XEROX CORP
Form 10-Q/A
March 27, 2003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended: March 31, 2002

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number 1-4471

XEROX CORPORATION

(Exact Name of Registrant as specified in its charter)

New York	**16-0468020**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
P.O. Box 1600 **Stamford, Connecticut**	**06904-1600**
(Address of principal executive offices)	**(Zip Code)**

(203) 968-3000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding at February 28, 2003**
Common Stock, $1 par value	740,320,265 shares

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PURPOSE OF AMENDMENT

The principal purpose for this Amendment No. 1 to Xerox Corporation s Quarterly Report on Form 10-Q is to restate interest expense for the three months ended March 31, 2002 and 2001 to correct an error in the calculation of interest expense related to a debt instrument and associated interest swap agreements, as announced in a Current Report on Form 8-K on December 20, 2002. The reissuance of these financial statements requires that we revise our financial statements to reflect the effects of the adoption of two Statements of Financial Accounting Standards during early 2002.

Accordingly, changes in this Amendment No. 1 reflects solely the financial information and disclosures related to:

(1) The restatement of interest expense for the three months ended March 31, 2002 and 2001,

(2) the effects of the transitional goodwill impairment testing as a result of adopting Statements of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS No. 142) on January 1, 2002, and

(3) the adoption of Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections (SFAS No. 145) on April 1, 2002.

All other financial information and disclosures remain unchanged.

References to we, our or us refer to Xerox Corporation and its consolidated subsidiaries.

In December 2002, we discovered an error in the calculation of our interest expense, related to a debt instrument and associated interest rate swap agreements. The error occurred in connection with the adoption of Statement of Financial Accounting Standards No. 133 (SFAS No. 133) in January 2001 and resulted in an understatement of interest expense of $60 million and an overstatement of gains on extinguishment of debt of $4 million for the cumulative period from January 1, 2001 to September 30, 2002. The total effects were a reduction of net income of $17 million ($27 million pre-tax) and an increase in net loss of $23 million ($37 million pre-tax) for the nine months ended September 30, 2002 and the year ended December 31, 2001, respectively. The related after-tax effects for the three months ended March 31, 2002 and 2001, were $5 million ($8 million pre-tax) and $5 million ($9 million pre-tax), respectively.

During 2002, we adopted SFAS No. 142 and SFAS No. 145 and are required to reflect their application in financial statements that are reissued in periods after which such financial accounting standards were adopted. Accordingly, we must reflect their application in this amendment. As a result of adopting SFAS No. 142, we finalized our goodwill impairment testing in the fourth quarter and recorded an impairment charge of $63 million that was required to be recorded as a cumulative effect of change in accounting principle in accordance with the provisions of SFAS No. 142 as of January 1, 2002. The adoption of SFAS No. 145 resulted in a reclassification of all gains on early extinguishment of debt reported as extraordinary items to operating income.

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Forward Looking Statements

From time to time we and our representatives may provide information, whether orally or in writing, including certain statements in this Quarterly Report on Form 10-Q/A which are forward-looking. These forward-looking statements and other information are based on our beliefs as well as assumptions made by us based on information currently available.

The words anticipate, believe, estimate, expect, intend, will, and similar expressions, as they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated or expected. We do not intend to update these forward-looking statements.

We are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors which could cause actual results to differ materially from those contained in the forward-looking statements. Such factors include, but are not limited to, the following:

Competition We operate in an environment of significant competition, driven by rapid technological advances and the demands of customers to become more efficient. There are a number of companies worldwide with significant financial resources which compete with us to provide document processing products and services in each of the markets we serve, some of whom operate on a global basis. Our success in future performance is largely dependent upon our ability to compete successfully in the markets we currently serve and to expand into additional market segments.

Transition to Digital Presently, black and white light-lens copiers represent between 15%-20% of our revenues. This segment of the market is mature with anticipated declining industry revenues as the market transitions to digital technology. Some of our new digital products replace or compete with our current light-lens equipment. Changes in the mix of products from light-lens to digital, and the pace of that change as well as competitive developments could cause actual results to vary from those expected.

Expansion of Color Color printing and copying represents an important and growing segment of the market. Printing from computers has both facilitated and increased the demand for color. A significant part of our strategy and ultimate success in this changing market is our ability to develop and market technology that produce color prints and copies quickly, easily and at reduced cost. Our continuing success in this strategy depends on our ability to make the investments and commit the necessary resources in this highly competitive market as well as the pace of color adoption by our prospective customers.

Pricing Our success is dependent upon our ability to obtain adequate pricing for our products and services which provide a reasonable return to our shareholders. Depending on competitive market factors, future prices we obtain for our products and services may vary from historical levels. In addition, pricing actions to offset the effect of currency devaluations may not prove sufficient to offset further devaluations or may not hold in the face of customer resistance and/or competition.

Customer Financing Activities On average, we have historically financed approximately 80 percent of our equipment sales. To fund these arrangements, we have accessed the credit markets and used cash generated from operations. The long-term viability and profitability of our customer financing activities is dependent on our ability to borrow and the cost of borrowing in these markets. This ability and cost, in turn, is dependent on our credit ratings. We are currently funding our customer financing activity from cash generated from operations as well as from cash on hand, unregistered capital markets offerings and securitizations. There is no assurance that we will be able to continue to fund our customer financing activity at present levels. We continue to negotiate and implement third-party vendor financing programs and possible monetizations of portions of our existing finance receivable portfolios, and we continue to actively pursue alternative forms of financing including securitizations and secured borrowings. These initiatives are expected to improve our liquidity going forward. Our ability to continue to offer customer financing and be successful in the placement of equipment with customers is largely dependent upon successful implementation of our third party financing initiatives.

Productivity Our ability to sustain and improve profit margins is largely dependent on our ability to maintain an efficient, cost-effective operation. Productivity improvements through process re-engineering, design efficiency and supplier and manufacturing cost improvements are required to offset labor cost inflation, potential materials cost increases and competitive price pressures.

International Operations We derive approximately 40 percent of our revenue from operations outside the United States. In addition, we manufacture or acquire many of our products and/or their components outside the United States. Our future

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revenue, cost and results from operations could be affected by a number of factors, including changes in foreign currency exchange rates, changes in economic conditions from country to country, changes in a country s political conditions, trade protection measures, licensing requirements and local tax issues. Our ability to enter into new foreign exchange contracts to manage foreign exchange risk is currently severely limited given our below investment grade credit ratings, and we anticipate increased volatility in our results of operations due to changes in foreign exchange rates.

New Products/Research and Development The process of developing new high technology products and solutions is inherently complex and uncertain. It requires accurate anticipation of customers changing needs and emerging technological trends. We must then make long-term investments and commit significant resources before knowing whether these investments will eventually result in products that achieve customer acceptance and generate the revenues required to provide anticipated returns from these investments.

Revenue Trends Our ability to return to and maintain a consistent trend of revenue growth over the intermediate to longer term is largely dependent upon expansion of our worldwide equipment placements as well as sales of services and supplies occurring after the initial equipment placement (post sale revenue) in the key growth markets of color and multifunction devices. Revenue growth will be further enhanced through our consulting services in the areas of document content and knowledge management. The ability to achieve growth in our equipment placements is subject to the successful implementation of our initiatives to provide advanced systems, industry-oriented global solutions and services for major customers, improved direct sales productivity and expansion of our indirect distribution channels in the face of global competition and pricing pressures. The ability to grow our customers usage of our products may continue to be adversely impacted by the movement towards distributed printing and electronic substitutes. Our inability to return to and maintain a consistent trend of revenue growth could have a material adverse effect on the trend of our operating results.

Liquidity The adequacy of our continuing liquidity depends on our ability to successfully generate positive cash flow from an appropriate combination of operating improvements, financing from third parties, access to capital markets and additional asset sales including sales or securitizations of our receivables portfolios. We believe our liquidity is sufficient to meet current and anticipated needs, including all scheduled debt maturities; however, our ability to maintain positive liquidity is highly dependent on achieving our expected operating results, including capturing the benefits from restructuring activities, and completing several vendor financing and other initiatives that are discussed below. There is no assurance that these initiatives will be successful. Failure to successfully complete these initiatives could have a material adverse effect on our liquidity and our operations, and could require us to consider further measures, including deferring planned capital expenditures, modifying current restructuring plans, reducing discretionary spending, and selling additional assets.

As announced on June 21, 2002, we successfully completed the renegotiation of our $7 billion Revolving Credit Agreement dated as of October 22, 1997 (the Old Revolver). Of the original $7 billion in loans outstanding under the Old Revolver, $2.8 billion has been repaid and the remaining $4.2 billion has been refinanced under the terms of a new Amended and Restated Credit Agreement (the New Credit Facility). The New Credit Facility requires certain principal amortization payments as well as prepayments in the case of certain events. A full discussion of these terms and the final maturity dates of the various loans is included in the Capital Resources and Liquidity section in this Quarterly Report on Form 10-Q. The New Credit Facility contains affirmative and negative covenants including limitations on issuance of debt and preferred stock; certain fundamental changes; investments and acquisitions; mergers; certain transactions with affiliates; creation of liens; asset transfers; hedging transactions; payment of dividends; inter-company loans and certain restricted payments; and a requirement to transfer excess foreign cash, as defined, and excess cash of Xerox Credit Corporation to us in certain circumstances. It also contains additional financial covenants, including minimum EBITDA, maximum leverage (total adjusted debt divided by EBITDA, as defined) and maximum capital expenditures limits. We expect to be in full compliance with the covenants and other provisions of the New Credit Facility through at least the next twelve months. Any failure to be in compliance with any material provision of the New Credit Facility could have a material adverse effect on our liquidity and operations.

We expect to be in full compliance with the covenants and other provisions through December 31, 2002 and beyond.

Any failure to be in compliance with any material provision of the new credit facility could have a material adverse effect on our liquidity and operations.

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For additional information about Xerox Corporation and access to our Annual Reports to Shareholders and SEC filings, free of charge, please visit our World-Wide Web site at www.xerox.com/investor. Any information on or linked from the website is not incorporated by reference into this Form 10-Q/A.

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PART I FINANCIAL INFORMATION

Item 1

Xerox Corporation

Condensed Consolidated Statements of Operations (Unaudited)

(In millions, except per-share data)	Three months ended March 31, 2002 Restated Note 13	Three months ended March 31, 2001 Restated Notes 2 and 13
Revenues		
Sales	$ 1,583	$ 1,865
Service, outsourcing and rentals	2,011	2,134
Finance	264	292
Total Revenues	3,858	4,291
Costs and Expenses		
Cost of sales	1,025	1,377
Cost of service, outsourcing and rentals	1,159	1,292
Equipment financing interest	92	130
Research and development expenses	230	251
Selling, administrative and general expenses	1,169	1,149
Restructuring and asset impairment charges	146	129
Gain on sale of half of interest in Fuji Xerox		(769)
Other expenses, net	98	67
Total Costs and Expenses	3,919	3,626
(Loss) Income before Income Taxes (Benefits), Equity Income, Minorities Interests and Cumulative Effect of Change in Accounting Principle	(61)	665
Income taxes (benefits)	(23)	437
(Loss) Income before Equity Income, Minorities Interests and Cumulative Effect of Change in Accounting Principle	(38)	228
Equity in net income of unconsolidated affiliates	11	3
Minorities interests in earnings of subsidiaries	(24)	(7)
(Loss) Income before Cumulative Effect of Change in Accounting Principle	(51)	224
Cumulative effect of change in accounting principle	(63)	(2)

Net (Loss) Income	$ (114)	$ 222
Less: Preferred stock dividends, net		(12)
(Loss) income available to common shareholders	$ (114)	$ 210
Basic (loss) earnings per share:		
(Loss) Income before Cumulative Effect of Change in Accounting Principle	$ (0.07)	$ 0.31
Cumulative effect of change in accounting principle, net	(0.09)	
Net (Loss) Earnings per Share	$ (0.16)	$ 0.31
Diluted (loss) earnings per share:		
(Loss) Income before Cumulative Effect of Change in Accounting Principle	$ (0.07)	$ 0.28
Cumulative effect of change in accounting principle, net	(0.09)	
Net (Loss) Earnings per Share	$ (0.16)	$ 0.28

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

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Xerox Corporation

Condensed Consolidated Balance Sheets (Unaudited)

(In millions, except share data in thousands)	March 31, 2002 Restated Note 13	December 31, 2001 Restated Note 13
Assets		
Cash and cash equivalents	$ 4,747	$ 3,990
Accounts receivable, net	1,882	1,896
Finance receivables, net	3,827	3,922
Inventories	1,283	1,364
Deferred taxes and other current assets	1,338	1,428
Total Current Assets	13,077	12,600
Finance receivables due after one year, net	5,570	5,756
Equipment on operating leases, net	713	804
Land, buildings and equipment, net	1,878	1,999
Investments in affiliates, at equity	607	632
Intangible and other assets, net	4,383	4,409
Goodwill	1,419	1,445
Total Assets	$ 27,647	$ 27,645
Liabilities and Equity		
Short-term debt and current portion of long-term debt	$ 6,704	$ 6,637
Accounts payable	761	704
Accrued compensation and benefits costs	426	451
Unearned income	272	244
Other current liabilities	1,358	1,951
Total Current Liabilities	9,521	9,987
Long-term debt	10,695	10,107
Postretirement medical benefits	1,243	1,233
Deferred taxes and other liabilities	2,342	2,291
Total Liabilities	23,801	23,618
Minorities interests in equity of subsidiaries	75	73
Company-obligated, mandatorily redeemable preferred securities of subsidiary trusts holding solely subordinated debentures of the Company	1,691	1,687
Preferred stock	593	605
Deferred ESOP benefits	(135)	(135)
Common stock, including additional paid-in capital	2,634	2,622

Retained earnings	894	1,008
Accumulated other comprehensive loss	(1,906)	(1,833)
Total Liabilities and Equity	$ 27,647	$ 27,645
Shares of common stock issued and outstanding	725,295	722,314

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

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Xerox Corporation

Condensed Consolidated Statements of Cash Flows (Unaudited)

Three Months ended March 31, (In millions)	2002 Restated Note 13	2001 Restated Notes 2 and 13
Cash Flows from Operating Activities		
Net (Loss) Income	$ (114)	$ 222
Adjustments required to reconcile net (loss) income to cash flows from operating activities:		
Depreciation and amortization	319	361
Impairment of goodwill	63	
Provisions for receivables and inventory	149	182
Restructuring and asset impairment charges	146	129
Cash payments for restructurings	(122)	(156)
Gains on sales of businesses and assets	(19)	(767)
Gain on early extinguishment of debt		(28)
Minorities interests in earnings of subsidiaries	24	7
Undistributed equity in (income) loss of affiliated companies	(11)	28
Decrease in inventories	57	45
Increase in on-lease equipment	(36)	(94)
Decrease in finance receivables	157	67
(Increase) decrease in accounts receivable	(42)	60
Increase (decrease) in accounts payable and accrued compensation and benefits costs	68	(254)
Net change in current and deferred income taxes	(398)	444
Decrease in other current and non-current liabilities	(112)	(80)
Other, net	(40)	(77)
Net cash provided by operating activities	89	89
Cash Flows from Investing Activities		
Cost of additions to land, buildings and equipment	(26)	(69)
Proceeds from sales of land, buildings and equipment	3	38
Cost of additions to internal use software	(11)	(17)
Proceeds from divestitures	45	1,283
Funds placed in escrow and other restricted cash	(24)	
Net cash (used in) provided by investing activities	(13)	1,235
Cash Flows from Financing Activities		
Net change in debt	702	(212)
Dividends on common and preferred stock		(47)
Proceeds from issuances of common stock	2	28
Settlements of equity put options, net		(28)
Net cash provided by (used in) financing activities	704	(259)

Effect of exchange rate changes on cash and cash equivalents	(23)	(38)
Increase in cash and cash equivalents	757	1,027
Cash and cash equivalents at beginning of period	3,990	1,750
Cash and cash equivalents at end of period	$ 4,747	$ 2,777

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

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Xerox Corporation

Notes to Condensed Consolidated Financial Statements

($ in millions except per share data and where otherwise noted)

1. Basis of Presentation:

References herein to we or our or us refer to Xerox Corporation and consolidated subsidiaries unless the context specifically requires otherwise.

We have prepared the accompanying unaudited condensed consolidated interim financial statements in accordance with the accounting policies described in our 2001 Form 10-K, as amended (2001 Form 10-K Report) and the interim reporting requirements of Form 10-Q. Accordingly, certain information and note disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) has been condensed or omitted. You should read the condensed consolidated financial statements in conjunction with the 2001 Form 10-K Report. The condensed balance sheet information has been derived from such financial statements.

In our opinion, all adjustments (including normal recurring adjustments) for the quarters ended March 31, 2002 and 2001, which are necessary for a fair statement of operating results for the interim periods presented have been made. Interim results of operations are not necessarily indicative of the results of the full year.

The unaudited condensed consolidated financial statements have been restated (See Notes 2 and 13 to these Condensed Consolidated Financial Statements). All dollar and per share amounts have been adjusted throughout the notes to the Condensed Consolidated financial statements. For convenience and ease of reference, when we refer to (Loss) Income before Income Taxes (Benefits), Equity Income, Minorities Interests and Cumulative Effect of a Change in Accounting Principle that financial statement caption will hereafter be referred to as pre-tax income (loss).

Certain reclassifications have been made to prior year information to conform to the current year presentation.

In December 2002, we finalized our transitional goodwill impairment testing as a result of adopting Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS No. 142) on January 1, 2002, and recorded an impairment charge of $63 that was recorded as a cumulative effect of change in accounting principle in accordance with the provisions of SFAS No. 142 as of January 1, 2002. See Note 3 to these Condensed Consolidated Financial Statements for further discussion.

On April 1, 2002, we adopted the provisions of Statement of Financial Accounting Standards No. 145, Recission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections (SFAS No.145). See Note 3 to these Condensed Consolidated Financial Statements for further discussion.

Liquidity. Historically, our primary sources of funding have been cash flows from operations, borrowings under our commercial paper and term funding programs, and securitizations of accounts and finance receivables. Funds were used to finance customers purchases of our equipment, and to fund working capital requirements, capital expenditures and business acquisitions. Our specific business challenges, coupled with significant competitive and industry changes and adverse economic conditions, began to negatively affect our operations and liquidity in 2000. These challenges, which were exacerbated by significant technology and acquisition spending, negatively impacted our cash availability and created marketplace concerns regarding our liquidity, which led to credit rating downgrades and restricted access to capital markets.

Our access to many of the aforementioned sources is currently limited due to the below investment grade rating on our debt. Our debt ratings have been reduced several times since October 2000. These rating downgrades have had a number of significant negative impacts on us, including the unavailability of uncommitted bank lines, very limited ability to utilize derivative instruments to hedge foreign and interest currency exposures, thereby increasing volatility to changes in exchange rates, and higher interest rates on borrowings. Additionally, as more fully disclosed below, we are required to maintain minimum cash balances in escrow on certain borrowings, securitizations, swaps and letters of credit. These restricted cash balances are not considered cash or cash equivalents on our balance sheet.

On June 21, 2002, we permanently repaid $2.8 billion on our then-outstanding $7 billion revolving credit facility. An amended $4.2 billion credit facility replaced the previous $7 billion revolving credit facility. We currently have no incremental borrowing capacity under the new credit facility as the entire $4.2 billion is outstanding as of such date.

The new credit facility is disclosed in Note 9 and in more detail in Note 12 to our Consolidated Financial Statements included in our 2001 Form 10-K Report. The new credit facility contains more stringent financial covenants than the prior facility, including

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the following:

Minimum EBITDA (based on rolling quarters, as defined)
Maximum leverage (total adjusted debt divided by EBITDA, as defined)
Maximum capital expenditures (annual test)
Minimum consolidated net worth (quarterly test, as defined)

Failure to be in compliance with any material provision of the new credit facility could have a material adverse effect on our liquidity and operations.

In addition, as part of our Turnaround Plan (see Note 5 to these Condensed Consolidated Financial Statements), we have taken significant steps to improve our liquidity, including asset sales, monetizations of portions of our receivables portfolios, and general financings including issuance of high yield debt and preferred securities. Since early 2000, we have been restructuring our cost base. We have implemented a series of plans to resize our workforce and reduce our cost structure through such restructuring initiatives. Key factors influencing our liquidity include our ability to generate cash flow from an appropriate combination of operating improvements anticipated in our Turnaround Plan and continued execution of the initiatives described below. We believe our projected liquidity is sufficient to meet our current operating cash flow requirements and satisfy our scheduled debt maturities and other cash flow requirements. However, our ability to meet our obligations beyond March 31, 2003 is dependent on our ability to generate positive cash flow from a combination of operating improvements, capital markets transactions, third party vendor financing programs and receivable monetizations. Failure to implement these initiatives could have a material adverse effect on our liquidity and our results of operations and we would need to implement alternative plans that could include additional asset sales, additional reductions in operating costs, deferral of capital expenditures, further reductions in working capital and further debt restructurings. While we believe we could successfully complete the alternative plans, if necessary, there can be no assurance that such alternatives would be available or that we would be successful in their implementation.

2. Restatements:

Restatement for Correction of Interest Expense and Gain on Early Extinguishment of Debt:

In December 2002, we discovered an error in the calculation of our interest expense related to a debt instrument and associated interest rate swap agreements. The error occurred in connection with the adoption of Statement of Financial Accounting Standards No. 133 (SFAS No. 133) in January 2001 and resulted in an understatement of interest expense of $60 million and an overstatement of gains on extinguishment of debt of $4 for the cumulative period from January 1, 2001 to September 30, 2002. The total effects were a reduction of net income of $17 ($27 pre-tax) and an increase in net loss of $23 ($37 pre-tax) for the nine months ended September 30, 2002 and the year ended December 31, 2001, respectively. The related after-tax effects for the three months ended March 31, 2002 and 2001, were $5 ($8 pre-tax) and $5 ($9 pre-tax), respectively.

Restatement for Lease Revenue Recognition and Other Matters:

On April 11, 2002, we reached a settlement with the Securities and Exchange Commission (SEC) relating to matters that had been under investigation by the SEC since June 2000. In connection with the settlement, we agreed to restate our financial statements as of and for the years ended December 31, 1997 through 2000 as well as the first three quarters of 2001 and undertake a review of our material internal controls and accounting policies. In addition, as a result of the re-audit of our 2000 and 1999 Consolidated Financial Statements, additional adjustments were recorded. The restatement reflects adjustments which are corrections of errors made in the application of U.S. generally accepted accounting principles (GAAP) and includes (i) adjustments related to the application of the provisions of Statement of Financial Accounting Standards No. 13 Accounting for Leases (SFAS No. 13) and (ii) adjustments that arose as a result of other errors in the application of GAAP. The principal adjustments made to our Condensed Consolidated Financial Statements as of and for the three months ended March 31, 2001, reflect changes discussed in our 2001 Form 10-K Report and below.

Application of SFAS No. 13

Revenue allocations in bundled arrangements: We sell most of our products and services under bundled lease arrangements which contain multiple deliverable elements. These multiple element arrangements typically include separate equipment, service, supplies and financing components for which a customer pays a single fixed negotiated price on a monthly basis, as well as a variable amount for page volumes in excess of stated minimums. The restatement primarily reflects adjustments related to the allocation of revenue and the resultant timing of revenue recognition for sales-type leases under these bundled lease arrangements.

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The methodology we used in prior years for allocating revenue to our sales-type leases involved first, estimating the fair market value of the service and financing components of the leases. Specifically, with respect to the financing component, we estimated the overall interest rate to be applied to transactions to be the rate we targeted to achieve a fair return on equity for our financing operations. This is effectively a discounted cash flow valuation methodology. In estimating this interest rate we considered a number of factors including our cost of funds, debt levels, return on equity, debt to equity ratios, income generated subsequent to the initial lease term, tax rates, and the financing business overhead costs. We made service revenue allocations based, primarily, on an analysis of our service gross margins. After deducting service and finance values from the minimum payments due under the lease, the equipment value was derived. These allocation procedures resulted in adjustments to values initially reflected in our accounting systems, such that values attributed to the service and financing components were generally decreased and the values assigned to the equipment components were generally increased.

We have determined that the allocation methodology used in prior years did not comply with SFAS No. 13. Therefore, we have utilized a different methodology to account for our sales-type leases involving multiple element arrangements. This methodology begins by determining the fair value of the service component, as well as other executory costs and any profit thereon, and second, by determining the fair value of the equipment based on a comparison of the equipment values in our accounting system to a range of cash selling prices. The resultant implicit interest rate is then compared to fair market value rates to assess the reasonableness of the overall allocations to the multiple elements.

We conducted an extensive analysis of available verifiable objective evidence of fair value (VOE) based on cash sales prices and compared these prices to the range of equipment values recorded in our lease accounting systems. With the exception of Latin America, where operating lease accounting is applied as discussed below, the range of cash selling prices supports the reasonableness of the range of equipment lease prices as originally recorded, at the inception of the lease, in our accounting systems. In applying our new methodology described above, we have concluded that the revenue amounts allocated by our accounting systems to the equipment component of a multiple element arrangement represents a reasonable estimate of the fair value of the equipment. As a consequence, $109 of previously recorded equipment sale revenue during the three months ended March 31, 2001 have been reversed and we have recognized additional service and finance income of $129, which represents the impact of reversing amounts previously recorded as equipment sales-type leases and recognizing such amounts over the lease term. The net increase in revenue, as a result of this change, was $20 for the three month period ended March 31, 2001.

Transactions not qualifying as sales-type leases: We re-evaluated the application of SFAS No. 13 for leases originally accounted for as sales-type leases in our Latin American operations, and we determined that these leases should have been recorded as operating leases. This determination was made after we conducted an in-depth review of the historical effective lease terms compared to the contractual terms of our lease agreements. Since historically, and during all periods presented, a majority of leases were terminated significantly prior to the expiration of the contractual lease term, we concluded that such leases did not qualify as sales-type leases under certain provisions of SFAS No. 13. Specifically, because we generally do not collect the receivable from the initial transaction, upon termination of the contract or during the subsequent lease term, the recoverability of the lease investment was not predictable at the inception of the original lease term. As a consequence, $48 of previously recorded equipment sale revenue during the three months ended March 31, 2001, have been reversed and we have recognized additional rental revenue of $73, which represents the impact of changing the classification of previously recorded sales-type leases to operating leases. The net increase in revenue, as a result of this change, was $25 for the three month period ended March 31, 2001.

During the course of the restatement process, we concluded that the estimated economic life used for classifying leases for the majority of our products should have been five years versus the three to four years we previously utilized. This resulted from an in-depth review of our lease portfolios, for all periods presented, which indicated that the most frequent term of our lease contracts was 60 months. We believe that this has been and continues to be representative of the period during which the equipment is expected to be economically usable, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease. As a consequence, many shorter duration leases did not meet the criteria of SFAS No. 13 to be accounted for as sales-type leases. Additionally, other lease arrangements were found to not meet other requirements of SFAS No. 13 for treatment as sales-type leases. As a consequence $11 of equipment revenue recorded during the three months ended March 31, 2001 have been reversed and we have recognized additional rental revenue of $29, which represents the impact of changing the classification of previously recorded sales-type leases to operating leases. The net increase in revenue, as a result of this change was $18 for the three month period ended March 31, 2001.

Accounting for the sale of equipment subject to operating leases: We have historically sold pools of equipment subject to operating leases to third party finance companies (the counterparty) or through structured financings with third parties and recorded the transaction as a sale at the time the equipment is accepted by the counterparty. These transactions increased equipment sale revenue, primarily in Latin America, in 2000 and 1999 by $148 and $400, respectively. Upon additional review of the terms and conditions of these contracts, we determined that the form of the transactions at inception included retained

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ownership risk provisions or other contingencies that precluded these transactions from meeting the criteria for sale treatment under the provisions of SFAS No. 13. The form of these transactions notwithstanding, these risk of loss or contingency provisions have resulted in only minor impacts on our operating results. These transactions have however been restated and recorded as operating leases in our Consolidated Financial Statements. As a consequence we have recognized additional revenue of $60 during the three months ended March 31, 2001, which represents the impact of changing the classification of previously recorded sales-type leases to operating leases. Additionally, for transactions in which cash proceeds were received up-front we have recorded these proceeds as secured borrowings. The remaining balance of these borrowings aggregated $42 at March 31, 2002.

Other adjustments

In addition to the aforementioned revenue related adjustments, other errors in the application of GAAP were identified. These include the following:

Sales of receivables transactions: During 1999, we sold $1,395 of U.S. finance receivables originating from sales-type leases. These transactions were accounted for as sales of receivables. These sales were made to special purpose entities (SPEs), which qualified for non-consolidation in accordance with then existing accounting requirements. As a result of the changes in the estimated economic life of our equipment to five years, certain leases transferred in these transactions did not meet the sales-type lease requirements and were accounted for as operating leases. This change in lease classification affected a number of the leases that were sold into the aforementioned SPEs resulting in these entities now holding operating leases as assets. This change disqualified the SPEs from non-consolidation and effectively required us to record the proceeds received on these sales as secured borrowings. This increased our net finance receivables by $271 and debt by $320 as of March 31, 2001. The adjustment to increase receivables also resulted in the recognition of Financing revenue of $6 for the three month period ended March 31, 2001. The debt balance remaining was $39 at March 31, 2002.

South Africa deconsolidation: We determined that we had been inappropriately consolidating our South African affiliate since 1998, as the minority joint venture partner has substantive participating rights. Accordingly, we have deconsolidated all assets, liabilities, revenues and expenses. We now account for this investment on the equity method of accounting. The reduction in revenues was $17 for the three month period ended March 31, 2001, and there was no impact on Net Income or Common Shareholders Equity as the reduction in pre-tax income is offset by an increase in equity in net income of unconsolidated affiliates.

Purchase accounting reserves: In connection with the 1998 acquisition of XL Connect Solutions, Inc. (XLConnect), we recorded liabilities aggregating $65 for contingencies identified at the date of the acquisition. During 2000 and 1999, we determined that certain of these contingent liabilities were no longer required, and $29 of the liabilities were either reversed into income or we charged certain costs related to ongoing activities of the acquired business against these liabilities. Upon additional review it was subsequently determined that approximately $51 of these contingent liabilities did not meet the criteria to initially be recorded as acquisition liabilities. Accordingly, we have adjusted the goodwill and liabilities at the date of acquisition and corrected the 2000 and 1999 income statement impacts. The income statement impact for the three months ended March 31, 2001 was less than $1.

Restructuring reserves: During 2001 and 2000, we recorded restructuring charges associated with our decisions to exit certain activities of the business. Upon additional review we determined that certain adjustments made to the original charges were not in accordance with GAAP. The adjustments to decrease pre-tax income in the first quarter of 2001 of $28 consist primarily of corrections to the timing of the release of reserves originally recorded under the March 2000 restructuring program. We should have reversed the applicable reserves in late 2000 when the information was available that our original plan had changed indicating that such reserves were no longer necessary. Previously, the reversal was recorded in early 2001.

Other adjustments: In addition to the above items and in connection with our review of prior year s financial records we determined that other accounting errors were made with respect to the accounting for certain non-recurring transactions, the timing of recording and reversing certain liabilities and the timing of recording certain asset write-offs. We have restated our March 31, 2001 Condensed Consolidated Financial Statements for such items. These adjustments decreased pre-tax income by $1 for the three months ended March 31, 2001. There were also similar adjustments to reduce revenue by $23 for the three month period ended March 31, 2001.

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The following table presents the effects of the aforementioned adjustments on total revenue:

Increase (decrease) to total revenue:

	Three Months Ended March 31, 2001
Revenue, previously reported	$4,202
Application of SFAS No. 13:	
Revenue allocations in bundled arrangements	20
Latin America operating lease accounting	25
Other transactions not qualifying as sales-type leases	18
Sales of equipment subject to operating leases	60
Subtotal	123
Other revenue restatement adjustments:	
Sales of receivables transactions	6
South Africa deconsolidation	(17)
Other revenue items, net	(23)
Subtotal	(34)
Increase in total revenue	89
Revenue, restated	$4,291

The following table presents the effects of the aforementioned adjustments on pre-tax income:

Increase (decrease) to pre-tax income:

	Three Months Ended March 31, 2001
Pre-tax income, previously reported(1)	$631
Revenue restatement adjustments:	
Revenue allocations in bundled arrangements	21
Latin America operating lease accounting	15
Other transactions not qualifying as sales-type leases	13
Sales of equipment subject to operating leases	27
Sales of receivables transactions	(4)

South Africa deconsolidation	(2)
Other revenue items, net	2
Subtotal	72
Other restatement adjustments:	
Restructuring reserves	(28)
Other, net	(1)
Subtotal	(29)
Increase in pre-tax income	43
Correction of interest expense (see Note 13)	(9)
Pre-tax income, restated	$665