2002	**(877)**
Net carrying amount	
At 31 December 2001	4,193
At 31 December 2002	**3,610**

note ▸ In accordance with FRS 11 'Impairment of fixed assets and goodwill' the carrying value of the Group's acquired subsidiaries has been compared to their recoverable amounts, represented by their value in use to the Group. The review has resulted in an impairment charge of £10m (2001: £58m).

12 TANGIBLE FIXED ASSETS

all figures in £ millions	FREEHOLD AND LEASEHOLD PROPERTY	PLANT AND EQUIPMENT	ASSETS IN COURSE OF CONSTRUCTION	TOTAL
Cost				
At 31 December 2001	316	719	7	1,042
Exchange differences	(16)	(37)	–	(53)
Reclassifications	–	3	(3)	–
Owned by subsidiaries acquired	–	14	–	14
Capital expenditure	21	89	16	126
Disposals	(10)	(74)	–	(84)
At 31 December 2002	**311**	**714**	**20**	**1,045**
Depreciation				
At 31 December 2001	(90)	(410)	–	(500)
Exchange differences	5	25	–	30
Provided in the year	(17)	(105)	–	(122)
Owned by subsidiaries acquired	–	(14)	–	(14)
Disposals	6	58	–	64
At 31 December 2002	**(96)**	**(446)**	**–**	**(542)**
Net book value				
At 31 December 2001	226	309	7	542
At 31 December 2002	**215**	**268**	**20**	**503**

Freehold and leasehold property ▸ Net book value includes: freehold of £130m (2001: £150m) and short leases of £85m (2001: £76m).

Capital commitments ▸ The Group had capital commitments for fixed assets, including finance leases, already under contract amounting to £12m at 31 December 2002 (2001: £15m).

Other notes ▸ The net book value of Group tangible fixed assets includes £6m (2001: £10m) in respect of assets held under finance leases. Depreciation on these assets charged in 2002 was £2m (2001: £5m).

13 JOINT VENTURES

	2002		2001	
all figures in £ millions	VALUATION	BOOK VALUE	VALUATION	BOOK VALUE
Unlisted joint ventures	**7**	**7**	7	7

note ▸ The valuations of unlisted joint ventures are directors' valuations as at 31 December 2002. If realised at these values there would be no liability for taxation. The Group had no capital commitments to subscribe for further capital and loan stock.

all figures in £ millions	EQUITY	RESERVES	TOTAL NET ASSETS
Summary of movements			
At 31 December 2001	45	(38)	7
Exchange differences	–	(3)	(3)
Additions	16	–	16
Retained loss for the year	–	(13)	(13)
At 31 December 2002	**61**	**(54)**	**7**

13 JOINT VENTURES CONTINUED

all figures in £ millions	2002 Operating loss	2002 Total net assets	2001 Operating loss	2001 Total net assets
Analysis of joint ventures				
Business sectors				
Pearson Education	(1)	–	–	1
FT Group	(13)	3	(20)	3
The Penguin Group	1	4	1	3
	(13)	7	(19)	7
Geographical markets supplied and location of net assets				
United Kingdom	1	4	(1)	3
Continental Europe	(13)	3	(18)	3
North America	(1)	–	–	1
	(13)	7	(19)	7

all figures in £ millions	2002	2001
Reconciliation to retained loss		
Operating loss of joint ventures	(13)	(19)
UK taxation	–	(6)
Retained loss for the year	(13)	(25)

14 ASSOCIATES

all figures in £ millions	2002 Valuation	2002 Book value	2001 Valuation	2001 Book value
Listed associates	17	17	984	829
Unlisted associates	214	88	258	63
Loans	1	1	1	1
	232	106	1,243	893

note ▸ Principal associates are listed in note 34. The valuations of unlisted associates are directors' valuations as at 31 December 2002. If all associates were realised at these values there would be an estimated liability for taxation, at year end rates, of £nil (2001: £59m). The Group had no capital commitments to subscribe for further capital and loan stock.

all figures in £ millions	Share of equity	Loans	Reserves	Total	Goodwill	Total net assets
Summary of movements						
At 31 December 2001	228	1	7	236	657	893
Exchange differences	(2)	–	1	(1)	(3)	(4)
Additions	20	–	–	20	1	21
Disposals	(182)	–	(1)	(183)	(575)	(758)
Retained profit for the year	–	–	2	2	–	2
Goodwill amortisation	–	–	–	–	(48)	(48)
At 31 December 2002	**64**	**1**	**9**	**74**	**32**	**106**

note ▸ On 30 January 2002, the Group sold its interest in the RTL Group for £920m, giving rise to a profit on sale of £18m, after goodwill written back from reserves of £144m and before tax estimated to be £6m.

14 ASSOCIATES CONTINUED

all figures in £ millions	2002 Operating loss	2002 Total net assets	2001 Operating loss	2001 Total net assets
Analysis of associates				
Business sectors				
Pearson Education	2	8	(1)	10
FT Group	(37)	98	(49)	120
Continuing operations	(35)	106	(50)	130
Discontinued operations	(3)	–	2	763
	(38)	106	(48)	893
Geographical markets supplied and location of net assets				
United Kingdom	11	9	4	12
Continental Europe	(1)	92	2	72
North America	(45)	(5)	(59)	36
Rest of world	–	10	3	10
Continuing operations	(35)	106	(50)	130
Discontinued operations	(3)	–	2	763
	(38)	106	(48)	893

all figures in £ millions	2002
Reconciliation to retained profit	
Operating profit of associates (before goodwill amortisation)	10
Profit on sale of subsidiaries and associates	3
Taxation	(4)
Dividends (including tax credits) from unlisted associates	(7)
Retained profit for the year	2

note ▸ The profit on sale of subsidiaries and associates by an associate is £3m relating to the finalised profit on disposal of the Journal of Commerce by the Economist which took place in 2001 (2001: £(36)m).

The aggregate of the Group's share in its associates is shown below:

all figures in £ millions	2002	2001
Sales	141	700
Fixed assets	28	270
Current assets	130	384
Liabilities due within one year	(76)	(360)
Liabilities due after one year or more	(8)	(58)
Net assets	74	236

15 OTHER FIXED ASSET INVESTMENTS

all figures in £ millions	2002 VALUATION	2002 BOOK VALUE	2001 VALUATION	2001 BOOK VALUE
Listed	**67**	**64**	67	55
Unlisted	**20**	**20**	29	29
	87	**84**	96	84

note ‣ The valuations of unlisted investments are directors' valuations as at 31 December 2002. If all investments were realised at valuation there would be a liability for taxation of £nil (2001: £6m).

all figures in £ millions	OWN SHARES HELD	OTHER	TOTAL
Cost			
At 31 December 2001	91	107	198
Exchange differences	–	(4)	(4)
Additions	17	4	21
Disposals	–	(10)	(10)
At 31 December 2002	**108**	**97**	**205**
Provision			
At 31 December 2001	59	55	114
Provided during the year	7	–	7
At 31 December 2002	**66**	**55**	**121**
Net book value			
At 31 December 2001	32	52	84
At 31 December 2002	**42**	**42**	**84**

note ‣ The Pearson Employee Share Trust and Pearson plc Employee Share Ownership Trusts hold 7.9m (2001: 5.5m) Pearson plc ordinary shares which had a market value of £45m at 31 December 2002 (2001: £43m). These shares have been acquired by the trusts, using funds provided by Pearson plc, to meet obligations under various executive and employee option and restricted share plans. Under these plans the participants become entitled to shares after a specified number of years and subject to certain performance criteria being met. Pearson aims to hedge its liability under the plans by buying shares through the trusts to meet the anticipated future liability. Dividends on the shares held by the trusts have been waived.

The Group operates a worldwide Save As You Earn scheme together with a similar scheme for US employees that allows the grant of share options at a discount to the market price of the option granted. The Group has made use of the exemption under UITF 17 not to recognise any compensation charge in respect of these options.

Employer's National Insurance and similar taxes arise on the exercise of certain share options. In accordance with UITF 25 a provision is made, calculated using the market price of the company's shares at the balance sheet date, pro-rated over the vesting period of the options.

16 STOCKS

all figures in £ millions	2002	2001
Raw materials	22	32
Work in progress	36	45
Finished goods	297	370
Pre-publication costs	379	402
	734	849

note ▸ The replacement cost of stocks is not materially different from book value.

17 DEBTORS

all figures in £ millions	2002	2001
Amounts falling due within one year		
Trade debtors	778	745
Associates	1	2
Royalty advances	109	103
Other debtors	51	49
Prepayments and accrued income	44	40
	983	939
Amounts falling due after more than one year		
Royalty advances	63	54
Other debtors	10	11
Prepayments and accrued income	1	1
	74	66
	1,057	1,005

18 CASH AT BANK AND IN HAND

	2002		2001	
all figures in £ millions	GROUP	COMPANY	GROUP	COMPANY
Cash, bank current accounts and overnight deposits	417	–	300	–
Certificates of deposit and commercial paper	15	–	15	–
Term bank deposits	143	8	78	22
	575	8	393	22

19 FINANCIAL INSTRUMENTS

A full discussion on treasury policy is given in the Financial Review on pages 33 to 34. Short-term debtors and creditors have been excluded from all the following disclosures, other than currency risk disclosures.

a. Maturity of borrowings and other financial liabilities

The maturity profile of the Group's borrowings and other financial liabilities is shown below:

all figures in £ millions	2002 GROUP	2002 COMPANY	2001 GROUP	2001 COMPANY
Maturity of borrowings				
Short-term				
Bank loans and overdrafts	101	175	65	109
10.75% Sterling Bonds 2002	–	–	100	–
5% Euro Bonds 2003	148	148	–	–
Total due within one year	249	323	165	109
Medium and long-term				
Loans or instalments thereof repayable:				
From one to two years	458	338	154	154
From two to five years	616	371	1,285	705
After five years not by instalments	660	660	1,168	1,168
Total due after more than one year	1,734	1,369	2,607	2,027
Total borrowings	1,983	1,692	2,772	2,136

note ▸ At 31 December 2002 £91m (2001: £557m) of debt, including commercial paper, currently classified from two to five years would be repayable within one year if refinancing contracts were not in place. The short-term bank loans and overdrafts of the Group are lower than those of the company because of bank offset arrangements.

all figures in £ millions	2002 GROUP FINANCE LEASES	2002 GROUP OTHER FINANCIAL LIABILITIES	2002 GROUP TOTAL	2001 GROUP FINANCE LEASES	2001 GROUP OTHER FINANCIAL LIABILITIES	2001 GROUP TOTAL
Maturity of other financial liabilities						
Amounts falling due:						
In one year or less or on demand	4	11	15	5	11	16
In more than one year but not more than two years	2	8	10	1	9	10
In more than two years but not more than five years	1	16	17	8	18	26
In more than five years	–	22	22	–	11	11
	7	57	64	14	49	63

b. Borrowings by instrument

all figures in £ millions	2002 GROUP	2002 COMPANY	2001 GROUP	2001 COMPANY
Unsecured				
10.75% Sterling Bonds 2002	–	–	100	–
5% Euro Bonds 2003	148	148	154	154
9.5% Sterling Bonds 2004	120	–	133	–
4.625% Euro Bonds 2004	338	338	353	353
7.375% US Dollar notes 2006	154	–	170	–
6.125% Euro Bonds 2007	370	370	448	448
10.5% Sterling Bonds 2008	100	100	100	100
7% Global Dollar Bonds 2011	310	310	342	342
7% Sterling Bonds 2014	250	250	278	278
Variable rate loan notes	1	1	72	72
Bank loans and overdrafts and commercial paper	192	175	622	389
Total borrowings	1,983	1,692	2,772	2,136

19 FINANCIAL INSTRUMENTS CONTINUED

c. Undrawn committed borrowing facilities

all figures in £ millions	2002	2001
Expiring within one year	–	–
Expiring between one and two years	–	–
Expiring in more than two years	1,059	1,172
	1,059	1,172

note ▸ All of the above committed borrowing facilities incur commitment fees at market rates.

d. Currency and interest rate risk profile

	2002			Fixed rate borrowings	
	Borrowings £m	Total variable rate £m	Total fixed rate £m	Weighted average interest rate %	Weighted average period for which rate is fixed – years
Currency and interest rate risk profile of borrowings					
US dollar	1,350	752	598	5.9	4.0
Sterling	241	161	80	10.5	5.5
Euro	380	305	75	5.2	1.5
Other currencies	12	12	–	–	–
	1,983	1,230	753		

note ▸ There is an interest rate collar instrument which matures in 2007 with a notional value of £31m equivalent, that is classified at year end as a variable rate US dollar borrowing. This instrument limits our interest rate liability above 4.5%.

	2001			Fixed rate borrowings	
	Borrowings £m	Total variable rate £m	Total fixed rate £m	Weighted average interest rate %	Weighted average period for which rate is fixed – years
Currency and interest rate risk profile of borrowings					
US dollar	1,829	625	1,204	6.1	3.5
Sterling	520	410	110	9.3	5.1
Euro	404	320	84	5.2	2.4
Other currencies	19	19	–	–	–
	2,772	1,374	1,398		

note ▸ The figures shown in the tables above take into account interest rate, currency swaps and forward rate contracts entered into by the Group. Variable rate borrowings bear interest at rates based on relevant national LIBOR equivalents.

	2002		
all figures in £ millions	Other financial liabilities	Total fixed rate	Total no interest paid
Currency and interest rate risk profile of other financial liabilities			
US dollar	45	5	40
Sterling	8	2	6
Euro	11	–	11
	64	7	57

19 FINANCIAL INSTRUMENTS CONTINUED

d. Currency and interest rate risk profile (continued)

all figures in £ millions	2001 Other financial liabilities	2001 Total fixed rate	2001 Total no interest paid
Currency and interest rate risk profile of other financial liabilities			
US dollar	48	11	37
Sterling	6	3	3
Euro	9	–	9
	63	14	49

all figures in £ millions	2002 US dollar	Sterling	Euro	Other currencies	Total
Currency and interest rate risk profile of financial assets					
Cash at bank and in hand	279	9	67	62	417
Short-term deposits	2	18	127	11	158
Other financial assets	28	6	–	–	34
	309	33	194	73	609
Floating rate	281	27	193	73	574
No interest received	28	6	1	–	35
	309	33	194	73	609

all figures in £ millions	2001 US dollar	Sterling	Euro	Other currencies	Total
Currency and interest rate risk profile of financial assets					
Cash at bank and in hand	166	40	62	32	300
Short-term deposits	10	27	40	16	93
Other financial assets	37	4	3	–	44
	213	71	105	48	437
Floating rate	176	65	102	47	390
No interest received	37	6	3	1	47
	213	71	105	48	437

19 FINANCIAL INSTRUMENTS CONTINUED

e. Currency exposures

The table below shows the extent to which Group companies have monetary assets and liabilities in currencies other than their local currency.

all figures in £ millions	**2002 NET FOREIGN MONETARY ASSETS/(LIABILITIES)** US DOLLAR	STERLING	EURO	OTHER	TOTAL
Functional currency of entity:					
US dollar	**–**	**2**	**–**	**2**	**4**
Sterling	**48**	**–**	**41**	**8**	**97**
Euro	**–**	**1**	**–**	**6**	**7**
Other currencies	**4**	**4**	**5**	**–**	**13**
	52	**7**	**46**	**16**	**121**

all figures in £ millions	2001 NET FOREIGN MONETARY ASSETS/(LIABILITIES) US DOLLAR	STERLING	EURO	OTHER	TOTAL
Functional currency of entity:					
US dollar	–	–	–	3	3
Sterling	(67)	–	8	5	(54)
Euro	–	–	–	–	–
Other currencies	(5)	(2)	–	–	(7)
	(72)	(2)	8	8	(58)

f. Fair values of financial assets and financial liabilities

The table below shows the book value and the fair value of the Group's financial assets and financial liabilities.

all figures in £ millions	**2002** BOOK VALUE	**2002** FAIR VALUE	2001 BOOK VALUE	2001 FAIR VALUE
Primary financial instruments held or issued to finance the Group's operations				
Other financial assets	**34**	**34**	44	44
Other financial liabilities	**(64)**	**(64)**	(63)	(63)
Cash at bank and in hand	**417**	**417**	300	300
Short-term deposits	**158**	**158**	93	93
Short-term borrowings	**(249)**	**(253)**	(165)	(165)
Medium and long-term borrowings	**(1,734)**	**(1,877)**	(2,607)	(2,527)
Derivative financial instruments held to manage the interest rate and currency profile				
Interest rate swaps	**–**	**26**	–	(30)
Currency swaps	**–**	**32**	–	16
Foreign exchange contracts	**–**	**4**	–	(1)

note ▸ Other financial assets, other financial liabilities, cash at bank and in hand, short-term deposits and short-term borrowings: the fair value approximates to the carrying value due to the short maturity periods of these financial instruments. Medium and long-term borrowings: the fair value is based on market values or, where these are not available, on the quoted market prices of comparable debt issued by other companies. Interest rate swaps: the fair value of interest rate swaps is based on market values. At 31 December 2002 the notional principal value of these swaps was £1,605m (2001: £2,391m). Currency swaps: the fair value of these contracts is based on market values. At 31 December 2002 the Group had £758m (2001: £924m) of such contracts outstanding.

19 FINANCIAL INSTRUMENTS CONTINUED

g. Hedges

The Group's policy on hedges is explained on page 33. The table below shows the extent to which the Group has off-balance sheet (unrecognised) gains and losses in respect of financial instruments used as hedges at the beginning and end of the year. It also shows the amount of such gains and losses which have been included in the profit and loss account for the year and those gains and losses which are expected to be included in next year's or later profit and loss accounts.

all figures in £ millions	GAINS	UNRECOGNISED LOSSES	TOTAL NET GAINS/(LOSSES)
Gains and losses on hedges at 31 December 2001	43	(58)	(15)
Gains and losses arising in previous years that were recognised in 2002	(1)	34	33
Gains and losses arising before 31 December 2001 that were not recognised in 2002	42	(24)	18
Gains and losses arising in 2002 that were not recognised in 2002	71	(27)	44
Unrecognised gains and losses on hedges at 31 December 2002	113	(51)	62
Of which:			
Gains and losses expected to be recognised in 2003	6	–	6
Gains and losses expected to be recognised in 2004 or later	107	(51)	56

20 OTHER CREDITORS

all figures in £ millions	**2002**	2001
Amounts falling due within one year		
Trade creditors	**376**	390
Taxation	**24**	111
Social security and other taxes	**13**	2
Other creditors	**83**	85
Accruals and deferred income	**499**	501
Obligations under finance leases	**4**	5
Dividends	**115**	109
	1,114	1,203
Amounts falling due after more than one year		
Other creditors	**31**	30
Accruals and deferred income	**26**	15
Obligations under finance leases	**3**	9
	60	54

21 DEFERRED TAXATION

all figures in £ millions	
Summary of movements	
At 31 December 2001 as previously reported	(5)
Prior year adjustment (see below)	277
As restated	272
Exchange differences	(29)
Transfers	(3)
Net release in the year	(66)
At 31 December 2002	**174**

all figures in £ millions	**2002**	2001 RESTATED
Deferred taxation derives from:		
Capital allowances	**(47)**	(10)
Tax losses carried forward	**170**	172
Taxation on unremitted overseas earnings	**(16)**	(15)
Other timing differences	**67**	125
	174	272
Deferred taxation not provided		
Relating to revalued assets and timing differences	**–**	–
Relating to gains subject to roll-over relief	**1**	1
	1	1

note ▸ The Group has calculated deferred tax not provided on rolled over gains in 2002, taking into account the indexation allowance which would be deductible on a disposal of the asset into which the gain was rolled.

Prior year adjustment

FRS 19 'Deferred Tax' has been adopted for the first time in these financial statements. The Group previously provided deferred tax using the liability method under SSAP 15 and only recognised deferred tax liabilities to the extent that it was probable that the liabilities would crystallise. Deferred tax assets were only recognised to the extent that their recoverability was assured beyond reasonable doubt. Under FRS 19 the recognition criteria for deferred tax assets has changed, with the result that the Group has recognised a deferred tax asset in respect of US tax losses and other timing differences that are regarded as recoverable against future taxable profits. The adoption of FRS 19 has also had an impact on capitalised goodwill since the restatement of deferred tax balances acquired has had a corresponding effect upon the goodwill recognised on those acquisitions. A prior year adjustment has been made in these financial statements to reflect the adoption of FRS 19 and comparative figures have been restated. The impact on the profit and loss account for 2002 has been to increase the loss after taxation by £45m (£50m relating to the tax charge and an offsetting £5m to goodwill amortisation) and to increase opening shareholders' funds by £209m. The effect on the loss after taxation for 2001 was to increase the loss by £32m.

22 PROVISIONS FOR LIABILITIES AND CHARGES

all figures in £ millions	POST-RETIREMENT	DEFERRED CONSIDERATION	INTEGRATION	REORGANI-SATIONS	LEASES	OTHER	TOTAL
At 31 December 2001	123	25	29	29	19	14	239
Exchange differences	(11)	(4)	(2)	(2)	(2)	–	(21)
Subsidiaries acquired/disposed	2	–	–	–	(1)	1	2
Deferred consideration arising on acquisitions	–	3	–	–	–	–	3
Released	–	–	–	(3)	(1)	(1)	(5)
Provided	59	–	8	9	7	1	84
Utilised	(81)	(13)	(18)	(14)	(4)	(7)	(137)
At 31 December 2002	**92**	**11**	**17**	**19**	**18**	**8**	**165**

note

a Post-retirement provisions are in respect of pensions, £36m (2001: £61m) and post-retirement medical benefits, £56m (2001: £62m).

b Deferred consideration. During the year, £13m was paid with respect to companies acquired as part of the NCS acquisition in 2000. The balance is expected to be utilised during 2003.

c Integration. These movements relate to The Penguin Group and Pearson Education. £9m has been utilised in relation to properties and a further £9m relating to severance and IT systems. No further integration charges are anticipated in 2003 relating to these prior year acquisitions, and the remaining provision should be utilised in the next three years.

d Reorganisations. £9m has been provided during 2002, mostly relating to the restructuring of our back office systems and processes. £14m has been utilised in the reorganisation of Family Education Network and FT Knowledge. The balance is expected to be utilised in the next two years.

e Lease commitments. These relate primarily to onerous lease contracts, acquired as part of the purchase of subsidiaries, which have various expiry dates up to 2010. The provision is based on current occupancy estimates.

f Other. The balance, which relates to a number of small items, is expected to be utilised over varying time periods.

23 SHARE CAPITAL

	NUMBER OF SHARES (000'S)	£m
Authorised		
Ordinary shares of 25p each		
At 31 December 2002	**1,174,000**	**294**
Called up, allotted and fully paid		
At 31 December 2001	800,589	200
Issued under share option and employee share schemes	1,073	–
At 31 December 2002	**801,662**	**200**

note ▸ The consideration received in respect of shares issued during the year was £6m (2001: £20m).

23 SHARE CAPITAL CONTINUED

	WHEN GRANTED	NUMBER OF SHARES (000'S)	PRICE (P)	ORIGINAL SUBSCRIPTION EXERCISE PERIOD
Options outstanding at 31 December 2002				
Worldwide Save for Shares plans	1995	20	390	2000 – 03
	1996	60	517	2001 – 04
	1997	114	530	2000 – 05
	1998	360	687	2001 – 06
	1999	544	913 – 970	2001 – 07
	2000	217	688 – 1,793	2001 – 08
	2001	532	957 – 1,096	2004 – 09
	2002	1,466	696	2005 – 10
		3,313		
Discretionary share option plans	1994	171	567 – 635	1997 – 04
	1995	194	487 – 606	1998 – 05
	1996	282	584 – 683	1999 – 06
	1997	1,156	664 – 758	2000 – 07
	1998	1,781	847 – 1,090	2001 – 08
	1999	3,681	1,081 – 1,922	2002 – 09
	2000	10,432	64 – 3,224	2000 – 10
	2001	14,599	822 – 1,421	2001 – 11
		32,296		

note ▸ The subscription prices have been rounded up to the nearest whole penny. The figures include replacement options granted to employees of Dorling Kindersley and the Family Education Network following their acquisition. The discretionary share option plans include all options granted under the Pearson Executive Share Option Plans, the Pearson Reward Plan, the Pearson Special Share Option Plan and the Pearson Long Term Incentive Plan.

24 RESERVES

all figures in £ millions	SHARE PREMIUM ACCOUNT	PROFIT AND LOSS ACCOUNT RESTATED
Summary of movements		
At 31 December 2001 as previously reported	2,459	929
Prior year adjustment – FRS 19	–	209
As restated	2,459	1,138
Exchange differences net of taxation	–	(312)
Premium on issue of 1m equity shares	6	–
Goodwill written back on disposal of an associate	–	144
Replacement options granted on acquisition of a subsidiary	–	1
Loss retained for the year	–	(298)
At 31 December 2002	**2,465**	**673**
Analysed as:		
Joint ventures and associates		(45)
Group excluding joint ventures and associates		718

note ▸ Cumulative goodwill relating to acquisitions made prior to 1998, which was deducted from reserves, amounts to £1,031m (2001: £1,249m). During 2002 Pearson plc received £6m on the issue of shares in respect of the exercise of options awarded under various share option plans. Employees paid £6m to the Group for the issue of these shares. The Group has taken advantage of the exemption available by UITF 17 and has not incurred a charge on options granted at a discount to market value for its Inland Revenue approved SAYE schemes and similar overseas schemes. Included in exchange differences are exchange gains of £70m arising on borrowings denominated in, or swapped into, foreign currencies designated as hedges of net investments overseas.

25 ACQUISITIONS

All acquisitions have been consolidated applying acquisition accounting principles.

a. Acquisition of subsidiaries

all figures in £ millions	2002	2001
Tangible fixed assets	–	5
Associates	(3)	(3)
Stocks	(2)	8
Debtors	2	(78)
Creditors	(4)	(19)
Provisions	(3)	(9)
Deferred taxation	–	(1)
Net cash and short-term deposits acquired	25	83
	15	(14)
Equity minority interests	(4)	(2)
Net assets/(liabilities) acquired at fair value	11	(16)
Fair value of consideration:		
Cash	(74)	(52)
Deferred cash consideration	(3)	(10)
Costs accrued	–	(1)
Net prior year adjustments	3	(8)
Total consideration	(74)	(71)
Goodwill arising	63	87

all figures in £ millions	2002
Acquisition fair values	
Book value of net assets acquired	25
Fair value adjustments	(14)
Fair value to the Group	11

note ‣ Of the fair value adjustments above, £(14)m relates to the finalisation of prior year provisional acquisition values. These adjustments relate primarily to: write down of stock to its recoverable amount and the recognition of a provision for royalty payments. For acquisitions made during 2002 the fair value adjustments are provisional and will be finalised in the 2003 financial statements.

b. Cash flow from acquisitions

all figures in £ millions	2002	2001
Cash – current year acquisitions	74	52
Deferred payments for prior year acquisitions and other items	13	76
Net cash outflow	87	128

26 DISPOSALS

all figures in £ millions	**2002**	2001 RESTATED
Disposal of subsidiaries		
Intangible assets	**(41)**	(53)
Tangible fixed assets	**–**	(7)
Stocks	**(3)**	(2)
Debtors	**(2)**	(15)
Creditors	**(3)**	14
Taxation	**–**	(5)
Provisions	**1**	1
Net debt	**(1)**	–
Equity minority interest	**3**	–
Net assets disposed of	**(46)**	(67)
Proceeds received	**11**	49
Costs	**(7)**	(7)
Net prior year adjustments	**(3)**	(1)
Loss on sale	**(45)**	(26)
Goodwill written back from reserves	**–**	(37)
Net loss on sale	**(45)**	(63)

all figures in £ millions	**2002**	2001
Cash flow from disposals		
Cash – current year disposals	**11**	49
Costs paid	**(3)**	(8)
Deferred receipts and payments from prior year disposals and other amounts	**(5)**	–
Net cash inflow	**3**	41

27 NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS

	2002	2001 RESTATED		
all figures in £ millions	TOTAL	CONTINUING	DISCONTINUED	TOTAL
a. Reconciliation of operating profit/(loss) to net cash inflow from operating activities				
Total operating profit/(loss)	**143**	(49)	2	(47)
Share of operating loss/(profit) of joint ventures and associates	**51**	69	(2)	67
Depreciation charges	**122**	125	–	125
Goodwill amortisation and impairment	**292**	350	–	350
Decrease/(increase) in stocks	**43**	(6)	–	(6)
(Increase)/decrease in debtors	**(111)**	102	–	102
Increase/(decrease) in creditors	**64**	(103)	–	(103)
(Decrease)/increase in operating provisions	**(50)**	3	–	3
Other and non-cash items	**(25)**	(1)	–	(1)
Net cash inflow from operating activities	**529**	490	–	490
Dividends from associates	**6**	7	18	25
Purchase of tangible fixed assets	**(126)**	(165)	–	(165)
Capital element of finance leases	**(5)**	(7)	–	(7)
Sale of tangible fixed assets	**7**	36	–	36
Add back: non operating fixed asset disposal proceeds	**–**	(11)	–	(11)
Add back: integration costs	**44**	69	–	69
Operating cash flow	**455**	419	18	437
Operating tax paid	**(46)**	(44)	–	(44)
Operating finance charges	**(104)**	(157)	–	(157)
Operating free cash flow	**305**	218	18	236
Non operating tax paid	**(9)**	(27)	–	(27)
Non operating finance charges	**(37)**	–	–	–
Integration costs	**(44)**	(69)	–	(69)
Total free cash flow	**215**	122	18	140
Dividends paid (including minorities)	**(182)**	(183)	–	(183)
Net movement of funds from operations	**33**	(61)	18	(43)
Acquisitions of businesses and investments	**(124)**	(100)	–	(100)
Disposals of businesses, investments and property	**930**	77	–	77
New equity	**6**	20	–	20
Other non operating items	**(5)**	(8)	–	(8)
Net movement of funds	**840**	(72)	18	(54)
Exchange movements on net debt	**131**	(24)	–	(24)
Total movement in net debt	**971**	(96)	18	(78)

note ‣ Operating cash flow, operating free cash flow and total free cash flow have been disclosed as they are part of Pearson's corporate and operating measures. Tax payments that can be clearly identified with disposals, integration and exchange differences taken to reserves are allocated as non operating tax payments.

27 NOTES TO CONSOLIDATED STATEMENT OF CASH FLOWS CONTINUED

all figures in £ millions	CASH	OVER-DRAFTS	SUB-TOTAL	SHORT-TERM DEPOSITS	DEBT DUE WITHIN ONE YEAR	DEBT DUE AFTER ONE YEAR	FINANCE LEASES	TOTAL
b. Analysis of net debt								
At 31 December 2001	300	(60)	240	93	(105)	(2,607)	(14)	(2,393)
Exchange differences	(15)	4	(11)	(2)	(6)	150	1	132
Acquired with subsidiary	–	–	–	24	–	–	–	24
Other non-cash items	–	–	–	–	(148)	146	1	(1)
Net cash flow	132	(21)	111	43	87	577	5	823
At 31 December 2002	**417**	**(77)**	**340**	**158**	**(172)**	**(1,734)**	**(7)**	**(1,415)**
At 31 December 2000	425	(110)	315	91	(2)	(2,705)	(16)	(2,317)
Exchange differences	(10)	1	(9)	1	–	(16)	–	(24)
Debt issue costs	–	–	–	–	–	1	–	1
Other non-cash items	–	–	–	–	(100)	99	(5)	(6)
Net cash flow	(115)	49	(66)	1	(3)	14	7	(47)
At 31 December 2001	300	(60)	240	93	(105)	(2,607)	(14)	(2,393)

note ▸ Finance leases are included within other creditors in the balance sheet (see note 20).

all figures in £ millions	**2002**	2001
c. Reconciliation of net cash flow to movement in net debt		
Decrease/(increase) in net debt from net cash flow	**111**	(66)
Decrease in net debt from management of liquid resources	**43**	1
Decrease in net debt from other borrowings	**664**	11
Decrease in finance leases	**5**	7
Acquired with subsidiary	**24**	–
Debt issue costs	**–**	1
Other non-cash items	**(1)**	(6)
Exchange differences	**132**	(24)
Movement in net debt in the year	**978**	(76)
Net debt at beginning of the year	**(2,393)**	(2,317)
Net debt at end of the year	**(1,415)**	(2,393)

28 CONTINGENT LIABILITIES

There are contingent Group and company 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 of the Group in respect of legal claims. None of these claims are expected to result in a material gain or loss to the Group.

29 COMMITMENTS UNDER LEASES

At 31 December 2002, the Group had commitments under leases other than finance leases, to make payments in 2003 as follows:

all figures in £ millions	LAND AND BUILDINGS	OTHER
For leases expiring:		
In 2003	10	3
Between 2004 and 2007	40	16
Thereafter	65	–
	115	19

30 RELATED PARTIES

Joint ventures and associates ▸ Loans and equity advanced to joint ventures and associates during the year and at the balance sheet date are shown in notes 13 and 14. Amounts falling due from joint ventures and associates are set out in note 17. Dividends receivable from joint ventures and associates are set out in notes 13 and 14.

There are no other related party transactions in 2002.

31 POST BALANCE SHEET EVENTS

In January 2003 Interactive Data Corporation announced its acquisition of S&P Comstock for $115m in cash.

32 COMPANY BALANCE SHEET AS AT 31 DEC 2002

all figures in £ millions	NOTE	2002	2001
Fixed assets			
Tangible fixed assets	33	–	–
Investments: subsidiaries	33	6,422	5,384
Investments: own shares held	33	39	24
		6,461	5,408
Current assets			
Debtors:			
Subsidiaries – due within one year		971	2,186
Subsidiaries – due after more than one year		1,453	1,312
Taxation		10	17
Other debtors		1	–
Prepayments and accrued income		–	1
Cash at bank and in hand	18	8	22
		2,443	3,538
Creditors – amounts falling due within one year			
Short-term borrowing	19	(323)	(109)
Subsidiaries		(2,641)	(2,006)
Other creditors		(1)	(1)
Accruals and deferred income		(13)	(15)
Dividends		(115)	(109)
		(3,093)	(2,240)
Net current (liabilities)/assets		(650)	1,298
Total assets less current liabilities		5,811	6,706
Creditors – amounts falling due after more than one year			
Medium and long-term borrowing	19	(1,369)	(2,027)
Subsidiaries		(393)	(392)
Provisions for liabilities and charges		(2)	(2)
		(1,764)	(2,421)
Net assets		4,047	4,285
Capital and reserves			
Called up share capital	23	200	200
Share premium account	33	2,465	2,459
Special reserve	33	397	397
Other reserves	33	50	50
Profit and loss account	33	935	1,179
Equity shareholders' funds		4,047	4,285

The financial statements were approved by the board of directors on 3 March 2003 and signed on its behalf by

DENNIS STEVENSON ▸ RONA FAIRHEAD.

33 NOTES TO THE COMPANY BALANCE SHEET

all figures in £ millions	**2002**	2001
Tangible fixed assets (leasehold property)		
Cost	**1**	1
Depreciation	**(1)**	(1)
Net book value	**–**	–

note ‣ The company had no capital commitments for fixed assets at the end of 2002.

all figures in £ millions	
Investment in subsidiaries	
At 31 December 2001	5,384
External acquisition	2
Subscription for additional share capital in subsidiaries	1,085
Disposal to subsidiary	(16)
Provision for diminution in value	(32)
Revaluations	(1)
At 31 December 2002	**6,422**

note ‣ Shares are stated at cost less provisions for diminution in value or directors' valuations.

Own shares held ‣ Amounts included within own shares held relate to Pearson plc ordinary shares held in respect of the Pearson plc Employee Share Ownership Trusts (see note 15).

all figures in £ millions	SHARE PREMIUM ACCOUNT	SPECIAL RESERVE	OTHER RESERVES	PROFIT AND LOSS ACCOUNT	TOTAL
Reserves					
Summary of movements					
At 31 December 2001	2,459	397	50	1,179	4,085
Currency translation differences	–	–	–	(46)	(46)
Premium on issue of 1m equity shares	6	–	–	–	6
Loss for the financial year	–	–	–	(11)	(11)
Dividends	–	–	–	(187)	(187)
At 31 December 2002	**2,465**	**397**	**50**	**935**	**3,847**

note ‣ The special reserve represents the cumulative effect of cancellation of the company's share premium account. As permitted by section 230(4) of the Companies Act 1985, only the Group's profit and loss account has been presented.

34 PRINCIPAL SUBSIDIARIES AND ASSOCIATES

	COUNTRY OF INCORPORATION OR REGISTRATION
Subsidiaries	
The principal operating subsidiaries are listed below. They operate mainly in the countries of incorporation or registration, the investments are in equity share capital and they are all 100% owned unless stated otherwise.	
Pearson Education	
Pearson Education Inc.	US
Pearson Education Ltd	England
NCS Pearson Inc.	US
FT Group	
The Financial Times Ltd	England
Financial Times Business Ltd	England
Interactive Data Corporation (60%)	US
Les Echos SA	France
Recoletos Grupo de Comunicación SA (79%)	Spain
The Penguin Group	
Penguin Putnam Inc.	US
The Penguin Publishing Co Ltd	England
Dorling Kindersley Holdings Ltd*	England

* Direct investment of Pearson plc.

	COUNTRY OF INCORPORATION OR REGISTRATION	CLASS OF SHARE	BENEFICIAL INTEREST %	ACCOUNTING YEAR END
Associates				
FT Group				
The Economist Newspaper Ltd	England	Ord 5p	50	March
		‘B’ 5p	100	
		‘A’ 5p	Nil	
		Trust 5p	Nil	
FT-SE International Ltd	England	Ord £1	50	December

Five year summary

all figures in £ millions	1998 RESTATED	1999 RESTATED	2000 RESTATED	2001 RESTATED	**2002**
Sales					
Continuing operations	1,908	2,977	3,689	4,225	**4,320**
Discontinued operations	487	355	185	–	**–**
	2,395	3,332	3,874	4,225	**4,320**
Sales – underlying growth %	6.7	7.6	10.5	(0.3)	**6.0**
EBITDA*	455	631	590	588	**615**
Trading margin %	13.1	14.0	11.5	10.5	**11.4**
Operating profit before goodwill charge and other items					
Pearson Education	99	254	237	274	**326**
FT Group	118	114	98	72	**80**
The Penguin Group	48	65	79	80	**87**
Continuing operations	265	433	414	426	**493**
Internet enterprises investment					
Pearson Education	–	(3)	(83)	(77)	**(25)**
FT Group	–	(36)	(113)	(60)	**(34)**
	–	(39)	(196)	(137)	**(59)**
Adjusted eps*	36.6p	39.5p	30.6p	21.4p	**30.3p**
Dividends per share*	18.8p	20.1p	21.4p	22.3p	**23.4p**
Net assets	1,237	1,527	4,398	3,973	**3,530**
Deferred taxation	(243)	(266)	(295)	(272)	**(174)**
Provisions for liabilities and charges	253	206	257	239	**165**
Net debt (excluding finance leases)	2,279	1,995	2,301	2,379	**1,408**
Capital employed	3,526	3,462	6,661	6,319	**4,929**
Operating free cash flow per share*	40.3p	43.4p	23.0p	29.6p	**38.3p**

* Before goodwill charge, integration costs and non operating items, and restated to reflect the rights issue of equity shares during 2000 and adoption of FRS 19.

Corporate and operating measures

Sales – underlying growth

Sales growth excluding the impact of acquisitions and disposals and movements in exchange rates.

all figures in £ millions	2002
Underlying increase	248
Portfolio changes	10
Foreign exchange	(163)
Total sales increase	95
Underlying increase	6.0%

Trading margin

Trading profit (operating profit excluding profit from joint ventures, associates and investments) as a proportion of sales.

all figures in £ millions	2002
Total operating profit – Group	496
Investment income	(2)
Trading profit	494
Sales	4,320
Trading margin	11.4%

Operating free cash flow per share*

Operating cash flow less taxation paid on operating profits and interest paid, divided by the weighted average number of shares in issue.

all figures in £ millions	2002
Operating profit	493
Cash conversion	92%
Operating cash flow	455
Tax paid on operating profits	(46)
Interest paid	(104)
Operating free cash flow	305
Weighted average shares in issue (millions)	796.3
Operating free cash flow per share	38.3p

* Before goodwill charge, integration costs and non operating items.

Shareholder Information

Payment of dividends to mandated accounts ‣ Where shareholders have given instruction for payment to be made direct into a bank or building society, this is done through the Bankers Automated Clearing System (BACS), with the associated tax voucher showing the tax credit attributable to the dividend payment sent direct to the shareholder at the address shown on our register. If you wish the tax voucher to be sent to your bank or building society, please inform our registrar, Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA. Telephone 0870 600 3986 or, for those shareholders with hearing difficulties, textphone number 0870 600 3950.

Dividend reinvestment plan (DRIP) ‣ The plan provides the benefit of giving shareholders the right to buy the company's shares on the London stock market with the cash dividend. If you would like further information about the DRIP, please contact Lloyds TSB Registrars. Telephone 0870 241 3018.

Personal Equity Plans (PEPs) and Individual Savings Accounts (ISAs) ‣ The government no longer permits investment to be made in PEPs, although existing PEPs may be continued. Existing Corporate PEP and Single Company PEP holders who require further information about their PEPs should ring the HBOS helpline on 0870 606 6417. Lloyds TSB Registrars offer ISAs in Pearson shares. They can be contacted for information on 0870 242 4244.

Low cost share dealing facility ‣ A postal facility, which provides a simple, low cost way of buying and selling Pearson shares, is available through the company's stockbroker, Cazenove & Co. Limited, 12 Tokenhouse Yard, London EC2R 7AN. Telephone 020 7588 2828.

Shareholder information on-line ‣ Lloyds TSB Registrars provide a range of shareholder information on-line. You can check your holding and find practical help on transferring shares or updating your details at www.shareview.co.uk. Lloyds TSB Registrars can be contacted for information on 0870 600 3970.

Information about the Pearson share price ‣ The current price of Pearson ordinary shares can be obtained from Financial Times CityLine. Telephone 0906 843 3620.

American Depositary Receipts (ADRs) ‣ Pearson's ordinary shares are listed on the New York Stock Exchange in the form of ADRs and traded under the symbol PSO. Each ADR represents one ordinary share. Voting rights as a shareholder may be exercised through The Bank of New York, ADR Department, 101 Barclay Street, New York, New York 10286, telephone 800 BNY ADRS (toll free within the US) or (1) 610 312 5315 (outside the US). All enquiries regarding ADR holder accounts and payment of dividends should be directed to The Bank of New York, the authorised depositary bank for Pearson's ADR programme, at the address given above. Pearson will file with the Securities and Exchange Commission a report on Form 20-F that will contain a US GAAP reconciliation.

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FINANCIAL CALENDAR FOR 2003

EX-DIVIDEND DATE	WEDNESDAY 12 MARCH
RECORD DATE	FRIDAY 14 MARCH
LAST DATE FOR DIVIDEND REINVESTMENT ELECTION	THURSDAY 24 APRIL
ANNUAL GENERAL MEETING	FRIDAY 25 APRIL
PAYMENT DATE FOR DIVIDEND AND SHARE PURCHASE DATE FOR DIVIDEND REINVESTMENT	FRIDAY 9 MAY
INTERIM RESULTS	MONDAY 28 JULY
INTERIM DIVIDEND	FRIDAY 26 SEPTEMBER

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