The directors are pleased to present their report to shareholders, together with the financial statements for the year ended 31 December 2005 on pages 38 to 41 and 44 to 116 respectively. Details of the businesses, the development of the Group and its subsidiaries and likely future developments are given on pages 1 to 13 and on pages 16 to 30 of the annual review and summary financial statements. Sales and profits of the different sectors and geographical markets are given on pages 53 to 56.

Results and dividend

The profit for the financial year ended 31 December 2005 was £644m (2004: £284m) and has been transferred to reserves. A final dividend of 17p per share is recommended for the year ended 31 December 2005. This, together with the interim dividend already paid, makes a total for the year of 27p (2004: 25.4p). The final dividend will be paid on 5 May 2006 to shareholders on the register at the close of business on 7 April 2006, the record date.

Significant acquisitions and disposals

In April 2005, Pearson disposed of its 79% interest in Recoletos Grupo de Comunicación, S.A. to Retos Cartera, a consortium of investors, for net cash proceeds of £371m. In January 2005, Pearson sold its 22% stake in MarketWatch to Dow Jones & Co. for $101m.

Transactions with related parties

Details of transactions with related parties, which are reportable under IAS 24 'Related party disclosures', are given in note 32 to the accounts on page 97.

Capital expenditure

The analysis of capital expenditure and details of capital commitments are shown in notes 11, 12, 17 and 31 to the accounts on pages 65 to 69, 75 and 97.

Events after the balance sheet date

On 9 January 2006, Pearson announced the purchase of 1,130,739 shares in Interactive Data Corporation (IDC) for $21.67 per share in cash. This purchase brings Pearson's total holding in IDC to almost 62%. On 23 January 2006, Pearson announced the acquisition of Promissor, a leading professional testing business from Houghton Mifflin Company for $42m in cash.

Directors

The present members of the board, together with their biographical details, are shown on page 31 of the annual review and summary financial statements. Dennis Stevenson, who was formerly chairman, retired with effect from 1 October 2005 and Glen Moreno was appointed as chairman in his place.

Details of directors' remuneration and interests in ordinary shares and options of the company are contained in the report on directors' remuneration on pages 21 to 37. Five directors, David Bell, Terry Burns, Reuben Mark, Vernon Sankey and Rana Talwar will retire by rotation at the forthcoming annual general meeting (AGM) on 21 April 2006. Three of them, being eligible, will offer themselves for re-election. Reuben Mark, who joined the board as a non-executive director in 1988, and Vernon Sankey, who joined the board as a non-executive director in 1993, will not offer themselves for re-election at the AGM. In addition, Glen Moreno, who joined the board as chairman on 1 October 2005, 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 26. 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 (hereinafter referred to as the Code) can be found on our website at www.pearson.com/investor/corpgov.htm, or by telephoning our company secretarial department on +44 (0)20 7010 2257 or 2253.

In terms of compliance with the Code during 2005, the only area where explanation is required, since the resignation of Peter Jovanovich, in January 2005, who had a service contract that provided for two years' severance pay, is the independence of both Reuben Mark and Vernon Sankey as non-executive directors, which is covered below. Except for this, the board believes that we are in full compliance with the Code.

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

Independence of directors As announced last year both Vernon Sankey and Reuben Mark will stand down from the board at the 2006 AGM. Both have served on the board for more than the recommended nine years under the Code, but both have continued to perform as exceptional independent directors. The board considered their independence during 2005, as they are required to do under the Code, and concluded that both continued to demonstrate a robust independence and to make a substantial, constructively critical contribution as directors. As a result of their standing down, and in order to restore balance to the board, we are expecting to announce the appointment of two new non-executive directors in the near future.

Following the approval of their appointments at the AGM, the board will then consist of six independent directors, four executive directors and the chairman.

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 2005:

	Board meetings (maximum 6)	Audit committee meetings (maximum 4)	Treasury committee meetings (maximum 1)	Personnel committee meetings (maximum 5)	Nomination committee meetings (maximum 2)
Chairman					
Dennis Stevenson*	5		1		2
Glen Moreno†	1				
Executive directors					
Marjorie Scardino	6				2
David Bell	6				
Rona Fairhead	6		1		
John Makinson	6				
Non-executive directors					
Terry Burns	5 and part of 1	3 and part of 1		5	2
Patrick Cescau	6	4			2
Susan Fuhrman	6				2
Reuben Mark	3 and part of 3	3 and part of 1		3	2
Vernon Sankey	6	4	1		2
Rana Talwar	6		1	5	2

*Until 1 October 2005.
†Glen Moreno was appointed chairman on 1 October 2005.

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 the services of the company secretary.

In addition to these formal roles, we aim 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 With the introduction of a new chairman late in the year, our focus is on continuing to enhance board and committee effectiveness going forward. The chairman has begun a process of meeting with the directors to discuss their views on board performance and effectiveness and to develop proposals for implementation during 2006. The results of this review will be reported back to the board at a forthcoming meeting. We also plan during the year, to review the composition and structure of each of our board committees. During 2005 the executive directors were evaluated by the chief executive for performance against personal objectives under the company's standard appraisal mechanism.

Directors' training Directors receive an induction programme and a range of information about the company when they join the board. This includes background information on Pearson and its directors and details of board procedures, directors' responsibilities and various governance-related issues, including procedures for dealing in Pearson shares; their legal obligations as directors; as well as continuing updates to the induction programme through presentations about the company's operations at board meetings and ongoing information. 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 by making available to the directors the opportunity for additional visits to operating company divisions and meetings with local management, as well as facilitating access to externally run courses should a director 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.

Dialogue with institutional shareholders There is an extensive programme for executive directors, including the chairman, 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 and at every board meeting on changes in market positions and shareholders' views.

Board committees

The board has established four 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.

i Audit committee During the year, the committee comprised: Vernon Sankey (chairman), Terry Burns, Patrick Cescau, Reuben Mark.

All of the committee members are independent non-executive directors and have significant financial experience due to the senior positions they hold or held in other listed or publicly traded companies.

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.

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. The committee 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 four times during the year with the chief financial officer, head of group control and other members of the senior management team, together with the external auditors, in attendance. The committee meets privately with the external auditors and the head of group control at least once a year or more regularly if required at its or their request.

Following the departure of Vernon Sankey from the board at the 2006 AGM, the board plans to review the composition and structure of the audit committee and will appoint a new chairman of the committee in due course.

ii Personnel committee During the year, the committee comprised: Reuben Mark (chairman), Terry Burns, Rana Talwar.

The committee is comprised solely of independent non-executive directors and meets at least three times a year and on other occasions when circumstances require.

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. It also reviews the company's management development, diversity and succession plans.

The committee takes independent advice from consultants when required. No executive 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 21 to 37.

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.

Following the departure of Reuben Mark from the board at the 2006 AGM, the board plans to review the composition and structure of the personnel committee and will appoint a new chairman of the committee in due course.

iii Nomination committee During the year the committee comprised: Dennis Stevenson (chairman), Marjorie Scardino, Terry Burns, Patrick Cescau, Susan Fuhrman, Reuben Mark, Vernon Sankey, Rana Talwar.

The committee is comprised of the chairman, chief executive and all of the non-executive directors and meets as and when required. 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. 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 they 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.

During the year Glen Moreno was appointed to the board as chairman. When considering the appointment of a new chairman the committee reviews the current balance of skills and experience on the board. A detailed specification is drawn up to include any specific knowledge or expertise that is considered necessary for the board. External search consultants are then used to identify suitable candidates who are shortlisted and then evaluated by the committee before it submits its recommendation to the board as a whole.

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.

iv Treasury committee During the year the committee comprised: Dennis Stevenson (chairman), Rona Fairhead, Vernon Sankey, Rana Talwar.

The committee sets the policies for the company's treasury department and reviews its procedures on a regular basis. The treasury committee schedules one meeting a year and arranges to meet at other times, if necessary.

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 Combined Code, the directors confirm that they have reviewed its effectiveness.

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 2005 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 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, group control 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 meets, 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 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 group control for evaluation and onward reporting to the board, via the audit committee. Throughout the year, risk sessions facilitated by group control, are held with operating company management and with the Pearson executive committee to discuss and review the significant risks facing the business.

v Group control – The group control 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 group control to monitor operating companies' progress in implementing its recommendations and resolve any control deficiencies. Regular reports on its findings are provided to executive management and, via the audit committee, to the board.

The head of group control 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 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.

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

As a requirement of our US listing we are required to comply with various provisions of the Sarbanes Oxley Act, including Section 404 relating to the effectiveness of our financial reporting internal controls. This will apply to Pearson for the first time in 2006. Significant work has already been undertaken to ensure compliance and we continue on track to meet our deadlines.

Going concern

Having reviewed the Group's liquid resources and borrowing facilities, and the 2006 and 2007 cash flow forecasts contained in the 2006 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 2005, 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 21 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 2005, Pearson employed over 33,000 people in 60 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. Twice a year, the European Employee Forum meets to discuss issues of importance to staff in their businesses across Europe.

The directors 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 regulation. With more than half 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 2005 were equivalent to 30 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 2005, Pearson's charitable giving totalled £3.3m (2004: £2.5m). In addition to cash donations, Pearson provides in-kind support such as books, publishing expertise, advertising space and staff time. We focus our charitable giving on projects related to education. We encourage our employees to support their personal charities by matching donations and payroll giving.

More details can be found on our website at www.pearson.com/community/csr_report2005.

Share capital

Details of share issues are given in note 25 to the accounts on page 92. At the AGM held on 29 April 2005, 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 21 April 2006.

At 26 February 2006, 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
Franklin Resources, Inc.	104,485,808	13.00%
The Capital Group Companies Inc.	55,653,209	6.92%

Annual general meeting – The notice convening the AGM to be held at 12 noon on Friday, 21 April 2006 at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE, is contained in a circular to shareholders to be dated 21 March 2006.

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 on page 59 to the accounts.

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. 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 38 to 41 and 44 to 116 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.

Approved by the board on 26 February 2006 and signed on its behalf by

Philip Hoffman, *Secretary*