## A SIGNIFICANT ACCOUNTING POLICIES

*Principles of Consolidation*

The consolidated financial statements include the accounts of International Business Machines Corporation and its controlled subsidiary companies, which in general are majority owned. Investments in business entities in which the company does not have control, but has the ability to exercise significant influence over operating and financial policies (generally 20-50 percent ownership), are accounted for by the equity method. Other investments are accounted for by the cost method. The accounting policy for other investments in securities is described on page 70 within Marketable Securities.

*Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions that the company may undertake in the future, actual results may be different from the estimates.

*Revenue*

The company recognizes revenue when it is realized or realizable and earned. The company considers revenue realized or realizable and earned when it has persuasive evidence of an arrangement, the product has been shipped or the services have been provided to the customer, the sales price is fixed or determinable and collectibility is reasonably assured. The company reduces revenue for estimated customer returns. In addition to the aforementioned general policy, the following are the specific revenue recognition policies for each major category of revenue.

#### HARDWARE

Revenue from hardware sales or sales-type leases is recognized when the product is shipped to the customer and there are either no unfulfilled company obligations or any obligations will not affect the customer's final acceptance of the arrangement. Any cost of these obligations is accrued when the corresponding revenue is recognized. Revenue from rentals and operating leases is recognized monthly as the fees accrue.

#### SERVICES

Revenue from time and material service contracts is recognized as the services are provided. Revenue from fixed price long-term service contracts is recognized over the contract term based on the percentage of services that are provided during the period compared with the total estimated services to be provided over the entire contract. Losses on fixed price contracts are recognized during the period in which the loss first becomes apparent. Revenue from maintenance is recognized over the contractual period or as the services are performed. Revenue in excess of billings on service contracts is recorded as unbilled receivables and is included in trade accounts receivable. Billings in excess of revenue that is recognized on service contracts are recorded as deferred income until the aforementioned revenue recognition criteria are met.

#### SOFTWARE

Revenue from delivered elements of one-time charge licensed software is recognized at the inception of the license term, provided the company has vendor-specific objective evidence of the fair value of each undelivered element. Revenue is deferred for undelivered elements. Revenue is also deferred for the entire arrangement if vendor-specific objective evidence does not exist for each undelivered contract element. Examples of undelivered elements in which the timing of delivery is uncertain include contractual elements that give customers rights to any future upgrades at no additional charge, future maintenance that is provided within the overall price, and standard performance and function guarantees. The revenue that is deferred for any contract element is recognized when all of the revenue recognition criteria have been met for that element, which typically occurs within two to three years. Revenue from monthly software licenses is recognized on a subscription basis.

#### FINANCING

Revenue from financing is recognized at level rates of return over the term of the lease or receivable.

*Selling, General and Administrative Expense*

Selling, general and administrative expense is charged to income as incurred. Expenses of promoting and selling products are classified as selling expense and include such items as advertising, sales commissions and travel. General and administrative expense includes such items as officers' salaries, office supplies, taxes, insurance and office rental. In addition, general and administrative expense includes recurring other operating items such as gains and losses from sales and disposals of assets other than securities, licensing of intellectual property, amortization of goodwill and currency exchange gains/losses.

*Income Taxes*

Income tax expense is based on reported income before income taxes. Deferred income taxes reflect the effect of temporary differences between assets and liabilities that are recognized for financial reporting purposes and the amounts that are recognized for income tax purposes. These deferred taxes are measured by applying currently enacted tax laws. Valuation allowances are recognized to reduce the deferred tax assets to the amount that is more likely than not to be realized. In assessing the likelihood of realization, management considers estimates of future taxable income.

*Translation of Non-U.S. Currency Amounts*
Assets and liabilities of non-U.S. subsidiaries that operate in a local currency environment are translated to U.S. dollars at year-end exchange rates. Income and expense items are translated at weighted-average rates of exchange prevailing during the year. Translation adjustments are recorded in Accumulated gains and losses not affecting retained earnings within stockholders' equity.

Inventories, plant, rental machines and other property, and other non-monetary assets and liabilities of non-U.S. subsidiaries and branches that operate in U.S. dollars, or whose economic environment is highly inflationary, are translated at approximate exchange rates prevailing when the company acquired the assets or liabilities. All other assets and liabilities are translated at year-end exchange rates. Cost of sales and depreciation are translated at historical exchange rates. All other income and expense items are translated at the weighted-average rates of exchange prevailing during the year. Gains and losses that result from translation are included in net income.

*Derivative/Financial Instruments*
In the normal course of business, the company uses a variety of derivative financial instruments to manage currency exchange rate and interest rate risk. To qualify for hedge accounting, the company requires that the instruments are effective in reducing the risk exposure that they are designed to hedge. For instruments that are associated with the hedge of an anticipated transaction, hedge effectiveness criteria also require that it be probable that the underlying transaction will occur. Instruments that meet these hedging criteria are formally designated as hedges at the inception of the contract. When the terms of an underlying transaction are modified, or when the underlying hedged item ceases to exist, all changes in the fair value of the instrument are marked-to-market with changes in value included in net income each period until the instrument matures. Those risk management instruments that do not meet the hedging criteria are marked-to-market each period. Refer to note K, "Financial Instruments," on pages 76 and 77 for descriptions of the major risk management programs and classes of financial instruments used by the company, including the specific methods used to account for them.

In determining fair value of its financial instruments, the company uses a variety of methods and assumptions that are based on market conditions and risks existing at each balance sheet date. For the majority of financial instruments including most derivatives, long-term investments and long-term debt, standard market conventions and techniques such as discounted cash flow analysis, option pricing models, replacement cost and termination cost are used to determine fair value. Dealer quotes are used for the remaining financial instruments. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realized.

*Cash Equivalents*
All highly liquid investments with a maturity of three months or less at date of purchase are carried at fair value and considered to be cash equivalents.

*Marketable Securities*
Marketable securities included in current assets represent securities with a maturity of less than one year. The company also has marketable securities, including non-equity method alliance investments, with a maturity of more than one year. These non-current investments are included in Investments and sundry assets. The company's marketable securities, including certain non-equity method alliance investments, are considered available for sale and are reported at fair value with changes in unrealized gains and losses, net of applicable taxes, recorded in Accumulated gains and losses not affecting retained earnings within stockholders' equity. Realized gains and losses are calculated based on the specific identification method. Other than temporary declines in market value from original cost are charged to net income in the period the loss occurs. All other investment securities not described above or in the Principles of Consolidation on page 69, primarily non-publicly traded securities, are accounted for using the cost method.

*Inventories*
Raw materials, work in process and finished goods are stated at the lower of average cost or net realizable value.

*Customer Loan Receivables*
Global Financing is one of many sources of funding from which customers can choose. Customer loan receivables, net of allowances, comprise almost entirely loans made by the company's Global Financing segment, primarily to finance the purchase of the company's software and services. Separate contractual relationships on these financing agreements are generally for terms ranging from one to three years requiring straight-line payments over the term. Therefore, these agreements do not represent extended payment terms. Each financing contract is priced independently at competitive market rates. An allowance for loan losses is established based upon management's historical collection experience, adverse situations that may affect the customer's ability to repay, estimated value of any underlying collateral and prevailing economic conditions.

*Depreciation*

Plant, rental machines and other property are carried at cost and depreciated over their estimated useful lives using the straight-line method.

The estimated useful lives of depreciable properties generally are as follows: buildings, 50 years; building equipment, 20 years; land improvements, 20 years; plant, laboratory and office equipment, 2 to 15 years; and computer equipment, 1.5 to 5 years.

*Software Costs*

Costs that are related to the conceptual formulation and design of licensed programs are expensed as research and development. Also, for licensed programs, the company capitalizes costs that are incurred to produce the finished product after technological feasibility is established. The annual amortization of the capitalized amounts is the greater of the amount computed based on the estimated revenue distribution over the products' revenue-producing lives, or the straight-line method, and is applied over periods ranging up to three years. The company performs periodic reviews to ensure that unamortized program costs remain recoverable from future revenue. The company charges costs to support or service licensed programs against net income as the costs are incurred.

The company capitalizes certain costs that are incurred to purchase or to create and implement internal use computer software, which include software coding, installation, testing and data conversion. Capitalized costs are amortized on a straight-line basis over two years.

The company capitalizes costs incurred during certain phases of internal Web site development. Capitalized costs are amortized on a straight-line basis over two years.

*Retirement Plans and Nonpension Postretirement Benefits*

Current service costs of retirement plans and postretirement health care and life insurance benefits are accrued in the period. Prior service costs that result from amendments to the plans are amortized over the average remaining service period of the employees expected to receive benefits. Unrecognized net gains and losses that exceed 10 percent of the greater of the projected benefit obligation or the market-related value of plan assets are amortized over the average remaining service life of employees expected to receive benefits. Experience gains and losses, as well as the effects of changes in actuarial assumptions and plan provisions, are amortized over the average future service period of employees. See note V, "Retirement Plans," on pages 85 through 88 and note W, "Nonpension Postretirement Benefits," on pages 88 and 89 for further discussion.

*Goodwill*

Goodwill is amortized to expense on a straight-line basis over the periods estimated to benefit, generally not to exceed five years. The company performs reviews to evaluate the recoverability of goodwill and takes into account events or circumstances that warrant revised estimates of useful lives or that indicate that an impairment exists.

*Common Stock*

Common stock refers to the $.20 par value capital stock as designated in the company's Certificate of Incorporation. Treasury stock is accounted for using the cost method. When treasury stock is reissued, the value is computed and recorded using a weighted-average basis.

*Earnings Per Share of Common Stock*

Earnings per share of common stock—basic is computed by dividing Net income applicable to common stockholders by the weighted-average number of common shares outstanding for the period. Earnings per share of common stock—assuming dilution reflects the maximum potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock and would then share in the net income of the company. See note S, "Earnings Per Share of Common Stock," on page 83 for further discussion.

## B ACCOUNTING CHANGES

*Standards Implemented*

The company implemented new accounting standards in 2000, 1999 and 1998. These standards do not have a material effect on the financial position or results of operations of the company.

In 2000, the Financial Accounting Standards Board (FASB) issued Interpretation (FIN) No. 44, "Accounting for Certain Transactions Involving Stock Compensation, an interpretation of Accounting Principles Board Opinion No. 25." The requirements of FIN No. 44 are either not applicable to the company or are already consistent with the company's existing accounting policies.

Effective July 1, 2000, the company adopted Emerging Issues Task Force (EITF) Issue No. 00-2, "Accounting for Web Site Development Costs." See note A, "Significant Accounting Policies" on pages 69 through 71 for a description of the company's policies for Web site development costs.

Pursuant to the Securities and Exchange Commission's Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements," the company has reviewed its accounting policies for the recognition of revenue. SAB No. 101 was required to be implemented in fourth quarter 2000. SAB No. 101 provides guidance on applying generally accepted accounting principles to revenue recognition in financial statements. The company's policies for revenue recognition are consistent with the views expressed within SAB No. 101. See note A, "Significant Accounting Policies," on pages 69 through 71 for a description of the company's policies for revenue recognition.

Effective January 1, 1999, the company adopted American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." The SOP requires a company to capitalize certain costs that are incurred to purchase or to create and implement internal use computer software. See note A, "Significant Accounting Policies" on pages 69 through 71 for a description of the company's policies for internal use software.

Effective December 31, 1998, the company adopted Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information," which establishes standards for reporting operating segments and disclosures about products and services, geographic areas and major customers. See note X, "Segment Information," on pages 89 through 93 for the company's segment information.

Effective December 31, 1998, the company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," which establishes standard disclosures for defined benefit pension and postretirement benefit plans. See note V, "Retirement Plans," on pages 85 through 88 and note W, "Nonpension Postretirement Benefits," on pages 88 and 89 for the disclosures.

Effective January 1, 1998, the company adopted SFAS No. 130, "Reporting Comprehensive Income," which establishes standards for reporting and displaying in a full set of general-purpose financial statements the gains and losses not affecting retained earnings. The disclosures required by SFAS No. 130 are presented in the Accumulated gains and losses not affecting retained earnings section in the Consolidated Statement of Stockholders' Equity on pages 66 and 67 and in note M, "Stockholders' Equity Activity," on page 79.

Effective January 1, 1998, the company adopted the AICPA SOP No. 97-2, "Software Revenue Recognition." This SOP provides guidance on revenue recognition for software transactions. See note A, "Significant Accounting Policies" on pages 69 through 71 for a description of the company's policy for software revenue recognition.

*New Standards to be Implemented*

Effective January 1, 2001, the company adopted SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of SFAS No. 125." This statement provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities and revises the accounting standards for securitizations and transfers of financial assets and collateral. Management does not expect the adoption to have a material effect on the company's results of operations and financial position. This standard also requires new disclosures in 2000. Such requirements were not applicable to the company.

On January 1, 2001, the company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments. Specifically, SFAS No. 133 requires an entity to recognize all derivatives as either assets or liabilities in the statement of financial position and to measure those instruments at fair value. Additionally, the fair value adjustments will affect either stockholders' equity or net income depending on whether the derivative instrument qualifies as a hedge for accounting purposes and, if so, the nature of the hedging activity. As of January 1, 2001, the adoption of the new standard results in a net-of-tax increase of $219 million to Accumulated gains and losses not affecting retained earnings in the Consolidated Statement of Stockholders' Equity and a charge of $6 million to Cumulative effect of adopting accounting principle, net of tax in the Consolidated Statement of Earnings.

## C COMMON STOCK SPLIT

On April 27, 1999, the stockholders of the company approved amendments to the Certificate of Incorporation to increase the number of authorized shares of common stock from 1,875.0 million to 4,687.5 million, which was required to effect a two-for-one stock split approved by the company's Board of Directors on January 26, 1999. In addition, the amendment reduced the par value of the common shares from $.50 to $.20 per share. Common stockholders of record at the close of business on May 10, 1999, received one additional share for each share held. All share and per share data prior to the second quarter of 1999 presented in the consolidated financial statements and notes thereto reflect the two-for-one stock split.

## D ACQUISITIONS/DIVESTITURES

*Acquisitions*

**2000**

In 2000, the company completed nine acquisitions at a cost of approximately $511 million.

The largest acquisition was LGS Group Inc. (LGS). The company acquired all the outstanding stock of LGS in April for $190 million. LGS offers services ranging from application development to information technology consulting.

The following table presents the allocation of the purchase price of the 2000 acquisitions.

| *(dollars in millions)* | *LGS* | *Other* |
|---|---|---|
| Purchase price | $ 190 | $ 321 |
| Tangible net assets | 31 | 68 |
| Identifiable intangible assets | — | 36 |
| Goodwill | 159 | 220 |
| In-process research and development | — | 9 |
| Deferred tax liabilities related to identifiable intangible assets | — | (12) |

**1999**

In 1999, the company completed 17 acquisitions at a cost of approximately $1,551 million. Three of the major acquisitions for the year are detailed in the following discussion.

On September 24, 1999, the company acquired all of the outstanding capital stock of Sequent Computer Systems, Inc., an acknowledged leader in systems based on NUMA (non-uniform memory access) architecture, for approximately $837 million.

On September 29, 1999, the company acquired all of the outstanding stock of Mylex Corporation, a leading developer of technology for moving, storing, protecting and managing data in desktop and networked environments, for approximately $259 million.

On September 27, 1999, the company acquired all the outstanding stock of DASCOM, Inc., an industry leader in Web-based and enterprise-security technology, for approximately $115 million.

The following table presents the allocation of the purchase price of the 1999 acquisitions.

| *(dollars in millions)* | *Sequent* | *Mylex* | *DASCOM* | *Other* |
|---|---|---|---|---|
| Purchase price | $ 837* | $ 259 | $ 115 | $ 340 |
| Tangible net assets/(liabilities) | 382 | 67 | (17) | 45 |
| Identifiable intangible assets | 187 | 35 | 13 | — |
| Current technology | 87 | 26 | 19 | 9 |
| Goodwill | 192* | 145 | 92 | 286 |
| In-process research and development | 85 | 7 | 19 | — |
| Deferred tax liabilities related to identifiable intangible assets | (96) | (21) | (11) | — |

**In 2000, the total purchase price and goodwill numbers were adjusted primarily for increased stock options being exercised versus being converted to IBM options and at a higher gain per option than originally assumed.*

**1998**

In 1998, the company completed nine acquisitions at a cost of approximately $828 million. In January 1998, the company acquired all of the outstanding stock of Software Artistry, Inc., a leading provider of both consolidated service desk and customer relationship management solutions for distributed enterprise environments for approximately $203 million. In 2000, the company sold most of Software Artistry, representing the part of the business that is no longer considered strategic. In March 1998, the company acquired all of the outstanding stock of CommQuest Technologies, Inc., a company that designs and markets advanced semiconductors for wireless communications applications such as cellular phones and satellite communications for approximately $183 million.

The following table presents the allocation of the purchase price of the 1998 acquisitions.

| *(dollars in millions)* | *Software Artistry* | *CommQuest* | *Other* |
|---|---|---|---|
| Purchase price | $ 203 | $ 183 | $ 442 |
| Tangible net assets | 22 | 2 | 188 |
| Identifiable intangible assets | 24 | 79 | — |
| Current technology | 46 | 12 | — |
| Goodwill | 66 | 81 | 254 |
| In-process research and development | 70 | 41 | — |
| Deferred tax liabilities related to identifiable intangible assets | (25) | (32) | — |

All of these acquisitions were accounted for as purchase transactions, and accordingly, the assets and liabilities of the acquired entities were recorded at their estimated fair value at the date of acquisition. The effects of these acquisitions on the company's consolidated financial statements were not material. Hence, the company has not provided pro forma financial information as if the companies had combined at the beginning of the current period or the immediately preceding period.

The tangible net assets comprise primarily cash, accounts receivable, land, buildings and leasehold improvements. The identifiable intangible assets comprise primarily patents, trademarks, customer lists, assembled workforce, employee agreements and leasehold interests. The identifiable intangible assets and goodwill will be amortized on a straight-line basis, generally not to exceed five years.

In connection with these acquisitions, the company recorded pre-tax charges of $9 million, $111 million and $111 million for acquired in-process research and development (IPR&D) for 2000, 1999 and 1998, respectively. At the date of the acquisitions, the IPR&D projects had not yet reached technological feasibility and had no alternative future uses. The value of the IPR&D reflects the relative value and contribution of the acquired research and development to the company's existing research or product lines.

*Divestitures*

During 1999, the company completed the sale of its Global Network business to AT&T for $4,991 million. More than 5,300 IBM employees joined AT&T as a result of these sales of operations in 71 countries.

During 1999, the company recognized a pre-tax gain of $4,057 million ($2,495 million after tax, or $1.33 per diluted common share). The net gain reflects dispositions of plant, rental machines and other property of $410 million, other assets of $182 million and contractual obligations of $342 million. The gain was recorded as a reduction of Selling, general and administrative expense in the Consolidated Statement of Earnings.

## E INVENTORIES

*(dollars in millions)*

| AT DECEMBER 31: | 2000 | 1999 |
|---|---|---|
| Finished goods | $ 1,446 | $ 1,162 |
| Work in process and raw materials | 3,319 | 3,706 |
| Total | $ 4,765 | $ 4,868 |

## F FINANCING RECEIVABLES

The following table includes receivables resulting from leasing activities and installment loans to customers, as well as commercial financing activities primarily to dealers, arising from the Global Financing business. See note X, "Segment Information," on pages 89 through 93 for information on the total assets of the Global Financing segment, which also includes cash, rental machine fixed assets, intercompany amounts and other.

*(dollars in millions)*

| AT DECEMBER 31: | 2000 | 1999 |
|---|---|---|
| Short term: | | |
| Commercial financing receivables | $ 6,851 | $ 6,062 |
| Customer loan receivables | 4,065 | 3,764 |
| Installment payment receivables | 1,221 | 1,110 |
| Net investment in sales-type leases | 6,568 | 6,220 |
| Total short-term financing receivables | $ 18,705 | $ 17,156 |
| Long term: | | |
| Commercial financing receivables | $ 779 | $ 30 |
| Customer loan receivables | 4,359 | 4,219 |
| Installment payment receivables | 574 | 848 |
| Net investment in sales-type leases | 7,596 | 7,981 |
| Total long-term financing receivables | $ 13,308 | $ 13,078 |

Net investment in sales-type leases is for leases that relate principally to IBM equipment and is generally for terms ranging from two to five years. Net investment in sales-type leases includes unguaranteed residual values of approximately $751 million and $737 million at December 31, 2000 and 1999, respectively, and is reflected net of unearned income at those dates of approximately $1,500 million and $1,600 million, respectively. Scheduled maturities of minimum lease payments outstanding at December 31, 2000, expressed as a percentage of the total, are approximately as follows: 2001, 50 percent; 2002, 30 percent; 2003, 14 percent; 2004, 4 percent; and 2005 and beyond, 2 percent.

## G PLANT, RENTAL MACHINES AND OTHER PROPERTY

*(dollars in millions)*

| AT DECEMBER 31: | 2000 | 1999 |
|---|---|---|
| Land and land improvements | $ 896 | $ 1,026 |
| Buildings and building improvements | 9,904 | 10,395 |
| Plant, laboratory and office equipment | 22,354 | 22,503 |
| | 33,154 | 33,924 |
| Less: Accumulated depreciation | 18,857 | 19,268 |
| | 14,297 | 14,656 |
| Rental machines | 5,301 | 5,692 |
| Less: Accumulated depreciation | 2,884 | 2,758 |
| | 2,417 | 2,934 |
| Total | $ 16,714 | $ 17,590 |

## H INVESTMENTS AND SUNDRY ASSETS

*(dollars in millions)*

| AT DECEMBER 31: | 2000 | 1999 |
|---|---|---|
| Deferred taxes | $ 2,968 | $ 2,654 |
| Prepaid pension assets | 6,806 | 5,636 |
| Alliance investments: | | |
| Equity method | 629 | 595 |
| Other | 909 | 1,439 |
| Goodwill (less accum. amortization) | 848 | 1,045 |
| Marketable securities—non-current | 171 | 113 |
| Software | 782 | 663 |
| Other assets | 1,334 | 1,527 |
| Total | $ 14,447 | $ 13,672 |

## I SALE AND SECURITIZATION OF RECEIVABLES

The company manages assets of $136 million and $273 million from the securitization of loans, leases and trade receivables, at year-end 2000 and 1999, respectively. The company did not sell any receivables in 2000, and therefore had no cash proceeds for the year. Cash proceeds from the sale and securitization of these receivables and assets were $1,311 million in 1999. No significant gain or loss resulted from these transactions. The company expects recourse amounts associated with the aforementioned sale and securitization activities to be minimal and has adequate reserves to cover potential losses.

## J BORROWINGS

### *Short-term debt*

*(dollars in millions)*

| AT DECEMBER 31: | 2000 | 1999 |
|---|---|---|
| Commercial paper | $ 3,521 | $ 5,074 |
| Short-term loans | 3,975 | 3,351 |
| Long-term debt: Current maturities | 2,709 | 5,805 |
| Total | $ 10,205 | $ 14,230 |

The weighted-average interest rates for commercial paper at December 31, 2000 and 1999, were 6.7 percent and 5.9 percent, respectively. The weighted-average interest rates for short-term loans at December 31, 2000 and 1999, were 2.9 percent and 4.0 percent, respectively.

### *Long-term debt*

*(dollars in millions)*

| AT DECEMBER 31: | Maturities | 2000 | 1999* |
|---|---|---|---|
| U.S. Dollars: | | | |
| Debentures: | | | |
| 6.22% | 2027 | $ 500 | $ 500 |
| 6.5% | 2028 | 700 | 700 |
| 7.0% | 2025 | 600 | 600 |
| 7.0% | 2045 | 150 | 150 |
| 7.125% | 2096 | 850 | 850 |
| 7.5% | 2013 | 550 | 550 |
| 8.375% | 2019 | 750 | 750 |
| Notes: 6.3% average | 2001-2014 | 2,933 | 4,191 |
| Medium-term note program: 5.8% average | 2001-2014 | 4,305 | 6,230 |
| Other: 6.8% average | 2001-2012 | 1,092 | 1,618 |
| | | 12,430 | 16,139 |
| Other currencies (average interest rate at December 31, 2000, in parentheses): | | | |
| Euros (5.3%) | 2002-2005 | 3,042 | — |
| Japanese yen (1.4%) | 2001-2014 | 4,845 | 3,141 |
| Canadian dollars (5.7%) | 2002-2005 | 302 | 316 |
| Swiss francs (3.5%) | 2001-2003 | 231 | 78 |
| Other (8.1%) | 2001-2014 | 275 | 295 |
| | | 21,125 | 19,969 |
| Less: Net unamortized discount | | 45 | 40 |
| | | 21,080 | 19,929 |
| Less: Current maturities | | 2,709 | 5,805 |
| Total | | $ 18,371 | $ 14,124 |

**Reclassified to conform with 2000 presentation.*

Annual maturities in millions of dollars on long-term debt outstanding at December 31, 2000, are as follows: 2001, $2,709; 2002, $5,405; 2003, $3,364; 2004, $763; 2005, $1,873; 2006 and beyond, $7,011.

### *Interest on Debt*

Interest paid and accrued on borrowings of the company and its subsidiaries was $1,449 million in 2000, $1,475 million in 1999 and $1,585 million in 1998. Of these amounts, the company capitalized $20 million in 2000, $23 million in 1999 and $28 million in 1998. Of the remainder, the company charged $717 million in 2000, $727 million in 1999 and $713 million in 1998 to Interest expense on the Consolidated Statement of Earnings and charged $712 million in 2000, $725 million in 1999 and $844 million in 1998 to Cost of Global Financing in the Consolidated Statement of Earnings. Refer to the table and related discussion on page 92 in note X, "Segment Information," for the total interest expense of the Global Financing segment.

The decrease in total interest in 2000 versus 1999 was due primarily to lower average interest rates and a decline in average debt outstanding during 2000. The decrease in total interest in 1999 versus 1998 was due primarily to lower average interest rates, partially offset by an increase in average debt outstanding during 1999. The average effective interest rate for total debt was 5.0 percent, 5.1 percent and 5.7 percent in 2000, 1999 and 1998, respectively. These rates include the results of currency and interest rate swaps applied to the debt previously described.

### *Lines of Credit*

The company maintains a $10.0 billion global credit facility. The company's other committed and uncommitted lines of credit were $4.7 billion and $5.5 billion at December 31, 2000 and 1999, respectively. Interest rates and other terms of borrowing under these lines of credit vary from country to country depending on local market conditions at the time of the borrowing.

*(dollars in billions)*

| AT DECEMBER 31: | 2000 | 1999 |
|---|---|---|
| Unused lines | | |
| From the global credit facility | $ 9.1 | $ 8.6 |
| From other committed and uncommitted lines | 4.1 | 4.5 |
| Total unused lines of credit | $ 13.2 | $ 13.1 |

## K FINANCIAL INSTRUMENTS

The company maintains on- and off-balance sheet portfolios of financial instruments.

*Financial Instruments On-Balance Sheet (excluding derivatives)*

Cash and cash equivalents, marketable securities, notes and other accounts receivable and other investments are financial assets with carrying values that approximate fair value. Accounts payable, other accrued expenses and liabilities, and short-term and long-term debt are financial liabilities with carrying values that approximate fair value.

The following table summarizes the company's marketable securities, all of which are considered available for sale, and alliance investments.

MARKETABLE SECURITIES*

| (dollars in millions) AT DECEMBER 31: | Fair Value 2000 | 1999 |
|---|---|---|
| Current marketable securities: | | |
| U.S. government securities | $ — | $ 15 |
| Time deposits and other obligations | 153 | 746 |
| Non-U.S. government securities and other fixed-term obligations | 6 | 27 |
| Total | $ 159 | $ 788 |
| Marketable securities—non-current:** | | |
| Time deposits and other obligations | $ 163 | $ 105 |
| Non-U.S. government securities and other fixed-term obligations | 8 | 8 |
| Total | $ 171 | $ 113 |
| Non-equity method alliance investments** | $ 909 | $ 1,439 |

* *Gross unrealized gains (before taxes) on marketable securities and alliance investments were $47 million and $1,310 million at December 31, 2000 and 1999, respectively. Gross unrealized losses (before taxes) on marketable securities and alliance investments were $175 million and $7 million at December 31, 2000 and 1999, respectively. See note M, "Stockholders' Equity Activity," on page 79 for accumulated and net change in unrealized gains and losses on marketable securities.*

** *Included within Investments and sundry assets on the Consolidated Statement of Financial Position. (See note H, "Investments and Sundry Assets," on page 74.)*

*Financial Instruments Off-Balance Sheet (excluding derivatives)*

The company has guaranteed certain loans and financial commitments of its affiliates. The approximate amount of these financial guarantees was $0.4 billion and $1.2 billion at December 31, 2000 and 1999, respectively.

The company extended lines of credit, of which the unused amounts were $4.2 billion and $4.5 billion at December 31, 2000 and 1999, respectively. A portion of these amounts was available to the company's dealers to support their working capital needs.

The company enters into contracts that effectively provide the company with committed future borrowings in select foreign currencies. The aggregate amount of these contracts was $9.0 billion and $6.4 billion at December 31, 2000 and 1999, respectively. The terms of these contracts generally are less than eighteen months. Foreign exchange gains and losses associated with these contracts are recorded in net income as they are realized. These amounts have not been and are not expected to be material to the company's financial results.

*Derivatives and Hedging*

The company operates in approximately 40 functional currencies and is a significant lender and a borrower in the global financial markets. In the normal course of business, the company is exposed to the impact of interest rate changes and foreign currency fluctuations. The company limits these risks by following established risk management policies and procedures including the use of derivatives and, where cost-effective, financing with debt in the currencies in which assets are denominated. For interest rate exposures, derivatives are primarily used to align rate movements between interest rates associated with the company's lease and other financial assets and interest rates associated with its financing debt and to manage the related cost of debt. For currency exposures, derivatives are used to limit the effects of foreign exchange rate fluctuations on financial results.

The company does not use derivatives for trading or speculative purposes, nor is it a party to leveraged derivatives. Further, the company has a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors and maintains strict dollar and term limits that correspond to the institution's credit rating. The company's current credit exposure under these agreements is limited to the fair value of instruments with a positive fair value at the reporting date. When viewed in conjunction with the underlying and offsetting exposure that the derivatives are designed to hedge, the company has not sustained a material loss from these instruments nor does it anticipate any material adverse effect on its net income or financial position in the future from the use of derivatives.

In its hedging programs, the company employs the use of options, forwards, interest rate and currency swaps, caps, floors or a combination thereof depending upon the underlying exposure.

A description of the major hedging programs follows:

**DEBT RISK MANAGEMENT**

The company issues debt in the global capital markets, principally to fund its Global Financing lease and loan portfolio. Access to cost-effective financing can result in interest rate and/or currency mismatches with the underlying assets. To manage these mismatches and to reduce overall interest cost, the company uses interest-rate and currency instruments, principally swaps, to convert a portion of its fixed-rate debt into variable-rate debt and to convert a portion of its variable-rate debt to fixed-rate debt. Interest rate and currency rate differentials that arise under these swap contracts are recognized in interest expense over the life of the contracts. The resulting cost of funds is usually lower than that which would have been available if debt with matching characteristics was issued directly. The weighted-average remaining maturity of these swaps is approximately six years.

**ANTICIPATED ROYALTIES AND INTERCOMPANY TRANSACTIONS**

The company's operations generate significant non-functional currency intercompany payments for royalties and goods and services among the company's non-U.S. subsidiaries and with the parent company. In anticipation of these foreign currency cash flows and in view of the volatility of the currency markets, the company selectively employs foreign currency contracts to manage its currency risk. The terms of these instruments are generally less than eighteen months, commensurate with the underlying hedged anticipated cash flows. The effects of these instruments are reported in net income when the underlying transaction occurs.

For purchased options that hedge qualifying anticipated transactions, gains and losses are deferred and recognized in net income in the same period that the underlying transaction occurs, expires or otherwise is terminated. At December 31, 2000 and 1999, there were no material deferred gains or losses. The premiums associated with entering into these option contracts generally are amortized over the life of the options and are not material to the company's results. Unamortized premiums are recorded in prepaid assets. Gains and losses on purchased options that are intended to hedge anticipated transactions and do not qualify for hedge accounting are recorded in net income as they occur and are not material to the company's results. Similarly, gains and losses on written options are recorded in net income as they occur and are not material to the company's results.

**SUBSIDIARY CASH AND FOREIGN CURRENCY ASSET/LIABILITY MANAGEMENT**

The company uses its Global Treasury Centers to manage the cash of its subsidiaries. These centers principally use currency swaps to convert cash flows in a cost-effective manner, predominantly for the company's European subsidiaries. In addition, the company uses foreign exchange forward contracts to hedge, on a net basis, the foreign currency exposure of a portion of the company's non-functional currency assets and liabilities. The terms of these forward and swap contracts are generally less than one year. The interest rate differentials of these instruments are generally recognized in interest expense over the life of the contracts.

**LONG TERM INVESTMENTS IN FOREIGN SUBSIDIARIES ("NET INVESTMENT")**

A significant portion of the company's foreign denominated debt portfolio is designated as a hedge to reduce the volatility in stockholders' equity caused by changes in foreign exchange rates in the functional currency of major foreign subsidiaries with respect to the U.S. dollar. The company also uses currency swaps and other foreign currency contracts for this risk management purpose. The currency effects of these hedges are reflected in the Accumulated gains and losses not affecting retained earnings section of stockholders' equity thereby offsetting a portion of the translation of the net foreign assets.

The following table summarizes the notional value, carrying value and fair value of the company's derivative financial instruments, principally interest rate and currency contracts, both on- and off-balance sheet. The notional value at December 31 provides an indication of the extent of the company's involvement in these instruments at that time, but does not represent exposure to credit, interest rate or foreign exchange rate market risks.

| | *At December 31, 2000* | | | *At December 31, 1999* | | |
|---|---|---|---|---|---|---|
| *(dollars in millions)* | *Notional Value* | *Carrying Value* | *Fair Value** | *Notional Value* | *Carrying Value* | *Fair Value** |
| Derivative financial instruments | $ 18,873 | $ (21) | $ 178 | $ 31,535 | $ (198) | $ (437) |

*Amounts in parentheses are liabilities.*

** The estimated fair value of derivatives both on- and off-balance sheet at December 31, 2000 and 1999, comprises assets of $393 million and $616 million, respectively, and liabilities of $215 million and $1,053 million, respectively.*

## L OTHER LIABILITIES

| (dollars in millions) AT DECEMBER 31: | 2000 | 1999 |
|---|---|---|
| Nonpension postretirement benefits—U.S. and non-U.S. employees | $ 7,128 | $ 7,420 |
| Deferred income taxes | 1,623 | 1,354 |
| Deferred income | 1,266 | 1,081 |
| Restructuring actions | 854 | 1,162 |
| Executive compensation accruals | 769 | 746 |
| Post-employment/ pre-retirement liability | 585 | 710 |
| Environmental accruals | 226 | 228 |
| Other | 497 | 581 |
| Total | $ 12,948 | $ 13,282 |

Post-employment/pre-retirement liabilities represent workforce accruals for contractually obligated payments to employees terminated in the ongoing course of business other than those accruals presented separately above.

The company executed restructuring actions through 1993 and special actions in 1999. The non-current liabilities relating to these actions are included in restructuring actions in the table above. See note Q, "1999 Actions," on pages 81 and 82 for more information regarding the 1999 actions. The reconciliation of the December 31, 1999 to 2000 balances of the current and non-current liabilities for restructuring actions are presented below. The current liabilities presented in the table are included in Other accrued expenses and liabilities on the Consolidated Statement of Financial Position.

| (dollars in millions) | December 31, 1999 Balance | Payments | Other Adjustments* | December 31, 2000 Balance |
|---|---|---|---|---|
| Current: | | | | |
| Workforce | $ 188 | $ 178 | $ 138 | $ 148 |
| Space | 144 | 126 | 73 | 91 |
| MiCRUS Investment | 152 | 152 | — | — |
| Total | $ 484 | $ 456 | $ 211 | $ 239 |
| Non-current: | | | | |
| Workforce | $ 659 | $ — | $ (189) | $ 470 |
| Space | 503 | — | (119) | 384 |
| Total | $ 1,162 | $ — | $ (308) | $ 854 |

**Principally represents reclassification of non-current to current and currency translation adjustments.*

The workforce accruals relate to terminated employees who are no longer working for the company, but who were granted annual payments to supplement their state pensions in certain countries. These contractually required payments will continue until the former employee dies.

The space accruals are for ongoing obligations to pay rent for vacant space that could not be sublet or space that was sublet at rates lower than the committed lease arrangement. The length of these obligations varies by lease with the longest extending through 2012.

The company employs extensive internal environmental protection programs that primarily are preventive in nature. The cost of these ongoing programs is recorded as incurred.

The company continues to participate in environmental assessments and cleanups at a number of locations, including operating facilities, previously owned facilities and Superfund sites. The company accrues for all known environmental liabilities when it becomes probable that the company will incur cleanup costs, and those costs can reasonably be estimated. In addition, estimated environmental costs that are associated with post-closure activities (for example, the removal and restoration of chemical storage facilities and monitoring) are accrued when the decision is made to close a facility. The total amounts accrued, including amounts classified as current on the Consolidated Statement of Financial Position, that do not reflect actual or anticipated insurance recoveries, were $248 million and $240 million at December 31, 2000 and 1999, respectively.

The amounts accrued do not cover sites that are in the preliminary stages of investigation; that is, for which neither the company's percentage of responsibility nor the extent of cleanup required has been identified. Estimated environmental costs are not expected to materially affect the financial position or results of the company's operations in future periods. However, estimates of future costs are subject to change due to protracted cleanup periods and changing environmental remediation regulations.

## M STOCKHOLDERS' EQUITY ACTIVITY

### *Stock Repurchases*

From time to time, the Board of Directors authorizes the company to repurchase IBM common stock. The company repurchased 61,041,820 common shares at a cost of $6.7 billion and 71,618,800 common shares at a cost of $7.3 billion in 2000 and 1999, respectively. In 2000 and in 1999, the company did not retire the shares it repurchased. In 2000 and 1999, the company issued 2,174,594 and 906,829 treasury shares, respectively, as a result of exercises of stock options by employees of certain recently acquired businesses and by non-U.S. employees. At December 31, 2000, approximately $2.9 billion of Board authorized repurchases remained. The company plans to purchase shares on the open market from time to time, depending on market conditions.

In 1995, the Board of Directors authorized the company to repurchase all of its outstanding Series A 7-1⁄2 percent callable preferred stock. The company did not repurchase any shares in 2000 or in 1999. The company plans to purchase the outstanding shares on the open market and in private transactions from time to time, depending on market conditions. There were 2,546,011 shares outstanding at December 31, 2000 and 1999.

### *Employee Benefits Trust*

Effective November 1, 1997, the company created an employee benefits trust to which it contributed 20 million shares of treasury stock. The company is authorized to instruct the trustee to sell shares from time to time and to use proceeds from those sales, and any dividends paid on the contributed stock, toward the partial satisfaction of the company's future obligations under certain of its compensation and benefits plans. The shares held in trust are not considered outstanding for purposes of calculating earnings per share until they are committed to be released. The trustee will vote the shares in accordance with its fiduciary duties. As of December 31, 2000 and 1999, the company had not committed any shares to be released.

At December 31, 1998, the company began adjusting its valuation of the employee benefits trust to fair value. These adjustments affect only line items within stockholders' equity; not total stockholders' equity or net income.

### *Accumulated Gains and Losses Not Affecting Retained Earnings**

| *(dollars in millions)* | *Foreign Currency Items* | *Net Unrealized Gains/(Losses) on Marketable Securities* | *Total Gains/(Losses) Not Affecting Retained Earnings* |
|---|---|---|---|
| January 1, 1998 | $ 791 | $ 108 | $ 899 |
| Change for period | 69 | (57) | 12 |
| December 31, 1998 | 860 | 51 | 911 |
| Change for period | (546) | 796 | 250 |
| December 31, 1999 | 314 | 847 | 1,161 |
| Change for period | (531) | (925) | (1,456) |
| December 31, 2000 | $ (217) | $ (78) | $ (295) |

**Net of tax.*

#### NET CHANGE IN UNREALIZED GAINS/(LOSSES) ON MARKETABLE SECURITIES (NET OF TAX)

| *(dollars in millions)* FOR THE YEAR ENDED DECEMBER 31: | *2000* | *1999* |
|---|---|---|
| Net unrealized (losses)/gains arising during the period | $ (810) | $ 943 |
| Less net gains included in net income for the period | 115 | 147 |
| Net change in net unrealized (losses)/ gains on marketable securities | $ (925) | $ 796 |

Unrealized losses arising in 2000 relate primarily to previous unrealized gains from original cost occurring in prior years.

## N CONTINGENCIES

The company is subject to a variety of claims and suits that arise from time to time in the ordinary course of its business, including actions with respect to contracts, intellectual property, product liability and environmental matters. The company is a defendant and/or third-party defendant in a number of cases in which claims have been filed by current and former employees, independent contractors, estate representatives, offspring and relatives of employees seeking damages for wrongful death and personal injuries allegedly caused by exposure to chemicals in various of the company's facilities from 1964 to the present. The company believes that plaintiffs' claims are legally baseless and without factual support. The company will defend itself vigorously.

While it is not possible to predict the ultimate outcome of the matters discussed above, the company believes that any losses associated with any of such matters will not have a material effect on the company's business, financial condition or results of operations.