;counting Policies

Consolidation The consolidated financial statements include accounts of the Company and all majority-owned subsidiaries. The equity method of accounting is used for investments in associate companies and joint ventures where the Company has a 20% to 50% ownership interest.

Foreign Currency Translation The functional currency for principally all subsidiaries outside the United States is the local currency. Financial statements for these subsidiaries are translated into United States dollars at year-end exchange rates as to assets and liabilities and weighted average exchange rates as to revenues and expenses. The resulting translation adjustments are recorded in shareholders' equity.

Inventories Inventories are carried at lower of cost or market. Inventories in the United States are generally accounted for using the last-in, first-out (LIFO) method. Remaining United States and all other inventories are accounted for using the first-in, first-out (FIFO) method.

Depreciation and Amortization Depreciation and amortization are computed by the straight-line method for financial statement purposes. Cost of buildings is depreciated over forty years and machinery and equipment over principally three to ten years. Identified intangible assets primarily consist of patents, trademarks and tradenames, which are amortized over an average life of fifteen years. Excess of cost over net assets of businesses acquired is amortized over principally forty years. Excess of cost over net assets of businesses acquired and certain ...er long-lived assets are reviewed for impairment losses whenever .its or changes in circumstances indicate the carrying amount may not be recovered through future net cash flows generated by the assets.

Financial Instruments The Company selectively uses straightforward, nonleveraged financial instruments as part of foreign exchange and interest rate risk management programs. The Company does not buy and sell financial instruments solely for trading purposes, except for nominal amounts authorized under limited, controlled circumstances. Credit loss has never been experienced, and is not anticipated, as the counterparties to various financial instruments are major international financial institutions with strong credit ratings and due to control over the limit of positions entered into with any one party. Although financial instruments are an integral part of the Company's risk management programs, their incremental effect on financial condition and results of operations is not material.

The Company and its subsidiaries, operating in Canada, Europe, Latin America and the Pacific Region, are exposed to fluctuations in foreign currencies in the normal course of business. The Company seeks to reduce exposure to foreign currency fluctuations, primarily the European and Canadian currencies, through the use of foreign currency forward exchange contracts and options. Gains or losses on those financial instruments which hedge net investments in subsidiaries outside the United States are recorded in shareholders' equity. Gains or losses on those financial instruments which hedge specific transactions are recognized in net income, offsetting the underlying foreign currency transaction gains or losses. Cash premiums and discounts related to these financial instruments are amortized to other income—net over the lives of the agreements.

In the normal course of business, the Company's operations are also exposed to fluctuations in interest rates. The Company seeks to reduce the cost of and exposure to interest rate fluctuations through the use of interest rate swaps and caps. Gains or losses on interest rate swaps are included in interest expense since they hedge interest on debt. Cash premiums related to interest rate caps are amortized to interest expense over the lives of the agreements.

Options for Common Shares The Company applies the intrinsic value based method to account for stock options granted to employees to purchase Common Shares. Under this method, no compensation expense is recognized on the grant date since on that date the option price equals the market price of the underlying Common Shares. Net income and net income per Common Share for 1996 and 1995 would not have been significantly different from reported amounts if compensation expense had been determined based on the fair value method in Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation."

Net Income per Common Share Net income per Common Share is computed by dividing net income by the average month-end number of shares outstanding during each period. The dilutive effect of common stock equivalents, comprised solely of options for Common Shares, is not material.

Estimates Preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and notes. Actual results could differ from these estimates.

Acquisitions and Divestitures of Businesses

On April 16, 1996, the Company purchased CAPCO Automotive Products Corporation (CAPCO) for $135 million. CAPCO, a Brazilian manufacturer of transmissions for light- and medium-duty trucks and transaxle components for passenger cars, had sales of $176 million in 1995. This acquisition was accounted for as a purchase and, accordingly, the statements of consolidated income include the results of CAPCO from the effective date of acquisition.