

Notes to the Company Financial Statements

1 Accounting policies

a. Basis of preparation

The financial statements on pages 111 to 118 comprise the separate financial statements of Pearson plc. As permitted by section 230(4) of the Companies Act 1985, only the Group's income statement has been presented.

The Company has no employees.

b. Group accounting policies

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

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

2 Investments in subsidiaries

All figures in £ millions	2006	2005
At beginning of year	6,883	7,134
Subscription for share capital in subsidiaries	1,019	61
External acquisition	–	30
Share repurchase from subsidiary	–	(331)
Disposal to subsidiary	(779)	(11)
Provision for impairment	(20)	–
At end of year	7,103	6,883

3 Cash and cash equivalents (excluding overdrafts)

All figures in £ millions	2006	2005
Cash at bank and in hand	48	134
Short-term bank deposits	105	464
	153	598

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

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

	2006	2005
Cash and cash equivalents	153	598
Bank overdrafts	(336)	(326)
	(183)	272

4 Financial liabilities – Borrowings

All figures in £ millions	2006	2005
Non-current		
6.125% Euro Bonds 2007 (nominal amount €591m)	–	436
10.5% Sterling Bonds 2008 (nominal amount £100m)	105	107
7% Global Dollar Bonds 2011 (nominal amount \$500m)	266	307
7% Sterling Bonds 2014 (nominal amount £250m)	251	250
4.625% US Dollar notes 2018 (nominal amount \$300m)	139	161
	761	1,261
Current		
Due within one year or on demand:		
Bank loans and overdrafts	363	366
6.125% Euro Bonds 2007 (nominal amount €591m)	421	–
Total borrowings	1,545	1,627

Included in the non-current borrowings above is £10m of accrued interest (2005: £33m).

Included in the current borrowings above is £22m of accrued interest (2005: £nil).

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

All figures in £ millions	2006	2005
Between one and two years	105	436
Between two and five years	266	107
Over five years	390	718
	761	1,261

As at 31 December 2006 the exposure of the borrowings of the Company to interest rate changes when the borrowings re-price is as follows:

All figures in £ millions	Total	One year	One to five years	More than five years
Carrying value of borrowings	1,545	784	371	390
Effect of rate derivatives	–	629	(221)	(408)
	1,545	1,413	150	(18)

Notes to the Company Financial Statements *Continued*

4 Financial liabilities – Borrowings *continued*

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

All figures in £ millions	Effective interest rate	Carrying amount 2006	Market value 2006	Carrying amount 2005	Market value 2005
6.125% Euro Bonds 2007	6.18%	–	–	436	419
10.5% Sterling Bonds 2008	10.53%	105	106	107	113
7% Global Dollar Bonds 2011	7.16%	266	269	307	310
7% Sterling Bonds 2014	7.20%	251	265	250	282
4.625% US Dollar notes 2018	4.69%	139	135	161	155
		761	775	1,261	1,279

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

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

All figures in £ millions	2006	2005
US dollar	462	834
Sterling	654	357
Euro	429	436
	1,545	1,627

5 Derivative financial instruments

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

All figures in £ millions	2006		
	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	953	20	(17)
Interest rate derivatives – not in hedge relationship	1,026	9	(2)
Cross currency rate derivatives	410	57	–
Total	2,389	86	(19)

5 Derivative financial instruments *continued*

	2005		
All figures in £ millions	Gross notional amounts	Assets	Liabilities
Interest rate derivatives – in a fair value hedge relationship	1,109	31	(16)
Interest rate derivatives – not in hedge relationship	1,185	14	(6)
Cross currency rate derivatives	410	34	–
Total	2,704	79	(22)

The carrying value of the above derivative financial instruments equals their fair value. Fair values are determined by using market data and the use of established estimation techniques such as discounted cash flow and option valuation models. The net current portion of the above derivatives amounts to £50m (2005: £nil).

6 Share capital and share premium

	Number of shares 000s	Ordinary shares £m	Share premium £m
At 1 January 2005	803,250	201	2,473
Issue of shares – share option schemes	770	–	4
At 31 December 2005	804,020	201	2,477
Issue of shares – share option schemes	2,089	1	10
At 31 December 2006	806,109	202	2,487

The total authorised number of ordinary shares is 1,190m shares (2005: 1,186m shares) with a par value of 25p per share (2005: 25p per share). All issued shares are fully paid. All shares have the same rights.

7 Treasury shares

	Number of shares 000s	£m
At 1 January 2005	4,623	60
Purchase of treasury shares less contributions received	626	(5)
At 31 December 2005	5,249	55
Purchase of treasury shares less contributions received	4,700	26
Release of treasury shares	(1,188)	(16)
At 31 December 2006	8,761	65

The Company holds its own shares in trust to satisfy its obligations under its restricted share plans. These shares are held as treasury shares and have a par value of 25p per share. The nominal value of the Company's treasury shares amounts to £2.2m (2005: £2.1m). At 31 December 2006 the market value of the Company's treasury shares was £67.6m (2005: £36.2m).

Notes to the Company Financial Statements *Continued*

8 Other reserves and retained earnings

All figures in £ millions	Special reserve	Retained earnings	Total
At 1 January 2005	447	1,596	2,043
Loss for the financial year	–	(362)	(362)
Dividends paid	–	(205)	(205)
Transition adjustment on adoption of IAS 39	–	(3)	(3)
Balance at 31 December 2005	447	1,026	1,473
Profit for the financial year	–	78	78
Dividends paid	–	(220)	(220)
At 31 December 2006	447	884	1,331

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

Included within retained earnings in 2006 is an amount of £99m (2005: £nil) relating to profit on intra-group disposals that is not distributable.

During 2005, a dividend of £407m was repaid to a subsidiary as it was subsequently found that the subsidiary did not have adequate distributable reserves as defined under the Companies Act and the guidance set out in the Institute of Chartered Accountants in England and Wales – Technical Release 7/03 ('Guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 1985').

9 Contingencies

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

10 Audit fees

Statutory audit fees relating to the Company were £35,000 (2005: £30,000). Audit-related regulatory reporting fees relating to the Company were £nil (2005: £225,000).

11 Related party transactions

Subsidiaries The Company transacts and has outstanding balances with its subsidiaries. Amounts due from subsidiaries and amounts due to subsidiaries are disclosed on the face of the Company Balance Sheet. These loans are generally unsecured and interest is calculated based on market rates. The Company has interest payable to subsidiaries during the year of £149m (2005: £111m) and interest receivable from subsidiaries during the year of £61m (2005: £36m). Management fees payable to subsidiaries in respect of centrally provided services amounted to £33m (2005: £37m). Dividends received from subsidiaries in 2006 were £28m (2005: £266m) excluding the repayment of dividends referred to above.

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

There were no other material related party transactions.