Directors' Report

The directors are pleased to present their report to shareholders, together with the financial statements for the year ended 31 December 2006 on pages 52 to 55 and 58 to 119 respectively. Details of the businesses, the development of the Group and its subsidiaries and likely future developments are given on pages 1 to 17 of the annual review and summary financial statements. Sales and profits of the different sectors and geographical markets are given on pages 66 to 69.

Principal business activities

Pearson is an international media company with market-leading businesses in education, business information and consumer publishing. We lead our markets in quality, innovation and profitability. With more than 34,000 employees based in 58 countries, we are a large family of businesses which are focused on making the reading and learning experience as enjoyable and as beneficial as it can possibly be.

Results and dividend

The profit for the financial year ended 31 December 2006 was £469m (2005: £644m) and has been transferred to reserves. A final dividend of 18.8p per share is recommended for the year ended 31 December 2006. This, together with the interim dividend already paid, makes a total for the year of 29.3p (2005: 27p). The final dividend will be paid on 11 May 2007 to shareholders on the register at the close of business on 10 April 2007, the record date.

Business review

The chairman's statement and chief executive's review on pages 2 to 17 of the annual review and summary financial statements, report on the development and performance of the Group during the year ended 31 December 2006 and our likely future development. The elements covered in these reports, which are required by the business review, are incorporated into the directors' report by reference. The business review itself can be found on pages 1 to 23 of the governance and financial statements.

Significant acquisitions and disposals

Pearson has made a number of acquisitions during the year including: Mergermarket, a financial information company providing information to financial institutions, corporations and their advisors; Promissor, a computerised test provider focused on the regulatory market in the US; National Evaluation Systems, the leading provider of customised state assessments for teacher certification in the US; and Paravia Bruno Mondadori, one of Italy's leading educational publishers. Net consideration paid for all acquisitions during the year ended 31 December 2006 was £363m and provisional goodwill recognised was £246m. In total the acquisitions made in 2006 contributed an additional £147m of sales and £17m of operating profit.

Transactions with related parties

Details of transactions with related parties, which are reportable under IAS 24 'Related party disclosures', are given in note 34 to the accounts on page 110.

Capital expenditure

The analysis of capital expenditure and details of capital commitments are shown in notes 11,12 and 33 to the accounts on pages 77 to 81 and 109.

Events after the balance sheet date

On 15 February 2007 the Group completed the disposal of Pearson Government Solutions, its Government services business, to Veritas Capital. Sale proceeds consist of $560m in cash, $40m in preferred stock and 10% of the equity of the business.

Directors

The present members of the board, together with their biographical details, are shown on page 20 of the annual review and summary financial statements.

Details of directors' remuneration and interests in ordinary shares and options of the company are contained in the report on directors' remuneration on pages 32 to 51. Four directors, Patrick Cescau, Rona Fairhead, Susan Fuhrman and John Makinson will retire by rotation at the forthcoming annual general meeting (AGM) on 27 April 2007. All of them, being eligible, will offer themselves for re-election. Rana Talwar, who joined the board as a non-executive director in 2000, will retire at the forthcoming AGM and will not offer himself for re-election.

In addition, Robin Freestone, who joined the board as chief financial officer on 12 June 2006, will retire from office in accordance with the company's articles of association. He will offer himself for reappointment at the AGM.

Details of directors' service contracts can be found on page 41. No director was materially interested in any contract of significance to the company's business.

Corporate governance

Introduction A detailed account of how we comply with the provisions of the Combined Code on Corporate Governance (the Code) can be found on our website at www.pearson.com/investor/corpgov.htm

In terms of compliance with the Code during 2006, the only area where explanation is required relates to the independence of Vernon Sankey and Reuben Mark who had both served more than the recommended nine years when they resigned from the board in April. During the four months that Mr Sankey and Mr Mark were on the board, the board deemed them to be independent despite the length of their tenure. In all other areas the board believes that we are in full compliance with the Code.

Composition of the board The board consists of the chairman, Glen Moreno, five executive directors including the chief executive, Marjorie Scardino, and six independent non-executive directors. Terry Burns was appointed as our senior independent director in 2004.

Independence of directors The board considers all of the non-executive directors to be independent.

Board meetings

The board meets six times a year and at other times as appropriate. The following table sets out the attendance of our directors at the board and committee meetings during 2006:

	Board meetings (maximum 6)	Audit committee meetings (maximum 6)	Personnel committee meetings (maximum 4)	Nomination committee meetings (maximum 4)
Chairman				
Glen Moreno	6/6	–	–	4/4
Executive directors				
Marjorie Scardino	6/6	–	–	4/4
David Bell	5/6	–	–	–
Rona Fairhead	6/6	–	–	–
Robin Freestone[1]	4/4	–	–	–
John Makinson	6/6	–	–	–
Non-executive directors				
David Arculus[2]	4/5	3/4	2/3	2/2
Terry Burns[3]	5/6	1/2	4/4	3/4
Patrick Cescau	6/6	6/6	–	4/4
Susan Fuhrman[4]	5/6	3/4	–	3/4
Ken Hydon[5]	5/5	3/4	–	2/2
Reuben Mark[6]	1/2	1/2	0/1	1/2
Vernon Sankey[7]	2/2	2/2	–	2/2
Rana Talwar	4/6	–	3/4	2/4

1 Appointed to the board on 12 June 2006
2 Appointed to the board on 28 February 2006 and to the audit and personnel committees in April 2006
3 Resigned from the audit committee in April 2006
4 Appointed to the audit committee in April 2006
5 Appointed to the board on 28 February 2006 and to the audit committee in April 2006
6 Resigned on 21 April 2006
7 Resigned on 21 April 2006

The role and business of the board The formal matters reserved for the board's decision and approval are: the company's strategy; acquisitions, disposals and capital expenditure projects above certain thresholds; all guarantees over £10m; treasury policies; the interim and final dividends and the financial statements; borrowing powers; appointments to the board; and the appointment and removal of the company secretary.

The board receives timely, regular and necessary management and other information to fulfil its duties. Directors can obtain independent professional advice at the company's expense in the performance of their duties as directors. All directors have access to the advice and services of the company secretary.

In addition to these formal roles, we endeavour to give the non-executive directors access to the senior managers of the business via involvement at both formal and informal meetings. In this way we hope that the experience and expertise of the non-executive directors can be garnered to the benefit of the company. At the same time, the non-executive directors will develop an understanding of the abilities of the most senior managers that will help them judge the company's prospects and plans for succession.

Board evaluation
As we reported last year, with the introduction of a new chairman late in 2005, we have taken the opportunity to carry out a thorough review of the effectiveness of our board and of the board committees. The chairman has spent time with each of the directors over the last year in order to elicit their views and a number of proposals have been developed, some of which were implemented during the course of 2006. The chairman wrote to his fellow directors setting out his thoughts and observations on the effectiveness of the Pearson board, and the directors have had an opportunity to discuss this. The chairman is keen that particular emphasis be placed on ensuring that the board make their time together as productive as possible, and good progress has been made in setting a board calendar so that adequate time is set aside for the major topics to be covered. The board committees were restructured during the course of the year, and each has reviewed its remit and has a new chairman and terms of reference in place.

During the course of the year the executive directors were evaluated by the chief executive for performance against personal objectives under the company's standard appraisal mechanism. The chairman leads the assessment of the chief executive and the senior independent director conducts a review of the chairman's performance.

Directors' training Directors receive a significant induction programme and a range of information about the company when they join the board. This includes background information on Pearson and details of board procedures, directors' responsibilities and various governance-related issues, including procedures for dealing in Pearson shares and their legal obligations as directors. The induction also includes a series of meetings with members of the board, presentations regarding the business from senior executives and a briefing on Pearson's investor relations programme. We supplement the existing directors' training programme through continuing presentations about the company's operations at board meetings and by making available to the directors the opportunity for additional visits to operating company divisions as well as meetings with local management. Externally run courses are also made available should directors wish to make use of them.

Directors' indemnities The company grants an indemnity to all of its directors in accordance with section 337A of the Companies Act 1985 in relation to costs incurred by them in defending any civil or criminal proceedings and in connection with an application for relief under section 144(3) or (4) or section 727 of the Companies Act, so long as it is repaid not later than when the outcome becomes final if: i) they are convicted in the proceedings; ii) judgement is given against them; or iii) the court refuses to grant the relief sought.

The company has purchased and maintains Directors' and Officers' insurance cover against certain legal liabilities and costs for claims in connection with any act or omission by such directors and officers in the execution of their duties.

Dialogue with institutional shareholders There is an extensive programme for the chairman, executive directors and top managers to meet with institutional shareholders. The non-executive directors meet informally with shareholders both before and after the AGM, and respond to shareholder queries and requests. The chairman and senior independent director make themselves available to meet any significant shareholder as required. Makinson Cowell reports to the board each year the results of an extensive survey on major shareholders' views. Furthermore, reports on changes in shareholder positions and views are given to the board at every board meeting.

Board committees

The board has established three committees. Chairmen and members of these committees are appointed by the board on the recommendation (where appropriate) of the nomination committee and in consultation with each requisite committee chairman.

Following a review of the board committees by the new chairman during 2006, it was decided to disband the treasury committee, dividing its responsibilities between the board (with regard to approval of treasury policies) and the audit committee (to monitor compliance with these policies).

i Audit committee Following changes to our committee structure in April 2006, the audit committee now comprises Ken Hydon (chairman), David Arculus, Patrick Cescau and Susan Fuhrman.

All of the committee members are independent non-executive directors and have financial and/or related business experience due to the senior positions they hold or held in other listed or publicly traded companies and/or similar public organisations. Ken Hydon is our designated financial expert.

The committee has written terms of reference which clearly set out its authority and duties. These are reviewed annually and can be found on the company website at www.pearson.com/investor/corpgov.htm

The committee is established by the board primarily for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company. The committee is responsible for assisting the board's oversight of the quality and integrity of the company's external financial reporting and statements and the company's accounting policies and practices. The Group's internal and external auditors have direct access to the committee to raise any matter of concern and to report on the results of work directed by the committee. The committee reports to the full board of Pearson on a regular basis. It also reviews the objectivity of the external auditors, including non-audit services supplied, and ensures that there is an appropriate audit relationship.

The committee met six times during the year with the chief financial officer, head of internal audit and other members of the senior management team, together with the external auditors, in attendance. The committee met regularly in private with the external auditors and the head of internal audit during the year.

The requirement for training is kept under review and is provided to meet specific individual needs.

ii Personnel committee Following changes to our committee structure in April 2006, the members of the committee comprise David Arculus (chairman), Terry Burns, Rana Talwar and since 1 January 2007, Glen Moreno.

The committee has responsibility for determining the remuneration and benefits packages of the executive directors, the chief executives of the principal operating companies and other members of the management committee, as well as recommending the chairman's remuneration to the board for its decision.

The committee takes independent advice from consultants when required. No director takes part in any discussion or decision concerning their own remuneration. 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 32 to 51.

The committee meets at least three times a year and on other occasions when circumstances require, and has written terms of reference which clearly set out its authority and duties. These can be found on the company website at www.pearson.com/investor/corpgov.htm *iii Nomination committee* Following changes to our committee structure in April 2006, the nomination committee now comprises Glen Moreno (chairman), Marjorie Scardino, David Arculus, Terry Burns, Patrick Cescau, Susan Fuhrman, Ken Hydon and Rana Talwar.

The committee is comprised of the chairman, chief executive and all of the non-executive directors and meets as and when required. During 2006 the committee met four times. The committee primarily monitors the composition and balance of the board and its committees, and identifies and recommends to the board the appointment of new directors.

When considering the appointment of a new director the committee reviews the current balance of skills and experience of the board.

Whilst the chairman of the board chairs this committee he is not permitted to chair meetings when the appointment of his successor is being considered or during discussion regarding his performance.

In accordance with the company's articles of association, directors are subject to reappointment at the AGM immediately following the date of their appointment, and thereafter must seek re-election no more than three years from the date they were last re-elected. The committee will recommend to the board the names of the directors who are to seek re-election at the AGM.

The committee has written terms of reference which clearly set out its authority and duties. These can be found on the company website at www.pearson.com/investor/corpgov.htm

Internal control

The board of directors has overall responsibility for Pearson's system of internal control, which is designed to manage the risks facing the Group, safeguard assets and provide reasonable, but not absolute, assurance against material financial misstatement or loss.

In accordance with the provisions of the Code, the directors confirm that they have reviewed the effectiveness of the Group's internal control system. They also confirm that there is an ongoing process allowing for the identification, evaluation and management of significant business risks. This process accords with the revised Turnbull guidance and has been in place throughout 2006 and up to the date of approval of this annual report.

The Group's internal control framework covers financial, operational and compliance risks. Its main features are described below:

i Board – The board of directors, which has overall responsibility for Pearson's system of internal control, exercises that control through an organisational structure with clearly defined levels of responsibility and authority and appropriate reporting procedures. To maintain effective control over strategic, financial, operational and compliance matters the board meets regularly, and has a formal schedule of matters that is brought to it, or its duly authorised committees, for attention. Responsibility for monitoring financial management and reporting, internal control and risk management has been delegated to the audit committee by the board. At each meeting, the audit committee considers reports from management, internal audit and the external auditors, with the aim of reviewing the effectiveness of the internal financial and operating control environment of the Group.

ii Operating company controls – The identification and mitigation of major business risks is the responsibility of operating company management. Each operating company maintains internal controls and procedures appropriate to its structure and business environment, whilst complying with Group policies, standards and guidelines.

iii Financial reporting – There is a comprehensive strategic planning, budgeting and forecasting system with an annual operating plan approved by the board of directors. Monthly financial information, including trading results, balance sheets, cash flow statements and indebtedness, are reported against the corresponding figures for the plan and prior years, with corrective action outlined by operating company executives as appropriate. Group senior management meet, on a quarterly basis, with operating company management to review their business and financial performance against plan and forecast. Major business risks relevant to each operating company are reviewed in these meetings.

In addition, the chief executive prepares a monthly report 11 times a year for the board on key developments, performance and issues in the business.

iv Risk management – Operating companies undertake formal, semi-annual risk reviews to identify new or potentially under-managed risks. The results of these reviews are submitted to internal audit for evaluation and onward reporting to the board, via the audit committee. Throughout the year, risk sessions facilitated by internal audit are held with operating company management and with the Pearson Management Committee to discuss and review the significant risks facing the business.

v Internal audit – The internal audit function is responsible for providing independent assurance to management on the effectiveness of internal controls. The annual internal audit plan, derived from a risk model, is approved by the audit committee. Internal audit activity is supplemented by annual financial control self-assessment returns, completed by the businesses. Recommendations to improve internal controls and/or to mitigate risks are agreed with operating company management after each audit. Formal follow-up procedures allow internal audit to monitor operating companies' progress in implementing its recommendations and to resolve any control deficiencies. The internal audit function also has a remit to monitor significant group projects in order to provide assurance that appropriate project governance and risk management strategies are in place. Regular reports on the work of internal audit are provided to executive management and, via the audit committee, to the board.

The head of internal audit is jointly responsible with the group legal counsel for monitoring compliance with our Code of Business Conduct, and investigating any reported incidents.

vi Treasury management – The treasury department operates within policies approved by the board and its procedures are reviewed regularly by the audit 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 audit committee and the board.

vii Insurance – Insurance is provided through Pearson's insurance subsidiary or externally, depending on the scale of the risk and the availability of cover in the external market, with the objective of achieving the most cost effective balance between insured and uninsured risks.

Sarbanes-Oxley – Section 404

As a requirement of our US listing we must comply with the provisions of the Sarbanes-Oxley Act, including Section 404 relating to the effectiveness of our internal controls over financial reporting. At the date of this report, our 2006 404 attestation is tracking to plan. The only outstanding work relates to the testing of controls around the compilation of our Form 20-F, which will be filed later in 2007.

Going concern

Having reviewed the Group's cash, cash equivalents and borrowing facilities, and the 2007 and 2008 cash flow forecasts contained in the 2007 operating plan, the directors believe that Pearson has adequate resources to continue as a going concern for the foreseeable future. For this reason, the financial statements have, as usual, been prepared on that basis.

Shareholder communication

Pearson has an extensive programme of communication with all its shareholders – large and small, institutional and private. We also make a particular effort to communicate regularly with our employees, a large majority of whom are shareholders in the company. We post all company announcements on our website, www.pearson.com, as soon as they are released, and major shareholder presentations are made accessible via webcast or conference call. Our website 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 information about all of our businesses, links to their websites, and details of our corporate responsibility policies and activities.

In 2006 we continued our programme of educational seminars for our institutional shareholders focusing on individual parts of Pearson. The seminars are available to all shareholders via webcast on www.pearson.com

Our AGM – which will be held on 27 April this year – includes opportunities to meet the company's managers, presentations about Pearson's businesses and the previous year's results as well as general AGM business.

People

During 2006, Pearson employed over 34,000 people in 58 countries. Each business has detailed employment practices for recruitment, remuneration, employee relations, health and safety, and terms and conditions designed for the different sectors and countries in which it operates.

We are committed to equality of opportunity for all regardless of gender, race, age, physical ability, religion or sexual orientation. This applies equally to recruitment and to the promotion, development and training of people who are already part of Pearson. The company takes seriously its 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. Every effort is made to find suitable alternative jobs and, as necessary, training for those who are unable to continue in their existing role due to disability.

Pearson is committed to clear and timely communication with its people concerning business performance. It works hard to maintain effective channels of communication and supports employee representation to help positive employee relations.

We believe that the best way for people to profit from the success of the company is for them to become shareholders. Pearson operates worldwide share plans taking account of local country tax and securities regulations. With most of our people based in the US, we have taken special care to make it easy for them to acquire shares in Pearson. The listing of our shares on the New York Stock Exchange allows us to operate a US Employee Stock Purchase Plan that makes share ownership in Pearson accessible to the majority of our employees.

Supplier payment policy

Operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted. It is company policy that suppliers are aware of such terms of payment and that payments to them are made in accordance with these, provided that the supplier is also complying with all relevant terms and conditions. Group trade creditors at 31 December 2006 were equivalent to 31 days of purchases during the year ended on that date. The company does not have any significant trade creditors and therefore is unable to disclose average supplier payment terms.

External giving

In 2006, Pearson's cash charitable giving totalled £3.6m (2005: £3.3m). In addition to cash donations, Pearson also provides in-kind support such as books, publishing expertise, advertising space and staff time. Through the Pearson Foundation, we focus our charitable giving on education and literacy projects around the world: in a brain-powered world, we believe that no job is more important than helping people to learn. We encourage our employees to support their personal charities by matching donations and payroll giving and by providing volunteering opportunities.

More details can be found in our 2006 CSR report at www.pearson.com/community/csr_report2006

Share capital

Details of share issues are given in note 25 to the accounts on page 103. At the AGM held on 21 April 2006, 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 27 April 2007.

At 28 February 2007, the company had been notified of the following substantial shareholdings.

	Number of shares	Percentage
Franklin Resources, Inc.	103,908,285	12.92
FMR Corp. and Fidelity International Limited	49,800,888	6.19
Legal and General Group plc	28,868,364	3.57

Annual general meeting

The notice convening the AGM to be held at 12 noon on Friday, 27 April 2007 at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE, is contained in a circular to shareholders to be dated 26 March 2007.

Registered auditors

In accordance with section 384 of the Companies Act 1985 (the Act) resolutions proposing the reappointment of PricewaterhouseCoopers LLP as auditors to the company will be proposed at the AGM, at a level of remuneration to be agreed by the directors.

Auditor independence

In line with best practice, the audit committee has introduced a policy that defines those non-audit services that the independent auditors, PricewaterhouseCoopers LLP, may or may not provide to Pearson. The policy requires the provision of these services to be approved in advance by the audit committee. The policy also establishes other procedures to ensure that the auditors' independence has not been compromised. A full statement of the fees for audit and non-audit services is provided in note 5 to the accounts on page 71.

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 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 Act, and the report on directors' remuneration. They are also responsible for safeguarding the assets of the Group, and hence for taking reasonable steps towards preventing and detecting fraud and other irregularities. In preparing the financial statements on pages 52 to 55 and 58 to 119 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.

The directors confirm that the auditors have concluded that the directors' report is consistent with the financial statements.

The directors also confirm that, for all directors in office at the date of this report:

So far as each director is aware, there is no relevant audit information of which the company's auditors are unaware.

Each director has taken all the steps that they ought to have taken in their duty as directors to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Approved by the board on 9 March 2007 and signed on its behalf by

Philip Hoffman, *Secretary*