# Management's Discussion and Analysis of Financial Condition and Results of Operations

*Dollars in millions*

Employee terminations relating to the plans were as follows:

| | 1999 | 2000 | 2001 |
|---|---|---|---|
| Total estimated | 1,280 | 1,020 | **7,690** |
| Less terminated: | | | |
| 1999 | (595) | | |
| 2000 | (615) | (765) | |
| 2001 | (30) | (254) | **(3,571)** |
| **Balance at December 31, 2001** | **40** | **1** | **4,119** |

At December 31, 2001, $259 of restructuring charges remained in accrued liabilities. This balance was comprised of $206 for the reduction of approximately 4,200 employees to be completed in 2002 and $53 for lease terminations and other exit costs. The estimated annual cash expenditures will be approximately $120 in 2002, $38 in 2003 and $101 thereafter. Additional cash requirements will arise in 2002 as the remaining facility closures and work force reductions under the October 2001 plan are implemented. We currently expect the total cash expenditures in 2002 relative to the October 2001 initiatives to approximate $300. Our liquidity and cash flows, while projected to be more than adequate to satisfy our obligations related to our restructuring plans, will be adversely impacted in 2002 by these expenditures.

**Critical Accounting Policies**

The following discussion of accounting policies is intended to supplement the Summary of Significant Accounting Policies presented as Note 1 to our 2001 financial statements. These policies were selected because they are broadly applicable within our operating units. The expenses and accrued liabilities or allowances related to certain of these policies are initially based on our best estimates at the time of original entry in our accounting records. Adjustments are recorded when our actual experience differs from the expected experience underlying the estimates. These adjustments could be material if our experience were to change significantly in a short period of time. We make frequent comparisons of actual experience and expected experience in order to mitigate the likelihood of material adjustments.

*Goodwill and Impairment of Long-Lived Assets* – We perform impairment analyses of our recorded goodwill and long-lived assets whenever events and circumstances indicate that they may be impaired. When the undiscounted cash flows, without interest or tax charges, are less than the carrying value of the assets being reviewed for impairment, the assets are written down to fair market value. During 2001, we recorded goodwill and long-lived asset impairment provisions of $166, which largely resulted from the downturn in our markets and the resulting restructuring of our operations.

The adoption of SFAS 142, Goodwill and Other Intangible Assets (SFAS 142) on January 1, 2002, will change our methodology for assessing goodwill impairments. We believe that the initial application of this statement is likely to result in the impairment of goodwill due to the differences in the methods of calculating impairment. We have substantially completed the first step of the initial impairment test required by SFAS 142 and identified $400 of goodwill that may be impaired based upon the new accounting requirements. We will complete the impairment testing required to determine the actual amounts of goodwill impaired in 2002.

*Inventory* – Inventories are valued at the lower of cost or market. Cost is generally determined on the last-in, first-out basis for U.S. inventories and on the first-in, first-out or average cost basis for non-U.S. inventories. Where appropriate, standard cost systems are utilized for purposes of determining cost; the standards are adjusted as necessary to ensure they approximate actual costs. Estimates of lower of cost or market value of inventory are determined at the reporting unit level and are based upon the inventory at that location taken as a whole. These estimates are based upon current economic conditions, historical sales quantities and patterns and, in some cases, the specific risk of loss on specifically identified inventories.

*Sales Returns and Allowances* – Accruals for sales returns and allowances are provided at the time of shipment based upon past experience and are recorded as a reduction of sales. The estimated value of product that will be returned to inventory as a result of returns is recorded as a reduction of cost of sales and the accrued returns allowance. As new information becomes available the accruals are adjusted accordingly. Accrued liabilities at December 31, 2000 and 2001 were $67 and $66, respectively.

*Warranty* – Estimated costs related to product warranty are accrued at the time of sale and included in cost of sales. Estimated costs are based upon past warranty claims and sales history and adjusted as required to reflect actual costs incurred, as information becomes available. Warranty expense totaled $68, $90 and $92 in 1999, 2000 and 2001, respectively. Accrued liabilities for warranty expense at December 31, 2000 and 2001 was $127 and $138, respectively.

*Pension and Postretirement Benefits Other Than Pensions* – Annual net periodic expense and benefit liabilities under our defined plans are determined on an actuarial basis. Each September, we review the actual experience compared to the more significant assumptions used and make adjustments to the assumptions, if warranted. The healthcare trend rates are reviewed with the actuaries based upon the results of their review of claims experience. Discount rates are based upon an expected benefit payments duration analysis and the equivalent average yield rate for high-quality fixed-income investments. Pension benefits are funded through deposits with trustees and the expected long-term rate of return on fund assets is based upon actual historical returns modified for known changes in the market and any expected change in investment policy. Postretirement benefits are not funded and our policy is to pay these benefits as they become due.

Certain accounting guidance, including the guidance applicable to pensions, does not require immediate recognition of the effects of a deviation between actual and assumed experience or the revision of an estimate. This approach allows the favorable and unfavorable effects that fall within an acceptable range to be netted. Although this netting occurs outside the basic financial statements, disclosure of the net amount is disclosed as an unrecognized gain or loss in the footnotes to our financial statements. The actuarial loss related to our 2001 return on pension plan assets was offset, in part, by the unamortized portion of gains experienced in prior years. A portion of the unrecognized loss of $229 will be amortized into earnings in 2002. The effect on years beyond 2002 will depend in large part on the actual experience of the plans in 2002.