Other financial information

	2012 £m	2011 £m
Net finance costs		
Net interest payable	(65)	(55)
Finance income in respect of employee benefit plans	13	3
Net finance costs reflected in adjusted earnings	(52)	(52)
Other net finance costs	(29)	(19)
Total net finance costs	(81)	(71)

Net finance costs reported in our adjusted earnings comprise net interest payable and net finance income relating to post-retirement plans.

Net interest payable in 2012 was £65m, up from £55m in 2011. Although our fixed rate policy reduces the impact of changes in market interest rates, we were still able to benefit from low average US dollar and sterling interest rates during the year. Year-on-year, average three month LIBOR (weighted for the Group's net borrowings in US dollars and sterling at each year end) rose by 0.2% to 0.5%. This increase in floating market interest rates combined with an increase in the Group's average net debt helped drive the Group's higher interest charge. These factors combined with a decrease in interest income on deposits and the impact of new notes issued in 2012 created an increase in the Group's average net interest payable from 6.5% to 7.0%. The Group's average net debt rose by £92m, largely reflecting the acquisition activity during 2012.

Net finance income relating to post-retirement plans was £13m in 2012 compared to £3m in 2011. Also included in the statutory definition of net finance costs are finance costs on put options and deferred consideration associated with acquisitions, foreign exchange and other gains and losses. Finance costs for put options and deferred consideration are excluded from adjusted earnings as they relate to future earn outs and similar payments on acquisitions and therefore do not reflect cash expended. Foreign exchange and other gains and losses are excluded from adjusted earnings as they represent short-term fluctuations in market value and are subject to significant volatility. These other gains and losses may not be realised in due course as it is normally the intention to hold the related instruments to maturity. In 2012, the total of these items excluded from adjusted earnings was a loss of £29m compared to a loss of £19m in 2011. The majority of the loss in 2012 relates to movements in the valuation of put options associated with acquisitions. In 2011 the loss relates mainly to foreign exchange differences on a proportion of the unhedged US dollar proceeds from the Interactive Data sale in 2010.

Funding position and liquid resources

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. Our objective is to secure continuity of funding at a reasonable cost from diverse sources and with varying maturities. The Group does not use off-balance sheet special purpose entities as a source of liquidity or for any other financing purposes. The net debt position of the Group is set out below.

	2012 £m	2011 £m
Cash and cash equivalents	1,062	1,369
Marketable securities	6	9
Net derivative assets	178	174
Bonds	(2,200)	(1,955)
Bank loans and overdrafts	(55)	(78)
Finance leases	(17)	(18)
Net debt – continuing	(1,026)	(499)
Net cash classified as held for sale	108	–
Total net debt	(918)	(499)

Acquisition activity in 2012, is a large contributor to the increase in the Group's net debt. Reflecting the geographical and currency split of our business, a large proportion of our debt is denominated in US dollars (see note 19 for our policy). The strengthening of sterling against the US dollar during 2012 (from $1.55 to $1.63:£1) decreases the sterling equivalent value of our reported net debt.

Other financial information
continued

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's policy is to strive to maintain a rating of Baa1/ BBB+ over the long term.

In May 2012, the Group accessed the capital markets, raising $500m through the sale of notes maturing in May 2022 and bearing interest at 3.75%. The notes were swapped to floating rate to conform with the policy described in note 19.

The Group has a $1,750m committed revolving credit facility which matures in November 2015. At 31 December 2012 this facility was undrawn. The facility is used for short-term drawings and providing refinancing capabilities, including acting as a back-up for our US commercial paper programme. This programme is primarily used to finance our US working capital requirements, in particular our US educational businesses which have a peak borrowing requirement in June. At 31 December 2012, no commercial paper was outstanding.

The Group also maintains other committed and uncommitted facilities to finance short-term working capital requirements in the ordinary course of business.

Further details of the Group's approach to the management of financial risks are set out in note 19 to the financial statements.

Taxation

The effective tax rate on adjusted earnings in 2012 was 23.1% as compared to an effective rate of 22.4% in 2011. Our overseas profits, which arise mainly in the US, are largely subject to tax at higher rates than that in the UK (which had an effective statutory rate of 24.5% in 2012 and 26.5% in 2011). These higher tax rates were offset by amortisation-related tax deductions and by prior year adjustments including those arising from settlements with tax authorities.

The reported tax charge on a statutory basis was £148m (34.1%) compared to a charge of £162m (15.5%) in 2011. The increase in the statutory rate is largely due to the lack of tax relief on the loss on closure of Pearson in Practice together with the effect of a low tax charge in 2011 on the gain on disposal of FTSE International.

Tax paid in 2012 was £65m compared to £151m in 2011. The reduction in the 2012 tax paid is largely the result of the permitted deferral of US tax payments into 2013 following Hurricane Sandy.

Discontinued operations

In October 2012, Pearson and Bertelsmann announced an agreement to create a new consumer publishing business by combining Penguin and Random House. The transaction is expected to complete in 2013 and, at that point, Pearson will no longer control the Penguin Group of companies but will equity account for its 47% associate interest. The loss of control results in the Penguin business being classified as held for sale on the Pearson balance sheet at 31 December 2012 and the results for both 2011 and 2012 have been included in discontinued operations. Also included in discontinued operations are the costs associated with the formation of the Penguin Random House venture including provision for the settlement of litigation associated with the agency arrangements for ebooks.

Non-controlling interest

There are non-controlling interests in the Group's businesses in South Africa, China and India although none of these are material to the Group numbers.

Other comprehensive income

Included in other comprehensive income are the net exchange differences on translation of foreign operations. The loss on translation of £238m in 2012 compares to a loss in 2011 of £44m. The Group is principally exposed to movements in the US dollar as a significant proportion of the Group's operations are based in the US. In 2011 the US dollar strengthened only slightly from an opening rate of £1:$1.57 to a closing rate at the end of that year of £1:$1.55. Other currency movements were relatively more significant in 2011 causing a small loss. In 2012 the US dollar has weakened to close at £1:$1.63 and was the most significant contributor to the increase in the loss.

Also included in other comprehensive income in 2012 is an actuarial loss of £122m in relation to post-retirement plans. This loss arose largely because of unfavourable changes in the discount rate and other assumptions used in the actuarial valuation that offset the effect of continuing asset returns and deficit funding in the UK plan. In 2011 the loss of £64m was also due to discount rate and other assumption changes outweighing improved asset returns and deficit funding.

Dividends

The dividend accounted for in our 2012 financial statements totalling £346m represents the final dividend in respect of 2011 (28.0p) and the interim dividend for 2012 (15.0p). We are proposing a final dividend for 2012 of 30.0p, bringing the total paid and payable in respect of 2012 to 45.0p, a 7% increase on 2011. This final 2012 dividend was approved by the board in February 2013, is subject to approval at the forthcoming AGM and will be charged against 2013 profits. For 2012, the dividend is covered 1.9 times by adjusted earnings.

We seek to maintain a balance between the requirements of our shareholders for a rising stream of dividend income and the reinvestment opportunities which we identify around the Group and through acquisitions. The board expects to raise the dividend above inflation, more in line with earnings growth, thereby maintaining dividend cover at around two times earnings in the long term.

Pensions

Pearson operates a variety of pension plans. Our UK Group plan has by far the largest defined benefit section. We have some smaller defined benefit sections in the US and Canada but, outside the UK, most of our companies operate defined contribution plans.

The charge to profit in respect of worldwide pensions and post-retirement benefits for continuing operations amounted to £84m in 2012 (2011: £82m) of which a charge of £97m (2011: £85m) was reported in operating profit and a net benefit of £13m (2011: £3m) was reported against net finance costs. In addition to these amounts, in 2012 a charge of £11m (2011: £11m) has been reported in operating profit in respect of discontinued operations.

The overall surplus on the UK Group plan of £25m at the end of 2011 has become a deficit of £19m at 31 December 2012. The deficit has arisen due to unfavourable movements in the discount rate and other assumptions used to value the liabilities, offset by continuing asset returns and deficit funding. In total, our worldwide deficit in respect of pensions and post-retirement benefits increased from £141m in 2011 to £198m at the end of 2012; this amount includes a deficit of £26m which specifically relates to Penguin and has been classified as a liability held for sale.

Acquisitions

In May 2012, the Professional business acquired Certiport Inc. for $140m. Certiport is based in the US and is a leading provider of certification and assessment programmes in IT and digital literacy. In July 2012, the International Education business completed the purchase of GlobalEnglish Corporation, a leading provider of cloud-based, on demand business English learning, assessment and performance support software for a net cash consideration of $90m. Also in July 2012, Penguin acquired Author Solutions, Inc., the world's leading provider of professional self-publishing services, for $116m in cash. The $650m acquisition of EmbanetCompass by the North American Education business was completed in November 2012. EmbanetCompass partners with leading non-profit colleges in North America to provide online learning solutions for university programmes.

Net cash consideration for all acquisitions made in the year ended 31 December 2012 was £759m and provisional goodwill recognised was £505m. In total, acquisitions completed in the year contributed an additional £45m of sales and £5m of operating profit before acquisition costs and intangible amortisation.

Return on invested capital (ROIC)

Our ROIC is calculated as total adjusted operating profit less cash tax, expressed as a percentage of average gross invested capital. ROIC remained flat at 9.1% in both 2011 and 2012. The impact of lower cash tax payments in 2012 has been offset by slightly lower profit and increased investment in new acquisitions.

Other financial information
continued

Capital expenditure

Net capital expenditure in the year on property, plant equipment and software amounted to £152m. The analysis of capital expenditure and details of capital commitments are shown in notes 10, 11 and 36 of the financial statements.

Related party transactions

Transactions with related parties are shown in note 37 of the financial statements.

Post balance sheet events

In January 2013, the Group completed the purchase of a 5% equity investment in NOOK Media, LLC for $89.5m. NOOK Media is a new company consisting of Barnes & Noble's digital businesses including its NOOK e-reader and tablets, the NOOK digital bookstore and its 674 college bookstores across America.

In February 2013 the Group completed the purchase of the remaining minority interest in Tutorvista, the Bangalore-based tutoring services company for £17m.

Supplier payment policy

Operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted. These supplier payment terms vary by operating company, reflecting the different industries and countries in which they operate. 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 the relevant terms and conditions. Group trade creditors at 31 December 2012 were equivalent to approximately 34 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.