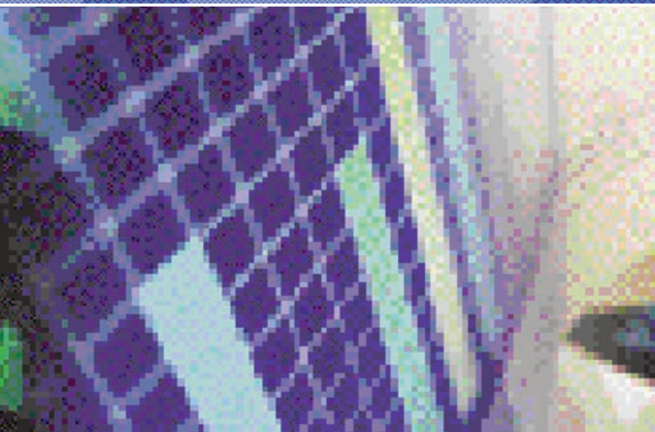

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What's New in Financial Reporting: Financial Statement Notes from Annual Reports

What's New in Financial Reporting: Financial Statement Notes from Annual Reports

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What's New in Financial Reporting: Financial Statement Notes from Annual Reports

Executive Summary

This study provides disclosures selected from 2006 annual reports to illustrate how companies addressed accounting issues recently promulgated by the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC). We selected specific accounting issues based on a review of recent pronouncements by the FASB, comment letters issued by the SEC, and other trends that appeared as we reviewed 2006 annual reports. Our report focuses most on four accounting areas where we found considerable variation in disclosures: (1) Commitments and contingencies, (2) Derivatives and financial instruments, (3) Goodwill and intangibles, and (4) Revenue recognition. We selected disclosures that used innovative techniques to clearly address difficult accounting issues, avoiding "boilerplate" disclosures that provide little company-specific information.

Financial executives can use this report in two ways: as a quick update of recent trends, or as a reference tool for dealing with challenging reporting issues. We have posted all financial statement footnotes gathered for this study on the Financial Executives International website.

Introduction

This study analyzes selected notes to 2006 financial statements to identify common practices and recent reporting trends. We identified accounting issues from the most recent financial reporting season, and then selected disclosures from annual reports to illustrate how companies addressed these issues. We focused on the most recent accounting pronouncements and trends in financial reporting in order to help financial executives to prepare disclosures.

To conduct this study, we reviewed annual reports for nearly all of the 100 largest publicly-traded companies, as filed for fiscal year-end December 2006. We identified accounting issues based on recent pronouncements, U.S. Securities and Exchange Commission (SEC) issuance of recent comment letters, and inclusion of topics in companies' critical accounting policies. Then, we selected individual disclosures that address these issues in innovative ways. Most of the disclosures that we selected appear to have been developed specifically for a company's own operations and industry standards, rather than "boilerplate" disclosures. As we read through company's annual reports, we selected other disclosures and topics that appeared to represent new trends.

While reviewing financial statements, we noted four areas where there was particular variation in disclosures: (1) Commitments and contingencies, (2) Derivatives and financial instruments, (3) Goodwill and intangibles, and (4) Revenue recognition. In each of these areas, we selected disclosures to represent a wide range of accounting issues and industry trends.

This Executive Report can be used in two ways. First, as a quick update to summarize recent trends in the most annual reporting season, we suggest that the financial executive thumb through the report. They'll find many interesting illustrations of how filers prepared disclosures to address complex reporting issues. Second, as a reference to address common accounting issues, we suggest that the financial executive review the disclosures in this report. To further facilitate use of this report as a reference tool, we have posted all financial statement footnotes gathered for this study in the Financial Executives International website at http://www.financialexecutives.org/eweb/DynamicPage.aspx?site=_fei&webcode=edg_home.

On October 19, 2007, the Financial Accounting Standards Board (FASB) announced the anticipated release of a beta version of the *FASB Accounting Standards Codification*. This codification integrates and topically organizes accounting pronouncements issued by the FASB, the American Institute of Certified Public Accountants, (AICPA), and the Emerging Issues Task Force (EITF). The FASB plans to provide free online access to the *Codification* in late 2007 or early 2008, and then to approve it as the single authoritative source of U.S. GAAP in early 2009.

Disclosures

Asset retirement obligations

Financial Accounting Standards Board Statement No. 143, Accounting for Asset Retirement Obligations (SFAS 143) http://www.fasb.org/pdf/fas143.pdf requires all entities to recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made (Par. 3). The obligation to incur an asset retirement obligation generally occurs upon the acquisition, construction, or development of an asset, or through the normal operation of the asset (Par. 2, FASB Interpretation 47 (FIN 47) http://www.fasb.org/pdf/fin%2047.pdf Par. 3).

SFAS 143 defines this fair value as the amount at which that liability could be settled in a current transaction between willing parties (Par. 7). In the absence of quoted market prices in active market prices, the FASB suggests a present value technique, based on estimates of expected cash flows (Par. 8). In most cases, the appropriate rate of interest should be based on a credit-adjusted risk-free rate.

Per SFAS 143, the entity must disclose:

a. A general description of the asset retirement obligations and the associated long-lived assets,
b. The fair value of assets legally restricted for purposes of settling asset retirement obligations, and
c. A reconciliation of beginning and ending aggregate carrying amount of asset retirement obligations, separately showing changes attributable to:
    1. Liabilities incurred in the current period
    2. Liabilities settled in the current period
    3. Accretion expense, and
    4. Revisions in estimated cash flows, whenever there is a significant change in one or more of those four components during the reporting period.

Entities must also disclose the facts and reasons for any asset retirement obligations whose fair values cannot be reasonably estimated (Par. 22).

FIN 47 clarifies the definition of a conditional asset retirement to be "a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity." While the timing or method of settlement may be conditional on a future event, and uncertainty exists about the timing and/or method of settlement, the entity's obligation to retire the asset is unconditional (Par. 3).

CONOCOPHILLIPS

ConocoPhillips combined its asset retirement obligation and environmental cost disclosures. In Note 1, the Company summarizes its accounting policies. In Note 14, it lists both asset retirement obligations and environmental cost liabilities, breaking these liabilities into current and long-term portions.

From Note 1, Accounting Policies:

Asset Retirement Obligations and Environmental Costs—We record the fair value of legal obligations to retire and remove long-lived assets in the period in which the obligation is incurred (typically when the asset is installed at the production location). When the liability is initially recorded, we capitalize this cost by increasing the carrying amount of the related properties, plants and equipment. Over time the liability is increased for the change in its present value, and the capitalized cost in properties, plants and equipment is depreciated over the useful life of the related asset. See Note 14—Asset Retirement Obligations and Accrued Environmental Costs, for additional information.

Environmental expenditures are expensed or capitalized, depending upon their future economic benefit. Expenditures that relate to an existing condition caused by past operations, and do not have a future economic benefit, are expensed. Liabilities for environmental expenditures are recorded on an undiscounted basis (unless acquired in a purchase business combination) when environmental assessments or cleanups are probable and the costs can be reasonably estimated. Recoveries of environmental remediation costs from other parties, such as state reimbursement funds, are recorded as assets when their receipt is probable and estimable.

Note 14—Asset Retirement Obligations and Accrued Environmental Costs

Asset retirement obligations and accrued environmental costs at December 31 were:

	Millions of Dollars	
	2006	2005
Asset retirement obligations	$ 5,402	3,901
Accrued environmental costs	1,062	989
Total asset retirement obligations and accrued environmental costs	6,464	4,890
Asset retirement obligations and accrued environmental costs due within one year*	(845)	(299)
Long-term asset retirement obligations and accrued environmental costs	$ 5,619	4,591

*Classified as a current liability on the balance sheet, under the caption "Other accruals." Included in 2006 was $386 million related to assets held for sale. See Note 9—Assets Held for Sale, for additional information.

Asset Retirement Obligations

SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation when it is incurred (typically when the asset is installed at the production location). When the liability is initially recorded, the entity capitalizes the cost by increasing the carrying amount of the related properties, plants and equipment. Over time, the liability increases for the change in its present value, while the capitalized cost depreciates over the useful life of the related asset.

In March 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143" (FIN 47). This Interpretation clarifies that an entity is required to recognize a liability for a legal obligation to perform asset retirement activities when the retirement is conditional on a future event and if the liability's fair value can be reasonably estimated. We implemented FIN 47 effective December 31, 2005. Accordingly, there was no impact on income from continuing operations in 2005. Application of FIN 47 increased net properties, plants and equipment by $269 million, and increased asset retirement obligation liabilities by $417 million. The cumulative effect of this

accounting change decreased 2005 net income by $88 million (after reduction of income taxes of $60 million).

We have numerous asset removal obligations that we are required to perform under law or contract once an asset is permanently taken out of service. Most of these obligations are not expected to be paid until several years, or decades, in the future and will be funded from general company resources at the time of removal. Our largest individual obligations involve removal and disposal of offshore oil and gas platforms around the world, oil and gas production facilities and pipelines in Alaska, and asbestos abatement at refineries.

SFAS No. 143 calls for measurements of asset retirement obligations to include, as a component of expected costs, an estimate of the price that a third party would demand, and could expect to receive, for bearing the uncertainties and unforeseeable circumstances inherent in the obligations, sometimes referred to as a market-risk premium. To date, the oil and gas industry has no examples of credit-worthy third parties who are willing to assume this type of risk, for a determinable price, on major oil and gas production facilities and pipelines. Therefore, because determining such a market-risk premium would be an arbitrary process, we excluded it from our SFAS No. 143 and FIN 47 estimates.

During 2006 and 2005, our overall asset retirement obligation changed as follows:

	Millions of Dollars	
	2006	2005 *
Balance at January 1	$ 3,901	3,089
Accretion of discount	248	165
New obligations	154	144
Burlington Resources acquisition	732	—
Changes in estimates of existing obligations	299	350
Spending on existing obligations	(130)	(75)
Property dispositions	(20)	—
Foreign currency translation	218	(189)
Adoption of FIN 47	—	417
Balance at December 31	$ 5,402	3,901

*Certain amounts have been reclassified to conform to current year presentation.

The following table presents the estimated pro forma effects of the retroactive application of the adoption of FIN 47 as if the Interpretation had been adopted on the dates the obligations arose:

	Millions of Dollars Except Per Share Amounts	
	2005	2004
Pro forma net income*	$13,600	8,113
Pro forma earnings per share		

Basic	9.76	5.87
Diluted	9.60	5.79
Pro forma asset retirement obligations at December 31	3,901	3,407

*Net income of $13,529 million for 2005 has been adjusted to remove the $88 million cumulative effect of the change in accounting principle attributable to FIN 47.

Accrued Environmental Costs

Total environmental accruals at December 31, 2006 and 2005, were $1,062 million and $989 million, respectively. The 2006 increase in total accrued environmental costs is due to new accruals and accretion, partially offset by payments on accrued environmental costs.

We had accrued environmental costs of $646 million and $552 million at December 31, 2006 and 2005, respectively, primarily related to cleanup at domestic refineries and underground storage tanks at U.S. service stations, and remediation activities required by Canada and the state of Alaska at exploration and production sites. We had also accrued in Corporate and Other $306 million and $320 million of environmental costs associated with non-operating sites at December 31, 2006 and 2005, respectively. In addition, $110 million and $117 million were included at December 31, 2006 and 2005, respectively, where the company has been named a potentially responsible party under the Federal Comprehensive Environmental Response, Compensation and Liability Act, or similar state laws. Accrued environmental liabilities will be paid over periods extending up to 30 years.

Because a large portion of the accrued environmental costs were acquired in various business combinations, they are discounted obligations. Expected expenditures for acquired environmental obligations are discounted using a weighted-average 5 percent discount factor, resulting in an accrued balance for acquired environmental liabilities of $756 million at December 31, 2006. The expected future undiscounted payments related to the portion of the accrued environmental costs that have been discounted are: $157 million in 2007, $123 million in 2008, $82 million in 2009, $63 million in 2010, $49 million in 2011, and $372 million for all future years after 2011.

Asset impairments

25 out of 100 filers in the 2006 reporting season reported tangible asset impairments as a critical accounting policy, according to a recent study by the author (Forthcoming, *CPA Journal*, December 2007),

SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets http://www.fasb.org/pdf/fas144.pdf established a single accounting model for long-lived assets to be disposed of by sale. A company shall report an impairment loss only if the carrying amount of a long-lived asset, or an asset group, is not recoverable and exceeds its fair value.

COMCAST

In its Summary of Significant Accounting Policies note, Comcast reported its Impairments Policies for Asset Impairments, Franchise Rights and Goodwill. Comcast provided substantial detail about how it tests for impairments.

Note 2, Summary of Significant Accounting Policies

Asset Impairments

Property and Equipment and Intangible Assets Subject to Amortization
We periodically evaluate the recoverability and estimated lives of our property and equipment and intangible assets subject to amortization in accordance with SFAS No. 144, "Accounting for the

Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). Our evaluations occur whenever events or changes in circumstances indicate that the carrying amount may not be recoverable or the useful life has changed, and they include analyses based on the cash flows generated by the underlying assets and profitability information, including estimated future operating results, trends or other determinants of fair value. If the total of the expected future undiscounted cash flows is less than the carrying amount of the asset, we recognize a loss for the difference between the fair value and the carrying value of the asset. Unless presented separately, the loss is included as a component of either depreciation expense or amortization expense, as appropriate.

Franchise Rights
We evaluate the recoverability of our franchise rights annually, or more frequently whenever events or changes in circumstances indicate that the assets might be impaired. We estimate the fair value of our cable franchise rights utilizing various valuation techniques, including discounted cash flow analysis, multiples of operating income before depreciation and amortization generated by the underlying assets, analyses of current market transactions and profitability information. If the value of our cable franchise rights determined by these evaluations is less than the carrying amount, we recognize an impairment charge for the difference between the estimated fair value and the carrying value of the assets. When we perform our impairment test, we group the recorded values of our various cable franchise rights into geographic regions. We evaluate these groups periodically to ensure impairment testing is performed at an appropriate level. We have not recorded any significant impairment charges as a result of our impairment testing.

Goodwill
Goodwill is the excess of the acquisition cost of an acquired entity over the fair value of the identifiable net assets acquired. We evaluate the recoverability of our goodwill annually, or more frequently whenever events or changes in circumstances indicate that the asset might be impaired. We perform the impairment assessment of our goodwill one level below the business segment level, except for our Cable business. In our Cable business, since components one level below the segment level are not separate reporting units and have similar economic characteristics, we aggregate the components into one reporting unit at the Cable segment level.

HESS

In its disclosure of Impairment policies, Hess explains how it estimates the fair value of oil and gas fields.

1. Summary of Significant Accounting Policies

Impairment of Long-Lived Assets: The Corporation reviews long-lived assets, including oil and gas properties at a field level, for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recovered. If the carrying amounts are not expected to be recovered by undiscounted future cash flows, the assets are impaired and an impairment loss is recorded. The amount of impairment is based on the estimated fair value of the assets determined by discounting anticipated future net cash flows. In the case of oil and gas fields, the net present value of future cash flows is based on management's best estimate of future prices, which is determined with reference to recent historical prices and published forward prices, applied to projected production volumes of individual fields and discounted at a rate commensurate with the risks involved. The projected production volumes represent reserves, including probable reserves, expected to be produced based on a stipulated amount of capital expenditures. The production volumes, prices and timing of production are consistent with internal projections and other externally reported information. Oil and gas prices used for determining asset impairments

will generally differ from the year-end prices used in the standardized measure of discounted future net cash flows.

SAFEWAY

The following two notes describe Safeway's policy on recognizing and recording impairments related to store closings, and the actual store closing and impairment charges incurred.

Note A: The Company and Significant Accounting Policies

Store Closing and Impairment Charges Safeway regularly reviews its stores' operating performance and assesses the Company's plans for certain store and plant closures. In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," losses related to the impairment of long-lived assets are recognized when expected future cash flows are less than the asset's carrying value. At the time a store is closed or because of changes in circumstances that indicate the carrying value of an asset may not be recoverable, the Company evaluates the carrying value of the assets in relation to its expected future cash flows. If the carrying value is greater than the future cash flows, a provision is made for the impairment of the assets to write the assets down to estimated fair value. Fair value is determined by estimating net future cash flows, discounted using a risk-adjusted rate of return. The Company calculates impairment on a store-by-store basis. These provisions are recorded as a component of operating and administrative expense and are disclosed in Note C.

When stores that are under long-term leases close, the Company records a liability for the future minimum lease payments and related ancillary costs, net of estimated cost recoveries that may be achieved through subletting properties or through favorable lease terminations, discounted using a risk-adjusted rate of interest. This liability is recorded at the time the store is closed. Activity included in the reserve for store lease exit costs is disclosed in Note C.

Note C: Store Closing and Impairment Charges

Impairment Write-Downs Safeway recognized impairment charges on the write-down of long-lived assets of $39.2 million in 2006, $78.9 million in 2005 and $39.4 million in 2004. This includes Randall's impairment charges of $54.7 million in 2005. These charges are included as a component of operating and administrative expense.

Store Lease Exit Costs The reserve for store lease exit costs includes the following activity for 2006, 2005 and 2004 (in millions):

	2006	2005	2004
Beginning balance	**$197.7**	$167.1	$129.1
Provision for estimated net future cash flows of additional closed stores (1)	**0.1**	67.3	55.1
Net cash flows, interest accretion, changes in estimates of net future cash flows	**(33.6)**	(36.7)	(17.1)
Ending balance	**$164.2**	$197.7	$167.1

(1) Estimated net future cash flows represents future minimum lease payments and related ancillary costs from the date of closure to the end of the remaining lease term, net of estimated cost recoveries that may be achieved through subletting properties or through favorable lease terminations.

Store lease exit costs are included as a component of operating and administrative expense, and the liability is included in accrued claims and other liabilities.

UNITED PARCEL SERVICE

The following note describes the Company's accounting policy for long-lived asset impairments, and discloses one impairment charge from December 2004.

NOTE 1. SUMMARY OF ACCOUNTING POLICIES

Impairment of Long-Lived Assets

In accordance with the provisions of FASB Statement No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," we review long-lived assets for impairment when circumstances indicate the carrying amount of an asset may not be recoverable based on the undiscounted future cash flows of the asset. If the carrying amount of the asset is determined not to be recoverable, a write-down to fair value is recorded. Fair values are determined based on quoted market values, discounted cash flows, or external appraisals, as applicable. We review long-lived assets for impairment at the individual asset or the asset group level for which the lowest level of independent cash flows can be identified.

In December 2004, we permanently removed from service a number of Boeing 727, 747 and McDonnell Douglas DC-8 aircraft. As a result of the actual and planned retirement of these aircraft, we conducted an impairment evaluation, which resulted in a $110 million impairment charge during the fourth quarter for these aircraft (including the related engines and parts), $91 million of which impacted the U.S. domestic package segment and $19 million of which impacted the international package segment.

This charge is included in the caption "Other expenses". UPS continues to operate all of its other aircraft and continues to experience positive cash flow, and no impairments of aircraft were recognized in 2006 or 2005.

Cash flows statement

Companies' cash flow disclosures now provide more detailed information about noncash investing and financing activities. Furthermore, many companies now report condensed consolidating cash flows statements as part of their segment disclosures, even though this information is not required by SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information.

BEST BUY

Best Buy reported a consolidating cash flows statement as part of its segment disclosures:

$ in millions, except per share amounts

Condensed Consolidating Statements of Cash Flows

Fiscal Year Ended March 3, 2007

	Best Buy Co., Inc.	Guarantor Subsidiary	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Total cash (used in) provided by operating activities	$ (213)	$ 170	$ 1,805	$ —	$ 1,762
Investing Activities					
Additions to property and equipment	—	(512)	(221)	—	(733)
Purchases of available-for-sale securities	(4,386)	—	(155)	—	(4,541)
Sales of available-for-sale securities	4,570	—	316	—	4,886
Acquisitions of businesses, net of cash acquired	—	—	(421)	—	(421)
Proceeds from disposition of investments	24	—	—	—	24
Other, net	(5)	4	6	—	5

Total cash provided by (used in) investing activities	203	(508)	(475)	—	(780)
Financing Activities					
Repurchase of common stock	(599)	—	—	—	(599)
Issuance of common stock under employee stock purchase plan and for the exercise of stock options	217	—	—	—	217
Dividends paid	(174)	—	—	—	(174)
Repayments of debt	(2)	—	(82)	—	(84)
Proceeds from issuance of debt	—	39	57	—	96
Excess tax benefits from stock-based compensation	50	—	—	—	50
Other, net	—	—	(19)	—	(19)
Change in intercompany receivable/payable	743	297	(1,040)	—	—
Total cash provided by (used in) financing activities	235	336	(1,084)	—	(513)
Effect of Exchange Rate Changes on Cash	—	—	(12)	—	(12)
Increase (Decrease) in Cash and Cash Equivalents	225	(2)	234	—	457
Cash and Cash Equivalents at Beginning of Year	10	79	659	—	748
Cash and Cash Equivalents at End of Year	$ 235	$ 77	$ 893	$ —	$ 1,205

NEWS CORP.

This disclosure describes cash paid for income tax and interest, and explains how business acquisitions were financed.

NOTE 23. ADDITIONAL FINANCIAL INFORMATION

Supplemental Cash Flow Information

	For the years ended June 30,		
	2006	2005	2004
	(in millions)		
Supplemental cash flows information:			
Cash paid for income taxes	$ 558	$ 455	$ 467
Cash paid for interest	715	671	614
Shares issued in lieu of cash dividend payments	—	35	63
Sale of other investments	22	10	1
Purchase of other investments	(50)	(37)	(92)
Supplemental information on businesses acquired:			
Fair value of assets acquired	2,215	6,253	7,013
Cash acquired	26	162	11
Less: Liabilities assumed	232	1,371	10
Assets exchanged	—	1,191	—
Minority interest acquired	(39)	(3,483)	—
Cash paid	2,015	232	3,286

Fair value of stock consideration issued to third parties	33	7,104	3,728
Treasury stock acquired	—	13,548	—
Fair value of stock consideration	$ 33	$ 20,652	$3,728

Change in accounting principle

In May 2005, FASB issued SFAS 154, Accounting Changes and Error Corrections http://www.fasb.org/pdf/fas154.pdf. The new Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, as if that principle had always been used, except in situations where it is impracticable to determine period-specific effects or the cumulative effect of the change. A change in accounting estimate, such as a change in depreciable life, shall be accounted for in the period of change, and/or future periods. The statement took effect for fiscal years beginning after December 15, 2005, so that the 2006 annual reports are the first to fall under this requirement.

In September 2006, the SEC released Staff Accounting Bulletin 108, *Considering the Effects of Prior Year Misstatements when Quanitfying Misstatements in Current Year Financial Statements*. See separate section in this Executive Report.

BEST BUY

Best Buy reported a change in accounting principle to recognize investment purchases and sales on the trade date, rather than the settlement date.

1. Summary of Significant Accounting Policies

Change in Accounting Principle

During the fourth quarter of fiscal 2007, we elected to change our accounting principle to recognize the purchase and sale of investments in marketable debt and equity securities on the trade date. Prior to the fourth quarter of fiscal 2007, we recognized these transactions in our consolidated financial statements on the settlement date. We concluded that use of the trade date was preferable to the settlement date as trade date reflects the risks and rewards of investment ownership on a more timely basis. In addition, this method more closely aligns with the standard methodology utilized by our new investment custodian to account for investment transactions. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 154, *Accounting Changes and Error Corrections,* this change in accounting principle has been applied retrospectively to our consolidated financial statements for all prior periods. This change in accounting principle had no effect on previously reported operating income, net earnings, shareholders' equity or cash flows. The effect on the consolidated balance sheets for each applicable quarter was as follows in fiscal 2007 and 2006 (unaudited):

	2007		2006	
	3rd Quarter	2nd Quarter	4th Quarter	1st Quarter
Cash and cash equivalents				
As reported	$ 1,202	$ 1,104	$ 748	$ 458
As adjusted	1,208	1,104	748	458
Short-term investments				
As reported	1,513	1,564	3,051	2,148
As adjusted	1,802	1,534	3,041	2,101

Receivables				
As reported	1,112	483	439	350
As adjusted	1,115	513	449	413
Accrued liabilities				
As reported	1,315	958	878	741
As adjusted	1,613	958	878	757

This change in accounting principle had no effect on any quarter of fiscal 2007 or 2006 other than those in the table above.

SYSCO

The following Changes in Accounting note discloses adoption of SFAS 158, and EITF 04-13.

2. CHANGES IN ACCOUNTING

Pension Measurement Date Change and SFAS 158 Adoption

Beginning in fiscal 2006, SYSCO changed the measurement date for the pension and other postretirement benefit plans from fiscal year-end to May 31st, which represents a change in accounting. Management believes this accounting change was preferable, as the one-month acceleration of the measurement date allows additional time for management to evaluate and report the actuarial pension measurements in the year-end financial statements and disclosures within the accelerated filing deadlines of the Securities and Exchange Commission. The cumulative effect of this change in accounting resulted in an increase to earnings in the first quarter of fiscal 2006 of $9,285,000, net of tax.

Pro forma net earnings and earnings per share adjusted for the effect of retroactive application of the change in measurement date on net pension costs, net of tax, are as follows:

	2005	2004 (53 Weeks)
Reported net earnings	$961,457,000	$907,214,000
Retroactive effect, net of tax	5,781,000	(1,254,000)
Pro forma net earnings	$967,238,000	$905,960,000
Basic earnings per share:		
Reported net earnings	$ 1.51	$ 1.41
Retroactive effect, net of tax	0.01	—
Pro forma net earnings	$ 1.52	$ 1.41
Diluted earnings per share:		
Reported net earnings	$ 1.47	$ 1.37
Retroactive effect, net of tax	0.01	—
Pro forma net earnings	$ 1.48	$ 1.37

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS 158). SFAS 158 has two major provisions. The recognition and disclosure provision requires an employer to recognize a plan's funded status in its statement of financial position and recognize the changes in a defined benefit postretirement plan's funded status in comprehensive income in the year in which the changes occur. The measurement date provision requires an employer to measure a plan's assets and obligations as of the end of the employer's fiscal year. SYSCO adopted SFAS 158's recognition and disclosure requirements as of June 30, 2007. In addition, SYSCO has elected to early adopt the measurement date provision in order to

adopt both provisions of this accounting standard at the same time. See discussion of the impact of adoption in Note 10, Employee Benefit Plans.

EITF 04-13 Adoption
In September 2005, the Emerging Issues Task Force reached a consensus on EITF 04-13 which requires that two or more inventory transactions with the same counterparty (as defined) should be viewed as a single nonmonetary transaction if the transactions were entered into in contemplation of one another. Exchanges of inventory between entities in the same line of business should be accounted for at fair value or recorded at carrying amounts, depending on the classification of such inventory. This guidance was effective for the fourth quarter of fiscal 2006 for SYSCO. SYSCO has certain transactions where finished goods are purchased from a customer or sourced by that customer for warehousing and distribution and resold to the same customer. These transactions are evidenced by title transfer and are separately invoiced. Historically, the company has recorded such transactions in the consolidated results of operations within cost of sales for the purchase amount and within sales for the sales amount. In fiscal 2007, the company recorded the net effect of such transactions in the consolidated results of operations within sales by reducing sales and cost of sales in the amount of $334,002,000. In the fourth quarter of fiscal 2006, the company recorded the net effect of such transactions in the consolidated results of operations within sales by reducing sales and cost of sales in the amount of $99,803,000. The amounts included in the consolidated results of operations within cost of sales for the 39 week period ended April 1, 2006 and fiscal 2005 that were recorded on a gross basis prior to the adoption of EITF 04-13 were $279,746,000 and $347,018,000, respectively. Such amounts were not restated when the new standard was adopted because only prospective treatment was allowed.

Commitments, contingencies and legal proceedings

In above-referenced *CPA Journal* article, contingencies appeared as the third-most listed item in companies' critical accounting policies disclosures, with 44 out of 100 filers including contingencies as a critical accounting policy.

Among the companies we reviewed, environmental contingencies affected many disclosures.

CHEVRON TEXACO

This excerpt from Chevron Texaco's Significant Accounting Policies describes the company's accounting policies with respect to environmental liabilities.

Environmental Expenditures Environmental expenditures that relate to ongoing operations or to conditions caused by past operations are expensed. Expenditures that create future benefits or contribute to future revenue generation are capitalized.

Liabilities related to future remediation costs are recorded when environmental assessments or cleanups or both are probable and the costs can be reasonably estimated. For the company's U.S. and Canadian marketing facilities, the accrual is based in part on the probability that a future remediation commitment will be required. For crude oil, natural gas and mineral producing properties, a liability for an asset retirement obligation is made, following FAS 143. Refer to Note 24, on page FS-58, for a discussion of FAS 143.

For federal Superfund sites and analogous sites under state laws, the company records a liability for its designated share of the probable and estimable costs and probable amounts for other potentially responsible parties when mandated by the regulatory agencies because the other parties are not able to pay their respective shares.

The gross amount of environmental liabilities is based on the company's best estimate of future costs using currently available technology and applying current regulations and the company's own internal environmental policies. Future amounts are not discounted. Recoveries or reimbursements are recorded as assets when receipt is reasonably assured.

GENERAL MOTORS

The following excerpt from GM's significant accounting policies note describes the company's accounting policies for environmental costs.

Environmental Costs

GM records a liability for environmental cleanup costs when it is both probable and reasonably estimable. For environmental sites where there are potentially multiple responsible parties, GM records a liability for the allocable share of the costs related to its involvement with the site, as well as an allocable share of costs related to insolvent parties or unidentified shares. For environmental sites where GM is the only potentially responsible party, GM records a liability for the total estimated costs of remediation before consideration of recovery from insurers or other third parties.

GM has an established process to develop its environmental reserve. This process consists of a number of phases which begins with the visual site inspections and an examination of historical site records. Once a potential problem has been identified, physical sampling of the site may include analysis of ground water and soil borings. The evidence obtained is then evaluated and based upon this evaluation, a remediation strategy is submitted for approval. The final phase of this process involves the commencement of remediation activities according to the approved plan. This process is used globally for all such sites.

Included in the estimated environmental liabilities are costs for ongoing operating, maintenance, and monitoring at environmental sites where remediation has been put in place. Subsequent adjustments to initial estimates are recorded as necessary based upon additional information developed in subsequent periods. This liability is determined based upon historical experience and discounted using a risk-free rate of return over the periods in which the ongoing maintenance is expected to occur, generally five to 30 years.

E. I. DUPONT DE NEMOURS

Dupont combines information about warranty liabilities, indemnifications, debt guarantees, and operating leases into a single note.

20. COMMITMENTS AND CONTINGENT LIABILITIES

Guarantees

Product Warranty Liability

The company warrants to the original purchaser of its products that it will, at its option, repair or replace, without charge, such products if they fail due to a manufacturing defect. The term of these warranties varies (30 days to 10 years) by product. The company's estimated product warranty liability as of December 31, 2006 is $17. The company has recourse provisions for certain products that would enable recovery from third parties for amounts paid under the warranties. The company accrues for product warranties when, based on available information, it is probable that customers will make claims under warranties relating to products that have been sold and a reasonable estimate of the costs (based on historical claims experience relative to sales) can be made.

Indemnifications

In connection with acquisitions and divestitures, the company has indemnified respective parties against certain liabilities that may arise in connection with these transactions and business activities prior to the completion of the transaction. The term of these indemnifications, which typically pertain to environmental, tax and product liabilities, is generally indefinite. In addition, the company indemnifies its duly elected or appointed directors and officers to the fullest extent permitted by Delaware law, against liabilities incurred as a result of their activities for the company, such as adverse judgments relating to litigation matters. If the indemnified party were to incur a liability or have a liability increase as a result of a successful claim, pursuant to the terms of the indemnification, the company would be required to reimburse the indemnified party. The maximum

amount of potential future payments is generally unlimited. The carrying amounts recorded for all indemnifications as of December 31, 2006 and 2005 is $105 and $103, respectively. Although it is reasonably possible that future payments may exceed amounts accrued, due to the nature of indemnified items, it is not possible to make a reasonable estimate of the maximum potential loss or range of loss. No assets are held as collateral and no specific recourse provisions exist.

In connection with the sale of INVISTA, the company indemnified Koch against certain liabilities primarily related to taxes, legal and environmental matters and other representations and warranties. The estimated fair value of these obligations of $70 is included in the indemnifications balance of $105 at December 31, 2006. The fair value was based on management's best estimate of the value expected to be required to issue the indemnifications in a standalone, arm's length transaction with an unrelated party and, where appropriate, by the utilization of probability weighted discounted net cash flow models.

Obligations for Equity Affiliates & Others

The company has directly guaranteed various debt obligations under agreements with third parties related to equity affiliates, customers, suppliers and other unaffiliated companies. At December 31, 2006, the company had directly guaranteed $551 of such obligations, plus $262 relating to guarantees of historical obligations for divested subsidiaries and affiliates. This represents the maximum potential amount of future (undiscounted) payments that the company could be required to make under the guarantees. The company would be required to perform on these guarantees in the event of default by the guaranteed party. No material loss is anticipated by reason of such agreements and guarantees.

The fair value of the guarantees that have been issued or modified since the company's adoption of FASB Interpretation No. 45 on January 1, 2003, is not material. As of December 31, 2006, the liabilities recorded for these obligations were not material. In certain cases, the company has recourse to assets held as collateral, as well as personal guarantees from customers and suppliers. Assuming liquidation, these assets are estimated to cover approximately 48 percent of the $251 of guaranteed obligations of customers and suppliers. Set forth below are the company's guaranteed obligations at December 31, 2006:

	Short-Term	Long-Term	Total
Obligations for customers, suppliers and other unaffiliated companies[1]			
Bank borrowings (terms up to 5 years)	$ 145	$ 104	$ 249
Revenue bonds (term 2 years)	—	2	2
Obligations for equity affiliates[2]			
Bank borrowings (terms up to 6 years)	244	23	267
Leases on equipment and facilities (terms up to 4 years)	—	33	33
Total obligations for customers, suppliers, other unaffiliated companies and equity affiliates	389	162	551
Obligations for divested subsidiaries and affiliates[3]			
Conoco (terms from 2-20 years)	—	159	159
Consolidation Coal Sales Company (term 4-5 years)	—	103	103
Total obligations for divested subsidiaries and affiliates	—	262	262
	$ 389	$ 424	$ 813

1 Existing guarantees for customers and suppliers arose as part of contractual agreements.

2	Existing guarantees for equity affiliates arose for liquidity needs in normal operations.
3	The company has guaranteed certain obligations and liabilities related to divested subsidiaries, including Conoco and its subsidiaries and affiliates and Consolidation Coal Sales Company. The Restructuring, Transfer and Separation Agreement between DuPont and Conoco requires Conoco to use its best efforts to have Conoco, or any of its subsidiaries, substitute for DuPont. Conoco and Consolidation Coal Sales Company have indemnified the company for any liabilities the company may incur pursuant to these guarantees.

Operating Leases

The company uses various leased facilities and equipment in its operations. The terms for these leased assets vary depending on the lease agreement.

As of December 31, 2006, the company had one synthetic lease program relating to short-lived equipment. In connection with this synthetic lease program, the company had residual value guarantees in the amount of $101 at December 31, 2006. The guarantee amounts are tied to the unamortized lease values of the assets under synthetic lease and are due should the company decide neither to renew these leases nor to exercise its purchase option. At December 31, 2006, the company had no liabilities recorded for these obligations. Any residual value guarantee amounts paid to the lessor may be recovered by the company from the sale of the assets to a third party.

Future minimum lease payments (including residual value guarantee amounts) under noncancelable operating leases are $294, $155, $109, $82 and $59 for the years 2007, 2008, 2009, 2010 and 2011 respectively, and $107 for subsequent years and are not reduced by noncancelable minimum sublease rentals due in the future in the amount of $10. Net rental expense under operating leases was $282 in 2006, $265 in 2005, and $272 in 2004.

FEDEX CORP.

FedEx Corp. provides detailed information about purchase commitments for aircraft in its Commitments note.

NOTE 13: COMMITMENTS

Annual purchase commitments under various contracts as of May 31, 2007 were as follows (in millions):

	Aircraft	Aircraft-Related [(1)]	Other [(2)]	Total
2008	$ 482	$150	$ 16	$ 648
2009	788	157	11	956
2010	907	146	11	1,064
2011	640	3	10	653
2012	31	—	9	40
Thereafter	—	—	107	107

(1) Primarily aircraft modifications.

(2) Primarily advertising and promotion contracts.

The amounts reflected in the table above for purchase commitments represent noncancelable agreements to purchase goods or services. Commitments to purchase aircraft in passenger configuration do not include the attendant costs to modify these aircraft for cargo transport unless we have entered into non-cancelable commitments to modify such aircraft. Open purchase orders

that are cancelable are not considered unconditional purchase obligations for financial reporting purposes.

In September 2006, we announced a $2.6 billion multi-year program to acquire and modify approximately 90 Boeing 757-200 ("B757") aircraft to replace our narrowbody fleet of Boeing 727-200 aircraft. We expect to bring the new aircraft into service during the eight-year period between calendar years 2008 and 2016 contingent upon identification and purchase of suitable B757 aircraft. As of May 31, 2007, we had entered into agreements to purchase 30 B757 aircraft under this program.

In November 2006, we entered into an agreement to acquire 15 new Boeing 777 Freighter ("B777F") aircraft and an option to purchase an additional 15 B777F aircraft. In connection with the decision to purchase these aircraft, we cancelled our order of ten Airbus A380-800F aircraft. In March 2007, we entered into a separate settlement agreement with Airbus that, among other things, provides us with credit memoranda applicable to the purchase of goods and services in the future. The net impact of this settlement was immaterial to our 2007 results and was recorded as an operating gain during the fourth quarter of 2007.

Deposits and progress payments of $109 million have been made toward these purchases and other planned aircraft-related transactions. In addition, we have committed to modify our DC10 aircraft for two-man cockpit configurations. Future payments related to these activities are included in the table above. Aircraft and aircraft-related contracts are subject to price escalations. The following table is a summary of the number and type of aircraft we are committed to purchase as of May 31, 2007, with the year of expected delivery:

	A300	A310	B757	B777F	Total
2008	9	2	7	—	18
2009	3	—	13	—	16
2010	—	—	4	6	10
2011	—	—	3	9	12
2012	—	—	3	—	3
Thereafter	—	—	—	—	—
Total	12	2	30	15	59

NOTE 14: CONTINGENCIES

Wage-and-Hour. We are a defendant in a number of lawsuits filed in federal or California state courts containing various class-action allegations under federal or California wage-and-hour laws. The plaintiffs in these lawsuits allege, among other things, that they were forced to work "off the clock," were not paid overtime and were not provided work breaks or other benefits. The plaintiffs generally seek unspecified monetary damages, injunctive relief, or both.

Race Discrimination. During the fourth quarter of 2007, we settled *Satchell v. FedEx Express*, a class action lawsuit in California that alleged discrimination in the Western region of the United States against certain current and former minority employees in pay and promotion. The settlement will require a payment of approximately $55 million, which is covered by insurance. The court has granted preliminary approval of the settlement, and a hearing is scheduled for August 2007 for the court to consider final approval of the settlement.

Other. We are subject to other legal proceedings that arise in the ordinary course of our business. In the opinion of management, the aggregate liability, if any, with respect to these other actions will not materially adversely affect our financial position, results of operations or cash flows.

HONEYWELL INTERNATIONAL

In the following excerpt, Honeywell provides very detailed information about environmental matters, including information about related accruals specific environmental sites.

Note 21—Commitments and Contingencies

Environmental Matters

We are subject to various federal, state, local and foreign government requirements relating to the protection of the environment. We believe that, as a general matter, our policies, practices and procedures are properly designed to prevent unreasonable risk of environmental damage and personal injury and that our handling, manufacture, use and disposal of hazardous or toxic substances are in accordance with environmental and safety laws and regulations. However, mainly because of past operations and operations of predecessor companies, we, like other companies engaged in similar businesses, have incurred remedial response and voluntary cleanup costs for site contamination and are a party to lawsuits and claims associated with environmental and safety matters, including past production of products containing toxic substances. Additional lawsuits, claims and costs involving environmental matters are likely to continue to arise in the future.

With respect to environmental matters involving site contamination, we continually conduct studies, individually or jointly with other potentially responsible parties, to determine the feasibility of various remedial techniques to address environmental matters. It is our policy to record appropriate liabilities for environmental matters when remedial efforts or damage claim payments are probable and the costs can be reasonably estimated. Such liabilities are based on our best estimate of the undiscounted future costs required to complete the remedial work. The recorded liabilities are adjusted periodically as remediation efforts progress or as additional technical or legal information becomes available. Given the uncertainties regarding the status of laws, regulations, enforcement policies, the impact of other potentially responsible parties, technology and information related to individual sites, we do not believe it is possible to develop an estimate of the range of reasonably possible environmental loss in excess of our accruals. We expect to fund expenditures for these matters from operating cash flow. The timing of cash expenditures depends on a number of factors, including the timing of remedial investigations and feasibility studies, the timing of litigation and settlements of remediation liability, personal injury and property damage claims, regulatory approval of cleanup projects, remedial techniques to be utilized and agreements with other parties. The following table summarizes information concerning our recorded liabilities for environmental costs:

	Years Ended December 31,		
	2006	2005	2004
Beginning of year	$ 879	$ 895	$ 593
Accruals for environmental matters deemed probable and reasonably estimable	218	186	536
Environmental liability payments	(264)	(247)	(248)
Other adjustments(1)	(2)	45	14
End of year	$ 831	$ 879	$ 895

(1) In 2005, $45 million principally relates to reclassification of the carrying value of land to property, plant and equipment with a corresponding increase to environmental liabilities.

Environmental liabilities are included in the following balance sheet accounts:

	December 31,	
	2006	2005
Accrued liabilities	$251	$237
Other liabilities	580	642
	$831	$879

Although we do not currently possess sufficient information to reasonably estimate the amounts of liabilities to be recorded upon future completion of studies, litigation or settlements, and neither the timing nor the amount of the ultimate costs associated with environmental matters can be determined, they could be material to our consolidated results of operations or operating cash flows in the periods recognized or paid. However, considering our past experience and existing reserves, we do not expect that these environmental matters will have a material adverse effect on our consolidated financial position.

New Jersey Chrome Sites—Provisions have been made in our financial statements for the estimated costs of the court-ordered excavation and transport for offsite disposal of approximately one million tons of chromium residue present at a predecessor Honeywell site located in Jersey City, New Jersey, which are expected to be incurred evenly over a five-year period that started in April 2006. We do not expect implementation of this remedy to have a material adverse effect on our future consolidated results of operations, operating cash flows or financial position. Provision also has been made in our financial statements for the estimated costs of implementing groundwater and sediment remedial plans, which have been proposed for the site and are presently under review by the court in which litigation concerning the site is pending. The ultimate cost of remediating the river sediments may be reduced as numerous third parties could be responsible for an as yet undetermined portion of these costs.

The above-referenced site is the most significant of the twenty-one sites located in Hudson County, New Jersey which are the subject of an Administrative Consent Order (ACO) entered into with the New Jersey Department of Environmental Protection (NJDEP) in 1993. Remedial investigations and activities consistent with the ACO have been conducted and are underway at the other sites (the "Honeywell ACO Sites"). We have recorded reserves for the Honeywell ACO Sites where appropriate under the accounting policy described above.

On May 3, 2005, NJDEP filed a lawsuit in New Jersey Superior Court against Honeywell and two other companies seeking declaratory and injunctive relief, unspecified damages, and the reimbursement of unspecified total costs relating to sites in New Jersey allegedly contaminated with chrome ore processing residue. The claims against Honeywell relate to the activities of a predecessor company which ceased its New Jersey manufacturing operations in the mid-1950's. While the complaint is not entirely clear, it appears that approximately 100 sites are at issue, including 17 of the Honeywell ACO Sites, sites that the other two companies have agreed to remediate under separate administrative consent orders, as well as approximately 53 other sites (identified in the complaint as the "Publicly Funded Sites") for which none of the three companies has signed an administrative consent order. In addition to claims specific to each company, NJDEP claims that all three companies should be collectively liable for all the chrome sites based on a "market share" theory. In addition, NJDEP is seeking treble damages for all costs it has incurred or will incur at the Publicly Funded Sites. Honeywell believes that it has no connection with the sites covered by the other companies' administrative consent orders and, therefore, has no responsibility for those sites. At the Honeywell ACO Sites, we are conducting remedial investigations and activities consistent with the ACO; thus, we do not believe the lawsuit will significantly change our obligations with respect to the Honeywell ACO Sites. Lawsuits have also been filed against Honeywell in the District Court under the Resource Conservation and Recovery Act (RCRA) by two New Jersey municipal utilities seeking the cleanup of chromium residue at two Honeywell ACO sites and by a citizens' group against Honeywell and thirteen other defendants with respect to contamination on about a dozen of the Honeywell ACO Sites. Discovery is underway in these

cases. For the reasons stated above, we do not believe these lawsuits will significantly change our obligations with respect to the Honeywell ACO sites.

Although it is not possible at this time to predict the outcome of the litigation and administrative proceedings discussed above, we believe that the allegations are without merit and we intend to vigorously defend against these lawsuits. We do not expect these matters to have a material adverse effect on our consolidated financial position. While we expect to prevail, an adverse litigation outcome could have a material adverse impact on our consolidated results of operations and operating cash flows in the periods recognized or paid.

Onondaga Lake, Syracuse, NY—A predecessor company to Honeywell operated a chemical plant which is alleged to have contributed mercury and other contaminants to the Lake. In July 2005, the New York State Department of Environmental Conservation (the DEC) issued its Record of Decision with respect to remediation of industrial contamination in the Lake. In October 2006, Honeywell entered into a Consent Decree with the State of New York to implement the remedy set forth in the Record of Decision. In January 2007, the Consent Decree was approved by the United States District Court for the Northern District of New York.

The Record of Decision calls for a combined dredging/capping remedy generally in line with the approach recommended in the Feasibility Study submitted by Honeywell in May 2004. Based on currently available information and analysis performed by our engineering consultants, we have accrued for our estimated cost of implementing the remedy set forth in the Record of Decision. Our estimating process considered a range of possible outcomes and the amounts recorded reflect our best estimate at this time. Given the scope and complexity of this project, it is possible that actual costs could exceed estimated costs by an amount that could have a material adverse impact on our consolidated results of operations and operating cash flows in the periods recognized or paid. At this time, however, we cannot identify any legal, regulatory or technical reason to conclude that a specific alternative outcome is more probable than the outcome for which we have made provisions in our financial statements. The DEC's aggregate cost estimate, which is higher than the amount reserved, is based on the high end of the range of potential costs for major elements of the Record of Decision and includes a contingency. The actual cost of the Record of Decision will depend upon, among other things, the resolution of certain technical issues during the design phase of the remediation. We do not believe that this matter will have a material adverse impact on our consolidated financial position. In December 2006, the United States Fish and Wildlife Service published notice of its intent to pursue natural resource damages related to the site. It is not possible to predict the outcome or timing of its assessments, which are typically lengthy processes lasting several years, or the amounts of or responsibility for these damages.

Dundalk Marine Terminal, Baltimore–Chrome residue from legacy chrome plant operations in Baltimore was deposited as fill at the Dundalk Marine Terminal ("DMT"), which is owned and operated by the Maryland Port Administration ("MPA"). Honeywell and the MPA have been sharing costs to investigate and mitigate related environmental issues, and have entered into a cost sharing agreement under which Honeywell will bear a 77 percent share of the costs of developing and implementing permanent remedies for the DMT facility. The investigative phase (which began in April 2006) is expected to take approximately 18 to 36 months, after which the appropriate remedies will be identified and chosen. We have negotiated a Consent Decree with the MPA and Maryland Department of the Environment ("MDE") with respect to the investigation and remediation of the DMT facility, and that Consent Decree was filed with the Maryland state court for Baltimore County, Maryland. BUILD, a Baltimore community group, together with a local church and two individuals, have intervened and are challenging the Consent Decree. We do not believe that this matter will have a material adverse impact on our consolidated financial position or operating cash flows. Given the scope and complexity of this project, it is possible that the cost of remediation, when determinable, could have a material adverse impact on our results of operations in the periods recognized.

In the following tables, Honeywell provides very detailed information about asbestos-related litigation.

Friction Products—Honeywell's Bendix friction materials (Bendix) business manufactured automotive brake pads that contained chrysotile asbestos in an encapsulated form. There is a group of existing and potential claimants consisting largely of individuals that allegedly performed brake replacements.

From 1981 through December 31, 2006, we have resolved approximately 105,000 Bendix related asbestos claims including trials covering 124 plaintiffs, which resulted in 116 favorable verdicts. Trials covering eight individuals resulted in adverse verdicts; however, two of these verdicts were reversed on appeal, three are or shortly will be on appeal, and the remaining three claims were settled. The following tables present information regarding Bendix related asbestos claims activity:

	Years Ended December 31,	
Claims Activity	2006	2005
Claims Unresolved at the beginning of year	79,502	76,348
Claims Filed	4,391	7,520
Claims Resolved	(26,785)	(4,366)(a)
Claims Unresolved at the end of year	57,108	79,502

	December 31,	
Disease Distribution of Unresolved Claims	2006	2005
Mesothelioma and Other Cancer Claims	4,843	4,810
Other Claims	52,265	74,692
Total Claims	57,108	79,502

Excludes 2,524 claims which were inadvertently included in resolved claims as of December 31, 2005 which had no impact on the recorded values for such claims and has been corrected for purposes of this presentation.

Approximately 45 percent of the approximately 57,000 pending claims at December 31, 2006 are on the inactive, deferred, or similar dockets established in some jurisdictions for claimants who allege minimal or no impairment. The approximately 57,000 pending claims also include claims filed in jurisdictions such as Texas, Virginia, and Mississippi that historically allowed for consolidated filings. In these jurisdictions, plaintiffs were permitted to file complaints against a pre-determined master list of defendants, regardless of whether they have claims against each individual defendant. Many of these plaintiffs may not actually have claims against Honeywell. Based on state rules and prior experience in these jurisdictions, we anticipate that many of these claims will ultimately be dismissed. During 2006 approximately 16,000 cases were dismissed. More than 85 percent of these dismissals occurred in Mississippi as a result of judicial rulings relating to non-resident filings and venue. We anticipate additional dismissals in this jurisdiction.

Honeywell has experienced average resolution values per claim excluding legal costs as follows:

	Years Ended December 31,		
	2006	2005	2004
		(in whole dollars)	
Malignant claims	$ 33,000	$ 58,000	$ 90,000
Nonmalignant claims	$ 250	$ 600	$ 1,600

It is not possible to predict whether resolution values for Bendix related asbestos claims will increase, decrease or stabilize in the future.

Our consolidated financial statements reflect an estimated liability for resolution of pending and future Bendix related abestos claims at December 31, 2006 of $528 million. Prior to December 2006, we only accrued for the estimated cost of pending Bendix related abestos claims as we could not reasonably estimate losses which could arise from future Bendix related abestos claims. Due to the steady three-year decline in the rate of Bendix related asbestos claims filed and reduced volatility in those rates, we believe that it is now possible to determine a reasonable estimate of the costs that will be incurred for claims filed over the next five years. Accordingly during the fourth quarter of 2006, we recorded a reserve of $335 million for the estimated cost of future Bendix related asbestos claims based on the number of pending claims at December 31, 2006, disease classifications, and expected resolution values and historic dismissal rates. Prior to December 2006, we have historically valued Bendix claims at the average resolution value of the previous five years. In December 2006, based on the Bendix related experience over the last five years we now believe that the average of the prior two years is a more accurate indicator of future resolution values, and accordingly, we have applied this two-year resolution value in calculating both the reserves for pending and future Bendix related asbestos claims. This change resulted in a reduction of $118 million in the reserve for pending Bendix claims in the fourth quarter of 2006. We will update the expected resolution values used to estimate the cost of pending and future Bendix claims during the fourth quarter each year.

The estimated liability for future claims represents the estimated value of future asbestos related bodily injury claims expected to be asserted against Bendix through 2011. In light of the uncertainties inherent in making long-term projections, as well as certain factors unique to friction product asbestos claims, we do not believe that we have a reasonable basis for estimating asbestos claims beyond 2011 under SFAS No. 5, "Accounting for Contingencies". The estimate is based upon Bendix historical experience in the tort system for the two years ended December 31, 2006 with respect to claims filing and resolution. The methodology used to estimate the liability for future claims has been commonly accepted by numerous courts. It is substantially similar to that used to estimate the future NARCO related asbestos claims liability, with the exception that the valuation methodology for Bendix includes payment rates based on Bendix resolution history, rather than expected trust payment rates.

....

Refractory and Friction Products—The following tables summarize information concerning NARCO and Bendix asbestos related balances:

Asbestos Related Liabilities

	Year Ended December 31, 2006			Year Ended December 31, 2005			Year Ended December 31, 2004		
	Bendix	NARCO	Total	Bendix	NARCO	Total	Bendix	NARCO	Total
Beginning of year	$287	$1,782	$2,069	$355	$2,395	$2,750	$249	$2,760	$3,009
Accrual for claims filed and defense costs incurred	125	-	125	170	-	170	186	-	186
Accrual for estimated cost of future claims	335	-	335	-	-	-	-	-	-
Reduction in estimated cost of future claims	-	(207)	(207)	-	-	-	-	-	-
Asbestos related liability payments	(103)	(316)	(419)	(153)	(597)	(750)	(153)	(365)	(518)
Settlement with plaintiff firms of certain pending asbestos claims (1)	-	32	32	-	(21)	(21)	-	-	-

Update of expected resolution on values for pending claims	(118)	-	(118)	(85)	-	(85)	73	-	73
Other	2	-	2	-	5	5	-	-	-
End of year	$528	$1,291	$1,819	$287	$1,782	$2,069	$355	$2,395	$2,750

(1) In 2006, charge of $32 million reflects a settlement of certain pending asbestos claims. In 2005, consists of a charge of $52 million to reflect a settlement of certain pending asbestos claims during the year and a credit of $73 million related to a re-estimation of asbestos reserves in connection with an additional settlement.

Insurance Recoveries for Asbestos Related Liabilities

	Year Ended December 31, 2006			Year Ended December 31, 2005			Year Ended December 31, 2004		
	Bendix	NARCO	Total	Bendix	NARCO	Total	Bendix	NARCO	Total
Beginning of year	$377	$1,096	$1,473	$336	$1,226	$1,562	$209	$1,238	$1,447
Probable insurance recoveries related to claims filed	11	-	11	34	-	34	96	-	96
Probable insurance recoveries related to annual update of expected resolution values for pending claims	39	-	39	(15)	-	(15)	39	-	39
Insurance receipts for asbestos related liabilities	(166)	(100)	(266)	(33)	(127)	(160)	(8)	(59)	(67)
Insurance receivables settlements and write-offs (1)	34	(41)	(7)	41	-	41	-	-	-
Other (2)	7	-	7	14	(3)	11	-	47	47
End of year	$302	$955	$1,257	$377	$1,096	$1,473	$336	$1,226	$1,562

(1) In 2006, $34 million reflects gains from settlements with two Bendix insurance carriers and $41 million represents the write-down of the NARCO insurance receivable to reflect the reduction in the estimated cost of future claims. In 2005, consists of gains from insurance settlements of $172 million principally related to a structured insurance settlement with a carrier which converted a policy into a future, fixed, non-contingent payment stream, and charges of $131 million for write-offs of certain amounts due from insurance carriers.

(2) In 2004, $47 million related to additional probable insurance recoveries identified in the second quarter of 2004 based on our ongoing evaluation of the enforceability of our rights under the various insurance policies.

NARCO and Bendix asbestos related balances are included in the following balance sheet accounts:

	December 31, 2006	December 31, 2005
Other current assets	$ 157	$ 171
Insurance recoveries for asbestos related liabilities	1,100	1,302
	$ 1,257	$ 1,473

Accrued liabilities	$ 557	$ 520
Asbestos related liabilities	1,262	1,549
	$ 1,819	$ 2,069

HALLIBURTON

Halliburton reports commitments and contingencies related to Foreign Corrupt Practices Act investigations, bidding practices, securities litigation, operations in Iran, RICO violations, operations in Iraq, environmental cleanup, and other issues.

Note 13. Other Commitments and Contingencies

Foreign Corrupt Practices Act investigations

The SEC is conducting a formal investigation into whether improper payments were made to government officials in Nigeria through the use of agents or subcontractors in connection with the construction and subsequent expansion by TSKJ of a multibillion dollar natural gas liquefaction complex and related facilities at Bonny Island in Rivers State, Nigeria. The DOJ is also conducting a related criminal investigation. The SEC has also issued subpoenas seeking information, which we are furnishing, regarding current and former agents used in connection with multiple projects, including current and prior projects, over the past 20 years located both in and outside of Nigeria in which the Halliburton energy services business, The M.W. Kellogg Company, M.W. Kellogg Limited, Kellogg Brown & Root or their or our joint ventures, are or were participants. In September 2006, the SEC requested that we enter into a tolling agreement with respect to its investigation. We anticipate that we will enter into an appropriate tolling agreement with the SEC.

TSKJ is a private limited liability company registered in Madeira, Portugal whose members are Technip SA of France, Snamprogetti Netherlands B.V. (a subsidiary of Saipem SpA of Italy), JGC Corporation of Japan, and Kellogg Brown & Root (a subsidiary of ours and successor to The M.W. Kellogg Company), each of which had an approximately 25% interest in the venture at December 31, 2006. TSKJ and other similarly owned entities entered into various contracts to build and expand the liquefied natural gas project for Nigeria LNG Limited, which is owned by the Nigerian National Petroleum Corporation, Shell Gas B.V., Cleag Limited (an affiliate of Total), and Agip International B.V. (an affiliate of ENI SpA of Italy). M.W. Kellogg Limited is a joint venture in which KBR had a 55% interest at December 31, 2006; and M.W. Kellogg Limited and The M.W. Kellogg Company were subsidiaries of Dresser Industries before our 1998 acquisition of Dresser Industries. The M.W. Kellogg Company was later merged with a subsidiary of ours to form Kellogg Brown & Root, one of our subsidiaries.

The SEC and the DOJ have been reviewing these matters in light of the requirements of the FCPA. In addition to performing our own investigation, we have been cooperating with the SEC and the DOJ investigations and with other investigations into the Bonny Island project in France, Nigeria and Switzerland. We also believe that the Serious Frauds Office in the United Kingdom is conducting an investigation relating to the Bonny Island project. Our Board of Directors has appointed a committee of independent directors to oversee and direct the FCPA investigations. Through our committee of independent directors, we will continue to oversee and direct the investigations, and KBR's directors who are independent of us and KBR, acting as a committee of KBR's Board of Directors, will monitor the continuing investigation directed by us.

The matters under investigation relating to the Bonny Island project cover an extended period of time (in some cases significantly before our 1998 acquisition of Dresser Industries and continuing through the current time period). We have produced documents to the SEC and the DOJ both voluntarily and pursuant to company subpoenas from the files of numerous officers and employees of Halliburton and KBR, including current and former executives of Halliburton and KBR, and we are making our employees available to the SEC and the DOJ for interviews. In addition, we understand that the SEC has issued a subpoena to A. Jack Stanley, who formerly served as a consultant and chairman of KBR, and to others, including certain of our and KBR's current and former employees, former executive officers of KBR, and at least one subcontractor of

KBR. We further understand that the DOJ has issued subpoenas for the purpose of obtaining information abroad, and we understand that other partners in TSKJ have provided information to the DOJ and the SEC with respect to the investigations, either voluntarily or under subpoenas.

The SEC and DOJ investigations include an examination of whether TSKJ's engagements of Tri-Star Investments as an agent and a Japanese trading company as a subcontractor to provide services to TSKJ were utilized to make improper payments to Nigerian government officials. In connection with the Bonny Island project, TSKJ entered into a series of agency agreements, including with Tri-Star Investments, of which Jeffrey Tesler is a principal, commencing in 1995 and a series of subcontracts with a Japanese trading company commencing in 1996. We understand that a French magistrate has officially placed Mr. Tesler under investigation for corruption of a foreign public official. In Nigeria, a legislative committee of the National Assembly and the Economic and Financial Crimes Commission, which is organized as part of the executive branch of the government, are also investigating these matters. Our representatives have met with the French magistrate and Nigerian officials. In October 2004, representatives of TSKJ voluntarily testified before the Nigerian legislative committee.

We notified the other owners of TSKJ of information provided by the investigations and asked each of them to conduct their own investigation. TSKJ has suspended the receipt of services from and payments to Tri-Star Investments and the Japanese trading company and has considered instituting legal proceedings to declare all agency agreements with Tri-Star Investments terminated and to recover all amounts previously paid under those agreements. In February 2005, TSKJ notified the Attorney General of Nigeria that TSKJ would not oppose the Attorney General's efforts to have sums of money held on deposit in accounts of Tri-Star Investments in banks in Switzerland transferred to Nigeria and to have the legal ownership of such sums determined in the Nigerian courts.

As a result of these investigations, information has been uncovered suggesting that, commencing at least 10 years ago, members of TSKJ planned payments to Nigerian officials. We have reason to believe that, based on the ongoing investigations, payments may have been made by agents of TSKJ to Nigerian officials. In addition, information uncovered in the summer of 2006 suggests that, prior to 1998, plans may have been made by employees of The M.W. Kellogg Company to make payments to government officials in connection with the pursuit of a number of other projects in countries outside of Nigeria. We are reviewing a number of recently discovered documents related to KBR activities in countries outside of Nigeria with respect to agents for projects after 1998. Certain of the activities discussed in this paragraph involve current or former employees or persons who were or are consultants to us and our investigation continues.

In June 2004, all relationships with Mr. Stanley and another consultant and former employee of M.W. Kellogg Limited were terminated. The terminations occurred because of violations of our Code of Business Conduct that allegedly involved the receipt of improper personal benefits from Mr. Tesler in connection with TSKJ's construction of the Bonny Island project.

In 2006, we suspended the services of another agent who, until such suspension, had worked for KBR outside of Nigeria on several current projects and on numerous older projects going back to the early 1980s. The suspension will continue until such time, if ever, as we can satisfy ourselves regarding the agent's compliance with applicable law and our Code of Business Conduct. In addition, we suspended the services of an additional agent on a separate current Nigerian project with respect to which we have received from a joint venture partner on that project allegations of wrongful payments made by such agent.

If violations of the FCPA were found, a person or entity found in violation could be subject to fines, civil penalties of up to $500,000 per violation, equitable remedies, including disgorgement (if applicable) generally of profit, including prejudgment interest on such profits, causally connected to the violation, and injunctive relief. Criminal penalties could range up to the greater of $2 million per violation or twice the gross pecuniary gain or loss from the violation, which could be substantially greater than $2 million per violation. It is possible that both the SEC and the DOJ could assert that there have been multiple violations, which could lead to multiple fines. The amount of any fines or monetary penalties that could be assessed would depend on, among other factors, the findings regarding the amount, timing, nature, and scope of any improper payments, whether any such payments were authorized by or made with knowledge of us or our affiliates, the amount of gross pecuniary gain or loss involved, and the level of cooperation provided the

government authorities during the investigations. Agreed dispositions of these types of violations also frequently result in an acknowledgement of wrongdoing by the entity and the appointment of a monitor on terms negotiated with the SEC and the DOJ to review and monitor current and future business practices, including the retention of agents, with the goal of assuring compliance with the FCPA. Other potential consequences could be significant and include suspension or debarment of our ability to contract with governmental agencies of the United States and of foreign countries. During 2006, KBR and its affiliates had revenue of approximately $5.8 billion from its government contracts work with agencies of the United States or state or local governments. If necessary, we would seek to obtain administrative agreements or waivers from the United States Department of Defense (DoD) and other agencies to avoid suspension or debarment. In addition, we may be excluded from bidding on United Kingdom Ministry of Defence (MoD) contracts in the United Kingdom if we are convicted for a corruption offense or if the MoD determines that our actions constituted grave misconduct. During 2006, KBR had revenue of approximately $1.0 billion from its government contracts work with the MoD. Suspension or debarment from the government contracts business would have a material adverse effect on our business, results of operations, and cash flows.

These investigations could also result in third-party claims against us, which may include claims for special, indirect, derivative or consequential damages, damage to our business or reputation, loss of, or adverse effect on, cash flow, assets, goodwill, results of operations, business prospects, profits or business value, adverse consequences on our ability to obtain or continue financing for current or future projects or claims by directors, officers, employees, affiliates, advisors, attorneys, agents, debt holders, or other interest holders or constituents of us or our subsidiaries. In this connection, we understand that the government of Nigeria gave notice in 2004 to the French magistrate of a civil claim as an injured party in that proceeding. We are not aware of any further developments with respect to this claim. In addition, we could incur costs and expenses for any monitor required by or agreed to with a governmental authority to review our continued compliance with FCPA law.

As of December 31, 2006, we are unable to estimate an amount of probable loss or a range of possible loss related to these matters.

Bidding practices investigation

In connection with the investigation into payments relating to the Bonny Island project in Nigeria, information has been uncovered suggesting that Mr. Stanley and other former employees may have engaged in coordinated bidding with one or more competitors on certain foreign construction projects, and that such coordination possibly began as early as the mid-1980s.

On the basis of this information, we and the DOJ have broadened our investigations to determine the nature and extent of any improper bidding practices, whether such conduct violated United States antitrust laws, and whether former employees may have received payments in connection with bidding practices on some foreign projects.

If violations of applicable United States antitrust laws occurred, the range of possible penalties includes criminal fines, which could range up to the greater of $10 million in fines per count for a corporation, or twice the gross pecuniary gain or loss, and treble civil damages in favor of any persons financially injured by such violations. Criminal prosecutions under applicable laws of relevant foreign jurisdictions and civil claims by, or relationship issues with customers, are also possible.

As of December 31, 2006, we are unable to estimate an amount of probable loss or a range of possible loss related to these matters.

Possible Algerian investigation

We believe that an investigation by a magistrate or a public prosecutor in Algeria may be pending with respect to sole source contracts awarded to Brown & Root Condor Spa, a joint venture with Kellogg Brown & Root Ltd UK, Centre de Recherche Nuclear de Draria, and Holding Services para Petroliers Spa. KBR had a 49% interest in this joint venture as of December 31, 2006.

Securities and related litigation

In June 2002, a class action lawsuit was filed against us in federal court on behalf of purchasers of our common stock during the approximate period of May 1998 until May 2002 alleging violations of the federal securities laws in connection with the accounting change and

disclosures involved in the SEC investigation related to a change in accounting for revenue on long-term construction projects and related disclosures, which we settled with the SEC in the second quarter of 2004. In addition, the plaintiffs allege that we overstated our revenue from unapproved claims by recognizing amounts not reasonably estimable or probable of collection. In the weeks that followed, approximately twenty similar class actions were filed against us. Several of those lawsuits also named as defendants Arthur Andersen LLP, our independent accountants for the period covered by the lawsuits, and several of our present or former officers and directors. The class action cases were later consolidated, and the amended consolidated class action complaint, styled *Richard Moore, et al. v. Halliburton Company, et al.,* was filed and served upon us in April 2003 (the "*Moore* class action").

In early May 2003, we announced that we had entered into a written memorandum of understanding setting forth the terms upon which the *Moore* class action would be settled. In June 2003, the lead plaintiffs in the *Moore* class action filed a motion for leave to file a second amended consolidated complaint, which was granted by the court. In addition to restating the original accounting and disclosure claims, the second amended consolidated complaint included claims arising out of the 1998 acquisition of Dresser Industries, Inc. by Halliburton, including that we failed to timely disclose the resulting asbestos liability exposure (the "Dresser claims"). The Dresser claims were included in the settlement discussions leading up to the signing of the memorandum of understanding and were among the claims the parties intended to have resolved by the terms of the proposed settlement of the consolidated *Moore* class action and the derivative action. The memorandum of understanding called for Halliburton to pay $6 million, which would be funded by insurance proceeds.

In June 2004, the court entered an order preliminarily approving the settlement. Following the transfer of the case to another district judge and a final hearing on the fairness of the settlement the court entered an order in September 2004 holding that evidence of the settlement's fairness was inadequate, denying the motion for final approval of the settlement in the *Moore* class action, and ordering the parties, among other things, to mediate. After the court's denial of the motion to approve the settlement, we withdrew from the settlement as we believe we were entitled to do by its terms. The mediation was held in January 2005, but was declared by the mediator to be at an impasse with no settlement reached.

In April 2005, the court appointed new co-lead counsel and a new lead plaintiff, directing that they file a third consolidated amended complaint and that we file our motion to dismiss. The court held oral arguments on that motion in August 2005, at which time the court took the motion under advisement. In March 2006, the court entered an order in which it granted the motion to dismiss with respect to claims arising prior to June 1999 and granted the motion with respect to certain other claims while permitting the plaintiffs to repled those claims to correct deficiencies in their earlier complaint. In April 2006, the plaintiffs filed their fourth amended consolidated complaint. We filed a motion to dismiss those portions of the complaint that had been repled. A hearing was held on that motion in July 2006, and we await the court's ruling. The lead plaintiff has filed a motion to discharge and replace co-lead counsel. That motion was granted on February 26, 2007.

As of December 31, 2006, we had not accrued any amounts related to this matter.

Newmont Gold

In July 1998, Newmont Gold, a gold mining and extraction company, filed a lawsuit over the failure of a blower manufactured and supplied to Newmont by Roots, a former division of Dresser Equipment Group. The plaintiff alleged that during the manufacturing process, Roots had reversed the blades of a component of the blower known as the inlet guide vane assembly, resulting in the blower's failure and the shutdown of the gold extraction mill for a period of approximately one month during 1996. In January 2002, a Nevada trial court granted summary judgment to Roots on all counts, and Newmont appealed. In February 2004, the Nevada Supreme Court reversed the summary judgment and remanded the case to the trial court, holding that fact issues existed requiring a trial. Based on pretrial reports, the damages claimed by the plaintiff were in the range of $33 million to $39 million, and trial was scheduled for February 2007. During the fourth quarter of 2006, the case was settled with no material impact on us.

Improper payments reported to the SEC

During the second quarter of 2002, we reported to the SEC that one of our foreign subsidiaries operating in Nigeria made improper payments of approximately $2.4 million to entities owned by a Nigerian national who held himself out as a tax consultant, when in fact he was an employee of a local tax authority. The payments were made to obtain favorable tax treatment and clearly violated our Code of Business Conduct and our internal control procedures. The payments were discovered during our audit of the foreign subsidiary. We conducted an investigation assisted by outside legal counsel, and, based on the findings of the investigation, we terminated several employees. None of our senior officers were involved. We are cooperating with the SEC in its review of the matter. We took further action to ensure that our foreign subsidiary paid all taxes owed in Nigeria. A preliminary assessment of approximately $4 million was issued by the Nigerian tax authorities in the second quarter of 2003. We are cooperating with the Nigerian tax authorities to determine the total amount due as quickly as possible.

Operations in Iran

We received and responded to an inquiry in mid-2001 from the Office of Foreign Assets Control (OFAC) of the United States Treasury Department with respect to operations in Iran by a Halliburton subsidiary incorporated in the Cayman Islands. The OFAC inquiry requested information with respect to compliance with the Iranian Transaction Regulations. These regulations prohibit United States citizens, including United States corporations and other United States business organizations, from engaging in commercial, financial, or trade transactions with Iran, unless authorized by OFAC or exempted by statute. Our 2001 written response to OFAC stated that we believed that we were in compliance with applicable sanction regulations. In the first quarter of 2004, we responded to a follow-up letter from OFAC requesting additional information. We understand this matter has now been referred by OFAC to the DOJ. In July 2004, we received a grand jury subpoena from an Assistant United States District Attorney requesting the production of documents. We are cooperating with the government's investigation and responded to the subpoena by producing documents in September 2004.

As of December 31, 2006, we had not accrued any amounts related to this investigation.

Separate from the OFAC inquiry, we completed a study in 2003 of our activities in Iran during 2002 and 2003 and concluded that these activities were in compliance with applicable sanction regulations. These sanction regulations require isolation of entities that conduct activities in Iran from contact with United States citizens or managers of United States companies. Notwithstanding our conclusions that our activities in Iran were not in violation of United States laws and regulations, we announced that, after fulfilling our current contractual obligations within Iran, we intend to cease operations within that country and withdraw from further activities there.

David Hudak and International Hydrocut Technologies Corp.

In October 2004, David Hudak and International Hydrocut Technologies Corp. (collectively, Hudak) filed suit against us in the United States District Court alleging civil Racketeer Influenced and Corporate Organizations Act violations, fraud, breach of contract, unfair trade practices, and other torts. The action, which seeks unspecified damages, arises out of Hudak's alleged purchase from us in early 1994 of certain explosive charges that were later alleged by the DOJ to be military ordnance, the possession of which by persons not possessing the requisite licenses and registrations is unlawful. As a result of that allegation by the government, Hudak was charged with, but later acquitted of, certain criminal offenses in connection with his possession of the explosive charges. As mentioned above, the alleged transaction(s) took place more than 10 years ago. The fact that most of the individuals that may have been involved, as well as the entities themselves, are no longer affiliated with us will complicate our investigation. For those reasons and because the litigation is in its most preliminary stages, it is premature to assess the likelihood of an adverse result. We filed a motion to dismiss and, alternatively, a motion to transfer venue. Those motions were denied during the first quarter of 2006. It is our intention to vigorously defend this action.

Amounts accrued related to this matter as of December 31, 2006 were not material.

Iraq overtime litigation

During the fourth quarter of 2005, a group of present and former employees working on the LogCAP contract in Iraq and elsewhere filed a class action lawsuit alleging that KBR wrongfully failed to pay time and a half for hours worked in excess of 40 per work week and that "uplift" pay, consisting of a foreign service bonus, an area differential, and danger pay, was only applied to the

first 40 hours worked in any work week. The class alleged by plaintiffs consists of all current and former employees on the LogCAP contract from December 2001 to present. The basis of plaintiffs' claims is their assertion that they are intended third-party beneficiaries of the LogCAP contract, and that the LogCAP contract obligated KBR to pay time and a half for all overtime hours. We moved to dismiss the case on a number of bases. On September 26, 2006, the court granted the motion to dismiss insofar as claims for overtime pay and "uplift" pay are concerned, leaving only a contractual claim for miscalculation of employees' pay. That claim remains open. It is premature to assess the probability of an adverse result on that remaining claim. However, because the LogCAP contract is cost-reimbursable, we believe that we could charge any adverse award to the customer. It is our intention to continue to vigorously defend the remaining claim.

As of December 31, 2006, we had not accrued any amounts related to this matter.

McBride qui tam suit

In September 2006, we became aware of a *qui tam* action filed against us by a former employee alleging various wrongdoings in the form of overbillings of our customer on the LogCAP III contract. This case was originally filed pending the government's decision whether or not to participate in the suit. In June 2006, the government formally declined to participate. The principal allegations are that our compensation for the provision of Morale, Welfare and Recreation (MWR) facilities under LogCAP III is based on the volume of usage of those facilities and that we deliberately overstated that usage. In accordance with the contract, we charged our customer based on actual cost, not based on the number of users. It was also alleged that during the period from November 2004 into mid-December 2004, we continued to bill the customer for lunches, although the dining facility was closed and not serving lunches. There are also allegations regarding housing containers and KBR's provision of services to its own employees and contractors. Our investigation is ongoing. However, we believe the allegations to be without merit, and we intend to vigorously defend this action.

As of December 31, 2006, we had not accrued any amounts in connection with this matter.

Wilson and Warren qui tam suit

During November 2006, we became aware of a *qui tam* action filed against us alleging that we overcharged the military $30 million by failing to adequately maintain trucks used to move supplies in convoys and by sending empty trucks in convoys. It was alleged that the purpose of these acts was to cause the trucks to break down more frequently than they would if properly maintained and to unnecessarily expose them to the risk of insurgent attacks, for the purpose of necessitating their replacement thus increasing our revenue. The suit also alleges that in order to silence the plaintiffs, who allegedly were attempting to report those allegations and other alleged wrongdoing, we unlawfully terminated them. On February 6, 2007, the court granted our motion to dismiss the plaintiffs' qui tam claims as legally insufficient and ordered the plaintiffs to arbitrate their claims that they were unlawfully discharged.

As of December 31, 2006, we had not accrued any amounts in connection with this matter.

M-I, LLC antitrust litigation

On February 16, 2007, we were informed that M-I, LLC, a competitor of ours in the drilling fluids market has sued us for allegedly attempting to monopolize the market for invert emulsion drilling fluids used in deep water and/or in cold water temperatures. The claims M-I asserts are based upon its allegation that the patent issued for our Accolade® drilling fluid was invalid as a result of its allegedly having been procured by fraud on the United States Patent and Trademark Office and that our subsequent prosecution of an infringement action against M-I amounted to predatory conduct in violation of Section 2 of the Sherman Antitrust Act. In October 2006, a federal court dismissed our infringement action based upon its holding that the claims in our patent were indefinite and the patent was, therefore, invalid. That judgment is now on appeal. M-I also alleges that we falsely advertised our Accolade® drilling fluid in violation of the Lanham Act and California law and that our earlier infringement action amounted to malicious prosecution in violation of Texas state law. M-I seeks compensatory damages, which it claims should be trebled, as well as punitive damages and injunctive relief. We believe that M-I's claims are without merit and intend to aggressively defend them.

As of December 31, 2006, we had not accrued any amounts in connection with this matter.

Environmental

We are subject to numerous environmental, legal, and regulatory requirements related to our operations worldwide. In the United States, these laws and regulations include, among others:

- the Comprehensive Environmental Response, Compensation, and Liability Act;
- the Resources Conservation and Recovery Act;
- the Clean Air Act;
- the Federal Water Pollution Control Act; and
- the Toxic Substances Control Act.

In addition to the federal laws and regulations, states and other countries where we do business often have numerous environmental, legal, and regulatory requirements by which we must abide. We evaluate and address the environmental impact of our operations by assessing and remediating contaminated properties in order to avoid future liabilities and comply with environmental, legal, and regulatory requirements. On occasion, we are involved in specific environmental litigation and claims, including the remediation of properties we own or have operated, as well as efforts to meet or correct compliance-related matters. Our Health, Safety and Environment group has several programs in place to maintain environmental leadership and to prevent the occurrence of environmental contamination.

We do not expect costs related to these remediation requirements to have a material adverse effect on our consolidated financial position or our results of operations. Our accrued liabilities for environmental matters were $43 million as of December 31, 2006 and $50 million as of December 31, 2005. The liability covers numerous properties and no individual property accounts for more than $5 million of the liability balance. We have subsidiaries that have been named as potentially responsible parties along with other third parties for 12 federal and state superfund sites for which we have established a liability. As of December 31, 2006, those 12 sites accounted for approximately $10 million of our total $43 million liability. In some instances, we have been named a potentially responsible party by a regulatory agency, but in each of those cases, we do not believe we have any material liability.

Letters of credit

In the normal course of business, we have agreements with banks under which approximately $1.0 billion of letters of credit or bank guarantees were outstanding as of December 31, 2006, including $676 million that relate to KBR. These KBR letters of credit or bank guarantees include $516 million that relate to their joint ventures' operations. Some of the outstanding letters of credit have triggering events which would entitle a bank to require cash collateralization.

Other commitments

As of December 31, 2006, we had commitments to fund approximately $156 million to related companies. These commitments arose primarily during the start-up of these entities or due to losses incurred by them. We expect approximately $13 million of the commitments to be paid during the next twelve months.

Liquidated damages

Many of our engineering and construction contracts have milestone due dates that must be met or we may be subject to penalties for liquidated damages if claims are asserted and we were responsible for the delays. These generally relate to specified activities within a project by a set contractual date or achievement of a specified level of output or throughput of a plant we construct. Each contract defines the conditions under which a customer may make a claim for liquidated damages. However, in most instances, liquidated damages are not asserted by the customer, but the potential to do so is used in negotiating claims and closing out the contract. We had not accrued for liquidated damages of $43 million at December 31, 2006 and $70 million at December 31, 2005 (including our share of amounts related to unconsolidated subsidiaries) that we could incur based upon completing the projects as forecasted.

Leases

We are obligated under operating leases, principally for the use of land, offices, equipment, field facilities, and warehouses. Total rentals, net of sublease rentals, were as follows:

Millions of dollars	2006	2005	2004

Rental expense	$ 580	$ 721	$ 693

Future total rentals on noncancelable operating leases are as follows: $188 million in 2007; $145 million in 2008; $125 million in 2009; $110 million in 2010; $103 million in 2011; and $367 million thereafter.

MERCK

The following excerpt from Merck's Contingencies and Environmental Liabilities note describes Vioxx litigation.

Vioxx Litigation

Product Liability Lawsuits

As previously disclosed, individual and putative class actions have been filed against the Company in state and federal courts alleging personal injury and/or economic loss with respect to the purchase or use of *Vioxx.* All such actions filed in federal court are coordinated in a multidistrict litigation in the U.S. District Court for the Eastern District of Louisiana (the "MDL") before District Judge Eldon E. Fallon. A number of such actions filed in state court are coordinated in separate coordinated proceedings in state courts in New Jersey, California and Texas, and the counties of Philadelphia, Pennsylvania and Clark County, Nevada. As of December 31, 2006, the Company had been served or was aware that it had been named as a defendant in approximately 27,400 lawsuits, which include approximately 46,100 plaintiff groups, alleging personal injuries resulting from the use of *Vioxx*, and in approximately 264 putative class actions alleging personal injuries and/or economic loss. (All of the actions discussed in this paragraph are collectively referred to as the "*Vioxx* Product Liability Lawsuits".) Of these lawsuits, approximately 8,300 lawsuits representing approximately 23,700 plaintiff groups are or are slated to be in the federal MDL and approximately 16,800 lawsuits representing approximately 16,800 plaintiff groups are included in a coordinated proceeding in New Jersey Superior Court before Judge Carol E. Higbee.

In addition to the *Vioxx* Product Liability Lawsuits discussed above, the claims of over 4,025 plaintiffs had been dismissed as of December 31, 2006. Of these, there have been over 1,225 plaintiffs whose claims were dismissed with prejudice (i.e., they cannot be brought again) either by plaintiffs themselves or by the courts. Over 2,800 additional plaintiffs have had their claims dismissed without prejudice (i.e., they can be brought again).

In the MDL, Judge Fallon in July 2005 indicated that he would schedule for trial a series of cases during the period November 2005 through 2006, in the following categories: (i) heart attack with short term use; (ii) heart attack with long term use; (iii) stroke; and (iv) cardiovascular injury involving a prescription written after April 2002 when the labeling for *Vioxx* was revised to include the results of the VIGOR trial. These trials began in November 2005 and concluded in December 2006. The next scheduled trial in the MDL is a re-trial in Barnett v. Merck on the issue of damages as discussed below.

Merck has entered into a tolling agreement (the "Tolling Agreement") with the MDL Plaintiffs' Steering Committee that establishes a procedure to halt the running of the statute of limitations (tolling) as to certain categories of claims allegedly arising from the use of *Vioxx* by non-New Jersey citizens. The Tolling Agreement applies to individuals who have not filed lawsuits and may or may not eventually file lawsuits and only to those claimants who seek to toll claims alleging injuries resulting from a thrombotic cardiovascular event that results in a myocardial infarction or ischemic stroke. The Tolling Agreement provides counsel additional time to evaluate potential claims. The Tolling Agreement requires any tolled claims to be filed in federal court. As of December 31, 2006, approximately 14,180 claimants had entered into Tolling Agreements.

Merck voluntarily withdrew *Vioxx* from the market on September 30, 2004. Many states have a two-year statute of limitations for product liability claims, requiring that claims must be filed within two years after the plaintiffs learned or could have learned of their potential cause of action. As a result, some may view September 30, 2006 as a deadline for filing *Vioxx* cases. It is important to note, however, that the law regarding statutes of limitations can be complex, varies from state to state, can be fact-specific, and in some cases, might be affected by the existence of pending class actions. For example, some states have three year statutes of limitations and, in some instances, the statute of limitations is even longer. Merck expects that there will be legal arguments concerning the proper application of these statutes, and the decisions will be up to the judges presiding in individual cases in state and federal proceedings.

The Company has previously disclosed the outcomes of several *Vioxx* Product Liability Lawsuits that were tried prior to September 30, 2006 (see chart below).

In August 2006, in Barnett v. Merck, a case before Judge Fallon in the MDL, a jury in New Orleans, Louisiana returned a plaintiff verdict in the second federal *Vioxx* case to go to trial. The jury awarded $50 million in compensatory damages and $1 million in punitive damages. On August 30, 2006, Judge Fallon overturned as excessive the damages portion of the verdict and ordered a new trial on damages. Judge Fallon has set re-trial for October 29, 2007 on the issue of damages. Merck has filed motions for a new trial on all issues and for Judgment as a Matter of Law, both of which are currently pending before the Court. Plaintiff has opposed Merck's motion and has asked the Judge to reduce the amount of the award rather than re-try the case.

Juries found in favor of Merck on all counts in the fourth and fifth cases to go to trial in the MDL. The jury returned its verdict for Merck in Mason v. Merck on November 8, 2006 and in Dedrick v. Merck on December 13, 2006.

On November 22, 2006, Judge Fallon denied a motion filed in the MDL to certify a nationwide class of all persons who allegedly suffered personal injury as a result of taking *Vioxx.*

On December 15, 2006, the jury in Albright v. Merck, a case tried in state court in Birmingham, Alabama, returned a verdict for Merck on all counts.

The Company previously disclosed that in April 2006, in Garza v. Merck, a jury in Rio Grande City, Texas returned a verdict in favor of the plaintiff. In September 2006, the Texas state court granted the Company's request to investigate possible jury bias because a juror admitted that he had, prior to the trial, on several occasions borrowed money from the plaintiff. On December 21, 2006, the court entered judgment for plaintiff in the amount of $7.75 million, plus interest, reduced from the original award of $32 million because of the Texas state cap on punitive damages. The Company is seeking a new trial and will appeal the verdict if the court does not grant a new trial.

On October 31, 2006, in California Superior Court in Los Angeles, a consolidated trial began in the cases Appell v. Merck and Arrigale v. Merck. On January 18, 2007, Judge Victoria Chaney declared a mistrial as to both plaintiffs after the jury reported that it was deadlocked.

On October 5, 2006, in the coordinated proceeding in New Jersey Superior Court, Judge Higbee dismissed claims of the United Kingdom plaintiffs. These plaintiffs have appealed.

The first case scheduled for trial in the Texas coordinated proceeding, Rigby v. Merck, was scheduled to begin trial on November 7, 2006. The Rigby case was voluntarily dismissed on October 23, 2006 when the plaintiff filed a notice of non-suit with the Court.

A consolidated trial, Hermans v. Merck and Humeston v. Merck, began on January 17, 2007, in the coordinated proceeding in New Jersey Superior Court before Judge Higbee. Humeston v. Merck was first tried in 2005, but Judge Higbee set aside the November 2005 jury verdict in favor of Merck and ordered a new trial on the grounds of newly discovered evidence. The Hermans/Humeston trial is separated into two phases: a general phase regarding Merck's conduct and a plaintiff-specific phase. There will be jury questions and a deliberation after phase I regarding Merck's conduct. If the jury answers any of the questions in the affirmative, the case will move to phase II. In phase II each plaintiff will present his or her specific case. At the end of phase II, the jury will deliberate and will answer questions with respect to each of the two plaintiffs. The jury will answer separate verdict sheets but in the course of only one deliberation. If the case moves to a punitive phase, there will be a single presentation for each side and one jury deliberation for both plaintiffs.

The first case scheduled for trial in the Philadelphia coordinated proceeding, McCool v. Merck, was scheduled to begin trial on February 26, 2007. The plaintiff voluntarily dismissed with prejudice her case on January 16, 2007.

On September 28, 2006, the New Jersey Superior Court, Appellate Division, heard argument on plaintiffs' appeal of Judge Higbee's dismissal of the Sinclair v. Merck case. This putative class action was originally filed in December 2004 and sought the creation of a medical monitoring fund. Judge Higbee had granted the Company's motion to dismiss in May 2005. On January 16, 2007, the Appellate Division reversed the decision and remanded the case back to Judge Higbee for further factual inquiry. The Company has petitioned the New Jersey Supreme Court for review of the Appellate Division's decision.

To date in the *Vioxx* Product Liability Lawsuits, of the 29 plaintiffs whose claims have been scheduled for trial, the claims of seven were dismissed, the claims of seven were withdrawn from the trial calendar by plaintiffs, and juries have decided in Merck's favor nine times and in plaintiffs' favor four times. In addition, in the recent California trial involving two plaintiffs, the jury could not reach a verdict for either plaintiff and a mistrial was declared. A New Jersey state judge set aside one of the nine Merck verdicts. With respect to the four plaintiffs' verdicts, Merck already has filed an appeal or sought judicial review in each of those cases, and in one of those four, a federal judge overturned the damage award shortly after trial. In addition, a consolidated trial with two plaintiffs is currently ongoing in the coordinated proceeding in New Jersey Superior Court before Judge Higbee and another trial, Schwaller v. Merck, has commenced in state court in Madison County, Illinois.

The following chart sets forth the results of all U.S. *Vioxx* Product Liability trials to date.

Verdict Date	Plaintiff	State or Federal Court	Result	Comments
Aug. 19, 2005	Ernst	Texas	Verdict for Plaintiff	Jury awarded plaintiff $253.4 million; the Court reduced amount to approximately $26.1 million plus interest. The judgment is now on appeal.
Nov. 3, 2005	Humeston	N.J.	Verdict for Merck; then judge overturned the verdict	Judge has ordered a new trial, which is currently ongoing.

Feb. 17, 2006	Plunkett	Federal	Mistrial after jury deadlocked in first trial; verdict for Merck in retrial	Merck prevailed in February 2006 retrial. Plaintiff has moved for a new trial.
April 5, 2006	McDarby	N.J.	Verdict for Plaintiff	Plaintiff was awarded $13.5 million in damages. Merck's motion for a new trial is pending, as is plaintiff's motion for attorney's fees.
April 5, 2006	Cona	N.J.	Verdict for Merck on failure to warn claim	However, the jury awarded plaintiff the nominal sum of $135 for his Consumer Fraud Act claim. Merck's motion for a new trial on the Consumer Fraud Act claim is pending, as is plaintiff's motion for attorney's fees.
April 21, 2006	Garza	Texas	Verdict for Plaintiff	Judge reduced $32 million jury award to $7.75 million plus interest. Merck has moved for a new trial.
July 13, 2006	Doherty	N.J.	Verdict for Merck	Plaintiff has moved for a new trial.
Aug. 2, 2006	Grossberg	California	Verdict for Merck	Plaintiff has moved for a new trial.
Aug. 17, 2006	Barnett	Federal	Verdict for Plaintiff	Plaintiff awarded $51 million in damages. The judge ruled the award was "grossly excessive," and has scheduled a new trial on damages in October 2007. Merck's motion for a new trial on the remaining issues is pending.
Sept. 26, 2006	Smith	Federal	Verdict for Merck	
Nov. 15, 2006	Mason	Federal	Verdict for Merck	
Dec. 13, 2006	Dedrick	Federal	Verdict for Merck	Plaintiff has moved for a new trial.
Dec. 15, 2006	Albright	Alabama	Verdict for Merck	Plaintiff has moved for a new trial.
Jan. 18, 2007	Arrigale/Appell	California	Mistrial declared after the jury deadlocked	

Other Lawsuits

As previously disclosed, on July 29, 2005, a New Jersey state trial court certified a nationwide class of third-party payors (such as unions and health insurance plans) that paid in whole or in part for the *Vioxx* used by their plan members or insureds. The named plaintiff in that case seeks recovery of certain *Vioxx* purchase costs (plus penalties) based on allegations that the purported class members paid more for *Vioxx* than they would have had they known of the product's alleged risks. Merck believes that the class was improperly certified. The trial court's ruling is procedural only; it does not address the merits of plaintiffs' allegations, which the Company intends to defend vigorously. On March 31, 2006, the New Jersey Superior Court, Appellate Division, affirmed the class certification order. On July 19, 2006, the New Jersey Supreme Court decided to exercise its discretion to hear the Company's appeal of the Appellate Division's decision. On August 24, 2006, the Appellate Division ordered a stay of the proceedings in Superior Court pending a ruling by the Supreme Court. Oral argument before the New Jersey Supreme Court is scheduled to take place in March 2007.

As previously reported, the Company has also been named as a defendant in separate lawsuits brought by the Attorneys General of Alaska, Louisiana, Mississippi, Montana, Texas and Utah. These actions allege that the Company misrepresented the safety of *Vioxx* and seek (i) recovery of the cost of *Vioxx* purchased or reimbursed by the state and its agencies; (ii) reimbursement of all sums paid by the state and its agencies for medical services for the treatment of persons injured by *Vioxx*; (iii) damages under various common law theories; and/or (iv) remedies under various state statutory theories, including state consumer fraud and/or fair business practices or Medicaid fraud statutes, including civil penalties.

Shareholder Lawsuits

As previously disclosed, in addition to the *Vioxx* Product Liability Lawsuits, the Company and various current and former officers and directors are defendants in various putative class actions and individual lawsuits under the federal securities laws and state securities laws (the "*Vioxx* Securities Lawsuits"). All of the *Vioxx* Securities Lawsuits pending in federal court have been transferred by the Judicial Panel on Multidistrict Litigation (the "JPML") to the United States District Court for the District of New Jersey before District Judge Stanley R. Chesler for inclusion in a nationwide MDL (the "Shareholder MDL"). Judge Chesler has consolidated the *Vioxx* Securities Lawsuits for all purposes. Plaintiffs request certification of a class of purchasers of Company stock between May 21, 1999 and October 29, 2004. The complaint alleges that the defendants made false and misleading statements regarding *Vioxx* in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, and seeks unspecified compensatory damages and the costs of suit, including attorneys' fees. The complaint also asserts a claim under Section 20A of the Securities and Exchange Act against certain defendants relating to their sales of Merck stock. In addition, the complaint includes allegations under Sections 11, 12 and 15 of the Securities Act of 1933 that certain defendants made incomplete and misleading statements in a registration statement and certain prospectuses filed in connection with the Merck Stock Investment Plan, a dividend reinvestment plan. Defendants have filed a motion to dismiss the complaint. Oral argument on the motion to dismiss is scheduled to take place in March 2007.

As previously disclosed, on August 15, 2005, a complaint was filed in Oregon state court by the State of Oregon through the Oregon state treasurer on behalf of the Oregon Public Employee Retirement Fund against the Company and certain current and former officers and directors. The complaint, which was brought under Oregon securities law, alleges that plaintiff has suffered damages in connection with its purchases of Merck common stock at artificially inflated prices due to the Company's alleged violations of law related to disclosures about *Vioxx.* The current and former officers and directors have entered into a tolling agreement and, on June 30, 2006, were dismissed without prejudice from the case. On July 19, 2006, the Court denied the Company's motion to dismiss the complaint, but required plaintiff to amend the complaint. Plaintiff filed an amended complaint on September 21, 2006. Merck filed a motion to require plaintiffs to make the complaint more definite and certain, which was denied by the Court. Merck filed an answer to the complaint in January 2007.

As previously disclosed, various shareholder derivative actions filed in federal court were transferred to the Shareholder MDL and consolidated for all purposes by Judge Chesler (the "*Vioxx* Derivative Lawsuits"). The consolidated complaint arose out of substantially the same factual allegations that are made in the *Vioxx* Securities Lawsuits. The *Vioxx* Derivative Lawsuits, which were purportedly brought to assert rights of the Company, assert claims against certain members of the Board past and present and certain executive officers for breach of fiduciary duty, waste of corporate assets, unjust enrichment, abuse of control and gross mismanagement. On May 5, 2006, Judge Chesler granted defendants' motion to dismiss and denied plaintiffs' request for leave to amend their complaint. Plaintiffs' appeal of the District Court's decision refusing them leave to amend the complaint is currently pending before the United States Court of Appeals for the Third Circuit.

As previously disclosed, on October 29, 2004, two individual shareholders made a demand on the Board of Directors of the Company to take legal action against Mr. Raymond Gilmartin, former Chairman, President and Chief Executive Officer and other individuals for allegedly causing damage to the Company with respect to the allegedly improper marketing of *Vioxx.* In July 2006, the Board received another shareholder letter demanding that the Board take legal action against the Board and management of Merck for allegedly causing damage to the Company relating to the Company's allegedly improper marketing of *Vioxx.* In December 2006, each of these demands was rejected by the Board of Directors.

As previously announced, the Board of Directors appointed a Special Committee to review the Company's actions prior to its voluntary withdrawal of *Vioxx*, to act for the Board in responding to shareholder litigation matters related to the withdrawal of *Vioxx*, and to advise the Board with

respect to any action that should be taken as a result of the review. In December 2004, the Special Committee retained the Honorable John S. Martin, Jr. of Debevoise & Plimpton LLP to conduct an independent investigation of senior management's conduct with respect to the cardiovascular safety profile of *Vioxx* during the period *Vioxx* was developed and marketed. The review was completed in the third quarter of 2006 and the full report (including appendices) was made public in September 2006.

In addition, as previously disclosed, various putative class actions filed in federal court under the Employee Retirement Income Security Act ("ERISA") against the Company and certain current and former officers and directors (the "*Vioxx* ERISA Lawsuits" and, together with the *Vioxx* Securities Lawsuits and the *Vioxx* Derivative Lawsuits, the "*Vioxx* Shareholder Lawsuits") have been transferred to the Shareholder MDL and consolidated for all purposes. The consolidated complaint asserts claims on behalf of certain of the Company's current and former employees who are participants in certain of the Company's retirement plans for breach of fiduciary duty. The lawsuits make similar allegations to the allegations contained in the *Vioxx* Securities Lawsuits. On October 7, 2005, defendants moved to dismiss the ERISA complaint. On July 11, 2006, Judge Chesler granted in part and denied in part defendants' motion to dismiss.

International Lawsuits

As previously disclosed, in addition to the lawsuits discussed above, the Company has been named as a defendant in litigation relating to *Vioxx* in various countries (collectively, the "*Vioxx* Foreign Lawsuits") in Europe, as well as Canada, Brazil, Argentina, Australia, Turkey, and Israel.

Additional Lawsuits

Based on media reports and other sources, the Company anticipates that additional *Vioxx* Product Liability Lawsuits, *Vioxx* Shareholder Lawsuits and *Vioxx* Foreign Lawsuits (collectively, the "*Vioxx* Lawsuits") will be filed against it and/or certain of its current and former officers and directors in the future.

Insurance

As previously disclosed, the Company has product liability insurance for claims brought in the *Vioxx* Product Liability Lawsuits with stated upper limits of approximately $630 million after deductibles and co-insurance. This insurance provides coverage for legal defense costs and potential damage amounts that have been or will be incurred in connection with the *Vioxx* Product Liability Lawsuits. The Company believes that this insurance coverage extends to additional *Vioxx* Product Liability Lawsuits that may be filed in the future. The Company has Directors and Officers insurance coverage applicable to the *Vioxx* Securities Lawsuits and *Vioxx* Derivative Lawsuits with stated upper limits of approximately $190 million. The Company has fiduciary and other insurance for the *Vioxx* ERISA Lawsuits with stated upper limits of approximately $275 million. Additional insurance coverage for these claims may also be available under upper-level excess policies that provide coverage for a variety of risks. There are disputes with certain insurers about the availability of some or all of this insurance coverage and there are likely to be additional disputes. The Company's insurance coverage with respect to the *Vioxx* Lawsuits will not be adequate to cover its defense costs and any losses.

As previously disclosed, the Company's upper level excess insurers (which provide excess insurance potentially applicable to all of the *Vioxx* Lawsuits) have commenced an arbitration seeking, among other things, to cancel those policies, to void all of their obligations under those policies and to raise other coverage issues with respect to the *Vioxx* Lawsuits. Merck intends to contest vigorously the insurers' claims and will attempt to enforce its rights under applicable insurance policies. The amounts actually recovered under the policies discussed in this section may be less than the amounts specified in the preceding paragraph.

Investigations

As previously disclosed, in November 2004, the Company was advised by the staff of the SEC that it was commencing an informal inquiry concerning *Vioxx.* On January 28, 2005, the Company announced that it received notice that the SEC issued a formal notice of investigation. Also, the Company has received subpoenas from the U.S. Department of Justice (the "DOJ") requesting information related to the Company's research, marketing and selling activities with respect to *Vioxx* in a federal health care investigation under criminal statutes. In addition, as previously disclosed, investigations are being conducted by local authorities in certain cities in Europe in order to determine whether any criminal charges should be brought concerning *Vioxx.* The Company is cooperating with these governmental entities in their respective investigations (the "*Vioxx* Investigations"). The Company cannot predict the outcome of these inquiries; however, they could result in potential civil and/or criminal dispositions.

As previously disclosed, the Company has received a number of Civil Investigative Demands ("CID") from a group of Attorneys General from 31 states and the District of Columbia who are investigating whether the Company violated state consumer protection laws when marketing *Vioxx.* The Company is cooperating with the Attorneys General in responding to the CIDs.

In addition, the Company received a subpoena in September 2006 from the State of California Attorney General seeking documents and information related to the placement of *Vioxx* on California's Medi-Cal formulary. The Company is cooperating with the Attorney General in responding to the subpoena.

Reserves

The Company currently anticipates that a number of *Vioxx* Product Liability Lawsuits will be tried throughout 2007. A trial in the Oregon securities case is scheduled for 2007, but the Company cannot predict whether this trial will proceed on schedule or the timing of any of the other *Vioxx* Shareholder Lawsuit trials. The Company believes that it has meritorious defenses to the *Vioxx* Lawsuits and will vigorously defend against them. In view of the inherent difficulty of predicting the outcome of litigation, particularly where there are many claimants and the claimants seek indeterminate damages, the Company is unable to predict the outcome of these matters, and at this time cannot reasonably estimate the possible loss or range of loss with respect to the *Vioxx* Lawsuits. The Company has not established any reserves for any potential liability relating to the *Vioxx* Lawsuits or the *Vioxx* Investigations, including for those cases in which verdicts or judgments have been entered against the Company, and are now in post-verdict proceedings or on appeal. In each of those cases the Company believes it has strong points to raise on appeal and therefore that unfavorable outcomes in such cases are not probable. Unfavorable outcomes in the *Vioxx* Litigation (as defined below) could have a material adverse effect on the Company's financial position, liquidity and results of operations.

Legal defense costs expected to be incurred in connection with a loss contingency are accrued when probable and reasonably estimable. As of December 31, 2005, the Company had a reserve of $685 million solely for its future legal defense costs related to the *Vioxx* Litigation.

During 2006, the Company spent $500 million in the aggregate, including $175 million in the fourth quarter, in legal defense costs worldwide related to (i) the *Vioxx* Product Liability Lawsuits, (ii) the *Vioxx* Shareholder Lawsuits, (iii) the *Vioxx* Foreign Lawsuits, and (iv) the *Vioxx* Investigations (collectively, the "*Vioxx* Litigation"). In the third quarter and fourth quarter of 2006, the Company recorded charges of $598 million and $75 million, respectively, to increase the reserve solely for its future legal defense costs related to the *Vioxx* Litigation to $858 million at December 31, 2006. In increasing the reserve, the Company considered the same factors that it considered when it previously established reserves for the *Vioxx* Litigation. Management now believes it has a better estimate of the Company's expenses and can reasonably estimate such costs through 2008. Some of the significant factors considered in the establishment and ongoing review of the reserve for the *Vioxx* legal defense costs were as follows: the actual costs incurred by the Company; the development of the Company's legal defense strategy and structure in light of the scope of the *Vioxx* Litigation; the number of cases being brought against the Company; the costs and outcomes

of completed trials and the most current information regarding anticipated timing, progression, and related costs of pre-trial activities and trials in the *Vioxx* Product Liability Lawsuits. Events such as scheduled trials, that are expected to occur throughout 2007 and into 2008, and the inherent inability to predict the ultimate outcomes of such trials, limit the Company's ability to reasonably estimate its legal costs beyond the end of 2008. The Company will continue to monitor its legal defense costs and review the adequacy of the associated reserves.

WAL-MART

Wal-Mart's Litigation note focuses on employment issues. Its Commitments note includes information about routine transactions such as lease commitments.

8 Litigation

The Company is involved in a number of legal proceedings. In accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," the Company has made accruals with respect to these matters, where appropriate, which are reflected in the Company's Consolidated Financial Statements. The Company may enter into discussions regarding settlement of these matters, and may enter into settlement agreements, if it believes settlement is in the best interests of the Company's shareholders. The matters, or groups of related matters, discussed below, if decided adversely to or settled by the Company, individually or in the aggregate, may result in liability material to the Company's financial condition or results of operations.

The Company is a defendant in numerous cases containing class-action allegations in which the plaintiffs are current and former hourly associates who allege that the Company forced them to work "off the clock" or failed to provide work breaks, or otherwise that they were not paid for work performed. The complaints generally seek unspecified monetary damages, injunctive relief, or both. Class or collective-action certification has yet to be addressed by the court in a majority of these cases. Where it has been addressed, certification has been denied in fourteen of these cases; has been granted in whole or in part in eight of these cases; and has been conditionally granted for notice purposes only in two of these cases. In another five such cases, certification was denied and the case was then dismissed, and in one additional such case, certification was granted and the case was then dismissed. The Company cannot reasonably estimate the possible loss or range of loss which may arise from these lawsuits.

One of the class-action lawsuits described above is *Savaglio v. Wal-Mart Stores, Inc.*, a class-action lawsuit in which the plaintiffs allege that they were not provided meal and rest breaks in accordance with California law, and seek monetary damages and injunctive relief. A jury trial on the plaintiffs' claims for monetary damages concluded on December 22, 2005. The jury returned a verdict of approximately $57 million in statutory penalties and $115 million in punitive damages. Following a bench trial in June 2006, the judge entered an order allowing some, but not all, of the injunctive relief sought by the plaintiffs. On December 27, 2006, the judge entered an order awarding the plaintiffs an additional amount of approximately $26 million in costs and attorneys' fees. The Company believes it has substantial defenses to the claims at issue, and on January 31, 2007, the Company filed its Notice of Appeal.

In another of the class-action lawsuits described above, *Braun/Hummel v. Wal-Mart Stores, Inc.,* a jury trial was commenced on September 5, 2006, in Philadelphia, Pennsylvania. The plaintiffs allege that the Company failed to pay class members for all hours worked and prevented class members from taking their full meal and rest breaks. On October 13, 2006, the jury awarded back-pay damages to the plaintiffs of approximately $78 million on their claims for off-the-clock work and missed rest breaks. The jury found in favor of the Company on the plaintiffs' meal-period claims. The plaintiffs are now seeking an additional award of approximately $62 million in statutory penalties, plus prejudgment interest and attorneys' fees. The Company believes it has substantial defenses to the claims at issue, and intends to challenge the verdict in post-trial motions and, if necessary, on appeal.

Another of the class-action lawsuits described above, *Salvas v. Wal-Mart Stores, Inc.,* had been scheduled to go to trial on October 2, 2006, before a jury in Cambridge, Massachusetts. The

plaintiffs alleged that the Company failed to pay class members for all hours worked and prevented class members from taking their full meal and rest breaks, and were seeking approximately $90 million in back pay, plus statutory treble damages, interest and attorneys' fees. Shortly before the scheduled trial date, however, the judge took the case off the trial docket in order to consider Wal-Mart's motion to decertify the class, and on November 7, 2006, the judge entered an order decertifying the class entirely. It is anticipated that the judge will certify his ruling for an immediate appeal.

A putative class action is pending in California challenging the methodology of payments made under various associate incentive bonus plans. The court has made no decision on class certification in this case. The Company cannot reasonably estimate the possible loss or range of loss which may result from this lawsuit.

The Company is currently a defendant in five putative class actions brought on behalf of salaried managers who challenge their exempt status under state and federal laws, which are pending in California, Michigan, New Mexico and Tennessee. Conditional certification for notice purposes under the FLSA has been granted in one of these cases (*Comer v. Wal-Mart Stores, Inc.*). In another, class certification has been denied (*Sepulveda v. Wal-Mart Stores, Inc.*). The Company cannot reasonably estimate the possible loss or range of loss which may arise from these lawsuits.

The Company is a defendant in *Dukes v. Wal-Mart Stores, Inc.*, a class-action lawsuit commenced in June 2001 and pending in the United States District Court for the Northern District of California. The case was brought on behalf of all past and present female employees in all of the Company's retail stores and warehouse clubs in the United States. The complaint alleges that the Company has engaged in a pattern and practice of discriminating against women in promotions, pay, training and job assignments. The complaint seeks, among other things, injunctive relief, front pay, back pay, punitive damages, and attorneys' fees. On June 21, 2004, the district court issued an order granting in part and denying in part the plaintiffs' motion for class certification. The class, which was certified by the district court for purposes of liability, injunctive and declaratory relief, punitive damages, and lost pay, subject to certain exceptions, includes all women employed at any Wal-Mart domestic retail store at any time since December 26, 1998, who have been or may be subjected to the pay and management track promotions policies and practices challenged by the plaintiffs. The class as certified currently includes approximately 1.6 million present and former female associates.

The Company believes that the district court's ruling is incorrect. On August 31, 2004, the United States Court of Appeals for the Ninth Circuit granted the Company's petition for discretionary review of the ruling. On February 6, 2007, a divided three-judge panel of the United States Court of Appeals for the Ninth Circuit issued a decision affirming the district court's certification order. On February 20, 2007, the Company filed a petition asking that the decision be reconsidered by a larger panel of the court. If the Company is not successful in its appeal of class certification, or an appellate court issues a ruling that allows for the certification of a class or classes with a different size or scope, and if there is a subsequent adverse verdict on the merits from which there is no successful appeal, or in the event of a negotiated settlement of the litigation, the resulting liability could be material to the Company. The plaintiffs also seek punitive damages which, if awarded, could result in the payment of additional amounts material to the Company. However, because of the uncertainty of the outcome of the appeal from the district court's certification decision, because of the uncertainty of the balance of the proceedings contemplated by the district court, and because the Company's liability, if any, arising from the litigation, including the size of any damages award if plaintiffs are successful in the litigation or any negotiated settlement, could vary widely, the Company cannot reasonably estimate the possible loss or range of loss which may arise from the litigation.

Until recently, the Company was a defendant in *Mauldin v. Wal-Mart Stores, Inc.*, a class-action lawsuit that was filed on October 16, 2001, in the United States District Court for the Northern District of Georgia, Atlanta Division. A class was certified on August 23, 2002, consisting of female Wal-Mart associates who were participants in the Associates Health and Welfare Plan at any time from March 8, 2001, to the present and who were using prescription contraceptives. The class sought amendment of the Plan to include coverage for prescription contraceptives, back pay for all

members in the form of reimbursement of the cost of prescription contraceptives, pre-judgment interest and attorneys' fees. On December 8, 2006, the plaintiffs filed an unopposed motion to dismiss the case voluntarily in light of the Company's recent amendment of the Plan to provide such coverage beginning January 1, 2007. On December 20, the Court entered an order granting the motion and dismissing the case.

The Company is a defendant in a lawsuit that was filed on August 24, 2001, in the United States District Court for the Eastern District of Kentucky. *EEOC (Janice Smith) v. Wal-Mart Stores, Inc.* is an action brought by the EEOC on behalf of Janice Smith and all other females who made application or transfer requests at the London, Kentucky, distribution center from 1995 to the present, and who were not hired or transferred into the warehouse positions for which they applied. The class seeks back pay for those females not selected for hire or transfer during the relevant time period. The class also seeks injunctive and prospective affirmative relief. The complaint alleges that the Company based hiring decisions on gender in violation of Title VII of the 1964 Civil Rights Act as amended. The EEOC can maintain this action as a class without certification. The Company cannot reasonably estimate the possible loss or range of loss which may arise from this litigation.

On November 8, 2005, the Company received a grand jury subpoena from the United States Attorney's Office for the Central District of California, seeking documents and information relating to the Company's receipt, transportation, handling, identification, recycling, treatment, storage and disposal of certain merchandise that constitutes hazardous materials or hazardous waste. The Company has been informed by the U.S. Attorney's Office for the Central District of California that it is a target of a criminal investigation into potential violations of the Resource Conservation and Recovery Act ("RCRA"), the Clean Water Act, and the Hazardous Materials Transportation Statute. This U.S. Attorney's Office contends, among other things, that the use of Company trucks to transport certain returned merchandise from the Company's stores to its return centers is prohibited by RCRA because those materials may be considered hazardous waste. The government alleges that, to comply with RCRA, the Company must ship from the store certain materials as "hazardous waste" directly to a certified disposal facility using a certified hazardous waste carrier. The Company contends that the practice of transporting returned merchandise to its return centers for subsequent disposition, including disposal by certified facilities, is compliant with applicable laws and regulations. The Company cannot reasonably estimate the possible loss or range of loss which may arise from this matter.

Additionally, the U.S. Attorney's Office in the Northern District of California has initiated its own investigation regarding the Company's handling of hazardous materials and hazardous waste and the Company has received administrative document requests from the California Department of Toxic Substances Control requesting documents and information with respect to two of the Company's distribution facilities. Further, the Company also received a subpoena from the Los Angeles County District Attorney's Office for documents and administrative interrogatories requesting information, among other things, regarding the Company's handling of materials and hazardous waste. California state and local government authorities and the State of Nevada have also initiated investigations into these matters. The Company is cooperating fully with the respective authorities. The Company cannot reasonably estimate the possible loss or range of loss which may arise from this matter.

9 Commitments

The Company and certain of its subsidiaries have long-term leases for stores and equipment. Rentals (including, for certain leases, amounts applicable to taxes, insurance, maintenance, other operating expenses and contingent rentals) under operating leases and other short-term rental arrangements were $1.4 billion, $1.0 billion and $1.1 billion in 2007, 2006 and 2005, respectively. Aggregate minimum annual rentals at January 31, 2007, under non-cancelable leases are as follows (in millions):

Fiscal Year	Operating Leases	Capital Leases

2008	$ 842	$ 538
2009	826	540
2010	768	520
2011	698	505
2012	634	480
Thereafter	6,678	3,132
Total minimum rentals	$10,446	5,715
Less estimated executory costs		29
Net minimum lease payments		5,686
Less imputed interest at rates ranging from 3.0% to 15.6%		1,888
Present value of minimum lease payments		$3,798

The Company has entered into sale/leaseback transactions involving buildings and the underlying land that were accounted for as capital and operating leases. Included in the annual maturities schedule above are $601 million of capital leases and $22 million of operating leases.

Certain of the Company's leases provide for the payment of contingent rentals based on a percentage of sales. Such contingent rentals amounted to $41 million, $27 million and $32 million in 2007, 2006 and 2005, respectively. Substantially all of the Company's store leases have renewal options, some of which may trigger an escalation in rentals.

In connection with certain debt financing, we could be liable for early termination payments if certain unlikely events were to occur. At January 31, 2007, the aggregate termination payment was $69 million. These two arrangements expire in fiscal 2011 and fiscal 2019.

In connection with the development of our grocery distribution network in the United States, we have agreements with third parties which would require us to purchase or assume the leases on certain unique equipment in the event the agreements are terminated. These agreements, which can be terminated by either party at will, cover up to a five-year period and obligate the Company to pay up to approximately $150 million upon termination of some or all of these agreements.

The Company has entered into lease commitments for land and buildings for 141 future locations. These underlying leases with real estate developers will provide for minimum rentals ranging from 4 to 30 years and will approximate $72 million annually over the lease terms based on current cost estimates.

Derivatives

Accounting for derivatives continued to evolve. SFAS 155, Accounting for Certain Hybrid Financial Instruments http://www.fasb.org/pdf/fas155.pdf, issued February 2006, provides for accounting for "hybrid" financial instruments that contain an embedded derivative that otherwise would require bifurcation, in addition to a list of other amendments to Statements 133 and 140. SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities http://www.fasb.org/pdf/fas159.pdf, permits expanding the use of fair value for measuring many financial instruments.

ALLSTATE

In the first note listed below (note 2), Allstate explains the accounting for different types of derivative instruments held.

In the second note listed below (note 6), Allstate presents the purpose for its derivatives, and describes its risk management strategies, which include asset-liability management, asset replication and portfolio duration management. The company explains how it calculates fair value, and the net impact to pretax income. Tables categorize strategies employed, by division,

giving notional and fair value amounts with net impact to pretax income. It lists where derivative instruments are recorded in the balance sheet, and provides a table of the different types of derivative instruments and their notional and fair values. It further summarizes the credit ratings of counterparties to different types of instruments, giving both the credit exposure and the exposure net of collateral. At the end of the note, Allstate discusses its off-balance-sheet financial instruments, including variable interest entities.

2. Summary of Significant Accounting Policies

Derivative and embedded derivative financial instruments

Derivative financial instruments include swaps, futures (interest rate and commodity), options (including swaptions), interest rate caps and floors, warrants, certain forward contracts for purchases of to-be-announced ("TBA") mortgage securities, certain investment risk transfer reinsurance agreements, forward sale commitments and certain bond forward purchase commitments, mortgage funding commitments and mortgage forward sale commitments. Derivatives that are required to be separated from the host instrument and accounted for as derivative financial instruments ("subject to bifurcation") are embedded in convertible and equity indexed fixed income securities, equity-indexed annuity contracts, variable annuity contracts which are reinsured, and certain funding agreements (see Note 6).

All derivatives are accounted for on a fair value basis and reported as other investments, other assets, other liabilities and accrued expenses or contractholder funds. Embedded derivative instruments subject to bifurcation are also accounted for on a fair value basis and are reported together with the host contracts. The change in the fair value of derivatives embedded in certain fixed income securities and subject to bifurcation is reported in realized capital gains and losses. The change in the fair value of derivatives embedded in liabilities and subject to bifurcation is reported in life and annuity contract benefits, interest credited to contractholder funds or realized capital gains and losses.

When derivatives meet specific criteria, they may be designated as accounting hedges and accounted for as fair value, cash flow, foreign currency fair value or foreign currency cash flow hedges. The hedged item may be either all or a specific portion of a recognized asset, liability or an unrecognized firm commitment attributable to a particular risk. At the inception of the hedge, the Company formally documents the hedging relationship and risk management objective and strategy. The documentation identifies the hedging instrument, the hedged item, the nature of the risk being hedged and the methodology used to assess the effectiveness of the hedging instrument in offsetting the exposure to changes in the hedged item's fair value attributable to the hedged risk, or in the case of a cash flow hedge, the exposure to changes in the hedged item's or transaction's variability in cash flows attributable to the hedged risk. The Company does not exclude any component of the change in fair value of the hedging instrument from the effectiveness assessment. At each reporting date, the Company confirms that the hedging instrument continues to be highly effective in offsetting the hedged risk. Ineffectiveness in fair value hedges and cash flow hedges is reported in realized capital gains and losses. The hedge ineffectiveness reported as realized capital gains and losses amounted to losses of $7 million, $7 million and $1 million in 2006, 2005 and 2004, respectively.

Fair value hedges The Company designates certain of its interest rate and foreign currency swap contracts and certain investment risk transfer reinsurance agreements as fair value hedges when the hedging instrument is highly effective in offsetting the risk of changes in the fair value of the hedged item.

For hedging instruments used in fair value hedges, when the hedged items are investment assets or a portion thereof, the change in the fair value of the derivatives is reported in net investment income, together with the change in the fair value of the hedged items. The change in the fair value of hedging instruments used in fair value hedges of contractholder funds liabilities or a portion thereof is reported in interest credited to contractholder funds, together with the change in the fair value of the hedged item. Accrued periodic settlements on swaps are reported together with the changes in fair value of the swaps in net investment income, interest credited to

contractholder funds or interest expense. The book value of the hedged asset or liability is adjusted for the change in the fair value of the hedged risk.

Cash flow hedges The Company designates certain of its foreign currency swap contracts and bond forward commitments as cash flow hedges when the hedging instrument is highly effective in offsetting the exposure of variations in cash flows for the hedged risk that could affect net income. The Company's cash flow exposure may be associated with an existing asset, liability or a forecasted transaction including the issuance of corporate debt. Anticipated transactions must be probable of occurrence and their significant terms and specific characteristics must be identified.

For hedging instruments used in cash flow hedges, the changes in fair value of the derivatives are reported in accumulated other comprehensive income. Amounts are reclassified to net investment income, realized capital gains and losses or interest expense as the hedged transaction affects net income or when the forecasted transaction affects net income. Accrued periodic settlements on derivatives used in cash flow hedges are reported in net investment income. The amount reported in accumulated other comprehensive income for a hedged transaction is limited to the lesser of the cumulative gain or loss on the derivative less the amount reclassified to net income; or the cumulative gain or loss on the derivative needed to offset the cumulative change in the expected future cash flows on the hedged transaction from inception of the hedge less the derivative gain or loss previously reclassified from accumulated other comprehensive income to net income. If the Company expects at any time that the loss reported in accumulated other comprehensive income would lead to a net loss on the combination of the hedging instrument and the hedged transaction which may not be recoverable, a loss is recognized immediately in realized capital gains and losses. If an impairment loss is recognized on an asset or an additional obligation is incurred on a liability involved in a hedge transaction, any offsetting gain in accumulated other comprehensive income is reclassified and reported together with the impairment loss or recognition of the obligation.

Termination of hedge accounting If, subsequent to entering into a hedge transaction, the derivative becomes ineffective (including if the hedged item is sold or otherwise extinguished, the occurrence of a hedged forecasted transaction is no longer probable, or the hedged asset becomes other than temporarily impaired), the Company may terminate the derivative position. The Company may also terminate derivative instruments or redesignate them as non-hedge as a result of other events or circumstances. If the derivative financial instrument is not terminated when a fair value hedge is no longer effective, the future gains and losses recognized on the derivative are reported in realized capital gains and losses. When a fair value hedge is no longer effective, is redesignated as non-hedge, or when the derivative has been terminated, the fair value gain or loss on the hedged asset, liability or portion thereof used to adjust the book value of the asset, liability or portion thereof, which has already been recognized in income while the hedge was in place, is amortized over the remaining life of the hedged asset liability or portion thereof to net investment income, interest credited to contractholder funds or interest expense beginning in the period that hedge accounting is no longer applied. If the hedged item of a fair value hedge is an asset which has become other than temporarily impaired, the adjustment made to the book value of the asset is subject to the accounting policies applied to other than temporarily impaired assets. When a derivative financial instrument used in a cash flow hedge of an existing asset or liability is no longer effective or is terminated, the gain or loss recognized on the derivative is reclassified from accumulated other comprehensive income to net income as the hedged risk impacts net income, beginning in the period hedge accounting is no longer applied or the derivative instrument is terminated. If the derivative financial instrument is not terminated when a cash flow hedge is no longer effective, the future gains and losses recognized on the derivative are reported in realized capital gains and losses. When a derivative financial instrument used in a cash flow hedge of a forecasted transaction is terminated because the forecasted transaction is no longer probable, the gain or loss recognized on the derivative is immediately reclassified from accumulated other comprehensive income to realized capital gains and losses in the period that hedge accounting is no longer applied. If a cash flow hedge is no longer effective, the gain or loss recognized on the derivative during the period the hedge was effective is reclassified from accumulated other comprehensive income to net income as the remaining hedged item affects net income.

Non-hedge derivative financial instruments The Company also has certain derivatives that are used in interest rate, equity price, commodity price and credit risk management strategies for which hedge accounting is not applied. These derivatives primarily consist of certain interest rate swap agreements, equity, commodity and financial futures contracts, interest rate cap and floor agreements, swaptions, foreign currency forward and option contracts, certain forward contracts for TBA mortgage securities and credit default swaps.

The Company replicates fixed income securities using a combination of a credit default swap and one or more highly rated fixed income securities to synthetically replicate the economic characteristics of one or more cash market securities. Fixed income securities are replicated when they are either unavailable in the cash market or more economical to acquire in synthetic form.

The Company enters into commodity-based investments through the use of excess return swaps whose return is tied to a commodity-based index. The Company also uses certain commodity futures to periodically rebalance its exposure under commodity-indexed excess return swaps as they are very liquid and highly correlated with the commodity-based index.

Based upon the type of derivative instrument and strategy, the income statement effects of these derivatives are reported in a single line item, with the results of the associated risk. Therefore, the derivatives' fair value gains and losses and accrued periodic settlements are recognized together in one of the following during the reporting period: net investment income, realized capital gains and losses, operating costs and expenses, life and annuity contract benefits or interest credited to contractholder funds. Cash flows from embedded derivatives requiring bifurcation and derivatives receiving hedge accounting are reported consistently with the host contracts and hedged risks respectively within the Consolidated Statement of Cash Flows. Cash flows on other derivatives are reported in cash flows from investing activities within the Consolidated Statement of Cash Flows.

6. Financial Instruments

Derivative financial instruments

The Company primarily uses derivatives for risk reduction and asset replication. In addition, the Company has derivatives embedded in financial instruments, which are required to be separated and accounted for as derivative instruments. With the exception of derivatives used for asset replication and embedded derivatives which are required to be separated, all of the Company's derivatives are evaluated for their ongoing effectiveness as either accounting or non-hedge derivative financial instruments on at least a quarterly basis (see Note 2). The Company does not use derivatives for trading purposes. Non-hedge accounting is used for "portfolio" level hedging strategies where the terms of the individual hedged items do not meet the strict homogeneity requirements prescribed in SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") to permit the application of SFAS 133's hedge accounting model. The principal benefit of a "portfolio" level strategy is in its cost savings through its ability to use fewer derivatives with larger notional amounts.

Asset-liability management is a risk management strategy that is principally employed by Allstate Financial to align the respective interest-rate sensitivities of its assets and liabilities. Depending upon the attributes of the assets acquired and liabilities issued, derivative instruments such as interest rate swaps, caps and floors are acquired to change the interest rate characteristics of existing assets and liabilities to ensure a properly matched relationship is maintained and to reduce exposure to rising or falling interest rates. Allstate Financial uses financial futures to hedge anticipated asset and liability purchases and financial futures and options for hedging the Company's equity exposure contained in equity indexed and variable annuity product contracts that offer equity returns to contractholders. In addition, Allstate Financial also uses interest rate swaps to hedge interest rate risk inherent in funding agreements and foreign currency swaps primarily to reduce the foreign currency risk associated with issuing foreign currency denominated funding agreements.

Asset replication refers to the "synthetic" creation of an asset through the use of a credit derivative and a high quality cash instrument to replicate fixed income securities that are either unavailable in the cash bond market or more economical to acquire in synthetic form. The Company replicates fixed income securities using a combination of a credit default swap and one or more highly rated fixed income securities to synthetically replicate the economic characteristics of one or more cash market securities.

Portfolio duration management is a risk management strategy that is principally employed by Property-Liability wherein, depending on the current portfolio duration relative to a designated target and the expectations of future interest rate movements, the Company uses financial futures to change the duration of the portfolio to mitigate the exposure that interest rates would otherwise have on the market value of its fixed income securities.

Property-Liability also uses futures to hedge the market risk related to deferred compensation liability contracts and equity index futures to lock-in equity gains.

Allstate Financial and Property-Liability have derivatives that are embedded in non-derivative "host" contracts. The Company's primary embedded derivatives are conversion options in fixed income investments, which provide the Company with the right to convert the instrument into a predetermined number of shares of common stock; equity options in annuity product contracts, which provide equity returns to contractholders; and equity-indexed notes containing equity call options, which provide a coupon payout based upon one or more indices.

Property-Liability enters into commodity-based investments through the use of excess return swaps whose return is tied to a commodity-based index. The Company also uses commodity futures to periodically rebalance its exposure under commodity-indexed excess return swaps as they are very liquid and highly correlated with the commodity-based index.

Corporate and Other uses interest rate swaps to hedge interest rate exposure on its debt issuances.

In the tables that follow:

The notional amounts specified in the contracts are used to calculate the exchange of contractual payments under the agreements and are not representative of the potential for gain or loss on these agreements.

Fair value, which is equal to the carrying value, is the estimated amount that the Company would receive (pay) to terminate the derivative contracts at the reporting date. For exchange traded derivative contracts, the fair value is based on dealer or exchange quotes. The exchange requires margin deposits as well as daily cash settlements of margin. As of December 31, 2006, the Company pledged $61 million of securities in the form of margin deposits. The fair value of non-exchange traded derivative contracts, including embedded derivative financial instruments subject to bifurcation, is based on either independent third party pricing sources, including broker quotes, or widely accepted pricing and valuation models which use independent third party data as inputs.

Carrying value amounts include the fair value of the derivatives, including the embedded derivatives, and exclude the accrued periodic settlements which are short term in nature and are reported in accrued investment income or other invested assets. The carrying value amounts for freestanding derivatives have been further adjusted for the effects, if any, of legally enforceable master netting agreements.

The net impact to pretax income includes the settlements for derivatives, including the accrued periodic settlements, as well as changes in the fair value of freestanding and embedded derivatives. For those derivatives which qualify for fair value hedge accounting, it also includes the changes in the fair value of the hedged risk, and therefore reflects any hedging ineffectiveness. For cash flow hedges, gains and losses amortized from accumulated other comprehensive income are included. For embedded derivatives in convertibles and equity-indexed notes subject to bifurcation, accretion income related to the host instrument has also been included.

The following table categorizes the accounting hedge (fair value and cash flow) and non-hedge strategies employed by the Company. The notional amount, the fair value of the hedge and the impact on pretax income have been provided to illustrate the relative volume, the Company's

exposure and the level of mark-to-market activity, respectively, for the derivative programs as of December 31.

	2006				2005				Net impact to pretax income		
		Fair value				Fair value					
	Notional amount	Fair value hedge	Cash flow hedge	Non-hedge	Notional amount	Fair value hedge	Cash flow hedge	Non-hedge	2006	2005	2004
Allstate Financial											
Risk reduction											
Interest rate exposure	$25,819	$ 24	$ —	$ 43	$22,304	$ 12	$ —	$ 82	$ (45)	$ (161)	$ (241)
Macro hedging	3,425	—	—	1	3,319	—	—	1	16	(9)	(32)
Hedging of equity exposure in annuity contracts	4,722	—	—	125	4,523	—	—	66	103	20	53
Hedging interest rate and foreign currency risk inherent in funding agreements	1,948	366	—	—	2,501	327	—	—	13	77	143
Other	470	3	(17)	(4)	642	3	(6)	(1)	(75)	(10)	(8)
Asset replication	395	—	—	2	432	—	—	—	4	2	1
Embedded derivatives											
Convertibles	488	—	—	187	453	—	—	159	51	27	14
Equity indexed notes	625	—	—	305	325	—	—	133	49	19	—
Annuity contracts	6,122	—	—	(171)	4,494	—	—	(113)	(57)	(8)	13
Other	14	—	—	—	12	—	—	—	—	—	—
Total Allstate Financial	44,028	393	(17)	488	39,005	342	(6)	327	59	(43)	(57)
Property-liability											
Risk reduction											
Adjusting portfolio duration	750	—	—	1	310	—	—	—	(1)	26	(71)
Hedging deferred compensation	131	—	—	(1)	118	—	—	—	13	2	12
Hedging unrealized gains on equity securities	750	—	—	3	—	—	—	—	(16)	—	—
Asset replication	77	—	—	—	90	—	—	—	2	—	—
Embedded derivatives											
Convertibles	901	—	—	349	800	—	—	284	76	40	28
Commodity derivatives for excess return	579	—	—	—	329	—	—	(1)	(111)	(8)	—
Other	332	—	—	1	196	—	—	1	(5)	(5)	—
Total Property-liability	3,520	—	—	353	1,843	—	—	284	(42)	55	(31)
Corporate and other											
Risk reduction											
Hedging interest rate exposure in debt	—	—	—	—	550	(12)	—	—	(13)	(5)	7
Other	—	—	—	—	—	—	—	—	—	—	—
Total Corporate and other	—	—	—	—	550	(12)	—	—	(13)	(5)	7
Total	$47,548	$ 393	$ (17)	$ 841	$41,398	$ 330	$ (6)	$ 611	$ 4	$ 7	$ (81)

Derivative instruments are recorded at fair value and presented in the Consolidated Statements of Financial Position as of December 31, as follows:

	Carrying value			
	Assets		(Liabilities)	
($ in millions)	**2006**	**2005**	**2006**	**2005**
Fixed income securities	$ 840	$ 575	$ —	—
Other investments	673	525	—	
Other assets	3	3	—	—
Contractholder funds	—	—	(171)	(113)
Other liabilities and accrued expenses	—	—	(128)	(55)
Total	$1,516	$1,103	$(299)	(168)

For cash flow hedges, unrealized net pre-tax losses included in accumulated other comprehensive income were $(17) million and $(6) million at December 31, 2006 and 2005, respectively. The net pre-tax changes in accumulated other comprehensive income due to cash flow hedges resulted from changes in fair value of $(11) million, $11 million and $(19) million in 2006, 2005 and 2004, respectively, and the amortization of gains and (losses) to income of $3 million in 2004. Amortization to net income of accumulated other comprehensive income related to cash flow hedges is expected to be less than $1 million in 2007.

The following table summarizes the notional amount, fair value and carrying value of the Company's derivative financial instruments at December 31, 2006.

	Notional	Fair	Carrying value	
($ in millions)	**amount**	**value**	**Assets**	**(Liabilities)**
Interest rate contracts				
Interest rate swap agreements	$ 14,929	$ 24	$ 31	$ (7)
Financial futures contracts	3,976	1	1	—
Interest rate cap and floor agreements	12,065	28	27	1
Total interest rate contracts	30,970	53	59	(6)
Equity and index contracts				
Options, financial futures and warrants	5,403	127	236	(109)
Foreign currency contracts				
Foreign currency swap agreements	1,551	362	375	(13)
Foreign currency forwards and options	158	2	2	—
Foreign currency futures contracts	—	—	—	—
Total foreign currency contracts	1,709	364	377	(13)
Credit default swaps used for asset replication	472	2	1	1
Commodity index excess return swaps and futures	578	—	—	—
Embedded derivative financial instruments				
Guaranteed accumulation benefit	1,608	7	—	7
Guaranteed withdrawal benefit	1,067	1	—	1
Conversion options in fixed income securities	1,390	535	535	—
Equity-indexed call options in fixed income securities	625	305	305	—
Equity-indexed and forward starting options in life and annuity product contracts	3,343	(189)	—	(189)
Other embedded derivative financial instruments	104	10	—	10
Total embedded derivative financial instruments	8,137	669	840	(171)
Other derivative financial instruments	279	2	3	(1)
Total derivative financial instruments	$ 47,548	$1,217	$ 1,516	$ (299)

The following table summarizes the notional amount, fair value and carrying value of the Company's derivative financial instruments at December 31, 2005.

($ in millions)	Notional amount	Fair value	Carrying value Assets	Carrying value (Liabilities)
Interest rate contracts				
Interest rate swap agreements	$ 12,062	$ 31	$ 49	$ (18)
Financial futures contracts	4,499	2	2	—
Interest rate cap and floor agreements	10,792	51	49	2
Total interest rate contracts	27,353	84	100	(16)
Equity and index contracts				
Options, financial futures and warrants	4,073	68	103	(35)
Foreign currency contracts				
Foreign currency swap agreements	2,765	321	323	(2)
Foreign currency forwards and options	102	(1)	—	(1)
Foreign currency futures contracts	31	—	—	—
Total foreign currency contracts	2,898	320	323	(3)
Credit default swaps used for asset replication	522	—	—	—
Commodity index excess return swaps and futures	329	(1)	—	(1)
Embedded derivative financial instruments				
Guaranteed accumulation benefit	1,208	2	—	2
Guaranteed withdrawal benefit	532	—	—	—
Conversion options in fixed income securities	1,253	442	442	—
Equity-indexed call options in fixed income securities	325	133	133	—
Equity-indexed and forward starting options in life and annuity product contracts	2,650	(120)	—	(120)
Other embedded derivative financial instruments	132	4	(1)	5
Total embedded derivative financial instruments	6,100	461	574	(113)
Other derivative financial instruments	123	3	3	—
Total derivative financial instruments	$ 41,398	$ 935	$ 1,103	$ (168)

The Company manages its exposure to credit risk by utilizing highly rated counterparties, establishing risk control limits, executing legally enforceable master netting agreements and obtaining collateral where appropriate. The Company uses master netting agreements for over-the-counter derivative transactions, including interest rate swap, foreign currency swap, interest rate cap, interest rate floor, credit default swap and certain option agreements. These agreements permit either party to net payments due for transactions covered by the agreements. Under the provisions of the agreements, collateral is either pledged or obtained when certain predetermined exposure limits are exceeded. As of December 31, 2006, counterparties pledged $361 million in cash to the Company and the Company pledged $10 million in securities to counterparties. The Company has not incurred any losses on derivative financial instruments due to counterparty nonperformance. Other derivatives including futures and certain option contracts are traded on organized exchanges, which require margin deposits and guarantee the execution of trades, thereby mitigating any associated potential credit risk.

Credit exposure represents the Company's potential loss if all of the counterparties concurrently fail to perform under the contractual terms of the contracts and all collateral, if any, becomes

worthless. This exposure is measured by the fair value of freestanding derivative contracts with a positive fair value at the reporting date reduced by the effect, if any, of legally enforceable master netting agreements.

The following table summarizes the counterparty credit exposure by counterparty credit rating at December 31, as it relates to interest rate swap, foreign currency swap, interest rate cap, interest rate floor, credit default swap and certain option agreements.

($ in millions)	2006				2005			
Rating[1]	Number of counter-parties	Notional amount	Credit exposure[2]	Exposure, net of collateral[2]	Number of counter-parties	Notional amount	Credit exposure[2]	Exposure, net of collateral[2]
AAA	1	$ 457	$ 10	$ 10	1	$ 484	$ 10	$ 10
AA	5	8,681	139	33	5	6,272	123	25
AA-	7	8,116	202	21	4	3,576	15	15
A+	3	12,688	86	20	6	16,206	273	23
A	—	—	—	—	1	30	—	—
Total	16	$ 29,942	$ 437	$ 84	17	$ 26,568	$ 421	$ 73

(1) Rating is the lower of S&P's or Moody's ratings.
(2) For each counterparty, only over-the-counter derivatives with a net positive fair value are included.

Market risk is the risk that the Company will incur losses due to adverse changes in market rates and prices. Market risk exists for all of the derivative financial instruments the Company currently holds, as these instruments may become less valuable due to adverse changes in market conditions. To limit this risk, the Company's senior management has established risk control limits. In addition, changes in fair value of the derivative financial instruments that the Company uses for risk management purposes are generally offset by the change in the fair value or cash flows of the hedged risk component of the related assets, liabilities or forecasted transactions.

Off-balance-sheet financial instruments and investment VIEs not consolidated

The contractual amounts and fair values of off-balance-sheet financial instruments at December 31 are as follows:

	2006		2005	
(in millions)	Contractual amount	Fair value	Contractual amount	Fair value
Commitments to invest	$ 1,430	$ —	$ 1,172	$ —
Private placement commitments	112	—	205	—
Commitments to extend mortgage loans	572	6	407	4

In the above table, the contractual amounts represent the amount at risk if the contract is fully drawn upon, the counterparty defaults and the value of any underlying security becomes worthless. Unless noted otherwise, the Company does not require collateral or other security to support off-balance-sheet financial instruments with credit risk.

Commitments to invest generally represent commitments to acquire financial interests or instruments. The Company enters into these agreements to allow for additional participation in certain limited partnership investments. Because the equity investments in the limited partnerships are not actively traded, it is not practical to estimate the fair value of these commitments.

Private placement commitments represent conditional commitments to purchase private placement debt and equity securities at a specified future date. The Company regularly enters into these agreements in the normal course of business. The fair value of these commitments generally

cannot be estimated on the date the commitment is made as the terms and conditions of the underlying private placement securities are not yet final.

Commitments to extend mortgage loans are agreements to lend to a borrower provided there is no violation of any condition established in the contract. The Company enters into these agreements to commit to future loan fundings at a predetermined interest rate. Commitments generally have fixed expiration dates or other termination clauses. Commitments to extend mortgage loans, which are secured by the underlying properties, are valued based on estimates of fees charged by other institutions to make similar commitments to similar borrowers.

In 2006, the Company established an investment management variable interest entity ("VIE") that holds assets under the management of Allstate Investment Management Company ("AIMCO"), a subsidiary of the Company, on behalf of unrelated third party investors. The VIE had assets consisting primarily of investment securities and cash totaling $401 million and liabilities, primarily long-term debt, totaling $378 million at December 31, 2006. The Company does not consolidate the VIE because it is not the primary beneficiary. The Company's maximum loss exposure related to its investment in the VIE is the current carrying value of its investment, which was $16 million at December 31, 2006.

The Company has an investment in a second investment management VIE, which was established in 2005 and holds assets under the management of AIMCO on behalf of unrelated third party investors. The VIE had assets consisting primarily of investment securities and cash totaling $335 million and liabilities, primarily long-term debt, totaling $313 million at December 31, 2006. The Company does not consolidate the VIE because it is not the primary beneficiary. The Company's maximum loss exposure related to its investment in the VIE is the current carrying value of its investment, which was $10 million at December 31, 2006.

COCA-COLA

We selected Coca-Cola as an example of how a company outside the financial services or insurance sectors discloses foreign exchange contracts.

Foreign Currency Management

The purpose of our foreign currency hedging activities is to reduce the risk that our eventual U.S. dollar net cash inflows resulting from sales outside the United States will be adversely affected by changes in foreign currency exchange rates.

We enter into forward exchange contracts and purchase foreign currency options (principally euro and Japanese yen) and collars to hedge certain portions of forecasted cash flows denominated in foreign currencies. The effective portion of the changes in fair value for these contracts, which have been designated as cash flow hedges, was reported in AOCI and reclassified into earnings in the same financial statement line item and in the same period or periods during which the hedged transaction affects earnings. Any ineffective portion, which was not significant in 2006, 2005 or 2004, of the change in the fair value of these instruments was immediately recognized in net income.

Additionally, the Company enters into forward exchange contracts that are effective economic hedges and are not designated as hedging instruments under SFAS No. 133. These instruments are used to offset the earnings impact relating to the variability in foreign currency exchange rates on certain monetary assets and liabilities denominated in nonfunctional currencies. Changes in the fair value of these instruments are immediately recognized in earnings in the line item other income (loss)—net of our consolidated statements of income to offset the effect of remeasurement of the monetary assets and liabilities.

The Company also enters into forward exchange contracts to hedge its net investment position in certain major currencies. Under SFAS No. 133, changes in the fair value of these instruments are recognized in foreign currency translation adjustment, a component of AOCI, to offset the change in the value of the net investment being hedged. For the years ended December 31, 2006, 2005 and 2004, we recorded net gain (loss) in foreign currency translation adjustment of approximately $3 million, $(40) million and $(8) million, respectively.

The following table presents the carrying values, fair values and maturities of the Company's foreign currency derivative instruments outstanding as of December 31, 2006 and 2005 (in millions):

	Carrying Values Assets/(Liabilities)	Fair Values Assets/(Liabilities)	Maturity
2006			
Forward contracts	$(21)	$(21)	2007-2008
Options and collars	18	18	2007
	$(3)	$(3)	

	Carrying Values Assets/(Liabilities)	Fair Values Assets/(Liabilities)	Maturity
2005			
Forward contracts	$28	$28	2006
Options and collars	11	11	2006
	$39	$39	

The Company estimates the fair value of its foreign currency derivatives based on quoted market prices or pricing models using current market rates. These amounts are primarily reflected in prepaid expenses and other assets in our consolidated balance sheets.

COUNTRYWIDE FINANCIAL

The following note excerpt describes Countrywide's risk management and derivatives related to mortgage loans and interest rates. The note also describes Countrywide's mortgage servicing rights (not shown).

Risk Management Activities Related to Mortgage Loan Inventory and Interest Rate Lock Commitments

Description of Risk Management Activities

The Company is exposed to price risk relative to its Mortgage Loan Inventory and its IRLCs. The Mortgage Loan Inventory is comprised of mortgage loans held by the Company pending sale, and is presently held for an average of approximately 26 days. IRLCs guarantee the rate and points on the underlying mortgage or group of mortgages for a specified period, generally from seven to 75 days.

With regard to loans held for sale, the Company is exposed to price risk from the time an IRLC is made to a mortgage applicant or financial intermediary to the time the resulting mortgage loan is sold. For loans held for investment, the Company is exposed to price risk from the time an IRLC is made to a financial intermediary to the time the loan is purchased. During these periods, the Company is exposed to losses if mortgage rates rise, because the value of the IRLC or mortgage loan held for sale declines. To manage this price risk the Company uses derivatives.

The price risk management of IRLCs is complicated by the fact that the ultimate percentage of applications that close within the terms of the IRLC is variable. The probability that the loan will fund within the terms of the IRLC is affected by a number of factors, in particular any change in mortgage rates subsequent to the lock date. This probability generally increases if mortgage rates rise, and decreases if mortgage rates fall, due primarily to the relative attractiveness of current mortgage rates compared to the applicant's committed rate. The probability that a loan will fund within the terms of the IRLC is also influenced by the source and age of the application, purpose for the loan (purchase or refinance), and the application approval rate. The Company has developed closing ratio estimates, using historical experience that take into account all of these

variables, as well as renegotiations of rate and point commitments that tend to occur when mortgage rates fall. Those closing ratio estimates are used to estimate the aggregate balance of loans that will fund within the terms of IRLCs.

To manage the price risk associated with the IRLCs, the Company generally uses a combination of net forward sales of MBS and put and call options on MBS, Treasury futures and Eurodollar futures. The Company generally makes forward sales of MBS in an amount equal to the portion of the IRLCs expected to close, assuming no change in mortgage rates. The Company acquires put and call options to protect against the variability of loan closings caused by changes in mortgage rates. To manage the credit spread risk associated with its IRLC's the Company may enter into credit default swaps.

The Company manages the price risk related to the Mortgage Loan Inventory primarily by entering into forward sales of MBS and Eurodollar futures. The value of these forward MBS sales and Eurodollar futures moves in opposite direction to the value of the Mortgage Loan Inventory. To manage the credit spread risk associated with its Mortgage Loan Inventory, the Company may enter into credit default swaps. The Company actively manages the risk profiles of its IRLCs and Mortgage Loan Inventory on a daily basis.

The Company manages the price risk and credit risk related to its commercial mortgage loans using interest rate swaps, total rate of return and credit default swaps.

The Company uses the following derivative instruments in its risk management activities related to the IRLCs and Mortgage Loan Inventory:

- *Forward Sales of MBS:* An obligation to sell MBS at a specified price on a specified date in the future. The value increases as mortgage rates rise.
- *Forward Purchases of MBS:* An obligation to buy MBS at a specified price on a specified date in the future. The value increases as mortgage rates fall.
- *Long Call Options on MBS:* A right to buy MBS at a specified price on a specified date in the future. The value increases as mortgage rates fall.
- *Long Put Options on MBS:* A right to sell MBS at a specified price on a specified date in the future. The value increases as mortgage rates rise.
- *Long Call Options on U.S. Treasury Futures:* A right to acquire a U.S. Treasury futures contract at a specified price in the future. The value increases as the benchmark U.S. Treasury rate falls.
- *Long Put Options on U.S. Treasury Futures:* A right to sell a U.S. Treasury futures contract at a specified price on a specified date in the future. The value increases as the benchmark U.S. Treasury rate rises.
- *Short Eurodollar Futures Contracts*: A standardized exchange-traded contract, the value of which is tied to spot Eurodollar rates at specified future dates. The value increases when Eurodollar rates rise.
- *Total Rate of Return Swaps:* An agreement to pay or receive the total return on a financial index or security in exchange for the payment or receipt of a floating rate of interest over the term of the contract. For use in the risk management of the commercial mortgage portfolio, the Company pays the return on a published CMBS index and receives the floating rate of interest. The value of these contracts increases as the value of the index declines.
- *Credit Default Swaps:* An agreement to purchase credit event protection based on a financial index or security in exchange for paying a fixed rate fee or premium over the term of the contract. For use in the risk management primarily of commercial and residential mortgage

loans, the Company receives credit protection and pays a fixed fee or premium. The value of these contracts increases when the probability of the occurrence of a credit event rises.

- *Interest Rate Floors:* Represents a right to receive cash if a reference interest rate falls below a contractual strike rate; therefore, its value increases as the reference interest falls. The reference interest rates used in the Company's interest rate floors include mortgage rates, Treasury rates and U.S. dollar ("USD") LIBOR.

The following table summarizes the balance or notional amounts, as applicable, of Mortgage Loan Inventory, IRLCs and the related derivative instruments at December 31, 2006:

	(in billions)
Mortgage Loan Inventory:	
Fixed rate	$ 13.8
Adjustable rate	17.5
Total	$ 31.3
Interest rate lock commitments:	
Fixed rate	$ 12.2
Adjustable rate	8.6
Total	$ 20.8
Mandatory forward trades:	
Sales	$ (43.2)
Buys	33.6
Net mandatory positions	$ (9.6)
Long U.S. Treasury options:	
Calls	$ 29.6
Puts	(1.0)
Net long U.S. Treasury options	$ 28.6
Short Eurodollar futures	$ (55.7)
Total rate of return swaps	$ 9.6
Credit default swaps	$ 0.9
Interest rate floor	$ 1.0

Accounting for Risk Management Activities

The change in value of all derivative instruments used in the risk management activities related to Mortgage Loan Inventory and IRLCs are recorded at fair value with changes in fair value included as a component of gain on sale of loans and securities in the consolidated statement of earnings.

IRLCs that qualify as derivative instruments are recorded at fair value with changes in fair value recognized in current period earnings as a component of gain on sale of loans and securities. The IRLCs related to loans held for sale and the IRLCs related to loans purchased for investment generally qualify as derivative instruments.

The Company estimates the fair value of an IRLC based on the change in estimated fair value of the underlying mortgage loan and the probability that the mortgage loan will fund within the terms of the IRLC. The change in fair value of the underlying mortgage loan is based upon quoted MBS prices and is measured from the date the IRLC is issued. At the time of issuance the estimated fair value of an IRLC is zero. Subsequent to issuance, the value of an IRLC can be either positive or negative, depending on the change in value of the underlying mortgage loan.

During 2006, the interest rate risk management activities associated with 66% of the fixed-rate mortgage loan inventory and 41% of the adjustable-rate mortgage loan inventory were accounted for as fair value hedges. For the years ended December 31, 2006, 2005 and 2004, the Company recognized pre-tax losses of $116.9 million, $49.7 million and $116.2 million, respectively, representing the ineffective portion of the hedges of its mortgage inventory that qualified as fair value hedges under SFAS 133. These amounts are included in gain on Sale of Loan and securities in the consolidated statements of earnings.

HARTFORD FINANCIAL SERVICES GROUP

Hartford summarizes and explains the purpose of different hedging strategies, providing notional amounts, fair values and hedge ineffectiveness, in a single table.

The following table summarizes the derivative instruments used by the Company and the primary hedging strategies to which they relate. Derivatives in the Company's separate accounts are not included because the associated gains and losses accrue directly to policyholders. The notional value of derivative contracts represents the basis upon which pay or receive amounts are calculated and are not reflective of credit risk. The fair value amounts of derivative assets and liabilities are presented on a net basis as of December 31, 2006 and 2005. The total ineffectiveness of all cash-flow, fair-value and net investment hedges and total change in value of other derivative-based strategies which do not qualify for hedge accounting treatment, including periodic derivative net coupon settlements, are presented below on an after-tax basis for the years ended December 31, 2006 and 2005.

	Notional Amount		Fair Value		Hedge Ineffectiveness, After-tax	
Hedging Strategy	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Cash-Flow Hedges						
Interest rate swaps						
Interest rate swaps are primarily used to convert interest receipts on floating-rate fixed maturity securities to fixed rates. These derivatives are predominantly used to better match cash receipts from assets with cash disbursements required to fund liabilities						
The Company also enters into forward starting swap agreements to hedge the interest rate exposure of anticipated future cash flows on floating-rate fixed maturity securities due to changes in the benchmark interest rate, London-Interbank Offered Rate ("LIBOR"). These derivatives were structured to hedge interest rate exposure inherent in the assumptions used to price primarily certain long-term disability products.						
Interest rate swaps are also used to hedge a portion of the Company's floating-rate guaranteed investment contracts. These derivatives convert the floating rate guaranteed investment contract payments to a fixed rate to better match the cash receipts earned from the supporting investment portfolio.	$6,093	$5,753	$(22)	$(18)	$(9)	$(11)
Foreign currency swaps						
Foreign currency swaps are used to convert foreign denominated cash flows associated with certain foreign denominated fixed maturity investments to U.S. dollars. The foreign fixed maturities are primarily denominated	1,871	1,758	(370)	(242)	(4)	4

	Notional Amount		Fair Value		Hedge Ineffectiveness, After-tax	
Hedging Strategy	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
in euros and are swapped to minimize cash flow fluctuations due to changes in currency rates. In addition, foreign currency swaps are also used to convert foreign denominated cash flows associated with certain liability payments in order to minimize cash flow fluctuations due to changes in currency rates.						
Fair-Value Hedges						
Interest rate swaps						
Interest rate swaps are used to hedge the changes in fair value of certain fixed rate liabilities and fixed maturity securities due to changes in the benchmark interest rate, LIBOR. In addition, a portion of the Company's fixed debt was hedged against increases in LIBOR, the designated benchmark interest rate.	3,846	2,476	10	(12)	(1)	2
Foreign currency swaps						
Foreign currency swaps are used to hedge the changes in fair value of certain foreign denominated fixed rate liabilities due to changes in foreign currency rates.	492	-	(9)	-	-	-
Total cash-flow and fair-value hedges	**$12,302**	**$9,987**	**$(391)**	**$(272)**	**$(14)**	**$(5)**
Other Investment and Risk						
Interest rate caps and swaption contracts						
The Company is exposed to policyholder surrenders during a rising interest rate environment. Interest rate cap and swaption contracts are used to mitigate the Company's loss in a rising interest rate environment. The increase in yield from the cap and swaption contracts in a rising interest rate environment may be used to raise credited rates, thereby increasing the Company's competitiveness and reducing the policyholder's incentive to surrender.						
The Company also may use an interest rate cap as an economic hedge of the interest rate risk related to Company issued debt. In a rising interest rate environment, the cap will limit the net interest expense on the hedged fixed rate debt.	$1,100	$1,616	$ -	$3	$(1)	$(1)
Interest rate swaps, caps and floors						
The Company uses interest rate swaps and floors to manage duration risk between assets and liabilities in certain portfolios. In addition, the Company enters into interest rate swaps to terminate existing swaps in hedging relationships, thereby offsetting the changes in value of the original swap. The Company also enters into interest rate caps to manage the duration risk in certain investment portfolios.	5.460	2,223	(30)	(4)	(33)	1
Interest rate forwards						
The Company uses interest rate forwards to replicate the purchase of mortgage-backed securities to manage duration risk and liquidity.	1,269	-	(7)	-	10	-
Foreign currency swaps and forwards						
The Company enters into foreign currency swaps and	663	766	(14)	(9)	(8)	20

	Notional Amount		Fair Value		Hedge Ineffectiveness, After-tax	
Hedging Strategy	2006	2005	2006	2005	2006	2005
forwards to hedge the foreign currency exposures in certain of its foreign fixed maturity investments.						
Credit default and total return swaps						
The Company enters into swap agreements in which the Company assumes credit exposure of an individual entity, referenced index or asset pool. These contracts entitle the company to receive a periodic fee in exchange for an obligation to compensate the derivative counterparty should a credit event occur on the part of the referenced security issuers. The maximum potential future exposure to the Company is the notional value of the swap contracts, which is $1,203 and $455, after-tax, as of December 31, 2006 and 2005, respectively.						
The Company also assumes exposure to the change in value of indices or asset pools through total return swaps and credit spreadlocks. As of December 31, 2006 and 2005, the maximum potential future exposure to the Company from such contracts is $1,386 and $899, after-tax, respectively.						
The Company enters into credit default swap agreements, in which the Company pays a derivative counterparty a periodic fee in exchange for compensation from the counterparty should a credit event occur on the part of the referenced security issuer. The Company entered into these agreements as an efficient means to reduce credit exposure to specified issuers or sectors. In addition, the Company enters into option contracts to receive protection should a credit event occur on the part of the referenced security issuer.	7,611	2,839	(194)	3	25	13
Yen fixed annuity hedging instruments						
The Company enters into currency rate swaps and forwards to mitigate the foreign currency exchange rate and yen interest rate exposures associated with the yen denominated individual fixed annuity product. The associated liability is adjusted for changes in spot rates which was $12 and $102, after-tax, as of December 31, 2006 and 2005, respectively, and partially offset the derivative change in value.	1,869	1,675	(225)	(179)	(64)	(143)
GMWB product derivatives						
The Company offers certain variable annuity products with a GMWB rider. The GMWB is a bifurcated embedded derivative that provides the policyholder with a GRB if the account value is reduced to zero through a combination of market declines and withdrawals. The GRB is generally equal to premiums less withdrawals. The policyholder also has the option, after a specified time period, to reset the GRB to the then-current account value, if greater. For a further discussion, see the Derivative Instruments section of Note 1. The notional value of the embedded derivative is the GRB	37,769	31,803	53	8	79	(42)

	Notional Amount		Fair Value		Hedge Ineffectiveness, After-tax	
Hedging Strategy	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
balance.						
GMWB reinsurance contracts						
Reinsurance arrangements are used to offset the Company's exposure to the GMWB embedded derivative for the lives of the host variable annuity contracts. The notional amount of the reinsurance contracts is the GRB amount.	7,172	8,575	(22)	(17)	(19)	19
GMWB hedging instruments						
The Company enters into interest rate futures, S&P 500 and NASDAQ index futures contracts and put and call options, as well as interest rate, EAFE index and equity volatility swap contracts to economically hedge exposure to the volatility associated with the portion of the GMWB liabilities which are not reinsured.						
In addition, the Company periodically enters into forward starting S&P 500 put options as well as S&P index futures and interest rate swap contracts to economically hedge the equity volatility risk exposure associated with anticipated future sales of the GMWB rider. [1]	8,379	5,086	346	175	(77)	1
Equity index swaps and options						
The Company offers certain equity indexed products, which may contain an embedded derivative that requires bifurcation. The Company enters into S&P index swaps and options to economically hedge the equity volatility risk associated with these embedded derivatives. In addition, the Company is exposed to bifurcated options embedded in certain fixed maturity investments.	30	16	-	-	-	(1)
Statutory reserve hedging instruments						
The Company purchases one and two year S&P 500 put option contracts to economically hedge the statutory reserve impact of equity exposure arising primarily from GMDB and GMWB obligations against a decline in the equity markets.	2,220	1,142	29	14	(9)	(20)
Total other investment and risk management activities	**$73,542**	**$55,741**	**$(64)**	**$(6)**	**$(97)**	**$(153)**
Total derivatives [2]	**$85,844**	**$65,728**	**$(455)**	**$(278)**	**$(111)**	**$(158)**

[1] The after-tax net gain related to derivatives purchased to hedge the anticipatory sales of the GMWB rider is $0 and $8 for the years ended December 31, 2006 and 2005, respectively.

[2] Derivative change in value includes hedge ineffectiveness for cash-flow hedges, fair-value hedges, and total change in value, including periodic derivative net coupon settlements, of other investment and risk management activities.

HESS CORPORATION

Hess reports outstanding hedge positions in Brent Crude Oil by Maturity, providing average selling price and Thousands of Barrels per Day. An excerpt from Hess' notes:

	Brent Crude Oil	
Maturity	Selling Price	Barrels per Day
2007	$25.85	24
2008	25.56	24
2009	25.54	24
2010	25.78	24
2011	26.37	24
2012	26.90	24

The Corporation had no WTI crude oil or natural gas hedges at year-end 2006. The Corporation also markets energy commodities including refined petroleum products, natural gas and electricity. The Corporation uses futures and swaps to manage the underlying risk in its marketing activities. At December 31, 2006, net after tax deferred losses in accumulated other comprehensive income (loss) from the Corporation's hedging contracts were $1,338 million ($2,101 million before income taxes). At December 31, 2005, net after-tax deferred losses were $1,304 million ($2,063 million before income taxes). The pre-tax amount of all deferred hedge losses is reflected in accounts payable and the related income tax benefits are recorded as deferred tax assets on the balance sheet.

METLIFE

Among other disclosures, MetLife reports the remaining life of its derivative instruments:

The following table presents the notional amounts of derivative financial instruments by maturity at December 31, 2006:

	Remaining Life				
	One Year or Less	After One Year Through Five Years	After Five Years Through Ten Years	After Ten Years	Total
	(In millions)				
Interest rate swaps	$ 1,734	$ 16,424	$ 5,192	$ 3,798	$ 27,148
Interest rate floors	—	7,619	29,818	—	37,437
Interest rate caps	2,770	23,698	—	—	26,468
Financial futures	8,432	—	—	—	8,432
Foreign currency swaps	572	8,841	7,390	2,824	19,627
Foreign currency forwards	2,934	—	—	—	2,934
Options	—	586	1	—	587
Financial forwards	—	—	—	3,800	3,800
Credit default swaps	518	5,618	221	—	6,357
Synthetic GICs	3,427	312	—	—	3,739
Other	—	250	—	—	250
Total	$ 20,387	$ 63,348	$ 42,622	$ 10,422	$136,779

PEPSICO

PepsiCo provides a clear footnote discussion of the risks of its business, and how it manages those risks.

Note 10 — Risk Management

We are exposed to the risk of loss arising from adverse changes in:

- commodity prices, affecting the cost of our raw materials and energy,
- foreign exchange risks,
- interest rates,
- stock prices, and
- discount rates affecting the measurement of our pension and retiree medical liabilities.

In the normal course of business, we manage these risks through a variety of strategies, including the use of derivatives. Certain derivatives are designated as either cash flow or fair value hedges and qualify for hedge accounting treatment, while others do not qualify and are marked to market through earnings. See "Our Business Risks" in Management's Discussion and Analysis for further unaudited information on our business risks.

For cash flow hedges, changes in fair value are deferred in accumulated other comprehensive loss within shareholders' equity until the underlying hedged item is recognized in net income. For fair value hedges, changes in fair value are recognized immediately in earnings, consistent with the underlying hedged item. Hedging transactions are limited to an underlying exposure. As a result, any change in the value of our derivative instruments would be substantially offset by an opposite change in the value of the underlying hedged items. Hedging ineffectiveness and a net earnings impact occur when the change in the value of the hedge does not offset the change in the value of the underlying hedged item. If the derivative instrument is terminated, we continue to defer the related gain or loss and include it as a component of the cost of the underlying hedged item. Upon determination that the underlying hedged item will not be part of an actual transaction, we recognize the related gain or loss in net income in that period.
We also use derivatives that do not qualify for hedge accounting treatment. We account for such derivatives at market value with the resulting gains and losses reflected in our income statement. We do not use derivative instruments for trading or speculative purposes, and we limit our exposure to individual counterparties to manage credit risk.

Commodity Prices
We are subject to commodity price risk because our ability to recover increased costs through higher pricing may be limited in the competitive environment in which we operate. This risk is managed through the use of fixed-price purchase orders, pricing agreements, geographic diversity and derivatives. We use derivatives, with terms of no more than two years, to economically hedge price fluctuations related to a portion of our anticipated commodity purchases, primarily for natural gas and diesel fuel. For those derivatives that qualify for hedge accounting, any ineffectiveness is recorded immediately. However, such commodity cash flow hedges have not had any significant ineffectiveness for all periods presented. We classify both the earnings and cash flow impact from these derivatives consistent with the underlying hedged item. During the next 12 months, we expect to reclassify net gains of $1 million related to cash flow hedges from accumulated other comprehensive loss into net income. Derivatives used to hedge commodity price risks that do not qualify for hedge accounting are marked to market each period and reflected in our income statement.

Foreign Exchange
Our operations outside of the U.S. generate approximately 40% of our net revenue, with Mexico, the United Kingdom and Canada comprising approximately 20% of our net revenue. As a result, we are exposed to foreign currency risks from unforeseen economic changes and political unrest. On occasion, we enter into hedges, primarily forward contracts with terms of no more than two years, to reduce the effect of foreign exchange rates. Ineffectiveness of these hedges has not been material.

Interest Rates
We centrally manage our debt and investment portfolios considering investment opportunities and risks, tax consequences and overall financing strategies. We may use interest rate and cross currency interest rate swaps to manage our overall interest expense and foreign exchange risk. These instruments effectively change the interest rate and currency of specific debt issuances.

These swaps are entered into concurrently with the issuance of the debt that they are intended to modify. The notional amount, interest payment and maturity date of the swaps match the principal, interest payment and maturity date of the related debt. These swaps are entered into only with strong creditworthy counterparties, are settled on a net basis and are of relatively short duration.

Stock Prices

The portion of our deferred compensation liability that is based on certain market indices and on our stock price is subject to market risk. We hold mutual fund investments and prepaid forward contracts to manage this risk. Changes in the fair value of these investments and contracts are recognized immediately in earnings and are offset by changes in the related compensation liability.

PFIZER

Pfizer provides a useful table that clearly summarizes aspects of each financial instrument. Shown are foreign currency derivatives, but Pfizer provides similar disclosures for interest risk instruments.

Foreign Exchange Risk—A significant portion of revenues, earnings and net investments in foreign affiliates is exposed to changes in foreign exchange rates. We seek to manage our foreign exchange risk in part through operational means, including managing expected same currency revenues in relation to same currency costs and same currency assets in relation to same currency liabilities. Depending on market conditions, foreign exchange risk is also managed through the use of derivative financial instruments and foreign currency debt. These financial instruments serve to protect net income and net investments against the impact of the translation into U.S. dollars of certain foreign exchange denominated transactions.

We entered into financial instruments to hedge or offset by the same currency an appropriate portion of the currency risk and the timing of the hedged or offset item. As of December 31, 2006 and 2005, the more significant financial instruments employed to manage foreign exchange risk follow:

INSTRUMENT[a]	PRIMARY BALANCE SHEET CAPTION[b]	HEDGE TYPE [c]	HEDGED OR OFFSET ITEM	NOTIONAL AMOUNT (MILLIONS OF DOLLARS)		MATURITY DATE
				2006	2005	
Forward	OCL	-	Short-term foreign currency assets	$7,939	$-	2007
Forward	OCL	-	Short-term foreign currency assets and liabilities[d]	-	6,509	2006
Swaps	ONCL	NI	Swedish krona net investments[e]	7,759	-	2008
Swaps	ONCL	CF	Swedish krona intercompany loan	4,759	-	2008
Forward	OCL	-	Short-term intercompany foreign currency loans[f]	3,484	-	2007
ST yen borrowings	STB	NI	Yet net investments	1,598	-	2007
ST yen borrowings	STB	NI	Yen net investments	-	1,620	2006
Swaps	OCL	NI	Euro net investments	1,369	-	2007
Swaps	OCL	NI	Euro net investments		1,233	2006
Forward	Prepaid	CF	Yen available-for-sale investments	1,136	-	2007
Swaps	OCL	CF	U.K. pound intercompany loan	811	717	2007

Swaps	OCL	NI	Yen net investments	**653**	**-**	2007
Swaps	OCL	NI	Yen net investments	**-**	**662**	2006
LT yen debt	LTD	NI	Yen net investments	**547**	**-**	After 2011
Forward	OCL	CF	Euro intercompany loan	**542**	**-**	2007
LT yen debt	LTD	NI	Yen net investments	**506**	**512**	2008
LT yen debt	LTD	NI	Yen net investments	**504**	**-**	2011
Forward	OCL	CF	Euro available-for-sale investments	**444**	**-**	2007
Forward	Prepaid	CF	Euro available-for-sale investments	**-**	**7371**	2006
Forward	Prepaid	CF	Danish krone available-for-sale investments	**-**	**810**	2006
Forward	OCL	CF	Swedish krona available-for-sale investments	**-**	**486**	2006

[a] Forward = Forward-exchange contracts; ST yen borrowings = Short-term yen borrowings; LT yen debt = Long-term yen debt.

[b] The primary balance sheet caption indicates the financial statement classification of the fair value amount associated with the financial instrument used to hedge or offset foreign exchange risk. The abbreviations used are defined as follows: Prepaid = *Prepaid expenses and taxes*; STB = *Short-term borrowings, including current portion of long-term debt*; OCL = *Other current liabilities*; LTD = *Long-term debt*; and ONCL = *Other noncurrent liabilities*.

[c] CF = Cash flow hedge; NI = Net investment hedge.

[d] Forward-exchange contracts used to offset short-term foreign currency assets and liabilities were primarily for intercompany transactions in euros, U.K. pounds, Australian dollars, Canadian dollars, Japanese yen and Swedish krona for the year ended December 31, 2006, and in euros, U.K. pounds, Australian dollars, Canadian dollars, Swedish krona, Japanese yen and Swiss francs for the year ended December 31, 2005.

[e] Reflects an increase in Swedish krona net investments due to the receipt of proceeds related to the sale of our Consumer Healthcare business in Sweden.

[f] Forward-exchange contracts used to offset foreign currency loans for intercompany contracts arising from the sale of our Consumer Healthcare business, primarily in Canadian dollars, U.K. pounds and euros.

All derivative contracts used to manage foreign currency risk are measured at fair value and reported as assets or liabilities on the balance sheet. Changes in fair value are reported in earnings or deferred, depending on the nature and effectiveness of the offset or hedging relationship, as follows:

- We recognize the earnings impact of foreign currency swaps and foreign currency forward-exchange contracts designated as cash flow hedges in *Other (income)/deductions—net* upon the recognition of the foreign exchange gain or loss on the translation to U.S. dollars of the hedged items.

- We recognize the earnings impact of foreign currency forward-exchange contracts that are used to offset foreign currency assets or liabilities in *Other (income)/deductions—net* during the terms of the contracts, along with the earnings impact of the items they generally offset.

- We recognize the earnings impact of foreign currency swaps designated as a hedge of our net investments in *Other (income)/deductions—net* in three ways: over time—for the periodic net swap payments; immediately—to the extent of any change in the difference between the foreign exchange spot rate and forward rate; and upon sale or substantial liquidation of our net investments—to the extent of change in the foreign exchange spot rates.

Any ineffectiveness in a hedging relationship is recognized immediately into earnings. There was no significant ineffectiveness in 2006, 2005 or 2004.

Discontinued operations

FASB Standard No. 144 requires presenting discontinued operations of any *component* of an entity on the income statement. This requirement expands on APB No. 30, which only required presenting discontinued operations of a *segment* of operations on the income statement. Standard No. 144 defines a component as having operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

CIANBRO

Cianbro reports discontinued operations for three different businesses.

Note 2: Discontinued Operations

Income from discontinued operations consists of the following results from Raytheon Aircraft, Raytheon Engineers & Constructors businesses (RE&C) and Aircraft Integration Systems business (AIS):

	Pretax			After-tax		
(In millions)	**2006**	2005	2004	**2006**	2005	2004
Raytheon Aircraft	**$274**	$187	$ 96	**$181**	$124	$ 65
RE&C	**(6)**	(41)	(42)	**(4)**	(50)	(48)
AIS	**(1)**	(33)	(23)	**(1)**	(21)	(15)
Total	**$267**	$113	$ 31	**$176**	$ 53	$ 2

No interest expense was allocated to discontinued operations for the years ended December 31, 2006, 2005 and 2004 since there was no debt specifically attributable to discontinued operations or required to be repaid with proceeds from the sale.

Raytheon Aircraft—In December 2006, we entered into a definitive agreement to sell Raytheon Aircraft Company for approximately $3.3 billion. The transaction, which is subject to customary conditions and regulatory approvals, is expected to close in the first half of 2007. We decided to explore strategic alternatives for Raytheon Aircraft, a provider of business and special mission aircraft, because, among other reasons, it did not address our core markets and had limited synergies with our government and defense businesses.

As a result of entering into the definitive agreement, we have reported Raytheon Aircraft as a discontinued operation in this Form 10-K in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-lived Assets. Accordingly, our results of operations for all periods presented have been reclassified to reflect Raytheon Aircraft as a discontinued operation, and the assets and liabilities of Raytheon Aircraft have been reclassified as held for sale for all periods presented. We will retain certain obligations of Raytheon Aircraft after the sale, including environmental liabilities, product liability and certain U.K. pension benefits. In addition, we will retain a residual interest in certain receivables sold by Raytheon Aircraft through 2006. These assets and liabilities are included within the relevant account balances in our consolidated financial statements. Any future income statement activity related to these accounts will be included in discontinued operations.

The income from discontinued operations related to Raytheon Aircraft was as follows:

(In millions)	**2006**	2005	2004
Net sales	**$2,983**	$2,856	$2,420
Operating expenses	**2,720**	2,681	2,333

Income before taxes	**274**	187	96
Federal and foreign income taxes	**93**	63	31
Income from discontinued operations	**$ 181**	$ 124	$ 65

Revenue from aircraft sales are recognized at the time of physical delivery of the completed aircraft. Revenue from certain qualifying non-cancelable aircraft lease contracts is accounted for as sales-type leases. The present value of all payments, net of executory costs, are recorded as revenue, and the related costs of the aircraft are charged to cost of sales. Associated interest, using the interest method, is recorded over the term of the lease agreements. All other leases for aircraft are accounted for under the operating method wherein revenue is recorded as earned over the rental period. Service revenue is recognized ratably over contractual periods or as services are performed.

In connection with certain aircraft sales, we have offered trade-in incentives whereby the customer will receive a pre-determined trade-in value if they purchase another aircraft from the Company. The difference between the value of these trade-in incentives, the majority of which expire by the end of 2008, and the current estimated fair value of the underlying aircraft was approximately $1 million at December 31, 2006. There is a high degree of uncertainty inherent in the assessment of the likelihood and value of trade-in commitments.

We use lot accounting for new commercial aircraft introductions at Raytheon Aircraft. Lot accounting involves selecting an initial lot size at the time a new aircraft begins to be delivered and measuring an average margin over the entire lot for each aircraft sold. The costs attributed to aircraft delivered are based on the estimated average margin of all aircraft in the lot and are determined under the learning curve concept, which anticipates a predictable decrease in unit costs from cost reduction initiatives and as tasks and production techniques become more efficient through repetition. Costs incurred on in-process and delivered aircraft in excess of the estimated average margin were included in assets held for sale and totaled $18 million and $67 million on Premier at December 31, 2006 and 2005, respectively, and $136 million and $112 million on Hawker 4000 at December 31, 2006 and 2005, respectively. Once the initial lot has been completed, the use of lot accounting is discontinued. We determine lot size based on several factors, including the size of firm backlog, the expected annual production on the aircraft and experience on similar new aircraft. The size of the initial lot for the Beechcraft Premier I is 200 units of which 166 units had been delivered at December 31, 2006. There was 23 units for the Premier in firm backlog of which 16 units are expected to be delivered from the initial lot. The size of the initial lot for the Hawker 4000 is 75 units and no units had been delivered at December 31, 2006. There was 81 units for the Hawker 4000 in firm backlog of which 41 units are expected to be delivered from the initial lot. At December 31, 2006, deferred costs of $13 million related to Premier and $89 million related to Hawker 4000 were not recoverable from existing firm orders.

General and program specific manufacturing equipment and tooling at Raytheon Aircraft are included in assets held for sale. There was $174 million and $191 million of program specific manufacturing equipment and tooling related to Premier and Hawker 4000 at December 31, 2006 and 2005, respectively.

The components of assets and liabilities related to Raytheon Aircraft were as follows at December 31:

(In millions)	**2006**	2005
Current assets	**$1,771**	$1,627
Noncurrent assets	**525**	746
Total assets	**$2,296**	$2,373
Current liabilities	**$ 872**	$ 740
Noncurrent liabilities	**137**	288
Total liabilities	**$1,009**	$1,028

Total assets consisted primarily of accounts receivable, net, of $165 million and $198 million, inventories of $1,426 million and $1,262 million and property, plant and equipment of $521 million and $539 million at December 31, 2006 and 2005, respectively. Total liabilities consisted primarily of advance payments and billings in excess of costs of $420 million and $334 million, accounts payable of $228 million and $149 million, accrued expenses of $186 million and $209 million and accrued retiree benefits and other long-term receivables of $137 million and $222 million at December 31, 2006 and 2005, respectively.

Raytheon Engineers & Constructors—In 2000, we sold RE&C to Washington Group International, Inc. (WGI). As a result of WGI's bankruptcy, we were required to perform various contract and lease obligations under letters of credit, surety bonds and guarantees (Support Agreements) that it had provided to project owners and other parties.

We have since settled many of its Support Agreement obligations. For the remaining Support Agreement obligations, we have various risks and exposures, including warranty close out, various liquidated damages issues and potential adverse claims resolution.

In 2005 and 2004, we recorded after-tax charges of $23 million and $24 million, respectively, for an estimated liability for foreign tax-related matters. Although not expected to be material, additional losses on foreign tax-related matters could be recorded in the future as estimates are revised or the underlying matters are settled.

Other accrued expenses included net current liabilities for RE&C of $23 million and $33 million at December 31, 2006 and 2005, respectively.

Aircraft Integration Systems—In 2002, we sold AIS for $1,123 million, net, subject to purchase price adjustments. As part of the transaction, we retained the responsibility for performance of the Boeing Business Jet (BBJ) program and retained certain assets related to the BBJ program, which is now essentially complete. In January 2006, a dispute regarding the AIS purchase price was resolved in arbitration and we recorded a pretax charge of $26 million in 2005 related to this settlement. In the first quarter of 2006, all liabilities related to the purchase price dispute were discharged.

Other accrued expenses included net current liabilities for AIS of $2 million and $16 million as of December 31, 2006 and 2005, respectively.

METLIFE

MetLife reports discontinued operations for the sale of certain real property, MetLife Indonesia, and a component called SSRM.

22. Discontinued Operations

Real Estate

The Company actively manages its real estate portfolio with the objective of maximizing earnings through selective acquisitions and dispositions. Income related to real estate classified as held-for-sale or sold is presented in discontinued operations. These assets are carried at the lower of depreciated cost or fair value less expected disposition costs.

The following information presents the components of income from discontinued real estate operations:

	Years Ended December 31,		
	2006	2005	2004
	(in millions)		
Investment income	$234	$395	$649
Investment expense	(150)	(244)	(388)

Net investment gains	4,795	2,125	146
Total revenues	4,879	2,276	407
Interest expense	-	-	13
Provision for income tax	1,723	808	138
Income from discontinued operations, net of income tax	$3,156	$1,468	$256

The carrying value of real estate related to discontinued operations was $7 million and $755 million at December 31, 2006 and 2005, respectively.

The following table presents the discontinued real estate operations by segment:

	Years Ended December 31,		
	2006	2005	2004
	(In millions)		
Net investment income			
Institutional	$ 6	$ 28	$ 37
Individual	4	20	30
Corporate & Other	74	103	194
Total net investment income	$ 84	$ 151	$ 261
Net investment gains (losses)			
Institutional	$ 58	$ 242	$ 9
Individual	23	443	3
Corporate & Other	4,714	1,440	134
Total net investment gains (losses)	$ 4,795	$ 2,125	$ 146
Interest expense			
Institutional	$ —	$ —	$ —
Individual	—	—	—
Corporate & Other	—	—	13
Total interest expense	$ —	$ —	$ 13

In the fourth quarter of 2006, the Company closed the sale of its Peter Cooper Village and Stuyvesant Town properties located in Manhattan, New York for $5.4 billion. The Peter Cooper Village and Stuyvesant Town properties together make up the largest apartment complex in Manhattan, New York totaling over 11,000 units, spread over 80 contiguous acres. The properties were owned by the Holding Company's subsidiary, MTL. Net investment income on these properties was $73 million, $72 million and $70 million for the years ended December 31, 2006, 2005 and 2004, respectively. The sale resulted in a gain of $3 billion, net of income tax.

In the second quarter of 2005, the Company sold its One Madison Avenue and 200 Park Avenue properties in Manhattan, New York for $918 million and $1.72 billion, respectively, resulting in gains, net of income tax, of $431 million and $762 million, respectively. Net investment income on One Madison Avenue and 200 Park Avenue was $13 million and $16 million, respectively, and $44 million and $67 million, respectively, for the years ended December 31, 2005 and 2004, respectively. In connection with the sale of the 200 Park Avenue property, the Company has retained rights to existing signage and is leasing space for associates in the property for 20 years with optional renewal periods through 2205.

In 2004, the Company sold one of its real estate investments, Sears Tower, resulting in a realized gain of $85 million, net of income tax.

Operations

On September 29, 2005, the Company completed the sale of MetLife Indonesia to a third party, resulting in a gain upon disposal of $10 million, net of income tax. As a result of this sale, the Company recognized income (loss) from discontinued operations of $5 million and ($9) million, net of income tax, for the years ended December 31, 2005 and 2004, respectively. The Company reclassified the operations of MetLife Indonesia into discontinued operations for all years presented.

The following table presents the amounts related to the operations of MetLife Indonesia that have been combined with the discontinued real estate operations in the consolidated statements of income:

	Years Ended December 31, 2005	2004
	(In millions)	
Revenues	$ 5	$ 5
Expenses	10	14
Income before provision for income tax	(5)	(9)
Provision for income tax	—	—
Loss from discontinued operations, net of income tax	(5)	(9)
Net investment gain, net of income tax	10	—
Income (loss) from discontinued operations, net of income tax	$ 5	$ (9)

On January 31, 2005, the Company completed the sale of SSRM to a third party for $328 million in cash and stock. As a result of the sale of SSRM, the Company recognized income from discontinued operations of $157 million, net of income tax, comprised of a realized gain of $165 million, net of income tax, and an operating expense related to a lease abandonment of $8 million, net of income tax. Under the terms of the sale agreement, MetLife will have an opportunity to receive additional payments based on, among other things, certain revenue retention and growth measures. The purchase price is also subject to reduction over five years, depending on retention of certain MetLife-related business. Also under the terms of such agreement, MetLife had the opportunity to receive additional consideration for the retention of certain customers for a specific period in 2005. Upon finalization of the computation, the Company received payments of $30 million, net of income tax, in the second quarter of 2006 and $12 million, net of income tax, in the fourth quarter of 2005 due to the retention of these specific customer accounts. In the fourth quarter of 2006, the Company eliminated $4 million of a liability that was previously recorded with respect to the indemnities provided in connection with the sale of SSRM, resulting in a benefit to the Company of $2 million, net of income tax. The Company believes that future payments relating to these indemnities are not probable.

The Company reported the operations of SSRM in discontinued operations. Additionally, the sale of SSRM resulted in the elimination of the Company's Asset Management segment. The remaining asset management business, which is insignificant, is reported in Corporate & Other. The Company's discontinued operations for the year ended December 31, 2005 included expenses of $6 million, net of income tax, related to the sale of SSRM.

The operations of SSRM include affiliated revenues of $5 million and $59 million for the years ended December 31, 2005 and 2004, respectively, related to asset management services provided by SSRM to the Company that have not been eliminated from discontinued operations as these transactions continued after the sale of SSRM. The following table presents the amounts related to operations of SSRM that have been combined with the discontinued real estate operations in the consolidated statements of income:

	Years Ended December 31, 2006	2005	2004
		(In millions)	
Revenues from discontinued operations	$ —	$ 19	$ 328
Expenses from discontinued operations	—	38	296
Income from discontinued operations before provision for income tax	—	(19)	32
Provision for income tax	—	(5)	13
Income (loss) from discontinued operations, net of income tax	—	(14)	19
Net investment gain, net of income tax	32	177	—
Income from discontinued operations, net of income tax	$ 32	$ 163	$ 19

PFIZER

The following note summarizes a long series of discontinued components.

3. Discontinued Operations

We evaluate our businesses and product lines periodically for strategic fit within our operations. As of December 31, 2006, we sold the following:

- In the fourth quarter of 2006, we sold our Consumer Healthcare business for $16.6 billion, and recorded a gain of approximately $10.2 billion ($7.9 billion, net of tax) in *Gains on sales of discontinued operations—net of tax* in the consolidated statement of income for 2006. This business was composed of:
  - substantially all of our former Consumer Healthcare segment;
  - other associated amounts, such as purchase-accounting impacts, acquisition-related costs and restructuring and implementation costs related to our Adapting to Scale (AtS) productivity initiative that were previously reported in the Corporate/Other segment; and
  - certain manufacturing facility assets and liabilities, which were previously part of our Pharmaceutical or Corporate/ Other segment but were included in the sale of our Consumer Healthcare business. The net impact to the Pharmaceutical segment was not significant.

The results of this business are included in *Income from discontinued operations—net of tax* for all periods presented.

Legal title to certain assets and legal control of the business in certain non-U.S. jurisdictions did not transfer to the buyer on the closing date of December 20 because the satisfaction of specific local requirements was pending. These operations represent a small portion of our Consumer Healthcare business and all are expected to close within one year of the transaction date, most within a few months. In order to ensure that the buyer was placed in the same economic position as if the assets, operations and activities of those businesses had been transferred on that date, we entered into an agreement that passed the risks and rewards of ownership to the buyer from December 20. We have treated these delayed-close businesses as sold for accounting purposes.

For a period of time, we will continue to generate cash flows and to report income statement activity in *Discontinued operations—net of tax* that are associated with our former Consumer Healthcare business. The activities that will give rise to these impacts are transitional in nature and generally result from agreements that ensure and facilitate the orderly transfer of business operations. For example, we entered into a number of transition services agreements that will allow the buyer sufficient time to prepare for the transfer of activities and to limit the risk of business disruption. The nature, magnitude and duration of the agreements vary depending on the specific circumstances of the service, location and/or business need. The agreements can include the following: manufacturing and product supply, logistics, customer service, support of financial processes, procurement, human resources, facilities management, data collection and information services. Most of these agreements extend for periods generally less than 24 months, but because of the inherent complexity of manufacturing processes and the risk of product flow disruption, the product supply agreements generally extend up to 36 months.

For the period of time prior to the final transfer of these activities to the buyer, we will continue to generate cash flows and to report gross revenues, income and expense activity in *Discontinued operations—net of tax*, although at a substantially reduced level. After the transfer of these activities, these cash flows and the income statement activity reported in *Discontinued operations—net of tax* will be eliminated.

None of these agreements confers upon us the ability to influence the operating and/or financial policies of the Consumer Healthcare business under its new ownership.

- In the third quarter of 2005, we sold the last of three European generic pharmaceutical businesses, which we had included in our Pharmaceutical segment, for 4.7 million euro (approximately $5.6 million). This business became a part of Pfizer in April 2003 in connection with our acquisition of Pharmacia. We recorded a loss of $3 million ($2 million, net of tax) in *Gains on sales of discontinued operations—net of tax* in the consolidated statement of income for 2005.

- In the first quarter of 2005, we sold the second of three European generic pharmaceutical businesses, which we had included in our Pharmaceutical segment, for 70 million euro (approximately $93 million). This business became a part of Pfizer in April 2003 in connection with our acquisition of Pharmacia. We recorded a gain of $57 million ($36 million, net of tax) in *Gains on sales of discontinued operations—net of tax* in the consolidated statement of income for 2005. In addition, we recorded an impairment charge of $9 million ($6 million, net of tax) related to the third European generic business in *Income from discontinued operations—net of tax* in the consolidated statement of income for 2005.

- In the fourth quarter of 2004, we sold the first of three European generic pharmaceutical businesses, which we had included in our Pharmaceutical segment, for 53 million euro (approximately $65 million). This business became a part of Pfizer in April 2003 in connection with our acquisition of Pharmacia. In addition, we recorded an impairment charge of $61 million ($37 million, net of tax), relating to a European generic business which was later sold in 2005, and is included in *Income from discontinued operations—net of tax* in the consolidated statement of income for 2004.

- In the third quarter of 2004, we sold certain non-core consumer product lines marketed in Europe by our former Consumer Healthcare business for 135 million euro (approximately $163 million) in cash. The majority of these products were small brands sold in single markets only and included certain products that became a part of Pfizer in April 2003 in connection with the acquisition of Pharmacia. We recorded a gain of $58 million ($41 million, net of tax) in *Gains on sales of discontinued operations—net of tax* in the consolidated statement of income for 2004.

- In the second quarter of 2004, we sold our surgical ophthalmic business, which we had included in our Pharmaceutical segment, for $450 million in cash. This business became a part of Pfizer in April 2003 in connection with our acquisition of Pharmacia. The results of this business were included in *Income from discontinued operations—net of tax*.

- In the second quarter of 2004, we sold our in-vitro allergy and autoimmune diagnostics testing (Diagnostics) business, which we had included in the Corporate/Other segment, for $575 million in cash. This business became a part of Pfizer in April 2003 in connection with our acquisition of Pharmacia. The results of this business were included in *Income from discontinued operations—net of tax*.

The following amounts, primarily related to our Consumer Healthcare business, have been segregated from continuing operations and included in *Discontinued operations—net of tax* in the consolidated statements of income:

	YEAR ENDED DEC. 31,		
(MILLIONS OF DOLLARS)	**2006**	**2005**	**2004**
Revenues	**$ 4,044**	$ 3,948	$ 3,933
Pre-tax income	**$ 643**	$ 695	$ 563

Provision for taxes on income[a]	**(210)**	(244)	(189)
Income from operations of discontinued businesses—net of tax	**433**	451	374
Pre-tax gains on sales of discontinued businesses	**10,243**	77	75
Provision for taxes on gains[b]	**(2,363)**	(30)	(24)
Gains on sales of discontinued businesses—net of tax	**7,880**	47	51
Discontinued operations—net of tax	**$ 8,313**	$ 498	$ 425

(a) Includes a deferred tax expense of $24 million in 2006 and $25 million in 2005, and a deferred tax benefit of $15 million in 2004.

(b) Includes a deferred tax benefit of $444 million in 2006, and nil in 2005 and 2004.

The following assets and liabilities have been segregated and included in *Assets of discontinued operations and other assets held for sale* and *Liabilities of discontinued operations and other liabilities held for sale*, as appropriate, in the consolidated balance sheet as of December 31, 2005, and primarily relate to our Consumer Healthcare business (amounts in 2006 were not significant):

(MILLIONS OF DOLLARS)	AS OF DEC. 31, 2005
Accounts receivable, less allowance for doubtful accounts	$ 661
Inventories	561
Prepaid expenses and taxes	71
Property, plant and equipment, less accumulated depreciation	1,002
Goodwill	2,789
Identifiable intangible assets, less accumulated amortization	1,557
Other assets, deferred taxes and deferred charges	18
Assets of discontinued operations and other assets held for sale	$ 6,659
Current liabilities	$ 538
Other	689
Liabilities of discontinued operations and other liabilities held for sale	$ 1,227

Net cash flows of our discontinued operations from each of the categories of operating, investing and financing activities were not significant for 2006, 2005 and 2004.

PRUDENTIAL FINANCIAL

Prudential summarizes the income (loss) from discontinued businesses over a three-year period in a single table, providing more details in footnotes.

Discontinued Operations

Income (loss) from discontinued businesses, including charges upon disposition, for the years ended December 31, are as follows:

2006	2005	2004
(in millions)		

Real estate investments sold or held for sale(1)	$ 98	$—	$ —
Canadian IWP and IH operations(2)	(10)	(31)	11
Philippine insurance operations(3)	(12)	—	—
Dryden Wealth Management(4)	(4)	(56)	(81)
International securities operations(5)	(8)	(26)	(42)
Healthcare operations(6)	29	22	6
Other	—	(7)	(9)
Income (loss) from discontinued operations before income taxes	93	(98)	(115)
Income tax expense (benefit)	28	(16)	(27)
Income (loss) from discontinued operations, net of taxes	$ 65	$ (82)	$ (88)

The Company's Consolidated Statements of Financial Position include total assets and total liabilities related to discontinued businesses of $296 million and $125 million, respectively, at December 31, 2006 and $704 million and $436 million, respectively, at December 31, 2005.

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(1) Reflects the income or loss from discontinued real estate investments. In the third quarter of 2006, the Company recorded a $96 million gain on the sale of wholly-owned real estate property.

(2) In the third quarter of 2006, the Company entered into a reinsurance transaction related to its Canadian Intermediate Weekly Premium ("IWP") and Individual Health ("IH") operations, which resulted in these operations being accounted for as discontinued operations.

(3) In the third quarter of 2006, the Company completed the sale of its Philippine insurance operations.

(4) On October 4, 2005, the Company completed the sale of its Dryden Wealth Management business ("Dryden"), which offered financial advisory, private banking and portfolio management services primarily to retail investors in Europe and Asia, to a subsidiary of Fortis N.V. Results for the year ended December 31, 2005 include $49 million of transaction and transaction related costs related to the sale. Results for the year ended December 31, 2004 include a charge of $53 million for the impairment of goodwill associated with this business.

(5) International securities operations include the European retail transaction-oriented stockbrokerage and related activities of Prudential Securities Group, Inc.

(6) The sale of the Company's healthcare business to Aetna was completed in 1999. The loss the Company previously recorded upon the disposal of its healthcare business was reduced in each of the years ended December 31, 2006, 2005 and 2004. The reductions were primarily the result of favorable resolution of certain legal, regulatory and contractual matters.

Charges recorded in connection with the disposals of businesses include estimates that are subject to subsequent adjustment. It is possible that such adjustments might be material to future results of operations of a particular quarterly or annual period.

Fair value disclosures and Fair value option for financial instruments

SFAS 157, Fair Value Measurements http://www.fasb.org/pdf/fas157.pdf establishes a common definition of fair value, with a framework to make measuring fair value more consistent and comparable. It also requires expanded disclosures that provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. For fiscal years beginning after November 15, 2007, companies will be required to implement the standard for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on

a recurring basis in financial statements. However, a one year deferral for the implementation of SFAS 157 is provided for other nonfinancial assets and liabilities.

FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities http://www.fasb.org/pdf/fas159.pdf expands the scope of specific assets and liabilities that may be carried at fair value on the balance sheet. It offers the option to record most financial assets and liabilities at fair value, with changes in fair value recorded in earnings. Statement No. 159 is effective for fiscal years beginning after November 15, 2007. We did not identify any companies that attempted to adopt Statement No. 159 for fiscal years ended December 31, 2006.

WACHOVIA

Wachovia's note includes estimated fair value of financial assets and liabilities, information about how these figures were computed, the fair value of collateral held, and a table of off-balance-sheet commitments.

NOTE 21: FAIR VALUE OF FINANCIAL INSTRUMENTS

Information about the fair value of on-balance sheet financial instruments at December 31, 2006 and 2005, is presented below.

	December 31,			
	2006		*2005*	
(In millions)	***Carrying Amount***	***Estimated Fair Value***	*Carrying Amount*	*Estimated Fair Value*
FINANCIAL ASSETS				
Cash and cash equivalents	**$ 34,916**	**34,916**	37,625	37,625
Trading account assets	**45,529**	**45,529**	42,704	42,704
Securities	**108,619**	**108,619**	113,698	113,698
Loans, net of unearned income and allowance for loan losses	**416,798**	**421,839**	256,291	259,792
Loans held for sale	**12,568**	**12,651**	6,405	6,459
Other financial assets	**$ 29,762**	**29,762**	25,444	25,444
FINANCIAL LIABILITIES				
Deposits	**407,458**	**407,701**	324,894	324,625
Short-term borrowings	**49,157**	**49,157**	61,953	61,953
Trading account liabilities	**18,228**	**18,228**	17,598	17,598
Other financial liabilities	**9,286**	**9,286**	7,351	7,351
Long-term debt	**$138,594**	**137,624**	48,971	50,342

The fair values of performing loans for all portfolio loans were calculated by discounting estimated cash flows through expected maturity dates using estimated market yields that reflect the credit and interest rate risks inherent in each category of loans, and prepayment assumptions. Estimated fair values for the commercial loan portfolio were based on weighted average discount rates ranging from 5.37 percent to 8.93 percent and 5.09 percent to 9.75 percent at December 31, 2006 and 2005, respectively, and for the consumer loan portfolio from 6.77 percent to 12.65 percent and 6.47 percent to 13.98 percent, respectively. For performing residential mortgage loans, fair values were estimated using discounted cash flow analyses utilizing yields for similar mortgage-backed securities. The fair values of nonperforming loans were calculated by discounting estimated cash flows using discount rates commensurate with the risk associated with the cash flows.

The fair values of noninterest-bearing deposits, savings and NOW accounts, and money market accounts were the amounts payable on demand at December 31, 2006 and 2005. The fair value of fixed-maturity certificates of deposit is estimated based on the discounted value of contractual cash flows using current market rates of instruments with similar remaining maturities. The fair value estimates for deposits do not include the value of the Company's long-term relationships with depositors.

The fair value of long-term debt is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt with similar terms.

Substantially all other financial assets and liabilities have maturities of three months or less, and accordingly, the carrying amount is deemed to be a reasonable estimate of fair value.

Fair value estimates are based on existing financial instruments, as defined, without estimating the value of certain ongoing businesses, the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. In the Company's opinion, these add significant value.

COLLATERAL

The Company has accepted collateral that may be sold or repledged based on contract or custom. At December 31, 2006 and 2005, the fair value of this collateral was approximately $14.8 billion and $23.7 billion, respectively. At December 31, 2006 and 2005, the Company had sold or repledged $1.6 billion and $4.6 billion of such collateral, respectively. The primary source of this collateral is reverse repurchase agreements.

The Company pledges securities as collateral in repurchase agreements, U.S. Government and other public deposits and other short-term borrowings. This collateral can be sold or repledged by the counterparties. At December 31, 2006, the Company has pledged certain trading account assets as collateral, with a carrying amount of $12.2 billion.

Information about the fair value of off-balance sheet financial instruments at December 31, 2006 and 2005, is presented below.

	December 31,			
	2006		*2005*	
(In millions)	***Notional Amount***	***Estimated Fair Value***	*Notional Amount*	*Estimated Fair Value*
OFF-BALANCE SHEET FINANCIAL INSTRUMENTS				
Lending commitments	$**249,633**	**320**	215,353	310
Standby letters of credit	**37,783**	**115**	35,568	108
Financial guarantees written	$ **97,999**	**59**	100,221	55

The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the current creditworthiness of the counterparties. Generally, for fixed rate loan commitments, fair value also considers the difference between the current level of interest rates and the committed rates.

The fair value of financial guarantees written is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the current creditworthiness of the counterparties.

CISCO SYSTEMS

Cisco's Significant Accounting Policies included the following disclosures.

SFAS No. 157, "Fair Value Measurements"

SFAS 157 In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently assessing the impact that SFAS 157 may have on its results of operations and financial position…

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115".

SFAS 159 In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 is expected to expand the use of fair value accounting but does not affect existing standards which require certain assets or liabilities to be carried at fair value. The objective of SFAS 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Under SFAS 159, a company may choose, at specified election dates, to measure eligible items at fair value and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently assessing the impact that SFAS 159 may have on its results of operations and financial position.

Goodwill and intangibles

Goodwill and intangibles continues to be a leading accounting issue for filers. The aforementioned *CPA Journal* article lists Intangibles Impairment as the fourth-most-cited Critical Accounting Policy in the 2006 year-end annual reports.

AETNA

The following note lists goodwill acquired from different acquisitions, including the disclosure of reclassifications of a prior year's goodwill into deferred tax assets. The note also provides the value of acquired intangible assets, and projections of future amortization.

Note 7. Goodwill and Other Acquired Intangible Assets

As a result of the acquisitions described in Note 3 on page 57, we increased the carrying value of goodwill in 2006 and 2005 as follows:

(Millions)	2006	2005
Balance, beginning of the period	$4,523.2	$3,687.8
Goodwill acquired:		
Broadspire Disability	99.0	—
ActiveHealth	(10.1) [1]	309.1
HMS	(9.1) [1]	290.8
SRC	—	139.8
Other	.6	95.7 [2]
Balance, end of the period	$4,603.6	$4,523.2

(1) In 2006, we determined that additional net operating loss carry forwards are available to us from the ActiveHealth and HMS acquisitions. As a result, goodwill was reduced in 2006 as we recognized deferred tax assets for these net operating loss carry forwards.

(2) Primarily includes goodwill recorded related to the 2005 acquisitions of certain assets from Magellan and the remaining interest in ASP. Refer to Note 3 on page 57 for additional information.

At December 31, 2006, goodwill was assigned to the Health Care and Group Insurance segments in the amounts of $4.5 billion and $99 million, respectively. At December 31, 2005, all goodwill was assigned to the Health Care segment.

Other acquired intangible assets at December 31, 2006 and 2005 were comprised of the following:

(Millions)	Cost	Accumulated Amortization	Net Balance	Amortization Period (Years)
2006				
Other acquired intangible assets:				
Provider networks	$ 696.2	$ 282.0	$ 414.2	12-25
Customer lists	250.6[1]	51.3	199.3	4-10
Technology	56.5[1]	21.3	35.2	3-5
Other	31.4[1]	10.8	20.6	3-12
Trademarks	22.3	—	22.3	Indefinite
Total other acquired intangible assets	$1,057.0	$ 365.4	$ 691.6	
2005				
Other acquired intangible assets:				
Customer lists	$1,132.4[2]	$ 937.5	$ 194.9	4-9
Provider networks	696.2[2]	253.2	443.0	12-25
Technology	44.1[2]	6.2	37.9	3-5
Other	29.9[2]	3.1	26.8	3-12
Trademarks	22.3[2]	—	22.3	Indefinite
Total other acquired intangible assets	$1,924.9	$ 1,200.0	$ 724.9	

(1) As a result of our acquisitions in 2006, we assigned $37.2 million to customer list assets, $12.4 million to technology assets and $2.7 million to other assets.

(2) As a result of our acquisitions in 2005, we assigned $213.4 million to customer list assets, $16.0 million to provider network assets, $40.1 million to technology assets, $29.9 million to other assets and $22.3 million to trademark assets.

We estimate annual pretax amortization for other acquired intangible assets over the next five calendar years to be as follows:

(Millions)	
2007	$87.2
2008	79.8
2009	68.8
2010	65.0
2011	60.3

BOEING

Boeing provides a roll-forward of its goodwill accounts by reportable segment.

Note 4 – Goodwill and Acquired Intangibles

Changes in the carrying amount of goodwill by reportable segment for the years ended December 31, 2006, 2005 and 2004 were as follows:

	Commercial Airplanes	Precision Engagement & Mobility Systems	Network & Space Systems	Support Systems	Other	Total
Balance at January 1, 2004	$ 282	$ 588	$ 922	$ 118	$ 3	$1,913
Goodwill Adjustments		25	2			27
Acquisitions		11				11
Impairment Losses					(3)	(3)
Balance at December 31, 2004	$ 282	$ 624	$ 924	$ 118		$1,948
Goodwill Adjustments	21	(13)	(18)	11		1
Divestitures	(23)		(2)			(25)
Balance at December 31, 2005	$ 280	$ 611	$ 904	$ 129		$1,924
Aviall acquisition	1,014			41		1,055
Other [1]	71		(3)			68
Balance at December 31, 2006	$ 1,365	$ 611	$ 901	$ 170		$3,047

1 The increase in goodwill is primarily the result of an acquisition in the second quarter 2006. The purchase price allocation for this acquisition was finalized in the fourth quarter of 2006.

The gross carrying amounts and accumulated amortization of our other acquired finite-lived intangible assets were as follows at December 31:

	2006		2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Developed technology	**$ 615**	**$ 369**	$ 576	$ 312
Product know-how	**308**	**64**	308	54
Customer base	**307**	**51**	96	34
Other	**536**	**83**	173	75
	$ 1,766	**$ 567**	$ 1,153	$ 475

Amortization expense for acquired finite-lived intangible assets for the years ended December 31, 2006 and 2005 was $100 and $91. Estimated amortization expense for the five succeeding years are as follows: 2007 – $148; 2008 – $148; 2009 – $147; 2010 – $129 and 2011 – $86.

As of December 31, 2006 and 2005, we had indefinite-lived intangible assets with carrying amounts of $499 and $197.

DELPHI

The following Goodwill note indicates how Delphi reported the impairment of goodwill.

10. GOODWILL

At December 31, 2006 and 2005, Delphi's goodwill balance was approximately $378 million and $363 million respectively. Approximately $138 million of goodwill is tax deductible through amortization.

The change in carrying amount of goodwill for the year ended December 31, 2006 and 2005 is as follows:

	2006	2005
	(in millions)	
Balance at January 1,	$363	$ 798
Acquisitions	—	—
Impairment	—	(390)
Other (primarily currency translation)	15	(45)
Balance at December 31,	$378(a)	$ 363(b)

(a) $161 million in Electrical/Electronic Architecture, $143 million in Electronics & Safety and $74 million in Other

(b) $167 million in Electrical/Electronic Architecture, $125 million in Electronics & Safety and $71 million in Other

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, Delphi reviews the recoverability of goodwill at least annually on May 31 and any other time business conditions indicate a potential change in recoverability. As more fully described in Note 9. Property, Net, Delphi experienced deteriorated financial performance resulting in substantial net losses in 2005. As a result, Delphi has lowered expectations for future performance absent the ability to complete a transformation plan through its reorganization under chapter 11 of the Bankruptcy Code. The deterioration of Delphi's U.S. financial performance, combined with an unfavorable outlook absent completion of a successful U.S. reorganization, was an indicator for potential impairment. The Company recorded no goodwill impairment charges in 2006 and approximately $390 million of goodwill impairment charges during 2005, of which $368 million related to the Powertrain Systems segment and $22 million related to the Automotive Holdings Group segment. In conjunction with the realignment of the Company's business operations effective July 1, 2006, Delphi evaluated reported goodwill for indicators of impairment and concluded no indicators were present.

Delphi determined the goodwill impairment charges by comparing the carrying value of each of its reporting units to the fair value of the reporting unit. In determining fair value of reporting units, Delphi utilized discounted cash flow analysis consistent with that used in the Company's SFAS No. 144 impairment analysis evaluating the recoverability of certain long-lived assets noted in Note 9. Property, Net. In accordance with SFAS No. 142, where the carrying value exceeded the fair value for a particular reporting unit, goodwill impairment charges were recognized. The goodwill impairment charges recognized were determined by stating all other assets and liabilities of a reporting unit at their fair values with the remaining fair value of the reporting unit attributed to goodwill. The resulting goodwill impairment charges are the excess of the recorded goodwill balance over the calculated fair value of goodwill for the reporting unit. Delphi's reporting units for purposes of SFAS No. 142 are global businesses focused on product families. The fair value of the reporting units was negatively impacted by the continued deterioration of business conditions, principally in the U.S., as previously described.

METLIFE

The following note describes the accounting for MetLife's acquisition of Travelers. The note provides the purchase price allocation, including allocations to goodwill, and a full balance sheet listing the assets and liabilities acquired.

2. Acquisitions and Dispositions

Travelers

On July 1, 2005, the Holding Company completed the acquisition of Travelers for $12.1 billion. The results of Travelers' operations were included in the Company's financial statements beginning July 1, 2005. As a result of the acquisition, management of the Company increased significantly the size and scale of the Company's core insurance and annuity products and expanded the Company's presence in both the retirement & savings' domestic and international markets. The distribution agreements executed with Citigroup as part of the acquisition provide the Company with one of the broadest distribution networks in the industry. The initial consideration paid by the Holding Company for the acquisition consisted of $10.9 billion in cash and 22,436,617 shares of the Holding Company's common stock with a market value of $1.0 billion to Citigroup and $100 million in other transaction costs. As described more fully below, additional consideration of $115 million was paid by the Holding Company to Citigroup in 2006. In addition to cash on-hand, the purchase price was financed through the issuance of common stock as described above, debt securities as described in Note 10, common equity units as described in Note 12 and preferred stock as described in Note 17.

The acquisition was accounted for using the purchase method of accounting, which requires that the assets and liabilities of Travelers be measured at their fair values as of July 1, 2005.

Final Purchase Price Allocation and Goodwill

The purchase price has been allocated to the assets acquired and liabilities assumed using management's best estimate of their fair values as of the acquisition date. The computation of the purchase price and the allocation of the purchase price to the net assets acquired based upon their respective fair values as of July 1, 2005, and the resulting goodwill, as revised, are presented below.

The Company revised the purchase price as a result of the finalization by both parties of their review of the June 30, 2005 financial statements and final resolution as to the interpretation of the provisions of the acquisition agreement which resulted in a payment of additional consideration of $115 million by the Company to Citigroup. Further consideration paid to Citigroup of $115 million, as well as additional transaction costs of $3 million, offset by a $4 million reduction in restructuring costs, resulted in a total increase in the purchase price of $114 million.

The purchase price allocation was updated as a result of the additional consideration of $114 million, an increase of $20 million in the value of the future policy benefit liabilities and other policyholder funds acquired resulting from the finalization of the evaluation of the Travelers' underwriting criteria, an increase in equity securities of $24 million resulting from the finalization of the determination of the fair value of such securities, a decrease in current income tax payables of $21 million resulting from a decree by the Argentine Government regarding the taxability of pesification-related gains, a decrease in other assets and an increase in other liabilities of $1 million and $4 million, respectively, due to the receipt of additional information and the reduction in restructuring costs, and the net impact of aforementioned adjustments increasing deferred income tax assets by $1 million. Goodwill increased by $93 million as a consequence of such revisions to the purchase price and the purchase price allocation.

	As of July 1, 2005 (In millions)
Sources:	
Cash	$4,312
Debt	2,716
Junior subordinated debt securities associated with common equity units	2,134

Preferred stock	2,100	
Common stock	1,010	
Total sources of funds		$12,272
Uses:		
Debt and equity issuance costs		$128
Investment in MetLife Capital Trusts II and III		64
Acquisition costs	112	
Purchase price paid to Citigroup	11,968	
Total purchase price		12,080
Total uses of funds		$12,272
Total purchase price		$12,080
Net assets acquired from Travelers	$ 9,412	
Adjustments to reflect assets acquired at fair value:		
Fixed maturity securities available-for-sale	(7)	
Mortgage and consumer loans	72	
Real estate and real estate joint ventures held-for-investment	17	
Real estate held-for-sale	22	
Other limited partnership interests	51	
Other invested assets	201	
Premiums and other receivables	1,008	
Elimination of historical deferred policy acquisition costs	(3,210)	
Value of business acquired	3,780	
Value of distribution agreement acquired	645	
Value of customer relationships acquired	17	
Elimination of historical goodwill	(197)	
Net deferred income tax assets	2,099	
Other assets	(89)	
Adjustments to reflect liabilities assumed at fair value:		
Future policy benefits	(4,089)	
Policyholder account balances	(1,905)	
Other liabilities	(17)	
Net fair value of assets and liabilities assumed		7,180
Goodwill resulting from the acquisition		$4,270

Goodwill resulting from the acquisition has been allocated to the Company's segments, as well as Corporate & Other, that are expected to benefit from the acquisition as follows:

	As of July 1, 2005 (In millions)
Institutional	$911
Individual	2,752
International	201
Corporate & Other	406
Total	$4,270

Of the goodwill of $4.3 billion, $1.6 billion is estimated to be deductible for income tax purposes.

Condensed Statement of Net Assets Acquired

The condensed statement of net assets acquired reflects the fair value of Travelers net assets as follows:

	As of July 1, 2005 (In millions)
Assets:	
Fixed maturity securities available-for-sale	$44,370
Trading securities	555
Equity securities available-for-sale	641
Mortgage and consumer loans	2,365
Policy loans	884
Real estate and real estate joint ventures held-for-investment	77
Real estate held-for-sale	49
Other limited partnership interests	1,124
Short-term investments	2,801
Other invested assets	1,686
Total investments	54,552
Cash and cash equivalents	844
Accrued investment income	539
Premiums and other receivables	4,886
Value of business acquired	3,780
Goodwill	4,270
Other intangible assets	662
Deferred tax assets	1,088
Other assets	736
Separate account assets	30,799
Total assets acquired	102,156
Liabilities:	
Future policy benefits	18,520
Policyholder account balances	36,634
Other policyholder funds	324
Short-term debt	25
Current income tax payable	45
Other liabilities	3,729
Separate account liabilities	30,799
Total liabilities assumed	90,076
Net assets acquired	$12,080

MICROSOFT

The following financial statement note describes Microsoft's Intangible Assets, classified according to function, rather than segment. The Company also gives weighted average life for each function.

NOTE 9 INTANGIBLE ASSETS

The components of finite-lived intangible assets were as follows:

(In millions)						
June 30	2007			2006		
	Gross carrying amount	Accumulated amortization	Net carrying amount	Gross carrying amount	Accumulated amortization	Net carrying amount

Contract-based	$ 988	$ (727)	$ 261	$ 954	$ (661)	$ 293
Technology-based	916	(407)	509	458	(255)	203
Marketing-related	57	(39)	18	42	(32)	10
Customer-related	122	(32)	90	54	(21)	33
Total	$ 2,083	$ (1,205)	$ 878	$ 1,508	$ (969)	$ 539

During fiscal year 2007 and 2006, we recorded additions to intangible assets of $473 million and $189 million, respectively. We estimate that we have no significant residual value related to our intangible assets. The components of finite-lived intangible assets acquired during fiscal years 2007 and 2006 were as follows:

(In millions)				
Year Ended June 30	2007		2006	
	Amount	Weighted average life	Amount	Weighted average life
Contract-based	$ 57	5 years	$ 36	4 years
Technology-based	333	4 years	140	4 years
Marketing-related	14	4 years	5	3 years
Customer-related	69	5 years	8	4 years
Total	$ 473		$ 189	

Intangible asset additions include $170 million of technology-based intangible assets with a weighted-average life of 4 years, and $84 million of other intangible assets with a weighted-average life of 4.9 years, related to the acquisitions of Softricity Inc., TellMe Networks, Inc., and the remaining 11 entities acquired.

Acquired intangibles are generally amortized on a straight-line basis over weighted average lives. Intangible assets amortization expense was $236 million for fiscal year 2007, $127 million for fiscal year 2006, and $161 million for fiscal year 2005. The estimated future amortization expense related to intangible assets as of June 30, 2007 is as follows:

(In millions)	
Year Ended June 30	Amount
2008	$ 263
2009	229
2010	184
2011	111
2012 and thereafter	91
Total	$ 878

PEPSICO

The following PepsiCo note for Long-lived assets lists intangible assets right below tangible property, plant and equipment. It also refers to Critical Accounting Policies as disclosed in the company's SEC filing under the Management Discussion & Analysis section.

Note 4 — Property, Plant and Equipment and Intangible Assets

	Average Useful Life	2006	2005	2004
Property, plant and equipment, net				
Land and improvements	10 – 30 yrs.	**$ 756**	$ 685	
Buildings and improvements	20 – 44	**4,095**	3,736	
Machinery and equipment, including fleet and software	5 – 15	**12,768**	11,658	
Construction in progress		**1,439**	1,066	
		19,058	17,145	
Accumulated depreciation		**(9,371)**	(8,464)	
		$ 9,687	$ 8,681	
Depreciation expense		**$ 1,182**	$ 1,103	$1,062
Amortizable intangible assets, net				
Brands	5 – 40	**$ 1,288**	$ 1,054	
Other identifiable intangibles	3 – 15	**290**	257	
		1,578	1,311	
Accumulated amortization		**(941)**	(781)	
		$ 637	$ 530	
Amortization expense		**$ 162**	$ 150	$ 147

Depreciation and amortization are recognized on a straight-line basis over an asset's estimated useful life. Land is not depreciated and construction in progress is not depreciated until ready for service. Amortization of intangible assets for each of the next five years, based on average 2006 foreign exchange rates, is expected to be $49 million in 2007, $49 million in 2008, $47 million in 2009, $46 million in 2010 and $44 million in 2011.

Depreciable and amortizable assets are only evaluated for impairment upon a significant change in the operating or macroeconomic environment. In these circumstances, if an evaluation of the undiscounted cash flows indicates impairment, the asset is written down to its estimated fair value, which is based on discounted future cash flows. Useful lives are periodically evaluated to determine whether events or circumstances have occurred which indicate the need for revision. For additional unaudited information on our amortizable brand policies, see " Our Critical Accounting Policies" in Management's Discussion and Analysis.

Nonamortizable Intangible Assets

Perpetual brands and goodwill are assessed for impairment at least annually. If the carrying amount of a perpetual brand exceeds its fair value, as determined by its discounted cash flows, an impairment loss is recognized in an amount equal to that excess. Goodwill is evaluated using a two-step impairment test at the reporting unit level. A reporting unit can be a division or business within a division. The first step compares the book value of a reporting unit, including goodwill, with its fair value, as determined by its discounted cash flows. If the book value of a reporting unit exceeds its fair value, we complete the second step to determine the amount of goodwill impairment loss that we should record. In the second step, we determine an implied fair value of the reporting unit's goodwill by allocating the fair value of the reporting unit to all of the assets and liabilities other than goodwill (including any unrecognized intangible assets). The amount of impairment loss is equal to the excess of the book value of the goodwill over the implied fair value of that goodwill. No impairment charges resulted from the required impairment evaluations. The change in the book value of nonamortizable intangible assets is as follows:

	Balance,	Acquisitions	Translation	Balance,	Acquisitions	Translation	**Balance,**

	Beginning 2005		and Other	End of 2005		and Other	**End of 2006**
Frito-Lay North America							
Goodwill	$ 138	$ —	$ 7	$ 145	$ 139	$ —	**$ 284**
PepsiCo Beverages North America							
Goodwill	2,161	—	3	2,164	39	—	**2,203**
Brands	59	—	—	59	—	—	**59**
	2,220	—	3	2,223	39	—	**2,262**
PepsiCo International							
Goodwill	1,435	278	(109)	1,604	183	145	**1,932**
Brands	869	263	(106)	1,026	–	127	**1,153**
	2,304	541	(215)	2,630	183	272	**3,085**
Quaker Foods North America							
Goodwill	175	—	—	175	—	—	**175**
Corporate							
Pension intangible	5	—	(4)	1	—	(1)	**—**
Total goodwill	3,909	278	(99)	4,088	361	145	**4,594**
Total brands	928	263	(106)	1,085	—	127	**1,212**
Total pension intangible	5	—	(4)	1	—	(1)	**—**
	$ 4,842	$ 541	$ (209)	$ 5,174	$ 361	$ 271	**$ 5,806**

TIME WARNER

The following note includes a detailed description of the Company's goodwill and intangibles impairment testing processes, information about recent impairments, rollforwards by segment, and disclosures about intangible assets.

3. GOODWILL AND INTANGIBLE ASSETS

As a creator and distributor of branded information and copyrighted entertainment products, Time Warner has a significant number of intangible assets, including cable television and sports franchises, film and television libraries and other copyrighted products, trademarks and customer lists. FASB Statement No. 142, *Goodwill and Other Intangible Assets* ("FAS 142") requires that goodwill and intangible assets deemed to have an indefinite useful life be reviewed for impairment at least annually.

Goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is to identify a potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. The estimates of fair value of a reporting unit, generally the Company's operating segments, are determined using various valuation techniques, with the primary technique being a discounted cash flow analysis. A discounted cash flow analysis requires one to make various judgmental assumptions, including assumptions about future cash flows, growth rates and discount rates. The assumptions about future cash flows and growth rates are based on the Company's operating segments' budgets and business plans, and assumptions are made about the varying perpetual growth rates for periods beyond the long-term business plan period. Discount rate assumptions are based on an assessment of the risk inherent in the future cash flows of the respective reporting units. In estimating the fair values of its reporting units, the Company also uses research analyst estimates, as well as comparable market analyses. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not deemed

to be impaired and the second step of the impairment test is not performed. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. In other words, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

The impairment test for other intangible assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. The estimates of fair value of intangible assets not subject to amortization are determined using various discounted cash flow valuation methodologies. The most common among these is a "relief from royalty" methodology, which is used in estimating the fair value of the Company's brands and trademarks, and income methodologies, which are used to value cable franchises. The income methodology used to value the cable franchises entails identifying the projected discrete cash flows related to such franchises and discounting them back to the valuation date. Market and income-based methodologies are used to value sports franchises. Significant assumptions inherent in the methodologies employed include estimates of royalty rates and discount rates. Discount rate assumptions are based on an assessment of the risk inherent in the respective intangible assets. Assumptions about royalty rates are based on the rates at which similar brands and trademarks are being licensed in the marketplace. The Company determined during its annual impairment reviews for goodwill, which occur in the fourth quarter, that no additional impairments existed at December 31, 2006, 2005 or 2004.

During 2006, the Company recorded a pretax goodwill impairment charge of $200 million to reduce the carrying value of The WB Network's goodwill prior to its contribution to The CW, as more fully described in Note 4. Additionally, in 2005 the Company recorded a pretax goodwill impairment charge of $24 million related to America Online Latin America, Inc. ("AOLA"). The impairment charges were noncash in nature and did not affect the Company's liquidity or result in non-compliance with respect to any debt covenants.

Included in noncurrent assets of discontinued operations for the years ended December 31, 2005 is goodwill of approximately $319 million, respectively. A summary of changes in the Company's goodwill related to continuing operations during the years ended December 31, 2006 and 2005 by reportable segment is as follows (millions):

	December 31, 2005	Acquisitions, Dispositions & Adjustments[a]	Impairment[b]	Translation Adjustments	December 31, 2006
AOL[c]	$ 3,144	$ (249)	$ —	$ 31	$ 2,926
Cable[d]	1,769	290	—	—	2,059
Filmed Entertainment	5,256	165	—	—	5,421
Networks[e]	20,572	556	(200)	(3)	20,925
Publishing[f]	9,398	41	—	183	9,622
Total	$ 40,139	$ 803	$ (200)	$ 211	$ 40,953

	December 31, 2004	Acquisitions & Adjustments[a]	Impairment[b]	Translation Adjustments[g]	December 31, 2005
AOL	$ 3,069	$ (14)	$ (24)	$ 113	$ 3,144
Cable	1,783	(14)	—	—	1,769
Filmed Entertainment	5,218	38	—	—	5,256
Networks[e]	20,444	128	—	—	20,572
Publishing[f]	8,875	256	—	267	9,398
Total	$ 39,389	$ 394	$ (24)	$ 380	$ 40,139

(a) Includes changes in estimates in deferred tax assets and liabilities acquired in purchase business combinations, with the net impact of decreasing goodwill by $107 million in 2006 and increasing goodwill by $207 million in 2005, respectively. The adjustments affected multiple segments.

(b) 2006 relates to a $200 million noncash goodwill impairment charge related to The WB Network. 2005 relates to the $24 million impairment charge of AOLA goodwill in the first quarter of 2005.

(c) 2006 primarily includes $318 million related to the transfer of goodwill to AOL's European access businesses sold or held for sale as well as the adjustments discussed in (a) above.

(d) 2006 primarily includes goodwill recorded of $1.1 billion in the Adelphia Acquisition and the Exchange, partially offset by a $738 million adjustment to goodwill related to the excess of the carrying value of the Comcast minority interests in TWC and TWE over the total fair value of the Redemptions as well as the adjustments discussed in (a) above. Of the $738 million adjustment to goodwill, $719 million is associated with the TWC Redemption and $19 million is associated with the TWE Redemption. Refer to Note 2 for additional information regarding the Adelphia/Comcast Transactions.

(e) 2006 primarily includes $722 million related to the acquisition of the remaining interest in Court TV partially offset by a $73 million transfer to investment in The CW as well as the adjustments discussed in (a) above. 2005 primarily includes $174 million related to changes in valuation of net deferred tax liabilities related to historical purchase business combinations offset by a $39 million reduction, net of tax, related to reversals of purchase accounting reserves and the adjustments discussed in (a) above.

(f) 2006 primarily includes $127 million related to goodwill associated with the purchase of the remaining interest in Synapse Group, Inc. partially offset by $25 million related to the transfer of Grupo Editorial Expansión's goodwill to intangible assets and the adjustments discussed in (a) above. 2005 includes $111 million at the Publishing segment related to the purchase price allocation for the acquisition of the remaining ownership interest in Essence Communications Partners ("Essence") and $75 million related to the preliminary purchase price allocation for the acquisition of Grupo Editorial Expansión as well as the adjustments discussed in (a) above.

(g) Includes a translation adjustment related to periods prior to January 1, 2005. This adjustment had no impact on consolidated net income or cash flows in the current or any prior period. In addition, the adjustment is not considered material to the consolidated assets or equity of the current or any prior period.

The Company's intangible assets and related accumulated amortization consisted of the following (millions):

	As of December 31, 2006			As of December 31, 2005		
	Gross	Accumulated Amortization[a]	Net	Gross	Accumulated Amortization[a]	Net

Intangible assets subject to amortization:						
Film library	$ 3,967	$ (1,277)	$ 2,690	$ 3,967	$ (1,064)	$ 2,903
Customer lists and other intangible assets[b]	4,457	(1,917)	2,540	2,475	(1,902)	573
Total	$ 8,424	$ (3,194)	$ 5,230	$ 6,442	$ (2,966)	$ 3,476
Intangible assets not subject to amortization:						
Cable television franchises[c]	$39,342	$ (1,294)	$38,048	$28,939	$ (1,378)	$27,561
Sports franchises	282	(20)	262	282	(20)	262
Brands, trademarks and other intangible assets[d]	8,570	(257)	8,313	9,801	(257)	9,544
Total	$48,194	$ (1,571)	$46,623	$39,022	$ (1,655)	$37,367

(a) Amortization of customer lists and other intangible assets subject to amortization is provided generally on the straight-line method over their respective useful lives. The weighted-average useful life for customer lists is 4 years. The film library is amortized using a film forecast methodology. The Company evaluates the useful lives of its finite-lived intangible assets each reporting period to determine whether events or circumstances warrant revised estimates of useful lives.

(b) The change in 2006 includes approximately $1.3 billion related to the transfer of certain magazine trademarks from intangible assets not subject to amortization due to a reassessment of their useful lives, $882 million related to acquired customer lists from the Adelphia Acquisition and $79 million related to customer and advertising relationships acquired in the Court TV acquisition, partially offset by $286 million related to the transfer of customer lists to AOL's European access businesses sold or held for sale. The change in 2005 includes $79 million related to the Truveo, Inc. acquisition for acquired technology, $34 million related to the preliminary allocation of Essence goodwill to tradename and subscriber lists, $31 million related to the Wildseed, Ltd. Acquisition primarily for acquired technology and $30 million related to foreign currency translation of intangibles at AOL Europe and IPC Media.

(c) The increase is related to $10.5 billion of intangibles acquired in the Adelphia Acquisition and the Exchange.

(d) The change in 2006 is related to the approximate $1.3 billion aforementioned transfer of certain Publishing magazine trademarks to intangible assets subject to amortization. The change in 2005 includes $29 million related to intangibles at IPC. As a result of increased competition in the publishing business related to certain magazine titles, indefinite-lived tradename intangibles totaling approximately $1.3 billion were assigned a 25 year finite life and amortized beginning January 2006.

The Company recorded amortization expense of $605 million in 2006 compared to $587 million in 2005 and $615 million in 2004. Based on the current amount of intangible assets subject to amortization, the estimated amortization expense for each of the succeeding five years ended December 31 is as follows (millions):

2007	$633
2008	594
2009	538
2010	443
2011	277

These amounts may vary as acquisitions and dispositions occur in the future and as purchase price allocations are finalized.

Income Taxes

In June 2006, FASB issued FIN 48, Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109 http://www.fasb.org/pdf/fin%2048.pdf. Effective for fiscal years beginning after December 15, 2006, FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We did not identify any filers that adopted FIN 48 early.

BEST BUY

Best Buy discloses information about its tax contingencies reserve, in addition to the usual disclosures.

1. Summary of Significant Accounting Policies

Income Taxes

We account for income taxes under the liability method. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in income tax rates is recognized in our consolidated statement of earnings in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized.

In determining our provision for income taxes, we use an annual effective income tax rate based on annual income, permanent differences between book and tax income, and statutory income tax rates. The effective income tax rate also reflects our assessment of the ultimate outcome of tax audits. We adjust our annual effective income tax rate as additional information on outcomes or events becomes available. Discrete events such as audit settlements or changes in tax laws are recognized in the period in which they occur.

Our income tax returns, like those of most companies, are periodically audited by domestic and foreign tax authorities. These audits include questions regarding our tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. At any one time, multiple tax years are subject to audit by the various tax authorities. In evaluating the exposures associated with our various tax filing positions, we record reserves for probable exposures. A number of years may elapse before a particular matter, for which we have established a reserve, is audited and fully resolved or clarified. We adjust our tax contingencies reserve and income tax provision in the period in which actual results of a settlement with tax authorities differs from our established reserve, the statute of limitations expires for the relevant taxing authority to examine the tax position or when more information becomes available. We include our tax contingencies reserve, including accrued penalties and interest, in accrued income taxes on our consolidated balance sheets and in income tax expense in our consolidated statements of earnings.

In July 2006, the FASB issued FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*. In May 2007, the FASB issued FSP FIN No. 48-1, *Definition of "Settlement" in FASB Interpretation No.48*. We will adopt FIN No. 48 and FSP FIN No. 48-1 beginning in the first quarter of fiscal 2008. See *New Accounting Standards* below for further details.

New Accounting Standards

In July 2006, the FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109.* FIN No. 48 provides guidance regarding the recognition, measurement, presentation and disclosure in the financial statements of tax positions taken or expected to be taken on a tax return, including the decision whether to file or not to file in a particular jurisdiction. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. We will adopt FIN No. 48 beginning in the first quarter of fiscal 2008. The cumulative effect of applying the provisions of FIN No. 48 upon initial adoption will be reported as an adjustment to retained earnings as of the beginning of fiscal 2008. We are evaluating the impact, if any, the adoption of FIN No. 48 will have on our operating income, net earnings or retained earnings.

In May 2007, the FASB issued FSP FIN No. 48-1, *Definition of "Settlement" in FASB Interpretation No. 48*. FSP FIN No. 48-1 provides guidance on how a company should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. FSP FIN No. 48-1 is effective upon initial adoption of FIN No. 48, which we will adopt in the first quarter of fiscal 2008, as indicated above.

Note 10. Income Taxes

The following is a reconciliation of the federal statutory income tax rate to income tax expense from continuing operations in fiscal 2007, 2006 and 2005:

	2007	2006	2005
Federal income tax at the statutory rate	$ 747	$ 603	$ 505
State income taxes, net of federal benefit	38	34	29
Benefit from foreign operations	(36)	(37)	(7)
Non-taxable interest income	(34)	(28)	(22)
Other	37	9	4
Income tax expense	$ 752	$ 581	$ 509
Effective income tax rate	35.3%	33.7%	35.3%

During fiscal 2007, we reduced our tax contingencies reserve due to the resolution of certain tax matters associated with our acquisition of Future Shop. This adjustment resulted in a decrease of goodwill associated with Future Shop. During fiscal 2006 and 2005, we adjusted our tax contingencies reserve based on the resolution and clarification of certain federal and state income tax matters, including favorable rulings from the IRS and certain state jurisdictions.

The IRS has completed its audits through fiscal 2002. All tax years since the acquisition of Future Shop in fiscal 2002 are still subject to audit with Revenue Canada. Our tax obligations with respect to Pacific Sales and Five Star began on the respective dates of acquisition.

Income tax expense was comprised of the following in fiscal 2007, 2006 and 2005:

	2007	2006	2005
Current:			
Federal	$609	$640	$502
State	45	78	36
Foreign	16	14	(1)
	670	732	537
Deferred:			
Federal	51	(131)	(4)
State	19	(14)	(20)
Foreign	12	(6)	(4)
	82	(151)	(28)
Income tax expense	$752	$581	$509

Deferred taxes are the result of differences between the bases of assets and liabilities for financial reporting and income tax purposes. We have not recorded deferred taxes when earnings from

foreign operations are considered to be indefinitely reinvested outside the U.S. Such amounts would not be significant.

Deferred tax assets and liabilities were comprised of the following:

	March 3, 2007	Feb. 25, 2006
Accrued property expenses	$ 105	$ 93
Other accrued expenses	19	38
Deferred revenue	79	139
Compensation and benefits	71	47
Stock-based compensation	74	45
Net operating loss carryforwards	10	57
Goodwill	3	17
Other	57	43
Total deferred tax assets	418	479
Property and equipment	(168)	(153)
Convertible debt	(44)	(36)
Other	(27)	(22)
Total deferred tax liabilities	(239)	(211)
Net deferred tax assets	$ 179	$ 268

Deferred tax assets and liabilities included in our consolidated balance sheets were as follows:

	March 3, 2007	Feb. 25, 2006
Other current assets	$ 144	$ 126
Other assets	35	142
Net deferred tax assets	$ 179	$ 268

Management believes that the realization of the deferred tax assets is more likely than not, based upon the expectation that we will generate the necessary taxable income in future periods and, accordingly, no valuation reserves have been provided. At March 3, 2007, we had net operating loss carryforwards from our International operations of $29, which expire beginning in fiscal 2010 and through fiscal 2027. We expect to fully utilize the net operating loss carryforwards and, therefore, no valuation allowances have been recorded.

DOW CHEMICAL

Note Dow Chemical's detailed disclosure of tax contingencies.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Income Taxes

The Company accounts for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities using enacted rates.

Annual tax provisions include amounts considered sufficient to pay assessments that may result from examinations of prior year tax returns; however, the amount ultimately paid upon resolution of issues raised may differ from the amounts accrued. The Company accrues for tax contingencies when it is probable that a liability to a taxing authority has been incurred and the amount of the contingency can be reasonably estimated. Provision is made for taxes on

undistributed earnings of foreign subsidiaries and related companies to the extent that such earnings are not deemed to be permanently invested.

SAB No. 74 Disclosures for Accounting Standards Issued But Not Yet Adopted

In June 2006, the FASB issued FIN No. 48, "Accounting for Uncertainty in Income Taxes," which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. Pending further guidance from the FASB, the Company expects to increase liabilities and reduce retained earnings $200-$400 million due to the adoption of this interpretation in the first quarter of 2007.

NOTE R – INCOME TAXES

Operating loss carryforwards amounted to $4,858 million at December 31, 2006 and $3,680 million at December 31, 2005. Such amounts include U.S. state and local operating loss carryforwards determined more likely than not to be utilized. At December 31, 2006, $350 million of the operating loss carryforwards is subject to expiration in the years 2007 through 2011. The remaining balances expire in years beyond 2011 or have an indefinite carryforward period. Tax credit carryforwards at December 31, 2006 amounted to $1,081 million ($1,085 million at December 31, 2005), of which $1 million is subject to expiration in the years 2007 through 2011. The remaining tax credit carryforwards expire in years beyond 2011.

Undistributed earnings of foreign subsidiaries and related companies that are deemed to be permanently invested amounted to $5,951 million at December 31, 2006, $4,299 million at December 31, 2005 and $6,770 million at December 31, 2004. It is not practicable to calculate the unrecognized deferred tax liability on those earnings.

The Company had valuation allowances, which were primarily related to the realization of recorded tax benefits on tax loss carryforwards from operations in the United States, Brazil and Switzerland of $446 million at December 31, 2006 and $538 million at December 31, 2005.

During 2006, the Company developed tax planning strategies in Brazil and determined that it was more likely than not that tax loss carryforwards would be utilized, resulting in a reversal of valuation allowances of $63 million. This impact, combined with strong financial results in jurisdictions with lower tax rates than the United States, enacted reductions in the tax rates in Canada and The Netherlands, and improved earnings from a number of the Company's joint ventures, resulted in an effective tax rate for 2006 that was lower than the U.S. statutory rate. Dow's reported effective tax rate for 2006 was 23.2 percent.

The American Jobs Creation Act of 2004 (the "AJCA"), which was signed into law in October 2004, introduced a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer, provided certain criteria are met. In May 2005, tax authorities released the clarifying language necessary to enable the Company to finalize its plan for the repatriation and reinvestment of foreign earnings subject to the requirements of the AJCA, resulting in a credit of $113 million to the "Provision for income taxes" in the second quarter of 2005.

On January 23, 2006, the Company received an unfavorable tax ruling from the United States Court of Appeals for the Sixth Circuit reversing a prior decision by the United States District Court relative to corporate owned life insurance, resulting in a charge of $137 million to the "Provision for income taxes" in the fourth quarter of 2005.

The Company's tax rate for 2005 was lower than the U.S. statutory rate due to strong financial results in jurisdictions with lower tax rates than the United States, improved earnings from a number of joint ventures, and the impact of the repatriation provisions under the AJCA, offset by the unfavorable tax ruling on corporate owned life insurance. Dow's reported effective tax rate for 2005 was 27.8 percent.

In the first three quarters of 2004, PBBPolisur S.A., a wholly owned subsidiary of the Company in Argentina, recorded significantly improved earnings compared with the previous year, utilizing net operating losses for which a valuation allowance had previously been recorded. In the fourth quarter of 2004, the Company completed a revised earnings estimate and determined that it was more likely than not that the remaining valuation allowance of $28 million was no longer necessary; the valuation allowance was therefore reversed.

In addition, during the first three quarters of 2004, the Company recorded net valuation allowances on deferred tax assets for tax loss carryforwards from Italian subsidiaries. During the fourth quarter of 2004, tax planning strategies for these entities were considered viable and were expected to be implemented in 2006, utilizing most of the existing tax loss carryforwards for the entities. As a result, $68 million of the existing valuation allowances was reversed in 2004.

During 2004, based on tax planning strategies that were implemented in Brazil (across multiple entities), as well as projections of future earnings, it was determined that it was more likely than not that tax loss carryforwards would be utilized, resulting in a net reversal of valuation allowances of $5 million.

The Company's tax rate for 2004 was lower than the U.S. statutory rate due to improved financial results in jurisdictions with lower tax rates than the United States, continued strong performances by a number of joint ventures, revised estimates of the future utilization of operating loss carryforwards in Argentina and Italy and the impact of a legislated decrease in the tax rate in The Netherlands on deferred tax liabilities. Dow's reported effective tax rate for 2004 was 23.1 percent.

The reserve for tax contingencies related to issues in the United States and foreign locations was $732 million at December 31, 2006 and $860 million at December 31, 2005. This is management's best estimate of the potential liability for tax contingencies. The decrease in the tax contingency reserve was attributable to cash settlements in various jurisdictions, partially offset by current year requirements. Inherent uncertainties exist in estimates of tax contingencies due to changes in tax law, both legislated and concluded through the various jurisdictions' tax court systems. It is the opinion of the Company's management that the possibility is remote that costs in excess of those accrued will have a material adverse impact on the Company's consolidated financial statements.

Domestic and Foreign Components of Income before Income Taxes and Minority Interests

In millions	*2006*	*2005*	*2004*
Domestic	$ 2,244	$ 2,715	$ 457
Foreign	2,728	3,684	3,339
Total	$ 4,972	$ 6,399	$ 3,796

Reconciliation to U.S. Statutory Rate

In millions	*2006*	*2005*	*2004*
Taxes at U.S. statutory rate	$1,740	$2,240	$1,329
Equity earnings effect	(331)	(287)	(168)
Foreign rates other than 35% (1)	(517)	(409)	(524)
U.S. tax effect of foreign earnings and dividends	272	160	210
U.S. business and R&D credits	(44)	(48)	(47)
Tax contingency reserve adjustments	177	3	24
Benefit of repatriation under AJCA	–	(113)	–
Unfavorable tax ruling	–	137	–

Other – net	(142)	99	53
Total tax provision	$1,155	$1,782	$ 877
Effective tax rate	23.2%	27.8%	23.1%

(1) Includes the effect of changes in valuation allowances for foreign entities as follows: a decrease of $61 million in 2006, an increase of $14 million in 2005 and a decrease of $116 million in 2004.

Provision (Credit) for Income Taxes

In millions	*2006* Current	*2006* Deferred	*2006* Total	*2005* Current	*2005* Deferred	*2005* Total	*2004* Current	*2004* Deferred	*2004* Total
Federal	$ 367	$ 401	$ 768	$ 255	$ 535	$ 790	$ 214	$ (50)	$ 164
State and local	82	(99)	(17)	46	20	66	17	26	43
Foreign	602	(198)	404	741	185	926	391	279	670
Total	$ 1,051	$ 104	$1,155	$ 1,042	$ 740	$1,782	$ 622	$ 255	$ 877

Deferred Tax Balances at December 31

In millions	*2006* Deferred Tax Assets	*2006* Deferred Tax Liabilities	*2005* Deferred Tax Assets	*2005* Deferred Tax Liabilities
Property	$ 260	$ (2,128)	$ 382	$ (2,304)
Tax loss and credit carryforwards	2,721	–	2,656	–
Postretirement benefit obligations	1,820	(1,030)	1,501	(861)
Other accruals and reserves	1,397	(507)	1,666	(437)
Inventory	163	(149)	160	(184)
Long-term debt	229	(80)	216	(64)
Investments	213	(3)	282	–
Other – net	821	(332)	551	(643)
Subtotal	$ 7,624	$ (4,229)	$ 7,414	$ (4,493)
Valuation allowance	(446)	–	(538)	–
Total	$ 7,178	$ (4,229)	$ 6,876	$ (4,493)

MICROSOFT

Microsoft provides detailed information about tax contingencies in the following income tax disclosures.

NOTE 1 ACCOUNTING POLICIES

INCOME TAXES

Income tax expense includes U.S. and international income taxes, plus the provision for U.S. taxes on undistributed earnings of international subsidiaries not deemed to be permanently invested. Certain items of income and expense are not reported in tax returns and financial statements in the same year. The tax effect of such temporary differences is reported as deferred income taxes.

RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2006, the FASB issued Interpretation No. 48 ("FIN No. 48"), *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. The Interpretation provides a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Under FIN No. 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for us beginning July 1, 2007. Based on our current assessment, the adoption of FIN No. 48 is expected to decrease beginning retained earnings by $200 million to $400 million upon adoption.

NOTE 10 INCOME TAXES

The components of the provision for income taxes were as follows:

(In millions)			
Year Ended June 30	**2007**	**2006**	**2005**
Current taxes:			
U.S. Federal	**$4,593**	$4,471	$3,401
U.S. State and Local	**154**	101	152
International	**957**	882	911
Current taxes	**5,704**	5,454	4,464
Deferred taxes (benefits)	**332**	209	(90)
Provision for income taxes	**$6,036**	$5,663	$4,374

U.S. and international components of income before income taxes were as follows:

(In millions)			
Year Ended June 30	**2007**	**2006**	**2005**
U.S.	**$12,902**	$11,404	$ 9,806
International	**7,199**	6,858	6,822
Income before income taxes	**$20,101**	$18,262	$16,628

The items accounting for the difference between income taxes computed at the federal statutory rate and the provision for income taxes were as follows:

Year Ended June 30	2007	2006	2005
Federal statutory rate	**35.0%**	35.0%	35.0%
Effect of:			
Foreign earnings taxed at lower rates	**(5.1)%**	(4.6)%	(3.1)%
Examination settlements	**–**	(0.6)%	(4.7)%
Other reconciling items	**0.1%**	1.2%	(0.9)%
Effective rate	**30.0%**	31.0%	26.3%

The 2007 other reconciling items includes the impact of a $195 million reduction resulting from various changes in tax positions taken in prior periods, related primarily to favorable developments in an IRS position and multiple foreign audit assessments. The 2006 other reconciling item includes the impact of the $351 million non-deductible European Commission fine. The 2005 other reconciling items include a $179 million repatriation tax benefit under the American Jobs Creation Act of 2004.

The components of the deferred tax assets and liabilities were as follows:

(In millions)

June 30	2007	2006
Deferred income tax assets:		
Stock-based compensation expense	**$ 2,859**	$ 3,630
Other expense items	**1,735**	1,451
Unearned revenue	**842**	1,028
Impaired investments	**710**	989
Other revenue items	**58**	102
Deferred income tax assets	**$ 6,204**	$ 7,200
Deferred income tax liabilities:		
International earnings	**$(1,763)**	$(1,715)
Unrealized gain on investments	**(926)**	(801)
Other	**(227)**	(133)
Deferred income tax liabilities	**(2,916)**	(2,649)
Net deferred income tax assets	**$ 3,288**	$ 4,551
Reported as:		
Current deferred tax assets	**$ 1,899**	$ 1,940
Long-term deferred tax assets	**1,389**	2,611
Net deferred income tax assets	**$ 3,288**	$ 4,551

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when taxes are actually paid or recovered.

We have not provided deferred U.S. income taxes or foreign withholding taxes on temporary differences of approximately $6.10 billion resulting from earnings for certain non-U.S. subsidiaries which are permanently reinvested outside the United States. The amount of unrecognized deferred tax liability associated with these temporary differences is approximately $1.77 million.

The American Jobs Creation Act of 2004 (the "Act") was enacted in October 2004. The Act creates a temporary incentive for U.S. corporations to repatriate foreign subsidiary earnings by providing an elective 85% dividends received deduction for certain dividends from controlled foreign corporations. Under these provisions, we repatriated approximately $780 million in dividends subject to the elective 85% dividends received deduction and we recorded a corresponding tax provision benefit of $179 million from the reversal of previously provided U.S. deferred tax liabilities on these unremitted foreign subsidiary earnings in 2005. The dividend was paid in June 2006.

Income taxes paid were $5.24 billion in fiscal year 2007, $4.78 billion in fiscal year 2006, and $4.33 billion in fiscal year 2005.

Tax Contingencies. We are subject to income taxes in the United States and numerous foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes and recording the related assets and liabilities. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We are regularly under audit by tax authorities. Accruals for tax contingencies are provided for in accordance with the requirements of SFAS No. 5, *Accounting for Contingencies*.

Although we believe we have appropriate support for the positions taken on our tax returns, we have recorded a liability for our best estimate of the probable loss on certain of these positions, the non-current portion of which is included in other long-term liabilities. We believe that our accruals for tax liabilities are adequate for all open years, based on our assessment of many factors including past experience and interpretations of tax law applied to the facts of each matter, which matters result primarily from inter-company transfer pricing, restructuring of foreign operations, tax benefits from the Foreign Sales Corporation and Extra Territorial Income tax rules, the amount of research and experimentation tax credits claimed, state income taxes, and certain other matters. Although we believe our recorded assets and liabilities are reasonable, tax regulations are subject to interpretation and tax litigation is inherently uncertain; therefore our assessments can involve both a series of complex judgments about future events and rely heavily on estimates and assumptions. Although we believe that the estimates and assumptions supporting our assessments are reasonable, the final determination of tax audit settlements and any related litigation could be materially different than that which is reflected in historical income tax provisions and recorded assets and liabilities. If we were to settle an audit or a matter under litigation, it could have a material effect on our income tax provision, net income, or cash flows in the period or periods for which that determination is made. Due to the complexity involved we are not able to estimate the range of reasonably possible losses in excess of amounts recorded.

The Internal Revenue Service ("IRS") has completed and closed its audits of our consolidated federal income tax returns through 1999. The IRS is currently conducting audits of our consolidated federal income tax return for tax years 2000 through 2006.

Pensions

SFAS 158, Employes' Accounting for Defined Benefit Pension and Other Postretirement Plans, http://www.fasb.org/pdf/fas158.pdf requires employers to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability on the balance sheet. Gains or losses and prior service costs or credits arising during the period that are not recognized in net pension cost are recorded in other comprehensive income. Defined benefit plan assets and obligations must now be measured as of the date of the employer's fiscal year-end (with few exceptions). Furthermore, companies must disclose, in the notes to financial statements, additional information about how delayed recognition of the gains or losses, prior

service costs or credits, and transition asset or obligation will affect net pension cost in the next fiscal year.

Post-employment benefits was the most commonly listed critical accounting policy in the aforementioned *CPA Journal* study.

PFIZER

In the following disclosure, Pfizer provides information about four different categories of post-retirement benefits. It provides many helpful tables, including a table demonstrating how SFAS 158 affected different elements of the financial statements. The note also integrates significant accounting policies and adoption of new standards. The Company has not yet changed its pension measurement date to fiscal year-end.

13. Pension and Postretirement Benefit Plans and Defined Contribution Plans

We provide defined benefit pension plans and defined contribution plans for the majority of our employees worldwide. In the U.S., we have both qualified and supplemental (non-qualified) defined benefit plans. A qualified plan meets the requirements of certain sections of the Internal Revenue Code and, generally, contributions to qualified plans are tax deductible. A qualified plan typically provides benefits to a broad group of employees and may not discriminate in favor of highly compensated employees in its coverage, benefits or contributions. We also provide benefits through supplemental (non-qualified) retirement plans to certain employees. In addition, we provide medical and life insurance benefits to certain retirees and their eligible dependents through our postretirement plans.

We use a measurement date of December 31 for a majority of our U.S. pension and postretirement plans and November 30 for a majority of our international plans. In December 2003, the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act) was enacted. The Act introduced a prescription drug benefit under Medicare (Medicare Part D), as well as a federal subsidy to sponsors of retiree healthcare benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. During the third quarter of 2004, in accordance with FASB Staff Position No.106-2 (FSP 106-2), *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug Improvement and Modernization Act of 2003*, we began accounting for the effect of the federal subsidy under the Act; the associated reduction to the benefit obligations of certain of our postretirement benefit plans and the related benefit cost was not significant.

During 2006, pursuant to the divestiture of our Consumer Healthcare business, certain defined benefit obligations and related plan assets, if applicable, were transferred to the purchaser of that business.

A. Adoption of New Accounting Standard

As of December 31, 2006, we adopted the provisions of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (an amendment of FASB Statements No. 87, 88, 106 and 132R)*, which requires us to recognize on our balance sheet the difference between our benefit obligations and any plan assets of our defined benefit plans. In addition, we are required to recognize as part of other comprehensive income/(expense), net of taxes, gains and losses due to differences between our actuarial assumptions and actual experience (actuarial gains and losses) and any effects on prior service due to plan amendments (prior service costs or credits) that arise during the period and which are not being recognized as net periodic benefit costs. Upon adoption, SFAS 158 requires the recognition of previously unrecognized actuarial gains and losses, prior service costs or credits and net transition amounts within *Accumulated other comprehensive income (expense)*, net of tax. The incremental impact of applying SFAS 158 to our balance sheet as of December 31, 2006, was to reduce our total shareholders' equity by

$2.1 billion, primarily due to the recognition of previously unrecognized actuarial losses. The following table sets forth the incremental effect of applying SFAS 158 to individual line items in our balance sheet as of December 31, 2006:

	YEAR ENDED DEC. 31, 2006		
(MILLIONS OF DOLLARS)	BEFORE ADOPTION OF SFAS 158	ADJUSTMENTS[a]	AFTER ADOPTION OF SFAS 158
Identifiable intangible assets, less accumulated amortization	$ 24,365	$ (15)	$ 24,350
Other assets, deferred taxes and deferred charges	3,886	(1,748)	2,138
Other current liabilities	6,372	138	6,510
Pension benefit obligations	2,768	864	3,632
Postretirement benefit obligations	1,394	576	1,970
Deferred taxes	9,216	(1,201)	8,015
Accumulated other comprehensive income/(expense)	1,671	(2,140)	(469)

[a] The adoption of SFAS 158 also impacted the subtotals on the balance sheet, including, *Total assets*, *Total current liabilities*, *Total shareholders' equity* and *Total liabilities and shareholders' equity*.

B. Components of Net Periodic Benefit Costs

The annual cost of the U.S. qualified, U.S. supplemental (non-qualified) and international pension plans and postretirement plans for the years ended December 31, 2006, 2005 and 2004, follows:

	PENSION PLANS											
	U.S. QUALIFIED			U.S. SUPPLEMENTAL (NON-QUALIFIED)			INTERNATIONAL			POSTRETIREMENT PLANS		
(MILLIONS OF DOLLARS)	**2006**	2005	2004	**2006**	2005	2004	**2006**	2005	2004	**2006**	2005	2004
Service cost	**$ 368**	$ 318	$ 277	**$ 43**	$ 37	$ 33	**$ 303**	$ 293	$ 264	**$ 47**	$ 38	$ 39
Interest cost	**444**	410	391	**60**	59	60	**307**	309	288	**127**	113	113
Expected return on plan assets	**(628)**	(594)	(569)	**—**	—	—	**(311)**	(297)	(278)	**(28)**	(23)	(20)
Amortization of:												
Actuarial losses	**119**	101	99	**45**	39	35	**106**	95	59	**36**	21	15
Prior service costs/(credits)	**9**	10	17	**(3)**	1	2	**—**	(2)	5	**1**	1	1
Net transition obligation	**—**	—	—	**—**	—	—	**2**	1	1	**—**	—	—
Curtailments and settlements—net	**117**	12	37	**(8)**	4	1	**(17)**	19	(9)	**6**	—	—
Special termination benefits	**17**	5	—	**—**	—	—	**14**	29	21	**12**	2	(1)
Less: amounts included in discontinued operations	**(81)**	(15)	(13)	**4**	(2)	(2)	**15**	(2)	(2)	**9**	(4)	(3)
Net periodic benefit costs	**$ 365**	$ 247	$ 239	**$ 141**	$ 138	$ 129	**$ 419**	$ 445	$ 349	**$ 210**	$ 148	$ 144[a]

[a] Includes a credit of $21 million relating to the adoption of FSP 106-2 in 2004.

The increase in the 2006 U.S. qualified pension plans' net periodic benefit cost compared to 2005 was largely driven by changes in assumptions used, such as the decline in the discount rate and the adoption of updated mortality (life expectancy) assumptions.

C. Actuarial Assumptions

The following table provides the weighted-average actuarial assumptions:

(PERCENTAGES)	2006	2005	2004
Weighted-average assumptions used to determine benefit obligations:			
Discount rate:			
U.S. qualified pension plans	**5.9%**	5.8%	6.0%
U.S. non-qualified pension plans	**5.9**	5.8	6.0
International pension plans	**4.4**	4.3	4.7
Postretirement plans	**5.9**	5.8	6.0
Rate of compensation increase:			
U.S. qualified pension plans	**4.5**	4.5	4.5
U.S. non-qualified pension plans	**4.5**	4.5	4.5
International pension plans	**3.6**	3.6	3.6
Weighted-average assumptions used to determine net periodic benefit cost:			
Discount rate:			
U.S. qualified pension plans	**5.8**	6.0	6.3
U.S. non-qualified pension plans	**5.8**	6.0	6.3
International pension plans	**4.3**	4.7	5.0
Postretirement plans	**5.8**	6.0	6.3
Expected return on plan assets:			
U.S. qualified pension plans	**9.0**	9.0	9.0
International pension plans	**6.9**	6.9	7.3
Postretirement plans	**9.0**	9.0	9.0
Rate of compensation increase:			
U.S. qualified pension plans	**4.5**	4.5	4.5
U.S. non-qualified pension plans	**4.5**	4.5	4.5
International pension plans	**3.6**	3.6	3.6

The assumptions above are used to develop the benefit obligations at fiscal year-end and to develop the net periodic benefit cost for the subsequent fiscal year. Therefore, the assumptions used to determine net periodic benefit cost for each year are established at the end of each previous year, while the assumptions used to determine benefit obligations were established at each year-end.

The net periodic benefit cost and the benefit obligations are based on actuarial assumptions that are reviewed on an annual basis. We revise these assumptions based on an annual evaluation of long-term trends, as well as market conditions, that may have an impact on the cost of providing retirement benefits.

The expected rates of return on plan assets for our U.S. qualified, international and postretirement plans represent our long-term assessment of return expectations, which we will change based on significant shifts in economic and financial market conditions. The 2006 expected rates of return for these plans reflect our long-term outlook for a globally diversified portfolio, which is influenced by a combination of return expectations for individual asset classes, actual historical experience and our diversified investment strategy. The historical returns are one of the inputs used to provide context for the development of our expectations for future returns. Using this information, we develop ranges of returns for each asset class and a weighted-average expected return for our targeted portfolio, which includes the impact of portfolio diversification and active portfolio management.

The healthcare cost trend rate assumptions for our U.S. postretirement benefit plans are as follows:

(PERCENTAGES)	2006	2005
Healthcare cost trend rate assumed for next year	**9.9%**	9.8%
Rate to which the cost trend rate is assumed to decline	**5.0**	5.0
Year that the rate reaches the ultimate trend rate	**2014**	2013

A one-percentage-point increase or decrease in the healthcare cost trend rate assumed for postretirement benefits would have the following effects as of December 31, 2006:

(MILLIONS OF DOLLARS)	INCREASE	DECREASE
Effect on total service and interest cost components	$ 19	$ (15)
Effect on postretirement benefit obligation	226	(186)

D. Obligations and Funded Status

The following table presents an analysis of the changes in 2006 and 2005 in the benefit obligations, the plan assets and the funded status of our U.S. qualified, U.S. supplemental (non-qualified) and international pension plans, and our postretirement plans:

	PENSION PLANS							
	U.S. QUALIFIED		U.S. SUPPLEMENTAL (NON-QUALIFIED)		INTERNATIONAL		POSTRETIREMENT PLANS	
(MILLIONS OF DOLLARS)	2006	2005	2006	2005	2006	2005	2006	2005
Change in benefit obligation:								
Benefit obligation at beginning of year[a]	**$ 7,983**	$ 7,108	**$ 1,133**	$ 1,066	**$ 6,968**	$ 6,969	**$ 2,252**	$ 1,920
Service cost	**368**	318	**43**	37	**303**	293	**47**	38
Interest cost	**444**	410	**60**	59	**307**	309	**127**	113
Employee contributions	**—**	—	**—**	—	**22**	23	**34**	28
Plan amendments	**—**	(82)	**—**	(49)	**10**	15	**1**	5
Increases/(decreases) arising primarily from changes in actuarial assumptions	**(137)**	671	**(77)**	156	**150**	459	**152**	332
Foreign exchange impact	**—**	—	**—**	—	**769**	(793)	**(1)**	—
Acquisitions	**—**	—	**—**	—	**11**	18	**—**	—
Curtailments[b]	**(180)**	—	**(25)**	—	**(42)**	(3)	**9**	—
Settlements[b]	**(418)**	(33)	**(13)**	(15)	**(85)**	(56)	**(23)**	—
Special termination benefits	**17**	5	**—**	—	**14**	29	**12**	2
Benefits paid	**(285)**	(414)	**(76)**	(121)	**(283)**	(295)	**(194)**	(186)
Benefit obligation at end of year[a]	**$ 7,792**	$ 7,983	**$ 1,045**	$ 1,133	**$ 8,144**	$ 6,968	**$ 2,416**	$ 2,252
Change in plan assets:								
Fair value of plan assets at beginning of year	**$ 7,050**	$ 6,820	**$ —**	$ —	**$ 4,595**	$ 4,277	**$ 275**	$ 253

Actual gain on plan assets	**1,034**	625	**—**	1	**552**	687	**31**	23
Company contributions	**453**	52	**80**	135	**533**	439	**250**	158
Employee contributions	**—**	—	**—**	—	**22**	23	**34**	28
Foreign exchange impact	**—**	—	**—**	—	**525**	(490)	**—**	(1)
Acquisitions	**—**	—	**—**	—	**1**	10	**—**	—
Settlements[b]	**(436)**	(33)	**(4)**	(15)	**(65)**	(56)	**—**	—
Benefits paid	**(285)**	(414)	**(76)**	(121)	**(283)**	(295)	**(194)**	(186)
Fair value of plan assets at end of year	**$ 7,816**	$ 7,050	**$ —**	$ —	**$ 5,880**	$ 4,595	**$ 396**	$ 275
Funded status (plan assets greater than (less than) benefit obligation)	**$ 24**	$ (933)	**$ (1,045)**	$ (1,133)	**$ (2,264)**	$ (2,373)	**$ (2,020)**	$ (1,977)
Unrecognized:								
Actuarial losses		2,364		775		1,715		525
Prior service costs/(credits)		54		(35)		(6)		7
Net transition obligation		—		—		3		2
Net asset/(liability) recorded in consolidated balance sheet		$ 1,485		$ (393)		$ (661)		$ (1,443)

(a) For the U.S. and international pension plans, the benefit obligation is the projected benefit obligation. For the postretirement plans, the benefit obligation is the accumulated postretirement benefit obligation.

(b) For 2006, includes curtailments and settlements associated with the transfer of benefit obligations as part of the sale of our Consumer Healthcare business.

The favorable change in our U.S. qualified plans projected benefit obligations funded status from underfunded in the aggregate as of December 31, 2005, to overfunded in the aggregate as of December 31, 2006, was largely driven by our 2006 actual investment return of 15.2%, our voluntary contribution of $450 million and the 0.1 percentage-point increase in the discount rate.

The accumulated benefit obligations (ABO) for our U.S. qualified pension plans were $6.8 billion in 2006 and $6.4 billion in 2005. The ABO for our U.S. supplemental (non-qualified) pension plans were $883 million in 2006 and $843 million in 2005. The ABO for our international pension plans were $7.1 billion in 2006 and $6.0 billion in 2005.

The U.S. supplemental (non-qualified) pension plans are not generally funded, as there are no tax or other incentives that exist, and these obligations, which are substantially greater than the annual cash outlay for these liabilities, are paid from cash generated from operations.

Amounts recognized in the consolidated balance sheet as of December 31 follow:

	PENSION PLANS							
	U.S. QUALIFIED		**U.S. SUPPLEMENTAL (NON-QUALIFIED)**		**INTERNATIONAL**		**POSTRETIREMENT PLANS**	
(MILLIONS OF DOLLARS)	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Noncurrent assets[a]	**$ 441**	$ 1,678	**$ —**	$ —	**$ 40**	$ 553	**$ —**	$ —
Current liabilities[b]	**—**	(55)	**(100)**	(17)	**(34)**	(17)	**(50)**	(19)
Noncurrent liabilities[c]	**(417)**	(138)	**(945)**	(826)	**(2,270)**	(1,717)	**(1,970)**	(1,424)
Funded status	**$ 24**		**$ (1,045)**		**$ (2,264)**		**$ (2,020)**	
Accumulated other comprehensive income/(expense)[d]		—		450		520		—
Net amounts recognized		$ 1,485		$ (393)		$ (661)		$ (1,443)

(a) Included primarily in *Other assets, deferred taxes and deferred charges*.

(b) Included in *Other current liabilities* and *Liabilities of discontinued operations and other liabilities held for sale*, as appropriate.

(c) Included in *Pension benefit obligations* and *Postretirement benefit obligations*, as appropriate.

(d) Included in *Accumulated other comprehensive income/(expense)*.

The components of the amount recognized in *Accumulated other comprehensive income/(expense)* at December 31, 2006, follow:

	PENSION PLANS			
(MILLIONS OF DOLLARS)	U.S. QUALIFIED	U.S. SUPPLEMENTAL (NON-QUALIFIED)	INTERNATIONAL	POSTRETIREMENT PLANS
Actuarial losses	$ 1,418	$ 622	$ 1,649	$ 621
Prior service costs and other	50	(27)	(2)	6
Total	$ 1,468	$ 595	$ 1,647	$ 627

The actuarial losses primarily represent the cumulative difference between the actuarial assumptions and actual return on plan assets, changes in discount rates and plan experience. These actuarial losses are recognized in *Accumulated other comprehensive income/(expense)* and are amortized into income over an average period of 11 years for our U.S. plans and an average period of 14 years for our international plans.

The following table presents the amount in *Accumulated other comprehensive income/(expense)* expected to be amortized into 2007 net periodic benefit costs:

	PENSION PLANS			
(MILLIONS OF DOLLARS)	U.S. QUALIFIED	U.S. SUPPLEMENTAL (NON-QUALIFIED)	INTERNATIONAL	POSTRETIREMENT PLANS
Actuarial losses	$ 68	$ 46	$ 102	$ 50
Prior service costs and other	8	(2)	(1)	2
Total	$ 76	$ 44	$ 101	$ 52

Information related to the U.S. qualified, U.S. supplemental (non-qualified) and international pension plans as of December 31 follows:

	U.S. QUALIFIED PLANS		U.S. SUPPLEMENTAL (NON-QUALIFIED)		INTERNATIONAL PLANS	
(MILLIONS OF DOLLARS)	**2006**	2005	**2006**	2005	**2006**	2005
Pension plans with an accumulated benefit obligation in excess of plan assets:						
Fair value of plan assets	**$ 403**	$ 387	**$ —**	$ —	**$ 2,273**	$ 1,849
Accumulated benefit obligation	**468**	458	**883**	843	**4,002**	3,494
Pension plans with a projected benefit obligation in						

excess of plan assets:						
Fair value of plan assets	**4,897**	4,249	**—**	—	**5,265**	4,355
Projected benefit obligation	**5,314**	5,376	**1,045**	1,133	**7,569**	6,738

In the aggregate, our U.S. qualified pension plans had assets greater than their ABO and their PBO as of December 31, 2006.

E. Plan Assets

The following table presents the weighted-average long-term target asset allocations and the percentages of the fair value of plan assets for our U.S. qualified and international pension plans and postretirement plans by investment category as of December 31:

	TARGET ALLOCATION	PERCENTAGE OF PLAN ASSETS	
(PERCENTAGES)	2006	2006	2005
U.S. qualified pension plans:			
Global equity securities	**65.0**	**68.6**	66.8
Debt securities	**25.0**	**22.8**	23.9
Alternative investments[a]	**10.0**	**8.4**	8.9
Cash	**—**	**0.2**	0.4
Total	**100.0**	**100.0**	100.0
International pension plans:			
Global equity securities	**62.5**	**62.2**	63.9
Debt securities	**27.5**	**23.7**	26.0
Alternative investments[b]	**9.7**	**10.3**	8.8
Cash	**0.3**	**3.8**	1.3
Total	**100.0**	**100.0**	100.0
U.S. postretirement plans[c]:			
Global equity securities	**75.0**	**74.8**	75.4
Debt securities	**25.0**	**23.1**	24.6
Alternative investments[a]	**—**	**2.1**	—
Total	**100.0**	**100.0**	100.0

(a) Private equity, venture capital, private debt and real estate.

(b) Real estate, insurance contracts and other investments.

(c) Reflects postretirement plan assets, which support a portion of our U.S. retiree medical plans.

All long-term asset allocation targets reflect our asset class return expectations and tolerance for investment risk within the context of the respective plans' long-term benefit obligations. The long-term asset allocation is supported by an analysis that incorporates historical and expected returns by asset class, as well as volatilities and correlations across asset classes and our liability profile. This analysis, referred to as an asset-liability analysis, also provides an estimate of expected returns on plan assets, as well as a forecast of potential future asset and liability balances. Due to market conditions and other factors, actual asset allocations may vary from the target allocation outlined above. For the U.S. qualified pension plans, the year-end 2006 alternative investments allocation of 8.4% was below the target allocation, primarily due to the timing of our commitments. The assets are periodically rebalanced back to the target allocation.

The U.S. qualified pension plans held approximately 10.2 million shares (fair value of approximately $263 million, representing 3.3% of U.S. plan assets) as of December 31, 2006, and approximately 10.3 million shares (fair value of approximately $240 million, representing 3.5% of U.S. plan assets) as of December 31, 2005, of our common stock. The plans received approximately $10 million in dividends on these shares in 2006 and approximately $8 million in dividends on these shares in 2005.

F. Cash Flows

It is our practice to fund amounts for our qualified pension plans that are at least sufficient to meet the minimum requirements set forth in applicable employee benefit laws and local tax laws.

The following table presents expected cash flow information:

	PENSION PLANS			
FOR THE YEAR ENDED DECEMBER 31, (MILLIONS OF DOLLARS)	U.S QUALIFIED	U.S. SUPPLEMENTAL (NON-QUALIFIED)	INTERNATIONAL	POST-RETIREMENT PLANS
Employer contributions:				
2007 (estimated)	$ 3	$ 99	$ 347	$ 172
Expected benefit payments:				
2007	$ 420	$ 99	$ 286	$ 172
2008	407	82	301	176
2009	431	81	314	179
2010	454	79	324	182
2011	476	79	337	184
2012–2016	2,845	390	1,873	906

The table reflects the total U.S. plan benefits projected to be paid from the plans or from our general assets under the current actuarial assumptions used for the calculation of the benefit obligation and, therefore, actual benefit payments may differ from projected benefit payments. Under the provisions of the Medicare Prescription Drug Improvement and Modernization Act of 2003, the expected benefit payments for our U.S. postretirement plans were reduced by $161 million through 2016.

G. Defined Contribution Plans

We have savings and investment plans in several countries, including the U.S., Puerto Rico, Japan and Sweden. For the U.S. and Puerto Rico plans, employees may contribute a portion of their salaries and bonuses to the plans, and we match, largely in company stock, a portion of the employee contributions. In the U.S. and Puerto Rico, effective March 1, 2007, employees are permitted to diversify all or any portion of their company stock match contribution. The contribution match for certain legacy Pfizer U.S. participants is held in an employee stock ownership plan. We recorded charges related to our plans of $222 million in 2006, $234 million in 2005 and $313 million in 2004.

PEPSICO

The following excerpt from PepsiCo's Pension, Retiree Medical and Savings Plans note indicates expected amounts to be amortized in the next fiscal year.

The estimated amounts to be amortized from accumulated other comprehensive loss into benefit expense in 2007 for our pension and retiree medical plans are as follows:

	Pension		Retiree Medical
	U.S.	International	
Net loss	$136	$ 29	$ 18
Prior service cost/(credit)	5	3	(13)
Total	$141	$ 32	$ 5

PRUDENTIAL FINANCIAL

The following excerpt from Prudential Financial's Employee Benefit Plans note discloses how delayed recognition of transition obligations, prior service costs and actuarial losses will be reported in the next fiscal year's net income.

The amounts included in "Accumulated other comprehensive income" expected to be recognized as components of net periodic (benefit) cost in 2007 are as follows:

	Pension Benefits	Other Postretirement Benefits
	(in millions)	
Amortization of transition obligation	$ —	$ 1
Amortization of prior service cost	29	(6)
Amortization of actuarial (gain) loss, net	29	15
Total	$ 58	$ 10

GENERAL MOTORS

General Motors engaged in a series of transactions to restructure its pension plans. The following excerpt from GM's Pensions and Other Postretirement Benefits note explains these transactions and their accounting.

On February 7, 2006, GM announced it would increase the U.S. salaried workforce's participation in the cost of health care, capping GM's contributions to salaried retiree health care at the level of 2006 expenditures. The remeasurement of the U.S. salaried OPEB plans as of February 9, 2006 as a result of these benefit modifications generated a $0.5 billion reduction in OPEB expense for 2006 and is reflected in the components of expense table above. This remeasurement reduced the U.S. accumulated postretirement benefit obligation (APBO) by $4.7 billion.

On March 7, 2006, GM announced it would modify the terms of the U.S. salaried pension plan to freeze benefits under the current plan as of December 31, 2006 and implement a new plan using a new pension formula thereafter. The remeasurement of GM's U.S. salaried pension plans as of March 31, 2006 as a result of these benefit modifications generated a $0.4 billion reduction in pension expense for 2006 and is reflected in the components of expense table above. This remeasurement reduced the U.S. projected benefit obligation (PBO) by $2.8 billion.

Effective March 31, 2006, the U.S. District Court for the Eastern District of Michigan approved the tentative settlement agreement with the UAW (UAW Settlement Agreement) related to reductions in hourly retiree health care; this approval is now under appeal. The UAW Settlement

Agreement will remain in effect until at least September 2011, after which either GM or the UAW may cancel the agreement upon 90 days written notice. Similarly, GM's contractual obligations to provide health care benefits to UAW hourly retirees extends to at least September 2011 and will continue thereafter until terminated by either GM or the UAW. As a result, the provisions of the UAW Settlement Agreement will continue in effect for the UAW retirees beyond the expiration in September 2007 of the current collective bargaining agreement between GM and the UAW.

Given the significance of the effect of the UAW Settlement Agreement, the plans were remeasured. The remeasurement of the U.S. hourly OPEB plans as of March 31, 2006 due to the UAW Settlement Agreement generated a $1.3 billion reduction in OPEB expense for 2006 and is reflected in the components of expense table above. This remeasurement reduced the U.S. APBO by $14.5 billion.

GM accounted for the reduced health care coverage provisions of the UAW Settlement Agreement as an amendment of GM's Health Care Program for Hourly Employees (Modified Plan). GM previously estimated that the reduced health care coverage provisions of the UAW Settlement Agreement would result in an approximately $15 billion reduction of GM's OPEB obligations related to the Modified Plan. In conjunction with the measurement of the Modified Plan as of March 31, 2006, the estimated reduction of GM's OPEB obligations increased from $15 billion to $17.4 billion attributable primarily to an increase in the discount rate utilized in the March 31, 2006 measurement. The Modified Plan APBO reduction of $17.4 billion is being amortized on a straight-line basis over the remaining service lives of active UAW hourly employees (7.4 years) as a reduction of OPEB expense. This reduction of expense will be partially offset by the amortization over the same period of $2.9 billion related to capped benefits expected to be paid from contributions to the Mitigation Plan as discussed below, and the expense related to previously negotiated wage increases for active employees now diverted to the Mitigation Plan.

As mentioned above, the UAW Settlement Agreement also provides that GM make contributions to a new independent VEBA (Mitigation Plan). The assets of the Mitigation Plan will be used to mitigate the effect of reduced GM health care coverage on individual UAW retirees and, depending on the level of mitigation, are expected to be available for a number of years. The new independent Mitigation Plan is being partially funded by GM contributions of $1 billion in each of 2006, 2007 and 2011. The 2011 contribution may be accelerated under specified circumstances. GM will also make future contributions subject to provisions of the UAW Settlement Agreement that relate to profit sharing payments, increases in the value of a notional number of shares of GM's $12/3 par value common stock (collectively, the Supplemental Contributions), as well as wage deferral payments and dividend payments.

GM's obligation to make contributions to the Mitigation Plan are fixed or determined by a formula as defined in the UAW Settlement Agreement. GM's obligations are limited to these contributions. GM is not obligated to provide incremental funding in the event of an asset shortfall in the Mitigation Plan and the UAW Settlement Agreement further provides that the ability of the assets in the Mitigation Plan to mitigate retiree health care costs is not guaranteed by GM. Furthermore, the Mitigation Plan is completely independent of GM and is administered by an independent trust committee (the Committee) which shall not include any GM representatives. The assets of the independent VEBA trust for UAW retirees of GM are the responsibility of the Committee, which has full fiduciary responsibility for the investment strategy, safeguarding of assets and execution of the benefit plan as designed.

GM accounted for the Mitigation Plan as a defined benefit plan, with a cap on GM's OPEB obligation under the plan limited to the present value of the three $1 billion cash payments and minimum Supplemental Contributions required by the Settlement Agreement. The present value of GM's obligation to the Mitigation plan of $2.9 billion will be amortized on a straight-line basis over the remaining service lives of active UAW hourly employees (7.4 years) as OPEB expense. Payments from GM to the Mitigation Plan related to wage deferrals, dividends or changes in the estimate of Supplemental Contributions will be recorded as an expense in the quarter that the

hours are worked, the dividend is declared, or the change in estimate occurs, respectively. GM will recognize the expense for the wage deferrals as the future services are rendered, since the active-UAW represented-hourly-employees elected to forgo contractual wage increases and have those amounts contributed to the Mitigation Plan. During 2006, as required in the UAW Settlement Agreement, GM made a $1 billion contribution to the Mitigation Plan.

As of the measurement date, the Mitigation Plan had a benefit obligation totaling $2.8 billion and plan assets totaling $0.9 billion, as detailed in the table below. The ($1.9) billion net underfunded status of the Mitigation Plan is reflected [in] GM's financial statements and in the Changes in Benefit Obligation (under "U.S. Other Benefits") in the table above. The following represent the changes in plan assets and benefit obligation of the Mitigation Plan for the year ended December 31, 2006 (dollars in millions):

Changes in Benefit Obligation	
Benefit obligation at beginning of year	$ —
Interest cost	56
Amendments	2,876
Actuarial (gains)/losses	7
Benefits paid	(119)
Other	(15)
Benefit obligation at end of year	$2,805

Changes in Plan Assets	
Fair value at beginning of year	$ —
GM contributions	1,000
Wage deferral contributions	4
Mitigation payments on behalf of GM retirees	(119)
Actual return on plan assets	29
Fair value at end of year	$ 914

As detailed in Note 6, GM, Delphi, and the UAW reached an agreement on March 22, 2006 intended to reduce the number of U.S. hourly employees through the Attrition Program. As a result of the Attrition Program, GM has recognized curtailment losses under SFAS No. 88 and SFAS No. 106 due to the significant reduction in the expected aggregate years of future service of the employees in the U.S. hourly pension, OPEB and extended disability plans, respectively. The curtailment losses include recognition of the change in the PBO or APBO and a portion of the previously unrecognized prior service cost reflecting the reduction in expected future service. GM recognized a curtailment loss related to the U.S. hourly pension plan of approximately $4.4 billion at April 30, 2006. GM recognized a curtailment loss of $23 million in 2006 related to the U.S. hourly OPEB plans measured at May 31, 2006. GM recognized a curtailment gain of $132 million related to the U.S. hourly extended disability plan measured at June 30, 2006. The impacts for the pension and OPEB plans are reflected in the components of expense table above.

The remeasurement of GM's U.S. hourly pension plan as of April 30, 2006 as a result of the Attrition Program generated a $0.7 billion reduction in pension expense for 2006. This remeasurement reduced the U.S. pension PBO by $1.2 billion. The remeasurement of the U.S. hourly OPEB plans as of May 31, 2006 as a result of the Attrition Program generated an approximate $143 million reduction in OPEB expense for 2006. This remeasurement reduced the U.S. OPEB APBO by $0.7 billion. The effects of these restatements are reflected in the components of expense table above.

In October 2006, the GM Board of Directors approved a reduction in the levels of coverage for corporate-paid life insurance for salaried retirees. For eligible salaried employees who retire on or after May 1, 2007, coverage will reduce by 50% on the tenth anniversary of their retirement date,

and salaried employees who retire before May 1, 2007 will have their coverage reduced by 50% on January 1, 2017. This change reduced GM's year-end U.S. OPEB APBO by $0.5 billion and will be reflected in 2007 OPEB expense.

On November 30, 2006, GM sold a 51% controlling interest in GMAC. As a result of the sale, GMAC salaried employees will have their pension benefits frozen under the current GM pension plans. The remeasurement of GM's U.S. salaried pension plans as of November 30, 2006 as a result of this benefit modification generated a $0.1 billion curtailment gain and $8 million reduction in pension expense for 2006. This remeasurement increased the U.S. PBO by $0.2 billion. GM will also maintain the salaried OPEB obligation for current GMAC retirees and OPEB eligible employees. GMAC employees who were non-OPEB eligible were offered a cash lump sum payment based on credited service in lieu of GM provided OPEB at their date of retirement. The remeasurement of the U.S. and non-U.S. OPEB plans as of November 30, 2006 as a result of these modifications generated a $563 million curtailment gain, $27 million settlement loss, and $536 million reduction in OPEB expense for 2006. This remeasurement reduced the U.S. and Non-U.S. APBO by $0.1 billion. The impact to extended disability benefits generated a curtailment gain of $14 million.

Revenue recognition

3M

3M provides a detailed revenue recognition policy that is geared toward the industries in which it operates.

Revenue (sales) recognition: The Company sells a wide range of products to a diversified base of customers around the world and has no material concentration of credit risk. Revenue is recognized when the risks and rewards of ownership have substantively transferred to customers. This condition normally is met when the product has been delivered or upon performance of services. The Company records estimated reductions to revenue for customer and distributor incentives, such as rebates, at the time of the initial sale. The estimated reductions are based on the sales terms, historical experience, trend analysis and projected market conditions in the various markets served. Sales, use, value-added and other excise taxes are not recognized in revenue.

The majority of 3M's sales agreements are for standard products and services with customer acceptance occurring upon delivery of the product or performance of the service. 3M also enters into agreements that contain multiple elements (such as equipment, installation and service) or non-standard terms and conditions. For multiple-element arrangements, 3M recognizes revenue for delivered elements when it has stand-alone value to the customer, the fair values of undelivered elements are known, customer acceptance of the delivered elements has occurred, and there are only customary refund or return rights related to the delivered elements. In addition to the preceding conditions, equipment revenue is not recorded until the installation has been completed if equipment acceptance is dependent upon installation, or if installation is essential to the functionality of the equipment. Installation revenues are not recorded until installation has been completed. For prepaid service contracts, sales revenue is recognized on a straight-line basis over the term of the contract, unless historical evidence indicates the costs are incurred on other than a straight-line basis. License fee revenue is recognized as earned, and no revenue is recognized until the inception of the license term. On occasion, agreements will contain milestones, or 3M will recognize revenue based on proportional performance. For these agreements, and depending on the specifics, 3M may recognize revenue upon completion of a substantive milestone, or in proportion to costs incurred to date compared with the estimate of total costs to be incurred.

ALLSTATE

2. Summary of Significant Accounting Policies

Recognition of premium revenues and contract charges, and related benefits and interest credited

Property-liability premiums are deferred and earned on a pro-rata basis over the terms of the policies. The portion of premiums written applicable to the unexpired terms of the policies is recorded as unearned premiums. Premium installment receivables, net, represent premiums written and not yet collected, net of an allowance for uncollectible premiums. The Company regularly evaluates premium installment receivables and adjusts valuation allowances as appropriate. The valuation allowance for uncollectible premium installment receivables was $56 million and $50 million at December 31, 2006 and 2005, respectively.

Traditional life insurance products consist principally of products with fixed and guaranteed premiums and benefits, primarily term and whole life insurance products. Premiums from these products are recognized as revenue when due from policyholders. Benefits are recognized in relation to such revenue so as to result in the recognition of profits over the life of the policy and are reflected in life and annuity contract benefits.

Immediate annuities with life contingencies, including certain structured settlement annuities, provide insurance protection over a period that extends beyond the period during which premiums are collected. Premiums from these products are recognized as revenue when received at the inception of the contract. Benefits and expenses are recognized in relation to such revenue such that profits are recognized over the lives of the contracts.

Interest-sensitive life contracts, such as universal life and single premium life, are insurance contracts whose terms are not fixed and guaranteed. The terms that may be changed include premiums paid by the contractholder, interest credited to the contractholder account balance and any amounts assessed against the contractholder account balance. Premiums from these contracts are reported as contractholder fund deposits. Contract charges consist of fees assessed against the contractholder account balance for cost of insurance (mortality risk), contract administration and early surrender. These revenues are recognized when assessed against the contractholder account balance. Life and annuity contract benefits include life-contingent benefit payments in excess of the contractholder account balance.

Contracts that do not subject the Company to significant risk arising from mortality or morbidity are referred to as investment contracts. Fixed annuities, including market value adjusted annuities, equity-indexed annuities and immediate annuities without life contingencies, funding agreements (primarily backing medium-term notes) are considered investment contracts. Consideration received for such contracts is reported as contractholder fund deposits. Contract charges for investment contracts consist of fees assessed against the contractholder account balance for maintenance, administration and surrender of the contract prior to contractually specified dates, and are recognized when assessed against the contractholder account balance.

Interest credited to contractholder funds represents interest accrued or paid on interest-sensitive life contracts and investment contracts. Crediting rates for certain fixed annuities and interest-sensitive life contracts are adjusted periodically by the Company to reflect current market conditions subject to contractually guaranteed minimum rates. Crediting rates for indexed annuities and indexed funding agreements are based on a specified interest-rate index, such as LIBOR, or an equity index, such as the S&P 500. Pursuant to the adoption of Statement of Position No. 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts" ("SOP 03-1") in 2004, interest credited also includes amortization of deferred sales inducement ("DSI") expenses. DSI is amortized into interest credited using the same method used to amortize deferred policy acquisition costs ("DAC").

Contract charges for variable life and variable annuity products consist of fees assessed against the contractholder account values for contract maintenance, administration, mortality, expense and early surrender. Contract benefits incurred include guaranteed minimum death, income, withdrawal and accumulation benefits. Subsequent to the Allstate Financial segment's disposal of substantially all of its variable annuity business through reinsurance agreements with Prudential in 2006 (see Note 3), the contract charges and contract benefits related thereto are reported net of reinsurance ceded.

AMERISOURCEBERGEN

Note 1. Summary of Significant Accounting Policies

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, product has been delivered or services have been rendered, the price is fixed or determinable and collectibility is reasonably assured. Revenue as reflected in the accompanying consolidated statements of operations is net of sales returns and allowances.

The Company's customer sales return policy generally allows customers to return products only if the products can be resold at full value or returned to suppliers for full credit. During the fiscal year ended September 30, 2004, the Company changed its accounting policy for customer sales returns to reflect an accrual for estimated customer returns at the time of sale to the customer. Previously, the Company accounted for customer sales returns as a reduction of sales and cost of goods sold at the time of the return. As a result of this accounting policy change, operating revenue and cost of goods sold were each reduced by $316.8 million for the fiscal year ended September 30, 2004. Additionally, merchandise inventories were increased and accounts receivable were reduced by $316.8 million. At September 30, 2006 and 2005, the Company's accrual for customer sales returns was $275.8 million and $280.4 million, respectively.

The Company reports the gross dollar amount of bulk deliveries to customer warehouses in revenue and the related costs in cost of goods sold. Bulk delivery transactions are arranged by the Company at the express direction of the customer, and involve either shipments from the supplier directly to customers' warehouse sites or shipments from the supplier to the Company for immediate shipment to the customers' warehouse sites. The Company is a principal to these transactions because it is the primary obligor and has the ultimate and contractual responsibility for fulfillment and acceptability of the products purchased, and bears full risk of delivery and loss for products, whether the products are drop-shipped or shipped via cross-dock. The Company also bears full credit risk associated with the creditworthiness of any bulk delivery customer. As a result, and in accordance with the EITF No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," the Company records bulk deliveries to customer warehouses as gross revenues. Gross profit earned by the Company on bulk deliveries was not material in any year presented.

CISCO SYSTEMS

Revenue Recognition The Company's products are generally integrated with software that is essential to the functionality of the equipment. Additionally, the Company provides unspecified software upgrades and enhancements related to the equipment through its maintenance contracts for most of its products. Accordingly, the Company accounts for revenue in accordance with Statement of Position No. 97-2, "Software Revenue Recognition," and all related interpretations. For sales of products where software is incidental to the equipment, or in hosting arrangements, the Company applies the provisions of Staff Accounting Bulletin No. 104, "Revenue Recognition," and all related interpretations.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is reasonably assured. In instances

where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. Technical support services revenue is deferred and recognized ratably over the period during which the services are to be performed, which is typically from one to three years. Advanced services revenue is recognized upon delivery or completion of performance.

When a sale involves multiple elements, such as sales of products that include services, the entire fee from the arrangement is allocated to each respective element based on its relative fair value and recognized when revenue recognition criteria for each element are met. Fair value for each element is established based on the sales price charged when the same element is sold separately.

The Company uses distributors that stock inventory and typically sell to systems integrators, service providers, and other resellers. In addition, certain products are sold through retail partners. The Company refers to these sales through distributors and retail partners as its two-tier system of sales to the end customer. Revenue from distributors and retail partners is recognized based on a sell-through method using information provided by them. Distributors and retail partners participate in various cooperative marketing and other programs, and the Company maintains estimated accruals and allowances for these programs. The Company accrues for warranty costs, sales returns, and other allowances based on its historical experience.

COMCAST

Revenue Recognition

Cable revenues are principally derived from subscriber fees received for our video, high-speed Internet and phone services ("cable services") and from advertising. We recognize revenues from cable services as the service is provided. We manage credit risk by screening applicants through the use of credit bureau data. If a subscriber's account is delinquent, various measures are used to collect outstanding amounts, including termination of the subscriber's cable service. We recognize advertising revenue at estimated realizable values when the advertising is aired. Installation revenues obtained from the connection of subscribers to our cable systems are less than related direct selling costs. Therefore, such revenues are recognized as connections are completed. Revenues earned from other sources are recognized when services are provided or events occur. Under the terms of our franchise agreements, we are generally required to pay to the local franchise authority up to 5% of our gross revenues earned from providing cable services within the local franchise area. We normally pass these fees through to our cable subscribers and classify the fees as a component of revenues.

Our Programming businesses recognize revenue from cable and satellite distributors as programming is provided, generally pursuant to multiyear distribution agreements. From time to time these agreements expire while programming continues to be provided to the operator based on interim arrangements while the parties negotiate new contractual terms. Revenue recognition is generally limited to current payments being made by the operator, typically pursuant to the prior contract terms, until a new contract is negotiated, sometimes with effective dates that affect prior periods. Differences between actual amounts determined upon resolution of negotiations and amounts recorded during these interim arrangements are recorded in the period of resolution.

Advertising revenue for our Programming businesses is recognized in the period in which commercial announcements or programs are aired. In some instances, our Programming businesses guarantee viewer ratings for their programming. Revenue is deferred to the extent of an estimated shortfall in the ratings. Such shortfalls are primarily settled by providing additional advertising time, at which point the revenue is recognized.

DELL

NOTE 1 — Description of Business and Summary of Significant Accounting Policies

Revenue Recognition — Net revenue includes sales of hardware, software and peripherals, and services (including extended service contracts and professional services). These products and services are sold either separately or as part of a multiple-element arrangement. Dell allocates revenue from multiple-element arrangements to the elements based on the relative fair value of each element, which is generally based on the relative sales price of each element when sold separately. The allocation of fair value for a multiple-element software arrangement is based on vendor specific objective evidence ("VSOE") or in absence of VSOE for delivered elements, the residual method. In the absence of VSOE for undelivered elements, revenue is deferred and subsequently recognized over the term of the arrangement. For sales of extended warranties with a separate contract price, Dell defers revenue equal to the separately stated price. Revenue associated with undelivered elements is deferred and recorded when delivery occurs. Product revenue is recognized, net of an allowance for estimated returns, when both title and risk of loss transfer to the customer, provided that no significant obligations remain. Revenue from extended warranty and service contracts, for which Dell is obligated to perform, is recorded as deferred revenue and subsequently recognized over the term of the contract or when the service is completed. Revenue from sales of third-party extended warranty and service contracts, for which Dell is not obligated to perform, is recognized on a net basis at the time of sale.

Dell defers the cost of shipped products awaiting revenue recognition until the goods are delivered and revenue is recognized. In-transit product shipments to customers totaled $420 million and $430 million as of February 3, 2006 and January 28, 2005, respectively, and are included in other current assets on Dell's consolidated statement of financial position.

GENERAL DYNAMICS

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition. General Dynamics accounts for sales and earnings under long-term government contracts using the percentage-of-completion method of accounting in accordance with AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. The company estimates the profit on a contract as the difference between the total estimated revenue and the total estimated costs of a contract and recognizes that profit over the contract term. The company determines progress toward completion on production contracts based on either input measures, such as costs incurred, or output measures, such as units delivered, as appropriate. For services contracts, the company recognizes revenues as the services are rendered. The company applies earnings rates to all contract costs, including general and administrative (G&A) expenses on government contracts, to determine sales and operating earnings.

The company reviews earnings rates periodically to assess revisions in contract values and estimated costs at completion. The company applies the effect of any changes in earnings rates resulting from these assessments prospectively. The company charges any anticipated losses on contracts to earnings as soon as they are identified. Anticipated losses cover all costs allocable to the contracts, including G&A expenses on government contracts. The company recognizes revenue arising from claims either as income or as an offset against a potential loss only when the amount of the claim can be estimated reliably and its realization is probable.

The company accounts for contracts for business-jet aircraft in accordance with Statement of Position 81-1. These contracts usually provide for two major milestones: the manufacture of the "green" aircraft and its completion. Completion includes exterior painting and installation of customer-selected interiors and optional avionics. The company records revenue at two points: when green aircraft are delivered to, and accepted by, the customer and when the customer accepts final delivery of the fully outfitted aircraft. The company recognizes sales of all other aircraft products and services when the product is delivered or the service is performed.

INTEL

Note 2: Accounting Policies

Revenue Recognition

The company recognizes net revenue when the earnings process is complete, as evidenced by an agreement with the customer, transfer of title, and acceptance, if applicable, as well as fixed pricing and probable collectibility. Pricing allowances, including discounts based on contractual arrangements with customers, are recorded when revenue is recognized as a reduction to both accounts receivable and revenue. Because of frequent sales price reductions and rapid technology obsolescence in the industry, sales made to distributors under agreements allowing price protection and/or right of return are deferred until the distributors sell the merchandise. Shipping charges billed to customers are included in net revenue, and the related shipping costs are included in cost of sales.

LEHMAN BROTHERS

Note 1 Summary of Significant Accounting Policies
Revenue Recognition Policies

Principal transactions. Financial instruments classified as Financial instruments and other inventory positions owned and Financial instruments and other inventory positions sold but not yet purchased (both of which are recorded on a trade-date basis) are valued at market or fair value, as appropriate, with unrealized gains and losses reflected in Principal transactions in the Consolidated Statement of Income.

Investment banking. Underwriting revenues, net of related underwriting expenses, and revenues for merger and acquisition advisory and other investment-banking-related services are recognized when services for the transactions are completed. Direct costs associated with advisory services are recorded as non-personnel expenses, net of client reimbursements.

Commissions. Commissions primarily include fees from executing and clearing client transactions on stocks, options and futures markets worldwide. These fees are recognized on a trade-date basis.

Interest and dividends revenue and interest expense. We recognize contractual interest on Financial instruments and other inventory positions owned and Financial instruments and other inventory positions sold but not yet purchased on an accrual basis as a component of Interest and dividends revenue and Interest expense, respectively. Interest flows on derivative transactions are included as part of the mark-to-market valuation of these contracts in Principal transactions and are not recognized as a component of interest revenue or expense. We account for our secured financing activities and certain short- and long-term borrowings on an accrual basis with related interest recorded as interest revenue or interest expense, as applicable. Included in short- and long-term borrowings are structured notes (also referred to as hybrid instruments) for which the coupon and principal payments may be linked to the performance of an underlying measure (including single securities, baskets of securities, commodities, currencies, interest rates or credit events). Beginning with our adoption of SFAS 155 (as defined below) in the first quarter of our 2006 fiscal year, we account for all structured notes issued after November 30, 2005, as well as certain structured notes that existed at November 30, 2005, that contain an embedded derivative that would require bifurcation under SFAS 133 (as defined below) at fair value with stated interest coupons recorded as interest expense.

Asset management and other. Investment advisory fees are recorded as earned. Generally, high-net-worth and institutional clients are charged or billed quarterly based on the account's net asset value. Investment advisory and administrative fees earned from our mutual fund business (the "Funds") are charged monthly to the Funds based on average daily net assets under management. In certain circumstances, we receive asset management incentive fees when the return on assets under management exceeds specified benchmarks. Incentive fees are generally

based on investment performance over a twelve-month period and are not subject to adjustment after the measurement period ends.

Accordingly, incentive fees are recognized when the measurement period ends.We also receive private equity incentive fees when the returns on certain private equity funds' investments exceed specified threshold returns. Private equity incentive fees typically are based on investment periods in excess of one year, and future investment underperformance could require amounts previously distributed to us to be returned to the funds. Accordingly, these incentive fees are recognized when all material contingencies have been substantially resolved.

MICROSOFT

NOTE 1 ACCOUNTING POLICIES

REVENUE RECOGNITION

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectibility is probable. We enter into certain arrangements where we are obligated to deliver multiple products and/or services (multiple elements). In these arrangements, we generally allocate the total revenue among the elements based on the sales price of each element when sold separately (vendor-specific objective evidence).

Revenue for retail packaged products, products licensed to original equipment manufacturers ("OEM"), and perpetual licenses for current products under our Open and Select volume licensing programs generally is recognized as products are shipped. A portion of the revenue related to certain products, which include all Windows XP and previous PC operating systems, is recorded as unearned due to undelivered elements including, in some cases, free post-delivery telephone support and the right to receive unspecified upgrades/enhancements of Microsoft Internet Explorer on a when-and-if-available basis. The amount of revenue allocated to undelivered elements is based on the vendor-specific objective evidence of fair value for those elements using the residual method. Under the residual method, the total fair value of the undelivered elements, as indicated by vendor-specific objective evidence, is recorded as unearned, and the difference between the total arrangement fee and the amount recorded as unearned for the undelivered elements is recognized as revenue related to delivered elements. Unearned revenue due to undelivered elements is recognized ratably on a straight-line basis over the related product's life cycle. Revenue related to Windows Vista is not subject to a similar deferral because there are no significant undelivered elements.

Revenue from multi-year licensing arrangements are accounted for as subscriptions, with billings recorded as unearned revenue and recognized as revenue ratably over the billing coverage period. Certain multi-year licensing arrangements include rights to receive future versions of software product on a when-and-if-available basis under Open and Select volume licensing programs (Software Assurance). In addition, other multi-year licensing arrangements include a perpetual license for current products combined with rights to receive future versions of software products on a when-and-if-available basis under Open, Select, and Enterprise Agreement volume licensing programs. Premier support services agreements, MSN Internet Access subscriptions, Xbox Live, and Microsoft Developer Network subscriptions are also accounted for as subscriptions.

Revenue related to our Xbox game console and other hardware components is recognized upon shipment of the product to retailers. Revenue related to games published by us is recognized when those games have been delivered to retailers. Revenue related to games published by third parties for use on the Xbox platform is recognized when manufactured for the game publishers. Online advertising revenue is recognized as advertisements are displayed. Search advertising revenue is recognized when the ad appears in the search results or when the action necessary to earn the revenue has been completed. Consulting services revenue is recognized as services are rendered, generally based on the negotiated hourly rate in the consulting arrangement and the number of hours worked during the period. Consulting revenue for fixed-price services arrangements is recognized based on percentage of completion.

Costs related to insignificant obligations, which include telephone support for developer tools software, PC games, computer hardware, and Xbox, are accrued when the related revenue is recognized. Provisions are recorded for estimated returns, concessions, warranties, and bad debts.

PEPSICO

Note 2 — Our Significant Accounting Policies

Revenue Recognition

We recognize revenue upon shipment or delivery to our customers based on written sales terms that do not allow for a right of return. However, our policy for DSD and chilled products is to remove and replace damaged and out-of-date products from store shelves to ensure that our consumers receive the product quality and freshness that they expect. Similarly, our policy for warehouse-distributed products is to replace damaged and out-of-date products. Based on our historical experience with this practice, we have reserved for anticipated damaged and out-of-date products. For additional unaudited information on our revenue recognition and related policies, including our policy on bad debts, see "Our Critical Accounting Policies" in Management's Discussion and Analysis. We are exposed to concentration of credit risk by our customers, Wal-Mart and PBG. In 2006, Wal-Mart represented approximately 9% of our total net revenue, including concentrate sales to our bottlers which are used in finished goods sold by them to Wal-Mart; and PBG represented approximately 10%. We have not experienced credit issues with these customers.

SAFEWAY

Note A: The Company and Significant Accounting Policies

Revenue Recognition Retail store sales are recognized at the point of sale. Sales tax is excluded from revenue. Internet sales are recognized when the merchandise is delivered to the customer. Discounts provided to customers in connection with loyalty cards are accounted for as a reduction of sales.

Safeway records a deferred revenue liability when it sells Safeway gift cards. Safeway records a sale when a customer redeems the gift card. Gift cards do not expire. However, based on Safeway's historical experience, the likelihood of redemption after three years is remote. Therefore, the Company reduces the liability and operating and administrative expense, for the unused portion of gift cards ("breakage") after three years. Breakage amounts were not material to the Company's results of operations or financial position for the fiscal years presented in this report.

The Company, through its Blackhawk subsidiary, also sells third-party gift cards through Safeway retail operations and through other grocery, drug and convenience store retailers. Safeway records a commission as other revenue when the third-party gift card is sold. The liability for redemption and potential income for breakage remain with the third-party merchant; therefore, Safeway records no entries for redemption or breakage of these gift cards.

SPRINT NEXTEL

Revenue Recognition

Operating revenues primarily consist of wireless service revenues, revenues generated from handset and accessory sales and revenues from wholesale operators and PCS Affiliates, as well as long distance voice, data and Internet revenues. Service revenues consist of fixed monthly recurring charges, variable usage charges and miscellaneous fees such as activation fees, directory assistance, operator-assisted calling, equipment protection, late payment charges and certain regulatory related fees. We recognize service revenues as services are rendered and equipment revenue when title passes to the dealer or end-user customer, in accordance with Securities and Exchange Commission, or SEC, Staff Accounting Bulletin, or SAB, No. 104, Revenue Recognition, and EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. We recognize revenue for access charges and other services charged at fixed amounts ratably over the service period, net of credits and adjustments for service discounts,

billing disputes and fraud or unauthorized usage. We recognize excess wireless usage and long distance revenue at contractual rates per minute as minutes are used. Additionally, we recognize excess wireless data usage based on kilobytes and one-time use charges, such as for the use of premium services, as incurred. As a result of the cutoff times of our multiple billing cycles each month, we are required to estimate the amount of subscriber revenues earned but not billed from the end of each billing cycle to the end of each reporting period. These estimates are based primarily on rate plans in effect and our historical usage and billing patterns.

Certain of our bundled products and services, primarily in our Wireless segment, are considered to be revenue arrangements with multiple deliverables. Total consideration received in these arrangements is allocated and measured using units of accounting within the arrangement (i.e., service and handset contracts) based on relative fair values. The activation fee revenue associated with these arrangements in our direct sales channels is classified as equipment sales at the time the related handset is sold. For transactions in our indirect sales channels, the activation fee is solely linked to the service contract with the subscriber. Accordingly, the activation fee revenue is deferred and amortized over the estimated average service life of the end-user customer.

WALT DISNEY

2 Summary of Significant Accounting Policies

Revenue Recognition

Broadcast advertising revenues are recognized when commercials are aired. Revenues from television subscription services related to the Company's primary cable programming services are recognized as services are provided. Certain of the Company's contracts with cable service providers include annual programming commitments. In these cases, revenue subject to the commitment, that is generally collected ratably over the year is deferred until the annual commitments are satisfied, which generally results in higher revenue recognition in the second half of the year.

Revenues from advance theme park ticket sales are recognized when the tickets are used. For non-expiring, multi-day tickets, we recognize revenue over a three-year time period based on estimated usage patterns that are derived from historical usage patterns. Revenues from corporate sponsors at the theme parks are generally recognized over the period of the applicable agreements commencing with the opening of the related attraction.

Revenues from the theatrical distribution of motion pictures are recognized when motion pictures are exhibited. Revenues from video and video game sales, net of anticipated returns and customer incentives, are recognized on the date that video units are made available for sale by retailers. Revenues from the licensing of feature films and television programming are recorded when the material is available for telecasting by the licensee and when certain other conditions are met.

Merchandise licensing advances and guarantee royalty payments are recognized based on the contractual royalty rate when the licensed product is sold by the licensee. Non-refundable advances and minimum guarantee royalty payments in excess of royalties earned are generally recognized as revenue at the end of the contract term.

Segments

When reviewing annual reports, we found several companies' disclosures to include operational details that would help a user to better understand the nature of their operations.

CIAMBRO

Ciambro's disclosure provides helpful descriptions of each reportable segment.

Note 15: Business Segment Reporting

Reportable segments, which are organized based on capabilities and technologies, include: Integrated Defense Systems, Intelligence and Information Systems, Missile Systems, Network

Centric Systems, Space and Airborne Systems and Technical Services, together with our Other category.

Integrated Defense Systems provides ballistic missile defense, naval and maritime and homeland security solutions.

Intelligence and Information Systems provides integrated ground systems for signal and image intelligence and weather and climate systems, command and control solutions for air/space platforms, operations, maintenance and engineering (OM&E) services and information technology and homeland security solutions.

Missile Systems provides a broad range of weapon systems, including missiles, smart munitions, projectiles, kinetic kill vehicles and directed energy effectors.

Network Centric Systems provides net-centric mission solutions for networked sensors, command and control communications, air traffic management and homeland security.

Space and Airborne Systems provides integrated systems and solutions for advanced missions including surveillance and reconnaissance, precision engagement, unmanned aerial operations, special force operations and space.

Technical Services provides technology solutions for defense, federal government and commercial customers worldwide, specializing in counter-proliferation and counter-terrorism, base and range operations, customized engineering and manufacturing services and mission support.

We also have three other business segments consisting of Flight Options LLC, Raytheon Airline Aviation Services LLC and Raytheon Professional Services LLC, which we combine and disclose in the Other category.

Segment net sales and operating income generally include intersegment sales and profit recorded at cost plus a specified fee, which may differ from what the selling entity would be able to obtain on external sales. Corporate and Eliminations includes certain Company-wide accruals and intersegment sales and profit eliminations.

Segment financial results were as follows:

Net Sales (In millions)	**2006**	2005	2004
Integrated Defense Systems	**$4,220**	$3,807	$3,456
Intelligence and Information Systems	**2,560**	2,509	2,334
Missile Systems	**4,503**	4,124	3,844
Network Centric Systems	**3,561**	3,205	3,050
Space and Airborne Systems	**4,319**	4,175	4,068
Technical Services	**2,049**	1,980	1,987
Other	**828**	781	675
Corporate and Eliminations	**(1,749)**	(1,543)	(1,589)
Total	**$20,291**	$19,038	$17,825

Intersegment sales in 2006, 2005 and 2004, respectively, were $89 million, $101 million and $133 million for Integrated Defense Systems, $23 million, $37 million and $41 million for Intelligence and Information Systems, $29 million, $25 million and $16 million for Missile Systems, $414 million, $396 million and $444 million for Network Centric Systems, $561 million, $477 million and $428 million for Space and Airborne Systems, and $627 million, $534 million and $527 million for Technical Services.

Operating Income (In millions)	**2006**	2005	2004
Integrated Defense Systems	**$ 691**	$ 548	$ 417
Intelligence and Information Systems	**234**	229	203
Missile Systems	**479**	431	436
Network Centric Systems	**379**	333	269

Space and Airborne Systems604	**604**	606	568
Technical Services	**147**	146	148
Other	**(94)**	(123)	(31)
FAS/CAS Pension Adjustment	**(362)**	(448)	(457)
Corporate and Eliminations	**(238)**	(210)	(252)
Total	**$1,840**	$1,512	$1,301

Intersegment operating income in 2006, 2005 and 2004, respectively, were $7 million, $7 million and $10 million for Integrated Defense Systems, $2 million, $4 million and $3 million for Intelligence and Information Systems, $2 million, $2 million and $1 million for Missile Systems, $34 million, $35 million and $36 million for Network Centric Systems, $51 million, $46 million and $41 million for Space and Airborne Systems, and $57 million, $51 million and $47 million for Technical Services.

Included in intersegment operating income was a FAS/CAS income (expense) adjustment to our other postretirement benefit plans. In 2006, 2005 and 2004, respectively, this amount was ($5) million, ($5) million and ($21) million for Integrated Defense Systems, $2 million, $1 million and ($6) million for Intelligence and Information Systems, $15 million, $15 million and $14 million for Missile Systems, $6 million, $7 million and ($5) million for Network Centric Systems, $24 million, $24 million and $19 million for Space and Airborne Systems, and $3 million, $4 million and ($1) million for Technical Services.

Also included in operating income in 2006 was an $8 million benefit at Flight Options and a corresponding charge at Corporate related to a credit issued to Flight Options by Raytheon Aircraft in connection with the assumption by Flight Options of certain infrastructure and personnel related to the maintenance services previously provided by Raytheon Aircraft to Flight Options. We expect that this quarterly credit arrangement will continue through the second quarter of 2008.

The following table reconciles operating income to income from continuing operations before taxes:

	2006	2005	2004
Operating income	**$1,840**	$1,512	$1,301
Non-operating expense, net	**(152)**	(259)	(818)
Income from continuing operations before taxes	**$1,688**	$1,253	$ 483

Capital Expenditures (In millions)	**2006**	2005	2004
Integrated Defense Systems	**$ 78**	$ 67	$ 61
Intelligence and Information Systems	**22**	50	33
Missile Systems	**45**	39	47
Network Centric Systems	**53**	54	61
Space and Airborne Systems	**82**	75	77
Technical Services	**5**	7	12
Other	**2**	4	20
Corporate	**8**	2	6
Total	**$295**	$298	$317

Depreciation and Amortization (In millions)	**2006**	2005	2004
Integrated Defense Systems	**$ 63**	$ 53	$ 57
Intelligence and Information Systems	**29**	30	31
Missile Systems	**45**	37	46
Network Centric Systems	**57**	61	62
Space and Airborne Systems	**82**	87	81
Technical Services	**13**	16	9
Other	**18**	20	19

Corporate	**66**	54	44
Total	**$373**	$358	$349

Identifiable Assets (In millions) December 31:	**2006**	2005
Integrated Defense Systems	**$ 1,761**	$ 1,783
Intelligence and Information Systems	**1,946**	1,923
Missile Systems	**4,770**	4,716
Network Centric Systems	**3,731**	3,609
Space and Airborne Systems	**4,271**	4,210
Technical Services	**1,361**	1,290
Other	**1,045**	1,223
Corporate	**4,310**	3,254
Discontinued Operations	**2,296**	2,373
Total	**$25,491**	$24,381

Net Sales by Geographic Areas (In millions)	United States	Asia/ Pacific	All Other (Principally Europe)	Total
Net sales				
2006	**$16,601**	**$1,676**	**$ 2,014**	**$20,291**
2005	15,653	1,355	2,030	19,038
2004	14,549	1,191	2,085	17,825

The country of destination was used to attribute sales to either United States or Outside United States (including foreign military sales through the U.S. government of $1.3 billion, $1.1 billion and $1.0 billion in 2006, 2005 and 2004, respectively). Sales to major customers in 2006, 2005 and 2004 were: U.S. government, including foreign military sales, $17,016 million, $15,709 million and $14,568 million, respectively, including U.S. Department of Defense, $15,610 million, $14,272 million and $13,220 million, respectively.

Long-lived Assets by Geographic Areas (in millions)	United States	All Other (Principally Europe)	Total
December 31, 2006	**$4,128**	**$ 307**	**$4,435**
December 31, 2005	4,216	298	4,514

TIME WARNER

Time Warner provides three years' results by segment, and information about the nature of intersegment transactions. The table of operating income by segment provides helpful footnotes to understand each segment's performance.

16. SEGMENT INFORMATION

Time Warner classifies its business interests into five reportable segments: *AOL,* consisting principally of interactive services; *Cable,* consisting principally of interests in cable systems that provide video, high-speed data and Digital Phone services; *Filmed Entertainment,* consisting principally of feature film, television and home video production and distribution; *Networks,* consisting principally of cable television networks; and *Publishing,* consisting principally of magazine publishing.

Information as to the operations of Time Warner in each of its business segments is set forth below based on the nature of the products and services offered. Time Warner evaluates

performance based on several factors, of which the primary financial measure is operating income before depreciation of tangible assets and amortization of intangible assets ("Operating Income before Depreciation and Amortization"). Additionally, the Company has provided a summary of Operating Income by segment.

Year Ended December 31, 2006

	Subscription	Advertising	Content	Other	Total
		(millions)			
Revenues					
AOL	$ 5,784	$ 1,886	$ —	$ 196	$ 7,866
Cable	11,103	664	—	—	11,767
Filmed Entertainment	14	23	10,314	274	10,625
Networks	5,868	3,182	1,092	131	10,273
Publishing	1,615	2,879	81	674	5,249
Intersegment elimination	(682)	(119)	(718)	(37)	(1,556)
Total revenues	$ 23,702	$ 8,515	$ 10,769	$1,238	$44,224

Year Ended December 31, 2005

	Subscription	Advertising	Content	Other	Total
		(millions)			
Revenues					
AOL	$ 6,755	$ 1,338	$ —	$ 190	$ 8,283
Cable	8,313	499	—	—	8,812
Filmed Entertainment	—	4	11,704	216	11,924
Networks	5,370	3,071	1,022	107	9,570
Publishing	1,633	2,828	95	722	5,278
Intersegment elimination	(490)	(176)	(746)	(54)	(1,466)
Total revenues	$ 21,581	$ 7,564	$ 12,075	$1,181	$42,401

Year Ended December 31, 2004

	Subscription	Advertising	Content	Other	Total
		(millions)			
Revenues					
AOL	$ 7,477	$ 1,005	$ —	$ 210	$ 8,692
Cable	7,377	484	—	—	7,861
Filmed Entertainment	—	10	11,628	215	11,853
Networks	5,030	2,882	982	128	9,022
Publishing	1,615	2,693	88	693	5,089
Intersegment elimination	(472)	(170)	(794)	(88)	(1,524)
Total revenues	$ 21,027	$ 6,904	$ 11,904	$1,158	$40,993

Intersegment Revenues

In the normal course of business, the Time Warner segments enter into transactions with one another. The most common types of intersegment transactions include:

- The Filmed Entertainment segment generating Content revenues by licensing television and theatrical programming to the Networks segment;
- The Networks segment generating Subscription revenues by selling cable network programming to the Cable segment; and
- The AOL, Cable, Networks and Publishing segments generating Advertising revenues by promoting the products and services of other Time Warner segments.

These intersegment transactions are recorded by each segment at estimated fair value as if the transactions were with third parties and, therefore, impact segment performance. While intersegment transactions are treated like third-party transactions to determine segment performance, the revenues (and corresponding expenses or assets recognized by the segment that is counterparty to the transaction) are eliminated in consolidation and, therefore, do not themselves impact consolidated results. Additionally, transactions between divisions within the same reporting segment (e.g., a transaction between HBO and Turner within the Networks segment) are eliminated in arriving at segment performance and, therefore, do not themselves impact segment results. Revenues recognized by Time Warner's segments on intersegment transactions are as follows:

	Years Ended December 31,		
	2006	2005	2004
		(millions)	
Intersegment Revenues[a]			
AOL	$ 48	$ 28	$ 59
Cable	29	38	52
Filmed Entertainment	688	749	757
Networks[b]	738	553	569
Publishing	53	98	87
Total intersegment revenues	$ 1,556	$ 1,466	$ 1,524

(a) Intersegment revenues include intercompany Advertising revenues of $119 million, $176 million, and $170 million for the years ended December 31, 2006, 2005 and 2004, respectively.

(b) Intersegment revenues at the Networks segment include Subscription revenues generated by the sale of programming to the Acquired Systems since July 31, 2006.

Years Ended December 31,		
2006	2005	2004
	(millions)	

Operating Income before Depreciation and Amortization			
AOL[a]	$ 2,570	$ 1,845	$ 1,647
Cable	4,229	3,323	2,955
Filmed Entertainment[b]	1,136	1,231	1,404
Networks[c]	3,026	2,940	2,651
Publishing[d]	1,090	1,121	1,074
Corporate[e]	(1,096)	(3,339)	(1,129)
Intersegment elimination	(14)	(9)	(29)
Total Operating Income before Depreciation and Amortization	$ 10,941	$ 7,112	$ 8,573

(a) For the year ended December 31, 2006, includes a $769 million gain on the sales of AOL's French and U.K. access businesses, a $2 million gain from the resolution of a previously contingent gain related to the 2004 sale of Netscape Security Solutions ("NSS") and $13 million of noncash impairments. For the year ended December 31, 2005, includes a $24 million noncash impairment charge related to goodwill associated with AOLA, an approximate $5 million gain related to the sale of a building and a $5 million gain from the resolution of a previously contingent gain related to the 2004 sale of NSS. For the year ended December 31, 2004, includes a $10 million impairment charge related to a building that was held for sale, a gain of $13 million related to the sale of AOL Japan and a $7 million gain related to the sale of NSS.

(b) For the year ended December 31, 2005, includes a $5 million gain related to the sale of a property in California.

(c) For the year ended December 31, 2006, includes a $200 million noncash goodwill impairment charge related to The WB Network. For the year ended December 31, 2004, includes an approximate $7 million loss related to the sale of the winter sports teams.

(d) For the year ended December 31, 2006, includes a $5 million gain on the sale of a non-strategic magazine title. For the year ended December 31, 2005, includes an $8 million gain related to the collection of a loan made in conjunction with the Company's 2003 sale of Time Life, which was previously fully reserved due to concerns about recoverability. For the year ended December 31, 2004, includes an $8 million gain related to the sale of a building.

(e) For the year ended December 31, 2006, includes $650 million in legal reserves related to securities litigation and government investigations, $55 million in net expenses related to securities litigation and the government investigations and a $20 million gain on the sale of two aircraft. For the year ended December 31, 2005, includes $3 billion in legal reserves related to securities litigation and $135 million in net recoveries related to securities litigation and government investigations. For year ended December 31, 2004, includes $510 million in legal reserves related to the government investigations and $26 million in net expenses related to securities litigation and the government investigations. For the year ended December 31, 2004, includes $53 million of costs associated with the relocation from the Company's former corporate headquarters. For the year ended December 31, 2005, the Company reversed approximately $4 million of this charge, which was no longer required due to changes in estimates.

	Years Ended December 31,		
	2006	2005	2004
		(millions)	
Depreciation of Property, Plant and Equipment			
AOL	$ (503)	$ (548)	$ (652)
Cable	(1,883)	(1,465)	(1,329)
Filmed Entertainment	(139)	(121)	(104)
Networks	(286)	(238)	(212)

	2006	2005	2004
Publishing	(115)	(125)	(116)
Corporate	(48)	(44)	(43)
Total depreciation of property, plant and equipment	$ (2,974)	$ (2,541)	$ (2,456)

	Years Ended December 31,		
	2006	2005	2004
	(millions)		
Amortization of Intangible Assets			
AOL	$ (144)	$(174)	$(176)
Cable	(167)	(72)	(72)
Filmed Entertainment	(213)	(225)	(213)
Networks	(17)	(23)	(21)
Publishing	(64)	(93)	(133)
Total amortization of intangible assets	$ (605)	$(587)	$(615)

	Years Ended December 31,		
	2006	2005	2004
	(millions)		
Operating Income			
AOL[a]	$ 1,923	$ 1,123	$ 819
Cable	2,179	1,786	1,554
Filmed Entertainment[b]	784	885	1,087
Networks[c]	2,723	2,679	2,418
Publishing[d]	911	903	825
Corporate[e]	(1,144)	(3,383)	(1,172)
Intersegment elimination	(14)	(9)	(29)
Total operating income	$ 7,362	$ 3,984	$ 5,502

(a) For the year ended December 31, 2006, includes a $769 million gain on the sales of AOL's French and U.K. access businesses, a $2 million gain from the resolution of a previously contingent gain related to the 2004 sale of NSS and $13 million of noncash impairments. For the year ended December 31, 2005, includes a $24 million noncash impairment charge related to goodwill associated with AOLA, an approximate $5 million gain related to the sale of a building and a $5 million gain from the resolution of a previously contingent gain related to the 2004 sale of NSS. For the year ended December 31, 2004, includes a $10 million impairment charge related to a building that was held for sale, a gain of $13 million related to the sale of AOL Japan and a $7 million gain related to the sale of NSS.

(b) For the year ended December 31, 2005, includes a $5 million gain related to the sale of a property in California.

(c) For the year ended December 31, 2006, includes a $200 million noncash goodwill impairment charge related to The WB Network. For the year ended December 31, 2004, includes an approximate $7 million loss related to the sale of the winter sports teams.

(d) For the year ended December 31, 2006, includes a $5 million gain on the sale of a non-strategic magazine title. For the year ended December 31, 2005, includes an $8 million gain related to the collection of a loan made in conjunction with the Company's 2003 sale of Time Life, which was

previously fully reserved due to concerns about recoverability. For the year ended December 31, 2004, includes an $8 million gain related to the sale of a building.

(e) For the year ended December 31, 2006, includes $650 million in legal reserves related to securities litigation and government investigations, $55 million in net expenses related to securities litigation and the government investigations and a $20 million gain on the sale of two aircraft. For the year ended December 31, 2005, includes $3 billion in legal reserves related to securities litigation and $135 million in net recoveries related to securities litigation and government investigations. For year ended December 31, 2004, includes $510 million in legal reserves related to the government investigations and $26 million in net expenses related to securities litigation and the government investigations. For the year ended December 31, 2004, includes $53 million of costs associated with the relocation from the Company's former corporate headquarters. For the year ended December 31, 2005, the Company reversed approximately $4 million of this charge, which was no longer required due to changes in estimates.

	Years Ended December 31,	
	2006	2005
	(millions)	
Assets		
AOL	$ 5,762	$ 5,872
Cable	55,736	43,677
Filmed Entertainment	18,354	17,796
Networks	34,952	34,390
Publishing	14,900	14,740
Corporate	1,965	6,269
Total assets	$ 131,669	$ 122,744

	Years Ended December 31,		
	2006	2005	2004
		(millions)	
Capital Expenditures and Product Development Costs			
AOL	$ 387	$ 417	$ 417
Cable	2,718	1,837	1,559
Filmed Entertainment	168	184	178
Networks	335	343	320
Publishing	468	298	229
Corporate	9	23	165
tal capital expenditures and product development costs	$ 4,085	$ 3,102	$ 2,868

Because a substantial portion of international revenues are derived from the sale of U.S. copyrighted products abroad, assets located outside the United States, which represent approximately 8% of total assets, are not material. Revenues in different geographical areas are as follows:

Years Ended December 31,		
2006	2005	2004
	(millions)	

Revenues[a]			
United States	$ 35,604	$ 33,335	$ 32,590
United Kingdom	2,606	2,807	2,432
Germany	1,169	1,233	1,159
France	834	941	878
Canada	610	609	490
Japan	507	590	684
Other international	2,894	2,886	2,760
Total revenues	$ 44,224	$ 42,401	$ 40,993

(a) Revenues are attributed to countries based on location of customer.

UNITED TECHNOLOGIES

The following note also provides helpful information about each segment's operations and three years' results.

[Note 15] Segment Financial Data

Our operations are classified in six principal segments. Our UTC Fire & Security segment was created in the second quarter of 2005 upon the acquisition of Kidde and includes our former Chubb segment and the acquired Kidde business, excluding the aircraft fire protection systems business, which is included in the Hamilton Sundstrand segment. The segments are generally determined based on the management of the businesses and on the basis of separate groups of operating companies, each with general operating autonomy over diversified products and services.

OTIS products include elevators, escalators, moving walkways and service sold to customers in the commercial and residential property industries around the world.

CARRIER products include residential, commercial and industrial heating, ventilating, air conditioning and refrigeration systems and equipment, food service equipment, building automation and controls, HVAC and refrigeration components and installation, retrofit and aftermarket services.

UTC FIRE & SECURITY products include fire and special hazard and suppression systems and fire fighting equipment, electronic security, monitoring and rapid response systems and service and security personnel for a diversified international customer base principally in the industrial, commercial and residential property sectors.

PRATT & WHITNEY products include commercial, general aviation and military aircraft engines, parts and service, industrial gas turbines and space propulsion sold to a diversified customer base, including international and domestic commercial airlines and aircraft leasing companies, aircraft manufacturers, and U.S. and foreign governments. Pratt & Whitney also provides product support and a full range of overhaul, repair and fleet management services and produces land-based power generation equipment.

HAMILTON SUNDSTRAND provides aerospace and industrial products and aftermarket services for diversified industries worldwide. Aerospace products include power generation, management and distribution systems, flight systems, engine control systems, environmental control systems, fire protection and detection systems, auxiliary power units and propeller systems. Industrial products include air compressors, metering pumps and fluid handling equipment.

SIKORSKY products include military and commercial helicopters, aftermarket helicopter and aircraft parts and services.

Segment information for the years ended December 31 is as follows:

	Total Revenues	Operating Profits

(in millions of dollars)	2006	2005	2004	2006	2005	2004
Otis	**$10,290**	$ 9,575	$ 8,937	**$1,888**	$1,712	$1,413
Carrier	**13,481**	12,512	10,620	**1,237**	1,104	830
UTC Fire & Security	**4,747**	4,250	2,879	**301**	235	130
Pratt & Whitney	**11,112**	9,295	8,281	**1,817**	1,449	1,083
Hamilton Sundstrand	**4,995**	4,382	3,921	**832**	675	583
Sikorsky	**3,230**	2,802	2,506	**173**	250	200
Total segment	**47,855**	42,816	37,144	**6,248**	5,425	4,239
Eliminations & Other	**(26)**	(91)	301	**187**	81	368
General corporate expenses	**—**	—	—	**(337)**	(324)	(306)
Consolidated	**$47,829**	$42,725	$37,445	**$6,098**	$5,182	$4,301

	Total Assets			Capital Expenditures			Depreciation & Amortization		
(in millions of dollars)	2006	2005	2004	2006	2005	2004	2006	2005	2004
Otis	**$ 6,973**	$ 6,094	$ 5,939	**$ 93**	$ 79	$ 79	**$ 183**	$165	$175
Carrier	**10,127**	9,433	9,166	**148**	243	176	**157**	169	200
UTC Fire & Security	**8,518**	7,595	4,974	**106**	79	69	**176**	150	95
Pratt & Whitney	**9,828**	9,515	7,514	**335**	303	244	**280**	255	273
Hamilton Sundstrand	**9,418**	8,986	7,473	**142**	137	134	**142**	149	129
Sikorsky	**3,145**	2,592	1,965	**66**	49	46	**47**	42	42
Total segment	**48,009**	44,215	37,031	**890**	890	748	**985**	930	914
Eliminations & Other	**(868)**	1,710	3,410	**64**	39	47	**48**	54	64
Consolidated	**$47,141**	$45,925	$40,441	**$ 954**	$ 929	$ 795	**$1,033**	$984	$978

SEGMENT REVENUES AND OPERATING PROFIT. Total revenues by segment include intersegment sales, which are generally made at prices approximating those that the selling entity is able to obtain on external sales.

Geographic Areas

	External Revenues			Operating Profits			Long-Lived Assets		
(in millions of dollars)	2006	2005	2004	2006	2005	2004	2006	2005	2004
United States operations	**$23,524**	$20,505	$18,512	**$3,067**	$2,498	$1,972	**$2,939**	$2,882	$2,540
International operations									
Europe	**12,069**	11,255	9,389	**1,731**	1,457	1,167	**1,130**	1,020	1,036
Asia Pacific	**7,056**	6,525	5,717	**814**	968	781	**717**	733	758
Other	**4,809**	4,137	3,288	**637**	502	401	**698**	646	558
Eliminations & Other	**371**	303	539	**(151)**	(243)	(20)	**241**	342	339
Consolidated	**$47,829**	$42,725	$37,445	**$6,098**	$5,182	$4,301	**$5,725**	$5,623	$5,231

GEOGRAPHIC EXTERNAL REVENUES AND OPERATING PROFIT. Geographic external revenues and operating profits are attributed to the geographic regions based on their location of origin. United States external revenues include export sales to commercial customers outside the U.S. and sales to the U.S. government, commercial and affiliated customers, which are known to be for resale to customers outside the U.S.

Revenues from United States operations include export sales as follows:

(in millions of dollars)	2006	2005	2004
Europe	**$1,448**	$1,273	$1,126
Asia Pacific	**1,629**	1,480	1,309

Other	1,771	1,371	1,128
	$4,848	$4,124	$3,563

GEOGRAPHIC LONG-LIVED ASSETS. Long-lived assets are net fixed assets attributed to the specific geographic regions.

MAJOR CUSTOMERS. Revenues include sales under prime contracts and subcontracts to the U.S. government, primarily related to Pratt & Whitney, Hamilton Sundstrand and Sikorsky products, as follows:

(in millions of dollars)	2006	2005	2004
Pratt & Whitney	**$3,652**	$3,278	$2,990
Hamilton Sundstrand	**934**	868	761
Sikorsky	**1,819**	1,546	1,692
Other	**40**	60	62
	$6,445	$5,752	$5,505

Staff Accounting Bulletin No. 108

In September 2006, the SEC released Staff Accounting Bulletin 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements http://www.sec.gov/interps/account/sab108.pdf, requiring a registrant to quantify the effects of a misstatement on the balance sheet and income statement and disclosures, when evaluating the materiality of the error.

COSTCO WHOLESALE

Costco adopted Staff Accounting Bulletin 108 early, adjusting retained earnings for a series of items deemed immaterial, including an adjustment related to previous stock option grants.

Note 11—Staff Accounting Bulletin No. 108

As discussed under Recent Accounting Pronouncements in Note 1, in September 2006, the SEC released SAB 108. The transition provisions of SAB 108 permit the Company to adjust for the cumulative effect on retained earnings of immaterial errors relating to prior years. SAB 108 also requires the adjustment of any prior quarterly financial statements within the fiscal year of adoption for the effects of such errors on the quarters when the information is next presented. Such adjustments do not require previously filed reports with the SEC to be amended. Effective the beginning of the fiscal year ended September 3, 2006, the Company elected to early-adopt SAB 108. In accordance with SAB 108, the Company has adjusted beginning retained earnings for fiscal 2006 in the accompanying consolidated financial statements for the items described below. The Company considers these adjustments to be immaterial to prior periods.

Review of Stock Option Grant Practices

Following publicity regarding the granting of stock options, the Company initiated an internal review of its historical stock option grant practices to determine whether the stated grant dates of options were supported by the Company's books and records. As a result of this preliminary review, a special committee of independent directors was formed. The Company filed a Form 8-K dated October 12, 2006, which provides details regarding the special committee's review. The special committee engaged independent counsel and forensics experts, and comprehensively reviewed all equity grants made during the years 1996 through 2005. In late September 2006, the special committee reported its conclusions and recommendations to the board of directors, which, after further review, adopted these conclusions and recommendations. The review identified no evidence of fraud, falsification of records, concealment of actions or documentation, or intentional deviation from generally accepted accounting principles. The review indicated that, in several instances, it was impossible to determine with precision the appropriate measurement date for

specific grants. For these grants it was feasible only to identify a range of dates that included the appropriate measurement dates, where some dates in the range were after the recorded grant date.

The subject grants were made to over one thousand of the Company's employees, including, among others, the Company's warehouse managers and buyers. None of the options in which the review identified imprecision in the grant process were issued to the Company's chief executive officer, chairman, or non-employee directors, except in April 1997 both the chief executive officer and the chairman received, as part of a broad grant to hundreds of employees, one grant subject to imprecision that may have benefited each by up to approximately $200. Other grants subject to imprecision were made to a director who serves as executive vice president and chief financial officer and to a director who had no role in the determination of any grant date, but who serves as senior executive vice president and chief operating officer.

Given the lack of historical documentation, it was not possible to precisely determine the amount of the adjustments that should be made. Based on the recommendation of the special committee, which was based on the documentation that was available, the Company has recorded an adjustment to transfer $116,157 from retained earnings to paid-in capital, representing previously unrecorded after-tax compensation expense, and to increase the deferred tax asset account by $31,480. In those cases where the committee was unable to identify the likely grant date of the options, the latest date on which the decision could have been made was used. The Company also recorded $1,701 for the estimated federal income tax consequences stemming from the probable disallowance of compensation deductions claimed related to the subject option grants. The Company has informed the SEC of the special committee's investigation and conclusions and will cooperate fully in the event of any inquiry.

The special committee and management do not believe that the net effects of this adjustment were material, either quantitatively or qualitatively, in any of the years covered by the review. In reaching that determination, the following quantitative measures were considered:

Year	Net after-tax effect of adjustment	Reported net income(1)	Percent of reported net income
2005	$ 3,954	$1,063,092	0.37%
2004	6,430	882,393	0.73%
2003	9,092	721,000	1.26%
2002	14,872	699,983	2.12%
1996-2001	81,809	2,769,678	2.95%
Total	$ 116,157	$6,136,146	1.89%

(1) Excludes cumulative effect of accounting change related to membership fees of $118,023 (net of tax), reported in fiscal 1999.

Accounting for Reinsurance Agreements

The Company adjusted its beginning retained earnings for fiscal 2006 related to a correction in the historical accounting treatment of certain finite risk arrangements. Because of the limited amount of risk transfer included in the agreements, historical premium payments should have been accounted for as a deposit asset rather than expensed over the policy term.

Deferred Tax Liability Adjustment

The Company also adjusted its beginning retained earnings for fiscal 2006 for a historical misstatement in deferred taxes related to unreconciled differences in the detailed records supporting the deferred tax liability for depreciation of property and equipment. These differences had accumulated over a period of several years. This resulted in an overstatement of the tax basis and a corresponding understatement of the Company's net deferred tax liability.

Impact of Adjustments

The impact of each of the items noted above, net of tax, on fiscal 2006 beginning balances are presented below:

	Cumulative Effect as of August 29, 2005				
	Stock option grant practices	Income tax reserve for excess compensation	Deposit accounting	Deferred taxes	Total
Deferred income taxes and other current assets	$ —	$ —	$ 16,427	$ —	$ 16,427
Other current liabilities	—	(1,701)	—	—	(1,701)
Deferred income taxes and other liabilities	31,480	—	(6,383)	(31,667)	(6,570)
Additional paid-in-capital	(147,637)	—	—	—	(147,637)
Retained earnings	116,157	1,701	(10,044)	31,667	139,481
Total	$ —	$ —	$ —	$ —	$ —

As discussed under Recent Accounting Pronouncements in Note 1, in September 2006, the SEC released SAB 108. The transition provisions of SAB 108 permit the Company to adjust for the cumulative effect on retained earnings of immaterial errors relating to prior years. SAB 108 also requires the adjustment of any prior quarterly financial statements within the fiscal year of adoption for the effects of such errors on the quarters when the information is next presented. Such adjustments do not require previously filed reports with the SEC to be amended. Effective the beginning of the fiscal year ended September 3, 2006, the Company elected to early-adopt SAB 108. In accordance with SAB 108, the Company has adjusted beginning retained earnings for fiscal 2006 in the accompanying consolidated financial statements for the items described below. The Company considers these adjustments to be immaterial to prior periods.

Review of Stock Option Grant Practices

Following publicity regarding the granting of stock options, the Company initiated an internal review of its historical stock option grant practices to determine whether the stated grant dates of options were supported by the Company's books and records. As a result of this preliminary review, a special committee of independent directors was formed. The Company filed a Form 8-K dated October 12, 2006, which provides details regarding the special committee's review. The special committee engaged independent counsel and forensics experts, and comprehensively reviewed all equity grants made during the years 1996 through 2005. In late September 2006, the special committee reported its conclusions and recommendations to the board of directors, which, after further review, adopted these conclusions and recommendations. The review identified no evidence of fraud, falsification of records, concealment of actions or documentation, or intentional deviation from generally accepted accounting principles. The review indicated that, in several instances, it was impossible to determine with precision the appropriate measurement date for specific grants. For these grants it was feasible only to identify a range of dates that included the appropriate measurement dates, where some dates in the range were after the recorded grant date.

The subject grants were made to over one thousand of the Company's employees, including, among others, the Company's warehouse managers and buyers. None of the options in which the review identified imprecision in the grant process were issued to the Company's chief executive officer, chairman, or non-employee directors, except in April 1997 both the chief executive officer and the chairman received, as part of a broad grant to hundreds of employees, one grant subject to imprecision that may have benefited each by up to approximately $200. Other grants subject to imprecision were made to a director who serves as executive vice president and chief financial officer and to a director who had no role in the determination of any grant date, but who serves as senior executive vice president and chief operating officer.

Given the lack of historical documentation, it was not possible to precisely determine the amount of the adjustments that should be made. Based on the recommendation of the special committee, which was based on the documentation that was available, the Company has recorded an adjustment to transfer $116,157 from retained earnings to paid-in capital, representing previously unrecorded after-tax compensation expense, and to increase the deferred tax asset account by $31,480. In those cases where the committee was unable to identify the likely grant date of the options, the latest date on which the decision could have been made was used. The Company also recorded $1,701 for the estimated federal income tax consequences stemming from the probable disallowance of compensation deductions claimed related to the subject option grants. The Company has informed the SEC of the special committee's investigation and conclusions and will cooperate fully in the event of any inquiry.

The special committee and management do not believe that the net effects of this adjustment were material, either quantitatively or qualitatively, in any of the years covered by the review. In reaching that determination, the following quantitative measures were considered:

Year	Net after-tax effect of adjustment	Reported net income(1)	Percent of reported net income
2005	$ 3,954	$1,063,092	0.37%
2004	6,430	882,393	0.73%
2003	9,092	721,000	1.26%
2002	14,872	699,983	2.12%
1996-2001	81,809	2,769,678	2.95%
Total	$ 116,157	$6,136,146	1.89%

(1) Excludes cumulative effect of accounting change related to membership fees of $118,023 (net of tax), reported in fiscal 1999.

Accounting for Reinsurance Agreements

The Company adjusted its beginning retained earnings for fiscal 2006 related to a correction in the historical accounting treatment of certain finite risk arrangements. Because of the limited amount of risk transfer included in the agreements, historical premium payments should have been accounted for as a deposit asset rather than expensed over the policy term.

Deferred Tax Liability Adjustment

The Company also adjusted its beginning retained earnings for fiscal 2006 for a historical misstatement in deferred taxes related to unreconciled differences in the detailed records supporting the deferred tax liability for depreciation of property and equipment. These differences had accumulated over a period of several years. This resulted in an overstatement of the tax basis and a corresponding understatement of the Company's net deferred tax liability.

Impact of Adjustments

The impact of each of the items noted above, net of tax, on fiscal 2006 beginning balances are presented below:

	Cumulative Effect as of August 29, 2005				
	Stock option grant practices	Income tax reserve for excess compensation	Deposit accounting	Deferred taxes	Total
Deferred income taxes and other current assets	$ —	$ —	$ 16,427	$ —	$ 16,427

Other current liabilities	—	(1,701)	—	—	(1,701)
Deferred income taxes and other liabilities	31,480	—	(6,383)	(31,667)	(6,570)
Additional paid-in-capital	(147,637)	—	—	—	(147,637)
Retained earnings	116,157	1,701	(10,044)	31,667	139,481
Total	$ —	$ —	$ —	$ —	$ —

SPRINT NEXTEL

The following note describes adjustments made in connection with the Company's adoption of Staff Accounting Bulletin No. 108.

Note 17. Adoption of Staff Accounting Bulletin No. 108

Effective January 1, 2006, we adopted SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.* SAB No. 108 requires a dual approach for quantifying misstatements using both a method that quantifies a misstatement based on the amount of misstatement originating in the current year statement of operations, as well as a method that quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet. Prior to the adoption of SAB No. 108, we quantified any misstatements in our consolidated financial statements using the statement of operations method in addition to evaluating qualitative characteristics. As this method focuses solely on the statement of operations, this can lead to the accumulation of misstatements in the balance sheet that may become material if recorded in a particular period.

In the fourth quarter 2006, we discovered lease accounting misstatements during the process of migrating more than 30,000 leases into a single lease accounting system. During this process, we identified that we previously were not accurately calculating the straight-line impact of operating lease expense nor were we accurately following the definition of a lease term for a minor number of leases. Specifically, certain rent escalation clauses were not included in the minimum lease payment streams for certain leases and the lease term for certain leases did not include all reasonably assured renewal periods.

These misstatements accumulated over several years and were immaterial when quantifying the misstatements using the statement of operations method. Upon adoption of SAB No. 108 on January 1, 2006, we recorded an $81 million increase to the deferred rent liability for the cumulative misstatements as of December 31, 2005. Accordingly, we reduced retained earnings by $50 million and recorded $31 million as a deferred tax asset. The related 2006 misstatement of $17 million, or $10 million net of tax, was recorded in the fourth quarter 2006.

WACHOVIA

The following note from the Company's Summary of Significant Accounting Policies describes the adoption of Staff Accounting Bulletin No. 108, and the associated adjustments.

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements", ("SAB 108"). SAB 108 requires the use of both an income statement approach and a balance sheet approach when evaluating whether an error is material to an entity's financial statements, based on all relevant quantitative and qualitative factors. The SEC issued SAB 108 to address what the SEC identified as diversity in practice whereby entities were using either an income statement approach or a balance sheet approach, but not both. The Company consistently used an income statement approach in prior periods. SAB

108 became effective December 31, 2006, and any material adjustments arising from the adoption of SAB 108 were required to be recorded as a cumulative effect adjustment to beginning retained earnings.

In the fourth quarter of 2006, the Company completed its analysis in accordance with SAB 108 using both the income statement approach and the balance sheet approach and concluded the Company had no prior year misstatements that were material to its consolidated financial statements. However, in the process of performing the above analysis, the Company elected to record certain adjustments that were not significant on an individual or aggregate basis to a number of income statement line items.

The Company recorded adjustments to net interest income and service charges to reflect certain items that in the past had been recorded either when billed to the customer or on a lagged basis, but going forward will be recorded as earned. The Company recorded additional salaries and employee benefits expense to reflect the carryover of prior year's unused paid time off and additional sundry expense relating to prior year's invoices received and processed after year-end, but for which the services had been rendered prior to year-end. The Company also recorded additional other noninterest income for amounts recorded in other comprehensive income relating to a hedging relationship that had been discontinued in a prior year. In income taxes, the Company recorded the income tax effect of the above-referenced items and certain other adjustments to current income taxes payable. The net after-tax impact of all of these adjustments was a $13 million increase to net income.

Stock compensation

SFAS 123 (Revised 2004) Share-Based Payment (SFAS 123(R)) http://www.fasb.org/pdf/fas123r.pdf took effect for the annual reporting period beginning after December 15, 2005. Accordingly, 2006 was the first year-end where all companies were required to expense the cost of stock option compensation.

ALCOA

Alcoa uses the non-substantive vesting period approach and recently switched from the Black-Scholes pricing model to a lattice model.

A. Summary of Significant Accounting Policies

Stock-Based Compensation. Alcoa recognizes compensation expense for employee equity grants using the non-substantive vesting period approach, in which the expense (net of estimated forfeitures) is recognized ratably over the requisite service period based on the grant date fair value. Determining the fair value of stock options at the grant date requires judgment including estimates for the average risk-free interest rate, expected volatility, expected exercise behavior, expected dividend yield, and expected forfeitures. If any of these assumptions differ significantly from actual, stock-based compensation expense could be impacted. Prior to 2006, Alcoa used the nominal vesting approach related to retirement-eligible employees, in which the compensation expense is recognized ratably over the original vesting period. As part of Alcoa's stock-based compensation plan design, individuals that are retirement-eligible have a six-month requisite service period in the year of grant. Equity grants are issued in early January each year. As a result, a larger portion of expense will be recognized in the first and second quarters of each year for these retirement-eligible employees. Compensation expense recorded in 2006 was $72 ($48 after-tax). Of this amount, $20 pertains to the acceleration of expense related to retirement-eligible employees.

As of January 1, 2005, Alcoa switched from the Black-Scholes pricing model to a lattice model to estimate fair value at the grant date for future option grants. On December 31, 2005, Alcoa accelerated the vesting of 11 million unvested stock options granted to employees in 2004 and on January 13, 2005. The 2004 and 2005 accelerated options had weighted average exercise prices of $35.60 and $29.54, respectively, and in the aggregate represented approximately 12% of Alcoa's total outstanding options. The decision to accelerate the vesting of the 2004 and 2005 options was made primarily to avoid recognizing the related compensation expense in future financial statements upon the adoption of a new accounting standard. The accelerated vesting of

the 2004 and 2005 stock options reduced Alcoa's after-tax stock option compensation expense in 2006 by $21. In 2007, it is estimated that the accelerated vesting will reduce after-tax stock option compensation expense by $7.

An additional change has been made to the stock-based compensation program for 2006 grants. Plan participants can choose whether to receive their award in the form of stock options, restricted stock units (stock awards), or a combination of both. This choice is made before the grant is issued and is irrevocable. This choice resulted in an increased stock award expense in comparison to 2005.

AMERISOURCEBERGEN

AmerisourceBergen adopted SFAS 123R at the beginning of the year.

Note 1. Summary of Significant Accounting Policies

Recently Issued Financial Accounting Standards

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," which requires companies to measure compensation cost for all share-based payments at fair value for interim or annual periods beginning after June 15, 2005. As a result, the Company adopted SFAS No. 123R, using the modified-prospective transition method, beginning on October 1, 2005 and, therefore, began to expense the fair value of all outstanding options over their remaining vesting periods to the extent the options were not fully vested as of the adoption date and began to expense the fair value of all share-based compensation awards granted subsequent to September 30, 2005 over their requisite service periods (see Note 9 for further details). SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow ($21.9 million for the fiscal year ended September 30, 2006), rather than an operating cash flow as previously required. In accordance with SEC Staff Accounting Bulletin ("SAB") No. 107, the Company classified share-based compensation within distribution, selling and administrative expenses to correspond with the same line item as the cash compensation paid to employees.

Note 9. Share-Based Compensation

The Company has a number of stock option plans, a restricted stock plan and an employee stock purchase plan. In accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," the Company previously accounted for its stock option and employee stock purchase plans using the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB No. 25") and related interpretations through September 30, 2005. Under APB No. 25, because the exercise price of the Company's stock options equaled the market price of the underlying stock on the date of the grant, no compensation expense was recognized. As previously noted, the Company adopted SFAS No. 123R, using the modified-prospective transition method, beginning on October 1, 2005 and, therefore, began to expense the fair value of all options over their remaining vesting periods to the extent the options were not fully vested as of the adoption date and began to expense the fair value of all share-based compensation awards granted subsequent to September 30, 2005 over their requisite service periods.

During the fiscal year ended September 30, 2006, the Company recorded $16.4 million of share-based compensation expense, which was comprised of stock option expense of $12.2 million, restricted stock expense of $2.8 million, and employee stock purchase plan expense of $1.4 million.

The following table illustrates the impact of share-based compensation on reported amounts:

	Fiscal year ended September 30, 2006	
(in thousands, except per share data)	As	Impact of

	Reported	Share-Based Compensation Expense
Operating income	$ 748,706	$ 16,412
Income from continuing operations	468,012	10,372
Net income	467,714	10,372
Earnings per share:		
Basic	$ 2.28	$ 0.05
Diluted	$ 2.25	$ 0.05

Stock Option Plans

The Company's employee stock option plans provide for the granting of incentive and nonqualified stock options to acquire shares of Common Stock to employees at a price not less than the fair market value of the Common Stock on the date the option is granted. Option terms and vesting periods are determined at the date of grant by a committee of the board of directors. Employee options generally vest ratably, in equal amounts, over a four-year service period and expire in ten years. The Company's non-employee director stock option plans provide for the granting of nonqualified stock options to acquire shares of Common Stock to non-employee directors at the fair market value of the Common Stock on the date of the grant. Non-employee director options vest ratably, in equal amounts, over a three-year service period, and options expire in ten years.

At September 30, 2006, options for an additional 10.4 million shares may be granted under one employee stock option plan and options for an additional 0.3 million shares may be granted under one non-employee director stock option plan.

Effective September 1, 2004, the Company vested all employee options then outstanding with an exercise price in excess of $27.05 (the closing stock price on August 31, 2004). The accelerated vesting was approved by the Compensation and Succession Planning Committee of the Company's board of directors for employee retention purposes and in anticipation of the requirements of SFAS No. 123R. In accordance with APB No. 25, the Company did not incur a charge related to this accelerated vesting because the exercise price of all the accelerated options was greater than $27.05.

The fair values of all option grants are expensed as compensation on a straight-line basis over the requisite service periods of the awards and are net of estimated forfeitures. Beginning January 1, 2005, the Company began to estimate the fair values of option grants using a binomial option pricing model. Expected volatilities are based on the historical volatility of the Company's Common Stock and other factors, such as implied market volatility. The Company uses historical exercise data, taking into consideration the optionees' ages at grant date, to estimate the terms for which the options are expected to be outstanding. The Company anticipates that the terms of options granted in the future will be similar to those granted in the past. The risk-free rates during the terms of such options are based on the U.S. Treasury yield curve in effect at the time of grant. Prior to January 1, 2005, the fair values relating to all options granted were estimated using the Black-Scholes option pricing model.

The weighted average fair values of the options granted during the fiscal years ended September 30, 2006, 2005 and 2004 were $10.56, $8.32 and $10.14, respectively. The following assumptions were used to estimate the fair values of options granted:

	Fiscal year ended September 30,		
	2006	2005	2004
Weighted average risk-free interest rate	4.58%	4.10%	2.74%
Expected dividend yield	0.23%	0.17%	0.14%
Weighted average volatility of common stock	25.73%	27.98%	35.68%
Weighted average expected life of the options	4.17 years	4.51 years	5.00 years

Changes to the above valuation assumptions could have a significant impact on share-based compensation expense.

A summary of the Company's stock option activity and related information for its option plans for the fiscal year ended September 30, 2006 is presented below:

	Options (000's)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (000's)
Outstanding at September 30, 2005	16,123	$ 29		
Granted	2,506	43		
Exercised	(4,076)	28		
Forfeited	(296)	34		
Outstanding at September 30, 2006	14,257	$ 32	7 years	$ 189,761
Vested and expected to vest at September 30, 2006	13,577	$ 32	7 years	$ 184,247
Exercisable at September 30, 2006	8,882	$ 29	6 years	$ 143,450

The intrinsic value of stock option exercises during fiscal 2006, 2005 and 2004 was $59.5 million, $39.5 million and $11.0 million, respectively.

A summary of the status of the Company's nonvested options as of September 30, 2006 and changes during the fiscal year ended September 30, 2006 is presented below:

	Options (000's)	Weighted Average Grant Date Fair Value
Nonvested at September 30, 2005	4,200	$ 8
Granted	2,506	11
Vested	(1,117)	8
Forfeited	(214)	9
Nonvested at September 30, 2006	5,375	$ 9

Expected future compensation expense relating to the 5.4 million nonvested options outstanding as of September 30, 2006 is $36.3 million over a weighted-average period of 2.8 years.

Restricted Stock Plan

Restricted shares generally vest in full after three years. The fair value of restricted shares under the Company's restricted stock plans is determined by the product of the number of shares granted and the grant date market price of the Company's Common Stock. The fair value of restricted shares are expensed on a straight-line basis over the requisite service period of three years.

A summary of the status of the Company's restricted shares as of September 30, 2006 and changes during the fiscal year ended September 30, 2006 is presented below:

	Restricted Shares (000's)	Weighted Average Grant Date Fair Value

Nonvested at September 30, 2005	58	$ 30
Granted	289	43
Vested	(27)	29
Forfeited	(10)	43
Nonvested at September 30, 2006	310	$ 42

Expected future compensation expense relating to the 0.3 million restricted shares outstanding as of September 30, 2006 is $8.6 million over a weighted-average period of 2.1 years.

Employee Stock Purchase Plan

In February 2002, the stockholders approved the adoption of the AmerisourceBergen 2002 Employee Stock Purchase Plan, under which up to an aggregate of 8,000,000 shares of Common Stock may be sold to eligible employees (generally defined as employees with at least 30 days of service with the Company). Under this plan, the participants may elect to have the Company withhold up to 25% of base salary to purchase shares of the Company's Common Stock at a price equal to 85% of the fair market value of the stock on the first or last business day of each six-month purchase period, whichever is lower. Each participant is limited to $25,000 of purchases during each calendar year. During the fiscal years ended September 30, 2006, 2005 and 2004, the Company acquired 164,055 shares, 208,618 shares and 230,562 shares, respectively, from the open market for issuance to participants in this plan. As of September 30, 2006, the Company has withheld $1.5 million from eligible employees for the purchase of additional shares of Common Stock.

Pro Forma Disclosure

For purposes of pro forma disclosures, the estimated fair value of the stock options, restricted shares, and shares under the employee stock purchase plan were amortized to expense over their assumed vesting periods. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, to all stock-related compensation.

	Fiscal year ended September 30,	
(in thousands, except per share data)	**2005**	**2004**
Net income, as reported	$264,645	$468,390
Add: Share-related compensation expense included in reported net income, net of income taxes	461	880
Deduct: Share-related compensation expense determined under the fair value method, net of income taxes	(5,021)	(87,339)
Pro forma net income	$260,085	$381,931
Earnings per share:		
Basic, as reported	$ 1.25	$ 2.10
Basic, pro forma	$ 1.23	$ 1.71
Diluted, as reported	$ 1.24	$ 2.03
Diluted, pro forma	$ 1.22	$ 1.66

The SFAS No. 123 share-related compensation expense in the above table decreased in the fiscal year ended September 30, 2005 compared to the fiscal year ended September 30, 2004. This decline was primarily due to the Company, effective September 1, 2004, vesting all employee options then outstanding with an exercise price in excess of $27.05 (the closing stock price on August 31, 2004). As a result of the accelerated vesting, the pro forma compensation expense and the corresponding reduction in diluted earnings per share in fiscal 2004 was significantly greater than the pro forma compensation expense and the corresponding reduction in diluted earnings per share in fiscal 2005.

LOCKHEED-MARTIN

Lockheed-Martin also adopted SFAS 123R in 2006.

Note 11 – Stock-Based Compensation

Effective January 1, 2006, we adopted FAS 123(R), Share-Based Payments, and the related SEC rules included in Staff Accounting Bulletin No. 107, on a modified prospective basis. During the year ended December 31, 2006, we recorded non-cash compensation cost related to stock options and restricted stock totaling $111 million, which is included in our statement of earnings in cost of sales. The net impact to earnings for the year was $70 million ($0.16 per share). Compensation cost related to restricted stock in prior periods was not material. The above amounts approximate the incremental impact of adopting FAS 123(R) as compared to the application of the original provisions of FAS 123.

Stock-Based Compensations Plans

We had two stock-based compensation plans in place at December 31, 2006: the Lockheed Martin Amended and Restated 2003 Incentive Performance Award Plan (the Award Plan) and the Lockheed Martin Directors Equity Plan (the Directors Plan). Under the Award Plan, we have the right to grant key employees stock-based incentive awards, including options to purchase common stock, stock appreciation rights, restricted stock or stock units. Employees also may receive cash-based incentive awards. We evaluate the types and mix of stock-based incentive awards on an ongoing basis and may vary the mix based on our overall strategy regarding compensation.

Under the Award Plan, the exercise price of options to purchase common stock may not be less than 100% of the market value of our stock on the date of grant. No award of stock options may become fully vested prior to the second anniversary of the grant, and no portion of a stock option grant may become vested in less than one year (except for 1.5 million stock options that are specifically exempted from vesting restrictions). The minimum vesting period for restricted stock or stock units payable in stock is three years. Award agreements may provide for shorter vesting periods or vesting following termination of employment in the case of death, disability, divestiture, retirement, change of control or layoff. The Award Plan does not impose any minimum vesting periods on other types of awards. The maximum term of a stock option or any other award is 10 years.

We generally recognize compensation cost for stock options ratably over the three-year vesting period for active, non-retirement eligible employees and over the initial one-year vesting period for active, retirement eligible employees. We have continued to use the Black-Scholes option pricing model to estimate the fair value of stock options granted after the date of adoption of FAS 123(R). We record RSAs and RSUs issued under the Award Plan based on the market value of our common stock on the date of the award. We recognize the related compensation expense over the vesting period. Employees who earn RSAs receive the restricted shares and the related cash dividends. They may vote their shares, but may not sell or transfer shares prior to vesting. The RSAs generally vest over three to five years from the grant date. Employees who are granted RSUs also receive dividend-equivalent cash payments; however, the shares are not issued until the RSUs vest, generally three years from the date of the award. Otherwise, the accounting treatment for RSUs is similar to the accounting for RSAs.

Under the Directors Plan, directors receive approximately 50% of their annual compensation in the form of equity-based compensation. Each director may elect to receive his or her compensation in the form of stock units which track investment returns to changes in value of our common stock

with dividends reinvested, options to purchase common stock or a combination of the two. Under the Directors Plan, options to purchase common stock have an exercise price of not less than 100% of the market value of the underlying stock on the date of grant. Stock options and stock units issued under the Directors Plan vest on the first anniversary of the grant, except in certain circumstances. The maximum term of a stock option is 10 years.

Our stockholders have approved the Award Plan and the Directors Plan, as well as the number of shares of our common stock authorized for issuance under these plans. At December 31, 2006, we had 42 million shares reserved for issuance under our stock option and award plans, of which 17 million remained available for grant under the plans. We issue new shares upon the exercise of stock options or vesting of RSUs.

2006 Activity

Stock Options

The following table summarizes stock option activity during the year ended December 31, 2006:

	Number of Stock Options *(In thousands)*	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life *(In years)*	Aggregate Intrinsic Value *(In millions)*
Outstanding at December 31, 2005	34,138	$ 47.64		
Granted	3,847	67.83		
Exercised	(13,594)	46.13		
Terminated	(201)	53.95		
Outstanding at December 31, 2006	**24,190**	**51.65**	**6.3**	**$ 977.9**
Vested and unvested expected to vest at December 31, 2006	**24,019**	**51.56**	**6.3**	**973.1**
Exercisable at December 31, 2006	**14,074**	**45.88**	**5.0**	**650.1**

Stock options granted vest over three years and have 10-year terms. Exercise prices of stock options awarded for all periods were equal to the market price of the stock on the date of grant. The weighted-average grant-date fair value of stock options granted during the year ended December 31, 2006 was $17.64. In addition, the aggregate fair value of all the stock options that vested during the year was $103 million, while the aggregate intrinsic value of all of the stock options that were exercised was $389 million.

We estimate the fair value for stock options at the date of grant using the Black-Scholes option pricing model, which requires us to make certain assumptions. We estimate volatility based on the historical volatility of our stock price over the past five years. We base the average expected life on the contractual term of the stock option, historical trends in employee exercise activity and post-vesting employment termination trends. We base the risk-free interest rate on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life assumed at the date of grant. We estimate forfeitures at the date of grant based on historical experience. Prior to adopting FAS 123(R), we recorded forfeitures as they occurred for purposes of estimating pro forma compensation expense under FAS 123. The impact of forfeitures is not material.

We used the following weighted average assumptions in the Black-Scholes option pricing model to determine the fair values of stock-based compensation awards during the years ended December 31, 2006, 2005 and 2004:

	2006	*2005*	*2004*
Risk-free interest rate	**4.50%**	3.70%	3.19%
Dividend yield	**1.80%**	1.73%	1.50%
Volatility factors	**0.260**	0.259	0.365

Expected option life	5 years	5 years	5 years

RSU and RSA Activity

The following table summarizes activity related to nonvested RSUs and RSAs during the year ended December 31, 2006:

	Number of RSUs / RSAs *(In thousands)*	Weighted Average Grant-Date Fair Value Per Share
Nonvested at December 31, 2005	577	$ 46.04
Granted	1,328	68.48
Vested	(59)	52.84
Terminated	(59)	55.61
Nonvested at December 31, 2006	1,787	62.27

As of December 31, 2006, we had $118 million of unrecognized compensation cost related to nonvested stock options, RSUs and RSAs. We expect that cost to be recognized over a weighted-average period of 1.7 years. We received cash from the exercise of stock options totaling $627 million for the year ended December 31, 2006. In addition, we realized a $136 million tax benefit from the exercise of stock options during 2006. Consistent with FAS 123(R), we classified $129 million of this benefit as a financing cash inflow in the statement of cash flows, and the balance was classified as cash from operations. We realized $69 million and $34 million of tax benefits from stock options exercised during the years ended December 31, 2005 and 2004 and presented those tax benefits as cash from operations in their entirety.

2005 and 2004 Reported and Pro Forma Results

Reported and pro forma earnings per share information for the years ended December 31, 2005 and 2004 are as follows. The disclosures for 2005 include $33 million ($0.08 per share) as an inception-to-date adjustment of fair value-based, pro forma compensation expense related to retirement eligible employees with outstanding and unvested stock option awards. This adjustment reflects the service period as one year rather than the original vesting period, since our stock option award agreements allow employees to retain all stock option awards held through the initial one year vesting date prior to retirement and to continue vesting in the award as if their employment had continued.

The weighted average common shares outstanding for both the basic and fully diluted calculations are the same as those used to compute earnings per share (see Note 3).

(In millions, except per share data)	*2005*	*2004*
Net earnings		
As reported	$1,825	$1,266
Fair value-based compensation cost, net of taxes		
Fair value-based, pro forma compensation expense	(56)	(48)
Inception-to-date adjustment	(33)	—
Pro forma net earnings	$1,736	$1,218
Earnings per basic share		
As reported	$ 4.15	$ 2.86
Fair value-based, pro forma compensation expense	(0.12)	(0.11)
Inception-to-date adjustment	(0.08)	—
Pro forma	$ 3.95	$ 2.75
Earnings per diluted share		
As reported	$ 4.10	$ 2.83
Fair value-based, pro forma compensation expense	(0.12)	(0.11)

Inception-to-date adjustment	(0.08)	—
Pro forma	$ 3.90	$ 2.72

Variable interest entities

In December 2003, the FASB revised FIN 46, Consolidation of Variable Interest Entities http://www.fasb.org/pdf/fin%2046R.pdf. FIN 46(R) provides explicit guidance for identifying variable interest entities, and deciding when consolidation is necessary.

CONOCO PHILLIPS

Note 7—Variable Interest Entities (VIEs)

In June 2006, ConocoPhillips acquired a 24 percent interest in West2East Pipeline LLC (West2East), a company holding a 100 percent interest in Rockies Express Pipeline LLC (Rockies Express). Rockies Express plans to construct a 1,633-mile natural gas pipeline from Wyoming to Ohio. West2East is a VIE because a third party other than ConocoPhillips and our partners holds a significant voting interest in the company until project completion. We currently participate in the management committee of West2East as a non-voting member. We are not the primary beneficiary of West2East, and we use the equity method of accounting for our investment. We issued a guarantee for 24 percent of the $2 billion in credit facilities of Rockies Express. At December 31, 2006, we had made no capital investment in West2East. See Note 17—Guarantees, for additional information.

In June 2005, ConocoPhillips and OAO LUKOIL (LUKOIL) created the OOO Naryanmarneftegaz (NMNG) joint venture to develop resources in the Timan-Pechora province of Russia. The NMNG joint venture is a VIE because we and our related party, LUKOIL, have disproportionate interests. We have a 30 percent ownership interest with a 50 percent governance interest in the joint venture. We are not the primary beneficiary of the VIE and we use the equity method of accounting for this investment. At December 31, 2006, the book value of our investment in the venture was $984 million.

Production from the NMNG joint-venture fields is transported via pipeline to LUKOIL's existing terminal at Varandey Bay on the Barents Sea and then shipped via tanker to international markets. LUKOIL intends to complete an expansion of the terminal's oil-throughput capacity from 30,000 barrels per day to 240,000 barrels per day, with ConocoPhillips participating in the design and financing of the expansion. The terminal entity, Varandey Terminal Company, is a VIE because we and our related party, LUKOIL, have disproportionate interests. We have an obligation to fund, through loans, 30 percent of the terminal's costs, but we will have no governance or ownership interest in the terminal. We are not the primary beneficiary and account for our loan to Varandey Terminal Company as a financial asset. We estimate our total loan obligation for the terminal expansion to be approximately $460 million at current exchange rates, including interest to be accrued during construction. This amount will be adjusted as the project's cost estimate and schedule are updated and the ruble exchange rate fluctuates. Through December 31, 2006, we had provided $203 million in loan financing, including accrued interest.

In 2004, we finalized a transaction with Freeport LNG Development, L.P. (Freeport LNG) to participate in a liquefied natural gas (LNG) receiving terminal in Quintana, Texas. We have no ownership in Freeport LNG; however, we obtained a 50 percent interest in Freeport LNG GP, Inc., which serves as the general partner managing the venture. We entered into a credit agreement with Freeport LNG, whereby we will provide loan financing of approximately $630 million for the construction of the terminal. Through December 31, 2006, we had provided $520 million in financing, including accrued interest. Freeport LNG is a VIE, and we are not the primary beneficiary. We account for our loan to Freeport LNG as a financial asset.

In 2003, we entered into two 20-year agreements establishing separate guarantee facilities of $50 million each for two LNG ships then under construction. Subject to the terms of the facilities, we will be required to make payments should the charter revenue generated by the respective ships fall below a certain specified minimum threshold, and we will receive payments to the extent

that such revenues exceed those thresholds. To the extent we receive any such payments, our actual gross payments over the 20 years could exceed $100 million. In September 2003, the first ship was delivered to its owner and in July 2005, the second ship was delivered to its owner. Both agreements represent a VIE, but we are not the primary beneficiary and, therefore, we do not consolidate these entities. The amount drawn under the guarantee facilities at December 31, 2006, was approximately $5 million for both ships. We currently account for these agreements as guarantees and contingent liabilities. See Note 17—Guarantees, for additional information.

In 1997, Phillips 66 Capital II (Trust II) was created for the sole purpose of issuing mandatorily redeemable preferred securities to third-party investors and investing the proceeds thereof in an approximate amount of subordinated debt securities of ConocoPhillips. At December 31, 2006, we reported debt of $361 million of 8% Junior Subordinated Deferrable Interest Debentures due 2037. Trust II is a VIE, but we do not consolidate it in our financial statements because we are not the primary beneficiary. Effective January 15, 2007, we redeemed the 8% Junior Subordinated Deferrable Interest Debentures due 2037 at a premium of $14 million, plus accrued interest. See Note 15—Debt, for additional information about Trust II.

In December 2006, we terminated the lease of certain refining assets which we consolidated due to our designation as the primary beneficiary of the lease entity. As part of the termination, we exercised a purchase option of the assets totaling $111 million and retired the related debt obligations of $104 million 5.847% Notes due 2006. An associated interest rate swap was also liquidated.

Ashford Energy Capital S.A. (Ashford) is consolidated in our financial statements because we are the primary beneficiary. In December 2001, in order to raise funds for general corporate purposes, ConocoPhillips and Cold Spring Finance S.a.r.l. (Cold Spring) formed Ashford through the contribution of a $1 billion ConocoPhillips subsidiary promissory note and $500 million cash. Through its initial $500 million investment, Cold Spring is entitled to a cumulative annual preferred return, based on three-month LIBOR rates, plus 1.32 percent. The preferred return at December 31, 2006, was 6.69 percent. In 2008, and each 10-year anniversary thereafter, Cold Spring may elect to remarket their investment in Ashford, and if unsuccessful, could require ConocoPhillips to provide a letter of credit in support of Cold Spring's investment, or in the event that such letter of credit is not provided, then cause the redemption of their investment in Ashford. Should ConocoPhillips' credit rating fall below investment grade, Ashford would require a letter of credit to support $475 million of the term loans, as of December 31, 2006, made by Ashford to other ConocoPhillips subsidiaries. If the letter of credit is not obtained within 60 days, Cold Spring could cause Ashford to sell the ConocoPhillips subsidiary notes. At December 31, 2006, Ashford held $1.9 billion of ConocoPhillips subsidiary notes and $29 million in investments unrelated to ConocoPhillips. We report Cold Spring's investment as a minority interest because it is not mandatorily redeemable and the entity does not have a specified liquidation date. Other than the obligation to make payment on the subsidiary notes described above, Cold Spring does not have recourse to our general credit.

INTERNATIONAL PAPER

NOTE 4 RECENT ACCOUNTING DEVELOPMENTS

IMPLICIT VARIABLE INTERESTS

In March 2005, the FASB issued FSP FIN 46(R)-5, "Implicit Variable Interests Under FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities." This FSP states that implicit variable interests are implied financial interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interests. An implicit variable interest acts the same as an explicit variable interest except it involves the absorbing and (or) receiving of variability indirectly from the entity (rather than directly). The identification of an implicit variable interest is a matter of judgment that depends on the relevant facts and circumstances. International Paper applied the provisions of FSP FIN 46(R)-5 in the second quarter of 2005, with no material effect on its consolidated financial statements.

NOTE 8 VARIABLE INTEREST ENTITIES AND PREFERRED SECURITIES OF SUBSIDIARIES

VARIABLE INTEREST ENTITIES:

In connection with the 2006 sale of approximately 5.6 million acres of forestlands, International Paper received installment notes (the Timber Notes) totaling approximately $4.8 billion. The Timber Notes,

which do not require principal payments prior to their August 2016 maturity, are supported by irrevocable letters of credit obtained by the buyers of the forestlands. During the 2006 fourth quarter, International Paper contributed the Timber Notes to newly formed entities (the Borrower Entities) in exchange for Class A and Class B interests in these entities. Subsequently, International Paper contributed its Class A interests in the Borrower Entities, along with approximately $400 million of International Paper promissory notes, to other newly formed entities (the Investor Entities) in exchange for Class A and Class B interests in these entities. International Paper then sold its Class A membership interest in the Investor Entities to a third party investor. As a result, at December 31, 2006, International Paper holds Class B interests in the Borrower Entities and Class B interests in the Investor Entities valued at approximately $5.0 billion. International Paper has no obligation to make any further capital contributions to these entities. Based on an analysis of these entities under the provisions of FIN 46(R), International Paper determined that it is not the primary beneficiary of these newly formed entities and therefore its investments should be accounted for under the equity method of accounting.

Also during 2006, the Borrower Entities acquired approximately $4.8 billion of International Paper debt obligations for cash, resulting in a total of approximately $5.2 billion of International Paper debt obligations held by the Borrower and Investor Entities at December 31, 2006. The various agreements entered into in connection with these transactions provide that International Paper has, and International Paper intends to affect, a legal right to offset its obligation under these debt instruments with its investments in the entities. Accordingly for financial reporting purposes, as allowed under the provisions of FASB Interpretation No. 39, International Paper has offset $5.0 billion of Class B interests in the entities against $5.0 billion of International Paper debt obligations held by these entities. The remaining $200 million of debt obligations is included in floating rate notes due 2007 – 2016 in the summary of long-term debt in Note 12.

International Paper also holds variable interests in two financing entities that were used to monetize long-term notes received from the sale of forestlands in 2002 and 2001. International Paper transferred notes and cash having a value of approximately $1.0 billion to these entities in exchange for preferred interests, and accounted for the transfers as a sale of the notes with no associated gain or loss. In the same period, the entities acquired approximately $1.0 billion of International Paper debt obligations for

cash. International Paper has not consolidated the entities because it is not the primary beneficiary of the entities. At December 31, 2006, International Paper's $545 million preferred interest in one of the entities has been offset against related debt obligations since International Paper has, and intends to affect, a legal right of offset to net-settle these two amounts. The remaining $455 million of debt obligations are included in floating rate notes due 2007 – 2016 in the summary of long-term debt in Note 12.

PREFERRED SECURITIES OF SUBSIDIARIES:

In March 2003, Southeast Timber, Inc. (Southeast Timber), a consolidated subsidiary of International Paper, issued $150 million of preferred securities to a private investor with future dividend payments based on LIBOR. Southeast Timber, which through a subsidiary initially held approximately 1.5 million acres of forestlands in the southern United States, was International Paper's primary vehicle for sales of southern forestlands. As of December 31, 2006, substantially all of these forestlands have been sold. These preferred securities may be put back to International Paper by the private investor upon the occurrence of certain events, and have a liquidation preference that approximates their face amount. The $150 million preferred third-party interest is included in Minority interest in the accompanying consolidated balance sheet. Distributions paid to the third-party investor were $13 million, $10 million and $7 million in 2006, 2005 and 2004, respectively. The expense related to these preferred securities is shown in Minority interest expense in the accompanying consolidated statement of operations.

Prior to 2006, the agreement with the private investor placed certain limitations on International Paper's ability to sell forestlands in the southern United States. In 2006, the proceeds generated by International Paper's sales of forestlands resulted in the elimination of any limitations on future forestland sales.

LEHMAN BROTHERS

Note 3 Securitizations and Other Off-Balance-Sheet Arrangements

We are a market leader in mortgage- and asset-backed securitizations and other structured financing arrangements. In connection with our securitization activities, we use SPEs primarily for the securitization of commercial and residential mortgages, home equity loans, municipal and corporate bonds, and lease and trade receivables. The majority of our involvement with SPEs relates to securitization transactions where the SPE meets the SFAS 140 definition of a QSPE. Based on the guidance in SFAS 140, we do not consolidate QSPEs. We derecognize financial assets transferred in securitizations, provided we have relinquished control over such assets. We may continue to hold an interest in the financial assets we securitize ("interests in securitizations"), which may include assets in the form of residual interests in the SPEs established to facilitate the securitization. Interests in securitizations are included in Financial instruments and other inventory positions owned (primarily mortgages and mortgage-backed) in the Consolidated Statement of Financial Condition. For further information regarding the accounting for securitization transactions, refer to Note 1, "Summary of Significant Accounting Policies—Consolidation Accounting Policies."

During 2006 and 2005, we securitized approximately $168 billion and $152 billion of financial assets, including approximately $146 billion and $133 billion of residential mortgages, $19 billion and $13 billion of commercial mortgages, and $3 billion and $6 billion of municipal and other asset-backed financial instruments, respectively. At November 30, 2006 and 2005, we had approximately $2.0 billion and $700 million, respectively, of non-investment grade interests from our securitization activities (primarily junior security interests in residential mortgage securitizations), comprised of $2.0 billion and $500 million of residential mortgages and $34 million and $200 million of municipal and other asset-backed financial instruments, respectively. We record inventory positions held prior to securitization, including residential and commercial loans, at fair value, as well as any interests held post-securitization. Mark-to-market gains or losses are recorded in Principal transactions in the Consolidated Statement of Income. Fair value is determined based on listed market prices, if available. When market prices are not available, fair value is determined based on valuation pricing models that take into account relevant factors such as discount, credit and prepayment assumptions, and also considers comparisons to similar market transactions.

The following table presents the fair value of our interests in securitizations at November 30, 2006 and 2005, the key economic assumptions used in measuring the fair value of such interests, and the sensitivity of the fair value of such interests to immediate 10% and 20% adverse changes in the valuation assumptions, as well as the cash flows received on such interests in the securitizations.

Securitization Activity

Dollars in millions November 30	2006			2005		
	Residential Mortgages			Residential Mortgages		
	Investment Grade	Non-Investment Grade	Other	Investment Grade	Non-Investment Grade	Other
Interests in securitizations (in billions)	$ 5.3	$ 2.0	$ 0.6	$ 6.4	$ 0.5	$ 0.5
Weighted-average life (years)	5	6	5	6	5	14
Average CPR (1)	27.2	29.1	—	20.8	28.2	1.9
Effect of 10% adverse change	$ 21	$ 61	$ —	$ 11	$ 10	$ —

Effect of 20% adverse change	$ 35	$ 110	$ —	$ 28	$ 18	$ —
Weighted-average credit loss assumption	0.6%	1.3%	—	0.2%	1.2%	0.3%
Effect of 10% adverse change	$ 70	$ 109	$ —	$ 2	$ 23	$ 5
Effect of 20% adverse change	$ 131	$ 196	$ —	$ 6	$ 44	$ 11
Weighted-average discount rate	7.2%	18.4%	5.8%	6.6%	15.2%	6.2%
Effect of 10% adverse change	$ 124	$ 76	$ 13	$ 155	$ 22	$ 41
Effect of 20% adverse change	$ 232	$ 147	$ 22	$ 307	$ 41	$ 74
Year ended November 30	**2006**			**2005**		
Cash flows received on interests in securitizations	$ 664	$ 216	$ 59	$ 625	$ 138	$ 188

(1) Constant prepayment rate.

The above sensitivity analysis is hypothetical and should be used with caution since the stresses are performed without considering the effect of hedges, which serve to reduce our actual risk. We mitigate the risks associated with the above interests in securitizations through dynamic hedging strategies. These results are calculated by stressing a particular economic assumption independent of changes in any other assumption (as required by U.S. GAAP); in reality, changes in one factor often result in changes in another factor which may counteract or magnify the effect of the changes outlined in the above table. Changes in the fair value based on a 10% or 20% variation in an assumption should not be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear.

Mortgage servicing rights. Mortgage servicing rights ("MSRs") represent the Company's right to a future stream of cash flows based upon the contractual servicing fee associated with servicing mortgage loans and mortgage-backed securities. Our MSRs generally arise from the securitization of residential mortgage loans that we originate. MSRs are included in Financial instruments and other inventory positions owned on the Consolidated Statements of Financial Condition. At November 30, 2006 and 2005, the Company has MSRs of approximately $829 million and $561 million, respectively.

Effective with our early adoption of SFAS 156 as of the beginning of our 2006 fiscal year, MSRs are carried at fair value, with changes in fair value reported in earnings in the period in which the change occurs. On or before November 30, 2005, MSRs were carried at the lower of amortized cost or market value. The effect of this change in accounting from lower of amortized cost or market value to fair value has been reported as a cumulative effect adjustment to December 1, 2005 retained earnings, resulting in an increase of $18 million after-tax ($33 million pre-tax). See Note 1, "Summary of Significant Accounting Policies—Accounting and Regulatory Developments," for additional information.

The determination of fair value for MSRs requires valuation processes which combine the use of discounted cash flow models and extensive analysis of current market data to arrive at an estimate of fair value. The cash flow and prepayment assumptions used in our discounted cash flow model are based on empirical data drawn from the historical performance of our MSRs, which we believe are consistent with assumptions used by market participants valuing similar MSRs, and from data obtained on the performance of similar MSRs. These variables can, and generally will, change from quarter to quarter as market conditions and projected interest rates change.

The Company's MSRs activities for the year ended November 30, 2006:

In millions	**November 30, 2006**

Balance, beginning of period	$	561
Additions, net		507
Changes in fair value:		
Paydowns/servicing fees		(192)
Resulting from changes in valuation assumptions		(80)
Change due to SFAS 156 Adoption		33
Balance, end of period	$	829

The following table shows the main assumptions we used to determine the fair value of our MSRs at November 30, 2006 and the sensitivity of our MSRs to changes in these assumptions.

Mortgage Servicing Rights Dollars in millions		November 30, 2006
Weighted-average prepayment speed (CPR)		31
Effect of 10% adverse change	$	84
Effect of 20% adverse change	$	154
Discount rate		8%
Effect of 10% adverse change	$	17
Effect of 20% adverse change	$	26

The above sensitivity analysis is hypothetical and should be used with caution since the stresses are performed without considering the effect of hedges, which serve to reduce our actual risk. We mitigate the risks associated with the above interests in securitizations through dynamic hedging strategies. These results are calculated by stressing a particular economic assumption independent of changes in any other assumption (as required by U.S. GAAP); in reality, changes in one factor often result in changes in another factor which may counteract or magnify the effect of the changes outlined in the above table. Changes in the fair value based on a 10% or 20% variation in an assumption should not be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear.

The key risks inherent with MSRs are prepayment speed and changes in discount rates. We mitigate the income statement effect of changes in fair value of our MSRs by entering into hedging transactions, which serve to reduce our actual risk.

Cash flows received on contractual servicing in 2006 were approximately $255 million and are included in Principal transactions in the Consolidated Statement of Income.

Non-QSPE activities. Substantially all of our securitization activities are transacted through QSPEs, including residential and commercial mortgage securitizations. However, we are also actively involved with SPEs that do not meet the QSPE criteria due to their permitted activities not being sufficiently limited or because the assets are not deemed qualifying financial instruments (e.g., real estate). Our involvement with such SPEs includes credit-linked notes and other structured financing transactions designed to meet clients' investing or financing needs.

We are a dealer in credit default swaps and, as such, we make a market in buying and selling credit protection on single issuers as well as on portfolios of credit exposures. One of the mechanisms we use to mitigate credit risk is to enter into default swaps with SPEs, in which we purchase default protection. In these transactions, the SPE issues credit-linked notes to investors and uses the proceeds to invest in high quality collateral. We pay a premium to the SPE for assuming credit risk under the default swap. Third-party investors in these SPEs are subject to default risk associated with the referenced obligations under the default swap as well as the credit risk of the assets held by the SPE. Our maximum loss associated with our involvement with such credit-linked note transactions is the fair value of our credit default swaps with these SPEs, which amounted to $155 million and $156 million at November 30, 2006 and 2005, respectively. However, the value of our default swaps are secured by the value of the underlying investment

grade collateral held by the SPEs which was $10.8 billion and $5.7 billion at November 30, 2006 and 2005, respectively.

Because the results of our expected loss calculations generally demonstrate the investors in the SPE bear a majority of the entity's expected losses (because the investors assume default risk associated with both the reference portfolio and the SPE's assets), we generally are not the primary beneficiary and therefore do not consolidate these SPEs. However, in certain credit default transactions, generally when we participate in the fixed interest rate risk associated with the underlying collateral through an interest rate swap, we are the primary beneficiary of these transactions and therefore have consolidated the SPEs. At November 30, 2006 and 2005, we consolidated approximately $0.7 billion and $0.6 billion of these credit default transactions, respectively. We record the assets associated with these consolidated credit default transactions as a component of Financial instruments and other inventory positions owned.

We also invest in real estate directly through controlled subsidiaries and through variable interest entities. We consolidate our investments in variable interest real estate entities when we are the primary beneficiary. At November 30, 2006 and 2005, we consolidated approximately $3.4 billion and $4.6 billion, respectively, of real estate-related investments in VIEs for which we did not have a controlling financial interest. We record the assets associated with these consolidated real estate-related investments in VIEs as a component of Financial instruments and other inventory positions owned. After giving effect to non-recourse financing our net investment position in these consolidated VIEs was $2.2 billion and $2.9 billion at November 30, 2006 and 2005, respectively. See Note 2, "Financial Instruments and Other Inventory Positions," for a further discussion of our real estate held for sale.

In addition, we enter into other transactions with SPEs designed to meet clients' investment and/or funding needs. See Note 11, "Commitments, Contingencies and Guarantees," for additional information about these transactions and SPE-related commitments.

Conclusion

In this study, we selected disclosures from 2006 annual reports to illustrate how companies addressed accounting issues recently promulgated by the FASB and SEC. We found considerable variation in disclosures of four particular areas, for which we provided additional examples: (1) Commitments and contingencies, (2) Derivatives and financial instruments, (3) Goodwill and intangibles, and (4) Revenue recognition. When reviewing different topics we noted a number of trends. Companies combine environmental cost disclosures with contingencies and legal liabilities, or with asset retirement obligations, in a single note. Many provide meticulous detail about important legal contingencies, including roll-forward tables for contingent liabilities and insurance claims receivables. Companies provide more detailed information about cash flows statements, including segment information and noncash financing and investing activities. We found tables disclosing the estimated fair value and notional amount of derivatives classified by purpose, type, accounting method used, remaining life, and segment. Companies also provided tables of information about different acquired intangible assets, including accumulated amortization, useful life, and segments. Companies adopting SFAS 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, presented tables summarizing adjustments to balance sheet values from the new adoption and estimated employer contributions. All companies now expense the cost of stock options, in accordance with SFAS 123(R).

About the Author

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