

Notes to Financial Statements

In millions except share and per share amounts

Note 1. Summary of Significant Accounting Policies

Dana is a global leader in the engineering, manufacturing and distribution of components and systems for worldwide vehicular and industrial manufacturers and the related aftermarkets and a leading provider of lease financing services in selected markets through its wholly-owned subsidiary, Dana Credit Corporation (DCC).

The preparation of these financial statements requires estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying disclosures. Some of the more significant estimates include depreciation, amortization and impairment of long-lived assets; deferred tax assets and inventory valuations; sales returns, restructuring, environmental, product liability and warranty accruals; postemployment and postretirement benefits; residual values of leased assets and allowances for doubtful accounts. Actual results could differ from those estimates.

The following summary of significant accounting policies should help you evaluate the financial statements. Certain amounts in 1999 and 2000 have been reclassified to conform with the 2001 presentation.

Principles of Consolidation

The consolidated financial statements include all subsidiaries in which we have the ability to control operating and financial policies. Affiliated companies (20% to 50% ownership) are generally recorded in the statements using the equity method of accounting. Operations of affiliates accounted for on the equity method of accounting are generally included for periods ended within one month of our year end. Less-than-20%-owned companies are included in the financial statements at the cost of our investment. Dividends, royalties and fees from these cost basis affiliates are recorded in income when received.

Foreign Currency Translation

The financial statements of subsidiaries and equity affiliates outside the United States (U.S.) located in non-highly inflationary economies are measured using the currency of the primary economic environment in which they operate as the functional currency, which for the most part is the local currency. Transaction gains and losses which result from translating assets and liabilities of these entities into the functional currency are included in net earnings. When translating into U.S. dollars, income and expense items are translated at average monthly rates of exchange and assets and liabilities are translated at the rates of exchange at the balance sheet date. Translation adjustments resulting from translating the functional currency into U.S. dollars are deferred as a component of accumulated other comprehensive income in shareholders' equity. For affiliates operating in highly inflationary economies, non-monetary assets are translated into U.S. dollars at historical exchange rates and monetary assets are translated at current exchange rates. Translation adjustments for these affiliates are included in net earnings.

Inventories

Inventories are valued at the lower of cost or market. Cost is generally determined on the last-in, first-out (LIFO) basis for U.S. inventories and on the first-in, first-out (FIFO) or average cost basis for non-U.S. inventories.

Pre-Production Costs Related to Long-Term Supply Arrangements

The cost of tooling used to make products sold under long-term supply arrangements is capitalized as part of property, plant and equipment and amortized over its useful life if we own the tooling. These costs are also capitalized and amortized if we fund the purchase but our customer owns the tooling and grants us the noncancelable right to use the tooling over the contract period. Costs incurred in connection with the design and development of tooling that will be billed to customers upon completion is carried as a component of other accounts receivable. Design and development costs related to customer products are deferred if we have an agreement to collect such costs from the customer; otherwise, they are expensed.

Lease Financing

Lease financing consists of direct financing leases, leveraged leases and equipment on operating leases. Income on direct financing leases is recognized by a method which produces a constant periodic rate of return on the outstanding investment in the lease. Income on leveraged leases is recognized by a method which produces a constant rate of return on the outstanding net investment in the lease, net of the related deferred tax liability, in the years in which the net investment is positive. Initial direct costs are deferred and amortized using the interest method over the lease period. Equipment under operating leases is recorded at cost, net of accumulated depreciation. Income from operating leases is recognized ratably over the term of the leases.

Allowance for Losses on Lease Financing

Provisions for losses on lease financing receivables are determined based on loss experience and assessment of inherent risk. Adjustments are made to the allowance for losses to adjust the net investment in lease financing to an estimated collectible amount. Income recognition is generally discontinued on accounts which are contractually past due and where no payment activity has occurred within 120 days. Accounts are charged against the allowance for losses when determined to be uncollectible. Accounts where asset repossession has started as the primary means of recovery are classified within other assets at their estimated realizable value.

Goodwill

Cost in excess of net assets of companies acquired generally has been amortized on a straight-line basis over the estimated period of expected benefit, ranging from 10 to 40 years. The issuance of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," was approved by the Financial Accounting Standards Board in June 2001. The new guidance changes the post-acquisition accounting for goodwill and certain intangible assets by discontinuing the amortization of these assets and requiring impairment testing at least annually. After recording the impact of adopting the Statement, any reductions in the carrying value of goodwill or certain intangible assets will be included in the results of operations. Adoption of SFAS No. 142 is required in 2002.

We believe that the initial application of this Statement is likely to result in the impairment of a portion of our goodwill. We have substantially completed the first step of the initial impairment test required by the Statement and identified approximately \$400 of goodwill that may be impaired based upon the new requirements. We will complete the impairment testing required to determine the actual amount of goodwill impairment in 2002.