XEROX CORP
Form 10-K/A
January 27, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A
(Amendment No. 5)

(Mark One)

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended: December 31, 2001

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from: to

1-4471 (Commission File Number)

XEROX CORPORATION

(Exact name of registrant as specified in its charter)

New York	**16-0468020**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

P.O. Box 1600, Stamford, Connecticut
(Address of principal executive offices)

06904
(Zip Code)

Registrant s telephone number, including area code: (203) 968-3000

Securities registered pursuant to Section 12(b) of the Act:

Title of each Class	Name of Each Exchange on Which Registered
Common Stock, $1 par value	New York Stock Exchange Chicago Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes: x No: ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

The aggregate market value of the voting stock of the registrant held by non-affiliates as of December 31, 2002 was: $5,943,094,994.

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

Class	Outstanding at December 31, 2002
Common Stock, $1 par value	738,272,670 Shares

Documents Incorporated by Reference

Portions of the following documents are incorporated herein by reference:

Document	Part of Form 10-K in Which Incorporated
None.	

PURPOSE OF AMENDMENT

The principal purpose for this Amendment No. 5 to Xerox Corporation s Annual Report on Form 10-K, as announced on December 20, 2002, is to restate interest expense incurred during 2001 to correct an error in the calculation of interest expense related to a debt instrument and associated interest swap agreements. The reissuance of the 2001 financial statements, as restated, requires that we also reflect the adoption in early 2002 of two Statements of Financial Accounting Standards and adjustments to the presentation of operating segment financial information made in 2002.

Accordingly, this Amendment No. 5 relates solely to financial information and disclosures related to:

(1) Such restatement of interest expense incurred during 2001*;

(2) Adoption of Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets (SFAS No. 142) on January 1, 2002 (proforma presentation of net income and earnings per share for those years prior to adoption)**,

(3) Adoption of Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections (SFAS No. 145) on April 1, 2002 (relating to reclassification of extraordinary gains from extinguishment of debt to operating income)**, and

(4) Adjustment to the presentation of operating segment financial information to reflect a change in measurement of operating segment structure that was made in 2002.

All other financial information and disclosures remain unchanged.

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

* In December 2002, we discovered an error in the calculation of our interest expense related to a debt instrument and associated interest rate swap agreements. The error related to our application of SFAS No. 133 and resulted in an understatement of interest expense of $34 million and an overstatement of the gain on early extinguishment of debt of $3 million for the year ended December 31, 2001. Accordingly, we have restated our consolidated financial statements for these items within this amendment.

** The application of these accounting standards is required to be disclosed in financial statements that are reissued in periods after such financial accounting standards are adopted.

Forward Looking Statements

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

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

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

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

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

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

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

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

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

International Operations We derive approximately 40 percent of our revenue from operations outside the United States. In addition, we manufacture or acquire many of our products and/or their components outside the United States. Our future revenue, cost and results from operations could be affected by a number of factors, including changes in foreign currency exchange rates, changes in economic conditions from country to country, changes in a country s political conditions, trade protection measures, licensing requirements and local tax issues. Our ability to enter into new foreign exchange contracts to manage foreign exchange risk is currently severely limited given our below investment grade credit ratings, and we anticipate increased volatility in our results of operations due to changes in foreign exchange rates.

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

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

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

We have successfully completed the renegotiation of our $7 billion Revolving Credit Agreement (the Old Revolver). Of the original $7 billion in loans outstanding under the Old Revolver, $2.8 billion has been repaid and the remaining $4.2 billion has been refinanced under the terms of a new Amended and Restated Credit Agreement (the New Credit Facility), which is more fully discussed elsewhere in this Annual Report on Form 10-K. The New Credit Facility requires certain principal amortizations as well as prepayments in the case of certain events. A full discussion of all of these terms and the final maturity dates of the various loans is included in the Capital Resources and Liquidity section of this Annual Report on Form 10K. The New Credit Facility contains affirmative and negative covenants including limitations on issuance of debt and preferred stock; certain fundamental changes; investments and acquisitions; mergers; certain transactions with affiliates; creation of liens; asset transfers; hedging transactions; payment of dividends; inter-company loans and certain restricted payments; and a requirement to transfer excess foreign cash, as defined, and excess cash of Xerox Credit Corporation to Xerox Corporation in certain circumstances. It also contains additional financial covenants, including minimum EBITDA, maximum leverage (total adjusted debt divided by EBIDTA, as defined) and, maximum capital expenditures limits.

Any failure to be in compliance with any material provision of the New Credit Facility could have a material adverse effect on our liquidity and operations.

PART II

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

INDEX TO FINANCIAL SECTION

FINANCIAL REVIEW

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

Introduction. In this Management s Discussion and Analysis of Results of Operations and Financial Condition (MD&A) we begin by describing the matters considered by management to be important to an understanding of the results of our operations and our capital resources and liquidity as of and for the three years ended December 31, 2001. This section begins with a discussion of our recent settlement with the Securities and Exchange Commission (SEC) regarding accounting issues that had been under investigation since June 2000. The discussion includes the financial effects of the related restatement. Immediately following, is a new disclosure for most companies this year. It is an analysis of the critical accounting policies which affect the recognition and measurement of our transactions and the balances in our consolidated financial statements. In this section, we review the critical accounting judgments and estimates which we believe are most important to an understanding of the MD&A and the Consolidated Financial Statements. We then analyze the results of our operations for the last three years including the trends in the overall business and our operating segments including our Turnaround Program and important transactions and events such as asset sales. This section concludes with a summary of recent accounting pronouncements which will have an impact on our financial accounting practices. Thereafter, we discuss our cash flows and liquidity, capital markets events and transactions, debt ratings, our new credit facility, derivatives, our transition to vendor financing, special purpose entities, contractual commitments and related issues.

Restatement and Reclassification of 2001 Financial Statements. As more fully discussed in Note 21 to the Consolidated Financial Statements, we discovered an error during 2002 in the calculation of our interest expense for the year ended December 31, 2001, related to a debt instrument and associated interest rate swap agreements. The error had occurred in connection with the adoption of Statement of Financial Accounting Standards No. 133 in January 2001 and resulted in an understatement of interest expense of $34 million and an overstatement of the gain on early extinguishment of debt of $3 million for the year ended December 31, 2001. To adjust for these items, we have restated our 2001 financial statements.

In addition, as more fully discussed in Note 22 to the Consolidated Financial Statements, during 2002, in connection with the adoption of the provisions of Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections (SFAS No. 145), the gains on early extinguishment of debt previously reported in the Consolidated Statements of Operations as an extraordinary item were reclassified to Other expenses, net. After the effects of the restatement discussed in Note 21, the effect of this reclassification in the accompanying Consolidated Statements of Operations was a decrease to Other expenses, net of $63 and an increase to Income taxes of $25, from amounts previously reported, for the year ended December 31, 2001.

Restatement of 2000 and 1999 Financial Statements. We have determined that certain of our accounting practices misapplied U.S. generally accepted accounting principles (GAAP). Accordingly, we have restated our financial statements for the four years ended December 31, 2000 and revised our previously announced 2001 results included in our earnings release dated January 28, 2002. Throughout this MD&A, the term previously reported will be used to refer to our previously filed 1997-2000 Financial Statements as well as our 2001 results. The restatement adjustments relate almost exclusively to the timing of revenue and expense recognition. We reversed cumulative net revenue of $1.9 billion that was recognized in prior years, of which $1.3 billion is reflected in the years 1997 to 2001. This revenue adjustment is comprised of a reduction in equipment sales revenue, previously recognized from 1997 through 2001, of $6.4 billion offset by $5.1 billion of service, rental, document outsourcing and financing revenue now recognized from 1997 through 2001. The remaining net amount of revenue reversed, of $600 million, represents the cumulative net revenue impacts of reversing equipment sales transactions that were previously ecorded in periods prior to 1997. Based on the cumulative impacts of the revenue adjustments for all periods prior to December 31, 2001, including pre-1997 impacts, we anticipate the recognition of $1.9 billion in revenues over the next several years through 2006. This represents sales-type lease revenue that had previously been recorded, that is expected to be earned over time as a component of our rental, service and finance revenue. In addition to the aforementioned revenue timing adjustments, and as more fully discussed below, we permanently reduced reported revenue by $269 million, for the five-year period ended December 31, 2001, as a result of the deconsolidation of our South African affiliate. Revenues from 1997 through 2001 as originally reported were $92.6 billion compared to $91.0 billion after the restatement. Substantially all non-revenue items included in the restatement have reversed within the five-year period ended December 31, 2001; our liquidity is not impacted since the restatement items reflect timing differences. As of December 31, 2001 our restated

Common Shareholders Equity is $1.8 billion versus $3.1 billion as originally included in our January 28, 2002 earnings release.

Settlement with the Securities and Exchange Commission. On April 11, 2002, we reached a settlement with the SEC relating to matters that had been under investigation by the SEC since June 2000. We believe the settlement is in the best interests of our shareholders, customers, employees and other stakeholders because it resolves these matters eliminating the distraction and risk associated with potential SEC litigation thereby enabling us to focus on continuing to improve our operations and restore the Company s financial health. In addition, as a result of the settlement with the SEC, we are undertaking a review of our material internal accounting controls and accounting policies to determine whether any additional changes are required in order to provide additional reasonable assurance that the types of accounting errors that occurred are not likely to reoccur.

The restatement reflects adjustments which are corrections of errors made in the application of GAAP and includes (i) adjustments related to the application of the provisions of Statement of Financial Accounting Standards No. 13 Accounting for Leases (SFAS No. 13) and (ii) adjustments that arose as a result of other errors in the application of GAAP. In making these restatements we have conducted an extensive review of all significant transactions, accounting policies and procedures and disclosures for the period 1997 through 2001. The principal adjustments are discussed below.

Application of SFAS No. 13:

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

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

The SEC staff advised us of its view that our previous methodology, as described above, did not comply with the requirements of SFAS No. 13. SFAS No. 13 requires us to use the discount rate which causes the aggregate present value of the minimum lease payments, excluding executory and service income, and any unguaranteed residual value, to equal the fair value of the equipment. However, our revenue allocation processes with respect to the principal (i.e., equipment) and interest components of our leases did not begin with the estimated fair value of the equipment, and did not treat unearned finance income as the derived value.

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

We conducted an extensive analysis of available verifiable objective evidence of fair value (VOE) based on cash sales prices and compared these prices to the range of equipment values recorded in our lease accounting systems. With the exception of Latin America, where operating lease accounting is applied as discussed below, the range of cash selling prices supports the reasonableness of the range of equipment lease prices as originally recorded, at inception of the lease, in our accounting systems. In applying our new methodology described above, we have therefore concluded that the revenue amounts allocated by our accounting systems to the equipment component of a multiple element arrangement represents a reasonable estimate of the fair value of the equipment. As a consequence, $2.4 billion of previously recorded equipment sale revenue during the five years ended December 31, 2001 has been reversed and we have recognized additional service revenue and finance income of $1.7 billion, which represents the impact of reversing amounts previously recorded as equipment sales-type leases and recognizing such amounts over the lease term. The net cumulative reduction in revenue, as a result of this change, was $641 million for the five-year period ended December 31, 2001. In total approximately $840 million of revenue previously recognized has been reversed and will be recognized in future years, estimated as follows: $410 million 2002, $260 million 2003 and $170 million thereafter.

Transactions not qualifying as sales-type leases: We re-evaluated the application of SFAS No. 13 for leases originally accounted for as sales-type leases in our Latin American operations, and we determined that these leases should have been recorded as operating leases. This determination was made after we conducted an in-depth review of the historical effective lease terms compared to the contractual terms of our lease agreements. Since, historically, and during all periods presented, a majority of leases were terminated significantly prior to the expiration of the contractual lease term, we concluded that such leases did not qualify as sales-type leases under certain provisions of SFAS No. 13. Specifically, because we generally do not collect the receivable from the initial transaction upon termination of the contract or during the subsequent lease term, the recoverability of the lease investment was not predictable at the inception of the original lease term. The accounting for these transactions as sales-type leases is further complicated due to our very high market shares in many of these countries, which makes it difficult to establish a reasonable basis for estimating the fair value of the equipment component of our leases due to a lack of available VOE. In addition historical and continuing economic and political instability in many of these countries also raises concerns about reasonable assurance of collectibility. As a consequence, $2.8 billion of previously recorded equipment sale revenue during the five years ended December 31, 2001 has been reversed and we have recognized additional rental revenue of $2.2 billion, which represents the impact of changing the classification of previously recorded sales-type leases to operating leases. The net cumulative reduction in revenue, as a result of this change, was $633 million for the five-year period ended December 31, 2001. In total, approximately $800 million of revenue previously recognized has been reversed and will be recognized in future years, estimated as follows: $240 million 2002, $240 million 2003 and $320 million thereafter.

During the course of the restatement process, we concluded that the estimated economic life used for classifying leases for the majority of our products should have been five years versus the three to four years we previously utilized. This resulted from an in-depth review of our lease portfolios, for all periods presented, which indicated that the most frequent term of our lease contracts was 60 months. We believe that this has been and is representative of the period during which the equipment is expected to be economically usable, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease. As a consequence, many shorter duration leases did not meet the criteria of SFAS No. 13 to be accounted for as sales-type leases. Additionally, other lease arrangements were found to not meet other requirements of SFAS No. 13 for treatment as sales-type leases. As a consequence, $588 million of equipment revenue recorded during the five years ended December 31, 2001 has been reversed and we have recognized additional rental revenue of $387 million, which represents the impact of changing the classification of previously recorded sales-type leases to operating leases. The net cumulative reduction in revenue, as a result of this change, was $201 million for the five-year period ended December 31, 2001. In total approximately $140 million of revenue previously recognized has been reversed and will be recognized in future years, estimated as follows: $70 million 2002, $40 million 2003 and $30 million thereafter.

Accounting for the sale of equipment subject to operating leases: We have historically sold pools of equipment subject to operating leases to third party finance companies (the counterparties) or through structured financings with third parties and recorded the transaction as a sale at the time the equipment is accepted by the counterparties. These transactions increased equipment sale revenue, primarily in Latin America, in 2000 and 1999 by $148 million and $400 million, respectively. Upon additional review of the terms and conditions of these contracts, it was determined that the form of the transactions at inception included retained ownership risk provisions or other contingencies that precluded these transactions from meeting the criteria for sale treatment under the provisions of SFAS No. 13. The form of the transaction notwithstanding, these risk of loss or contingency provisions have resulted in only minor impacts on our operating results during the five years ended December 31, 2001. These transactions have however been restated and recorded as operating leases in our consolidated financial statements. As a consequence $569 million of equipment revenue recorded during the five years ended December 31, 2001 has been reversed and we have recognized additional rental revenue of $670 million, which represents the impact of changing the previously recorded transactions to operating leases. The net cumulative increase in revenue as a result of this change was $101 million for the five-year period ended December 31, 2001. In total approximately $110 million of revenue previously recognized has been reversed and will be recognized in future years, estimated as follows: $80 million 2002 and $30 million 2003. Additionally, for transactions in which cash proceeds were received up-front we have recorded these proceeds as secured borrowings. The remaining balance of these borrowings aggregated $55 million at December 31, 2001.

In summary and in connection with the restatement of reported results of operations regarding accounting for leases, our policy is to now measure the reasonableness of estimates of fair values of leased equipment by comparison to VOE from cash sales of the same or similar equipment or on the basis of other objective evidence of fair value. Going forward, due to a change in business model, we expect equipment sales in Latin America will either be for cash or will be financed by third party financial institutions. In connection with negotiations underway with third parties, we anticipate substantially exiting our financing business. Our business processes and the terms of our third party financing contracts may result in our customer transactions being initially recorded as leases in our financial statements prior to being sold to the financing companies. The accounting effect may require us to account for transactions with third party finance companies as sales of the underlying leases, and to recognize gains or losses on the sales of such leases as they are sold.

Other adjustments:

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

Sales of receivables transactions: During 2001 and 1999, we sold approximately $2.0 billion of U.S. finance receivables originating from sales-type leases ($1.4 billion in 1999 and $600 million in 2001). These transactions were originally accounted for as sales of receivables. These sales were made to special purpose entities (SPEs), which qualified for non-consolidation in accordance with then existing accounting requirements. As a result of the changes in the estimated economic life of our equipment to five years, certain leases transferred in these transactions did not meet the sales-type lease requirements and were accounted for as operating leases. This change in lease classification affected a number of the leases that were sold into the aforementioned SPEs resulting in these entities now holding operating leases as assets. This change disqualified the SPEs from non-consolidation and effectively required us to record the proceeds received on these sales as secured borrowings. This increased our debt by $490 million, $418 million and $950 million as of December 31, 2001, 2000 and 1999, respectively. These transactions are also discussed in Note 6 to the Consolidated Financial Statements. This change has no effect on our liquidity or amounts due to the SPEs from the Company.

During 1999, we sold $288 million of accounts receivables to financial institutions. Upon additional review of the terms and conditions of these transactions, we determined that $57 million (including $14 million which was restated in connection with the prior restatement of our financial statements) did not qualify for sale treatment as a result of our agreeing to reacquire the receivables in 2000. Accordingly, we have restated our previously reported results for these transactions and they are now reported in our Consolidated Financial Statements as short-term borrowings. This change increased Accounts receivable, net and debt by $57 million as of December 31, 1999; the transactions were settled in early 2000. No similar transactions have occurred since 1999.

South Africa deconsolidation: We determined that we inappropriately consolidated our South African affiliate since 1998 as the minority joint venture partner has substantive participating rights. Accordingly, we have deconsolidated all assets, liabilities, revenues and expenses. We now account for this investment on the equity method of accounting. The cumulative reduction in revenues through December 31, 2001 was $269 million and there was no impact on net income or Common Shareholder s Equity.

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

Restructuring reserves: During 2000 and 1998, we recorded restructuring charges associated with our decisions to exit certain activities of the business. Upon additional review we determined that certain adjustments made to the original charges were not in accordance with GAAP. The adjustments to increase pre-tax loss in 2001 of $87 million and decrease pre-tax loss in 2000 of $65 million consist primarily of corrections to the timing of the release of reserves originally recorded under the March 2000 restructuring program. We should have reversed the applicable reserves in late 2000 when the information was available that our original plan had changed indicating that such reserves were no longer necessary. Previously, the reversal was recorded in early 2001. Similarly, the adjustment of $12 million to decrease 1999 pre-tax income relates primarily to the inappropriate release of restructuring reserves which should have been recorded in 1998 based on information available at the time. The adjustments to reduce the 1998 restructuring provisions of $138 million related to charges which did not meet the criteria to be recorded as part of the initial restructuring reserves. Such charges did not qualify as exit costs or appropriate separation costs in accordance with the accounting guidance governing restructuring actions. In total, these adjustments increased pre-tax income by $104 million for the five year period ended December 31, 2001.

Tax refunds: In 1995, we received a final favorable court decision that entitled us to refunds of certain tax amounts paid in the U.S., plus accrued interest on the tax. The court established the legal precedent upon which the refunds were to be based. We recorded the income associated with the tax refunds and the related interest from 1995 through 1999. We determined that the benefit should have been recorded in periods prior to 1997. These adjustments decreased pre-tax income by $153 million for the five year period ended December 31, 2001.

Other adjustments: In addition to the above items and in connection with our review of prior year s financial records we determined that other accounting errors were made with respect to the accounting for certain non-recurring transactions, the timing of recording and reversing certain liabilities and the timing of recording certain asset write-offs. We have restated our 2000 and 1999 Consolidated Financial Statements, and revised our previously announced 2001 results for such items. These adjustments decreased pre-tax income by $290 million for the five year period ended December 31, 2001.

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

Increase (decrease) to total revenue:
(in millions)

	Year ended December 31,				
	2001	2000	1999	1998	1997
Revenue, previously reported	$ 16,502	$ 18,701	$ 19,567	$ 19,593	$ 18,225
Application of SFAS No. 13:					
Revenue allocations in bundled arrangements	65	(78)	(257)	(284)	(87)
Latin America operating lease accounting	187	(58)	57	(358)	(461)
Other transactions not qualifying as sales-type leases	73	57	(60)	(119)	(152)
Sales of equipment subject to operating leases	197	124	(243)	67	(44)
Subtotal	522	45	(503)	(694)	(744)
Other revenue restatement adjustments:					
Sales of receivables transactions	42	61	(6)		
South Africa deconsolidation	(66)	(72)	(71)	(60)	
Other revenue items, net	8	16	8	(62)	(24)
Subtotal	(16)	5	(69)	(122)	(24)
Increase (decrease) in total revenue	506	50	(572)	(816)	(768)
Revenues, restated	$ 17,008	$ 18,751	$ 18,995	$ 18,777	$ 17,457

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

Increase (decrease) to sales revenue:
(in millions)

	Year ended December 31,				
	2001	2000	1999	1998	1997
Revenue allocations in bundled arrangements	$ (440)	$ (541)	$ (650)	$ (508)	$ (233)
Latin America operating lease accounting	(125)	(459)	(300)	(902)	(1,007)
Other transactions not qualifying as sales type leases	(31)	(74)	(160)	(162)	(161)
Sales of equipment subject to operating leases	33	(111)	(342)	(20)	(129)
South Africa deconsolidation	(27)	(31)	(30)	(25)	
Other revenue items, net	5	(4)	8	(55)	(22)
Decrease in sales revenue	$ (585)	$ (1,220)	$ (1,474)	$ (1,672)	$ (1,552)

In total, approximately $1.9 billion of revenue recognized in years 2001 and prior has been reversed and is estimated to be recognized as follows: $800 million 2002, $570 million 2003 and $530 million thereafter.

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

Increase (decrease) to pre-tax income (loss):
(in millions)

	Year ended December 31,				
	2001	**2000**	**1999**	**1998**	**1997**
Pre-tax (loss) income, previously reported (1)	$ (71)	$ (384)	$ 1,908	$ 579	$ 2,005
Revenue restatement adjustments:					
Revenue allocations in bundled arrangements	68	(74)	(252)	(281)	(87)
Latin America operating lease accounting	335	80	39	(238)	(354)
Other transactions not qualifying as sales-type leases	54	12	(50)	(74)	(100)
Sales of equipment subject to operating leases	91	11	(162)	19	(35)
Sales of receivables transactions	12	18	(32)		
South Africa deconsolidation	(10)	(11)	(8)	(6)	
Other revenue items, net	10	12	22	(31)	(21)
Subtotal	560	48	(443)	(611)	(597)
Other restatement adjustments:					
Purchase accounting reserves	(2)	(7)	(20)		
Restructuring reserves	(87)	65	(12)	138	
Tax refunds			(14)	(97)	(42)
Other, net	31	(89)	(131)	(22)	(79)
Subtotal	(58)	(31)	(177)	19	(121)
Restatement of interest expense	(37)				
Increase (decrease) to pre-tax income (loss)	465	17	(620)	(592)	(718)
Pre-tax income (loss), restated	$ 394	$ (367)	$ 1,288	$ (13)	$ 1,287

(1) Amounts have been adjusted to reflect the reclassification of gains associated with extinguishments of debt from extraordinary items to pre-tax income (loss) required due to the adoption of SFAS No. 145. See Note 22 to these Consolidated Financial Statements for further discussion.

The impact of these adjustments on certain key ratios is as follows:

	Year ended December 31,				
	2001	2000	1999	1998	1997
Sales Gross Margin:					
- Previously reported	32.9%	37.5%	43.1%	43.8%	44.5%
- Adjusted and restated	30.5%	31.2%	37.2%	40.5%	39.5%
Service, Outsourcing and Rentals Gross Margin:					
- Previously reported	39.4%	37.6%	42.8%	44.4%	47.4%
- Adjusted and restated	42.2%	41.1%	44.7%	46.6%	48.4%
Finance Gross Margin:					
- Previously reported	34.6%	34.5%	49.4%	50.1%	48.8%
- Adjusted and restated	59.5%	57.1%	63.0%	58.2%	58.6%
Total Gross Margin:					
- Previously reported	36.0%	37.4%	43.3%	44.4%	46.9%
- As adjusted and restated	38.2%	37.4%	42.3%	44.3%	44.8%
Selling, Administrative and General Expenses as a percentage of revenue:					
- Previously reported	29.1%	30.2%	27.0%	27.3%	28.7%
- As adjusted and restated	27.8%	29.4%	27.4%	28.3%	29.8%

These adjustments resulted in the cumulative net reduction of Common Shareholders Equity of $1.3 billion as of December 31, 2001. The following table presents the impact of the restatement adjustments on Common Shareholders Equity as of January 1, 1997:

Increase (decrease) in Common Shareholders Equity (in millions):	
Common Shareholders Equity balance	
January 1, 1997, previously reported	$ 4,352
Revenue allocations in bundled arrangements	(223)
Latin America operating lease accounting	(1,326)
Other transactions not qualifying as sales-type leases	8
Sales of equipment subject to operating leases	(49)
Other items, net	285
Income tax impacts of above adjustments	436
Decrease in Common Shareholders Equity	(869)
Common Shareholders Equity balance	
January 1, 1997, restated	$ 3,483

The comparative impacts of changes to the amounts previously reported in our 2000 and 1999 financial statements are included in Note 2 to the consolidated financial statements. The following tables present the impact of the adjustments on our previously reported 2001 results on a condensed basis:

	Previously Reported (1)	As Restated
Year ended December 31, 2001		
(in millions, except per share data)		
Statement of operations:		
Total Revenues	$ 16,502	$ 17,008
Sales	8,028	7,443
Service, outsourcing, financing and rentals	8,474	9,565
Total Costs and Expenses (1)	16,573	16,614
Net Loss	(293)	(94)
Diluted Loss per Share	$ (0.43)	$ (0.15)
Balance Sheet:		
Accounts receivable and finance receivables, net	$ 6,557	$ 5,818
Inventories	1,345	1,364
Deferred taxes and other current assets	1,451	1,369
Total Current Assets	13,344	12,541
Finance receivables due after one year, net	6,336	5,756
Equipment on operating leases, net	521	804
Land, buildings and equipment, net	1,992	1,999
Other long-term assets	4,365	5,100
Goodwill, net	1,475	1,445
Total Assets	28,033	27,645
Short-term debt and current portion of long-term debt	9,737	6,637
Other current liabilities	3,671	3,623
Total Current Liabilities	13,408	10,260
Long-term debt	6,484	10,107
Other long-term liabilities	2,752	3,251
Total Liabilities	22,644	23,618
Common Shareholders Equity	3,148	1,797
Total Liabilities and Equity	$ 28,033	$ 27,645

(1) Amounts have been adjusted to reflect the reclassification of gains associated with extinguishments of debt from extraordinary items to pre-tax income required due to the adoption of SFAS No. 145. See Note 22 to these Consolidated Financial Statements for further discussion.

Application of Critical Accounting Policies. In preparing our financial statements and accounting for the underlying transactions and balances, we apply our accounting policies as disclosed in our Notes to Consolidated Financial Statements. We consider the policies discussed below as critical to an understanding of our financial statements because their application places the most significant demands on management s judgment, with financial reporting results relying on estimation about the effect of matters that are inherently uncertain. Specific risks for these critical accounting policies are described in the following paragraphs. The impact and any associated risks related to these policies on our business operations is discussed throughout this Management s Discussion and Analysis where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see Note 1 to the consolidated financial statements. Senior management has discussed the development and selection of the critical accounting estimates and the related disclosure included herein with the Audit Committee of the Board of Directors. Preparation of this Annual Report on Form 10-K requires us to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates.

Revenue Recognition for Sales-Type Leases Under Bundled Arrangements: We sell most of our products and services under bundled contract arrangements, which contain multiple deliverable elements. These arrangements typically include equipment, service and supplies, and financing components for which the customer pays a single negotiated price for all elements. These arrangements typically also include a variable service component for page volumes in excess of stated minimums. When separate prices are listed in multiple element customer contracts, they may not be representative of the fair values of those elements because the prices of the different components of the arrangement may be modified in customer negotiations, although the aggregate consideration may remain the same. Therefore, revenues under these arrangements are allocated based upon estimated fair values of each element. Our revenue allocation methodology first begins by determining the fair value of the service component, as well as other executory costs and any profit thereon and second, by determining the fair value of the equipment based on comparison of the equipment values in our accounting systems to a range of cash selling prices. The resultant implicit interest rate is then compared to fair market value rates to assess the reasonableness of the overall allocations to the multiple elements.

Determination of Appropriate Revenue Recognition for Sales-Type Leases: Our accounting for leases involves specific determination under SFAS No. 13 which often involve complex provisions and significant judgments. The general criteria for SFAS No. 13, at least one of which is required to be met in order to account for a lease as a sales-type lease versus as an operating lease, are (a) whether ownership transfers by the end of the lease term, (b) whether there is a bargain purchase option at the end of the lease term which is exercisable by the lessee, (c) whether the lease term is equal to or greater than at least 75 percent of the economic life of the equipment and (d) whether the present value of the minimum lease payments, as defined, are equal to or greater than 90 percent of the fair market value of the equipment. Criteria (a) and (b) are relatively minor considerations for qualifying our leases as sales, as we usually do not employ such contract terms. Under our current product portfolio and business strategies, generally a non-cancelable lease of 45 months or more qualifies under the economic life criteria as a sale. Certain of our lease contracts are customized for larger customers which result in complex terms and conditions and require significant judgment in applying the above criteria. In addition to these criteria, there are also other important criteria that are required to be assessed, including whether collectibility of the lease payments is reasonably predictable and whether there are important uncertainties related to costs that we have yet to incur with respect to the lease. In management s opinion, our sales-type lease portfolios contain only normal credit and collection risks and have no important uncertainties with respect to future costs.

The critical elements of SFAS No. 13 that we analyze with respect to our lease accounting are the determination of economic life and the fair value of equipment, including our estimates of residual values. Accounting for sales-type lease transactions requires management to make estimates with respect to economic lives and expected residual value of the equipment in accordance with specific criteria as set forth in generally accepted accounting principles. Those estimates are based upon historical experience with economic lives of all of our equipment products. We consider the most objective measure of historical experience for purposes of estimating the economic life to be the original contract term since most equipment is returned by lessees at or near the end of the contracted term. The most frequent contractual lease term for our principal products is five years and only a small percentage of our leases are for original terms longer than five years. Accordingly, we have estimated the economic life of most of our products to be five years. We believe that this is representative of the period during which the equipment is expected to be economically usable, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease. When we originally reported our 1999 and 2000 results, we had utilized an economic life for our principal products of three to four years. The increase to five years had the effect of reducing equipment sale revenue by $37 million, $66 million and $115 million for the years ended December 31, 2001, 2000 and 1999, respectively. Residual values are established at lease inception using estimates of fair value at the end of the lease term. Our residual values are established with due consideration to forecasted supply and demand for our various products, product retirement and future product launch plans, end of lease customer behavior, remanufacturing strategies, used equipment markets (to the extent they exist for the particular product), competition and technological changes. Since we are the developer, servicer and frequently the manufacturer of our products, we do not believe we have any significant risks to recovery of our recognized residual values.

Accounts and Finance Receivables Allowance for Doubtful Accounts and Credit Losses: We perform ongoing credit evaluations of our customers and adjust credit limits based upon customer payment history and current creditworthiness, as determined by our review of our customers current credit information. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. Measurement of such losses requires consideration of historical loss experience, including the need to adjust for current conditions, and judgments about the probable effects of relevant observable data, including present economic conditions such as delinquency rates and financial health of specific customers. In addition to provisions related to the credit worthiness of our customers, we also record provisions for customer accommodations, among other things. We recorded $506 million, $613 million and $450 million in provisions to the Consolidated Statements of Operations for doubtful accounts for both our accounts and finance receivables for the three years ended December 31, 2001, 2000 and 1999, respectively.

Historically about half of the provision relates to our finance receivables portfolio. This provision is inherently more difficult to estimate than the provision for trade accounts receivable because the underlying lease portfolio has an average maturity, at any time, of approximately four years and contains both past due billed amounts, as well as unbilled amounts. Estimated credit quality of any given customer, class of customer or geographic location can significantly change during the life of the portfolio. We consider all available information in our quarterly assessments of the adequacy of the reserves for uncollectible accounts.

Securitization and Transfers of Financial Assets: From time to time, we engage in securitization activities in connection with our accounts and finance receivables. We enter into these transactions for the purposes of generating cash from these assets through sales or secured borrowings. In several of the countries where we have completed lease transaction funding arrangements with third party finance companies we have effectively transferred substantially all of the related collection risk to these financiers. Gains and losses from securitizations, accounted for as sales, are recognized in the Consolidated Statements of Operations when we surrender control of the transferred financial assets. The gain or loss on the sale of financial assets depends in part on the previous carrying amount of the assets involved in the transfer, allocated between the assets sold and the retained interests based upon their respective fair values at the date of sale.

As part of the transactions accounted for as sales, the receivables are typically sold to a special purpose entity that meets the applicable accounting standards for non-consolidation. When special purpose entities are involved neither we, nor any of our employees has any involvement in the management of such entity. When we sell receivables, we may retain servicing rights, beneficial interests, and in some cases, a cash reserve account, all of which are retained interests in the securitized receivables. The retained interest is initially recorded at carrying value, which approximates fair value in our Consolidated Balance Sheets. Subsequently, decreases in the value of such interests, if any, are recognized in our Consolidated Statements of Operations. The securitization gain or loss involves our best estimates of key assumptions, consisting of receivable amounts, anticipated credit losses, and discount rates commensurate with the risks involved. The use of different estimates or assumptions could produce different financial results. For those transactions accounted for as secured borrowings, we have made the determination that the criteria for surrender of control were not met, or that the receivables were sold into a special purpose entity that did not meet the requirements for deconsolidation.

These transactions are often complex, involve highly structured contracts between us and the buyer or transferee and involve strict accounting rules application. The key distinction in the application of the accounting rules to the structured contracts and similar transactions (sale versus a secured borrowing) is the inclusion or exclusion of the related receivables and or associated obligations that would or would not be included in our Consolidated Balance Sheets, as well as any gain or loss that would result from a sale transaction. In order for a transaction to qualify as a sale, several accounting requirements must be met including the surrender of control over the receivables and the existence of a bankruptcy remote contract structure. Transactions not meeting these requirements must be accounted for as secured borrowings. See Note 6 to the consolidated financial statements for a discussion of our securitization transactions.

Provisions for Excess and Obsolete Inventory Losses and Residual Value Losses: We value our inventory at the lower of average cost or net realizable values. We regularly review inventory quantities on hand and record a provision for excess and obsolete inventory based primarily on our estimated forecast of product demand and production requirements for the next twelve months. Several factors may influence the realizability of our inventories, including our decisions to exit a product line (e.g., SOHO), technological change and new product development. These factors could result in an increase in the amount of obsolete inventory quantities on hand. Additionally, our estimates of future product demand may prove to be inaccurate, in which case we may have understated or overstated the provision required for excess and obsolete inventory. In the future, if we determine that our inventory was overvalued, we would be required to recognize such costs in Cost of sales at the time of such determination. Likewise, if we determine that our inventory is undervalued, we may have overstated Cost of sales in previous periods and would be required to recognize such additional operating income at the time of sale. Therefore, although we make every effort to ensure the accuracy of our forecasts of future product demand, including the impact of planned future product launches, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of our inventory and our reported operating results. We recorded $242 million, $235 million and $144 million in inventory write-down charges for the three years ended December 31, 2001, 2000 and 1999, respectively. These amounts include $42 million and $84 million in 2001 and 2000, respectively, associated with our restructuring programs. At this time, management does not believe that anticipated product launches will have a material effect on the recovery of our existing net inventory balances.

We have a similar accounting policy relating to unguaranteed residual values associated with equipment on lease, which totaled $414 million and $508 million in our Consolidated Balance Sheets at December 31, 2001 and 2000 respectively. We review residual values regularly and, when appropriate, adjust them based on estimates of forecasted demand including the impacts of future product launches. Impairment charges are recorded when available information indicates that the decline in recorded value is other than temporary and we would not therefore be able to fully recover the recorded values. We recorded $14 million, $17 million and $4 million in residual value impairment for the years ended December 31, 2001, 2000 and 1999, respectively.

Estimates Used Relating to Restructuring and Asset Impairments: Over the last several years we have engaged in significant restructuring actions, which have required us to develop formalized plans as they relate to exit activities. These plans have required us to utilize significant estimates related to salvage values of assets that were made redundant or obsolete. In addition, we have had to record estimated expenses for severance and other employee separation costs, lease cancellation and other exit costs. Given the significance of, and the timing of the execution of such actions, this process is complex and involves periodic reassessments of estimates made at the time the original decisions were made. The accounting for restructuring costs and asset impairments requires us to record provisions and charges when we have a formal and committed plan. Our policies, as supported by current authoritative guidance, require us to continually evaluate the adequacy of the remaining liabilities under our restructuring initiatives. As management continues to evaluate the business, there may be supplemental charges for new plan initiatives as well as changes in estimates to amounts previously recorded as payments are made or actions are completed.

Discontinued Operations: In the fourth quarter of 1995, we announced our planned disengagement from our insurance operations. From 1995 to 1998 all our insurance operations were sold. As part of the sales of these insurance operations, we were required to continue to provide aggregate excess of loss reinsurance coverage (the Reinsurance Agreements) to two former insurance entities through Ridge Reinsurance Limited (Ridge Re), a wholly owned subsidiary. The coverage limits for these two remaining Reinsurance Agreements total $578 million, which is exclusive of $234 million in coverage that Ridge Re reinsured in 1998. We have guaranteed that Ridge Re will meet all its financial obligations under the two remaining Reinsurance Agreements. As of December 31, 2001, Ridge Re has $684 million of cash and investments held in restricted trusts as collateral for their potential liability under these reinsurance obligations. Our remaining net investment in Ridge Re was $348 million, net of our expected liability of $336 million, at December 31, 2001. Based on Ridge Re s current projections of investment portfolio returns and reinsurance obligation payments, all of which are based on actuarial estimates, we expect to fully recover our remaining net investment of $348 million. Our ongoing evaluation of the insurance liabilities, and estimates thereof, could result in a significant change in our estimate of recoverability of this net investment. The expected liability is a discounted value, consistent with accounting standards applicable to insurance companies. A material change in the timing of the estimated payments could materially affect the liability recognized but not to an amount greater than our coverage limit as described above.

Pension and Postretirement Benefit Plan Assumptions: We sponsor pension plans in various forms covering substantially all employees who meet eligibility requirements. Postretirement benefit plans primarily only cover U.S. employees for retirement medical costs. Several statistical and other factors that attempt to anticipate future events are used in calculating the expense and liability related to the plans. These factors include assumptions we make about, among others, the discount rate, expected return on plan assets, rate of increase of health care costs and rate of future compensation increases. In addition, our actuarial consultants also use subjective factors such as withdrawal and mortality rates to estimate these factors. The actuarial assumptions we use may differ materially from actual results due to changing market and economic conditions, higher or lower withdrawal rates or longer or shorter life spans of participants. These differences may result in a significant impact to the amount of pension or postretirement benefits expenses we have recorded or may record. Assuming a constant employee base, the most important estimate associated with our post retirement plan is the assumed health care cost trend rate. A one-percentage-point increase in this estimate would increase the expense by approximately $5 million. A similar analysis for the expense associated with our pension plans is more difficult due to the variety of assumptions, plan types and regulatory requirements for these plans around the world. However, by way of example, for the U.S. plans, which represent approximately 70 percent of the consolidated projected benefit obligation at December 31, 2001, a 0.25 percent change in the discount rate would change the annual pension expense by approximately $6 million.

Income Taxes and Tax Valuation Allowances: We record the estimated future tax effects of temporary differences between the tax bases of assets and liabilities and amounts reported in our Consolidated Balance Sheets, as well as operating loss and tax credit carryforwards. We follow very specific and detailed guidelines in each tax jurisdiction regarding the recoverability of any tax assets recorded on the balance sheet and provide necessary valuation allowances as required. We regularly review our deferred tax assets for recoverability based on historical taxable income, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. If we continue to operate at a loss in certain jurisdictions or are unable to generate sufficient future taxable income, or if there is a material change in the actual effective tax rates or time period within which the underlying temporary differences become taxable or deductible, we could be required to increase the valuation allowance against all or a significant portion of our deferred tax assets resulting in a substantial increase in our effective tax rate and a material adverse impact on our operating results. Valuation allowance provisions were $247 million, $12 million, and $92 million for the years ended December 31, 2001, 2000 and 1999, respectively.

Goodwill and Other Acquired Intangible Assets: We have made acquisitions in the past that included the recognition of a significant amount of goodwill and other intangible assets. Under generally accepted accounting principles in effect through December 31, 2001, these assets were amortized over their estimated useful lives and were tested periodically to determine if they were recoverable from estimated future pre-tax cash flows on an undiscounted basis over their useful lives. Effective in 2002, goodwill will no longer be amortized but will be subject to an annual (or under certain circumstances more frequent) impairment test based on its estimated fair value. Other intangible assets that meet certain criteria will continue to be amortized over their useful lives and will also be subject to an impairment test based on estimated fair value. Estimated fair value is typically less than values based on undiscounted operating earnings because fair value estimates include a discount factor in valuing future cash flows. There are many assumptions and estimates underlying the determination of an impairment loss.

Legal Contingencies: We are a defendant in numerous litigation and regulatory matters including those involving securities law, patent law, environmental law, employment law and ERISA, as discussed in Note 16 to the consolidated financial statements. As required by SFAS No. 5, we determine whether an estimated loss from a loss contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. We analyze our litigation and regulatory matters based on available information to assess potential liability. We develop our views on estimated losses in consultation with outside counsel handling our defense in these matters which involves an analysis of potential results, assuming a combination of litigation and settlement strategies. Should these matters result in an adverse judgment or be settled for significant amounts, they could have a material adverse effect on our results of operations, cash flows and financial position in the period or periods in which such judgment or settlement occurs.

Other Significant Accounting Policies: Other significant accounting policies, not involving the same level of uncertainties as those discussed above, are nevertheless important to an understanding of the financial statements. See Note 1 to the consolidated financial statements, Summary of Significant Accounting Policies, which discusses accounting policies that must be selected by management when there are acceptable alternatives.

Other accounts affected by management estimates.

The following table summarizes other significant areas which require management estimates:

(in millions)	Year ended December 31		
	2001	**2000**	**1999**
	Restated	**Restated**	**Restated**
Amortization of goodwill and intangible assets	**$ 94**	$ 86	$ 50
Depreciation of equipment on operating leases	**657**	626	560
Depreciation of land, buildings and equipment	**402**	417	416
Amortization of capitalized software	**179**	115	64
Pension benefits net periodic benefit cost	**99**	44	102
Other benefits net periodic benefit cost	**130**	109	107

Financial Overview

As previously discussed we have restated our prior year s financial statements and our previously released 2001 results. All dollar and per share amounts, and financial ratios have been revised, as appropriate, to reflect these restatements. In 2001 we reduced our net loss to $94 million or $(0.15) per share from a net loss of $273 million, or $(0.48) per share in 2000. In 2001 we executed aggressive plans to exit certain businesses, outsource some internal functions and substantially reduce our cost base in order to restore our financial strength and significantly improve our core operations while effectively positioning ourselves to exploit future opportunities in the production, office and services markets. These actions resulted in strong 2001 fourth quarter performance including the highest gross margin in the past two years; lower year over year selling, administrative and general expenses; reduction of inventory to historically low levels; improved cash and reduced net debt. We believe the combination of actions already implemented, continuing cost reduction activities and our focus on more profitable revenue positions us for continued improvement and builds a solid foundation for future growth.

The 2001 net loss of $94 million included $507 million of after-tax charges ($715 million pre-tax) for restructuring and asset impairments associated with our Turnaround Program, aimed at creating a leaner, faster and more flexible enterprise, and our disengagement from our worldwide Small Office/Home Office (SOHO) business. 2001 results also included a $304 million after-tax gain ($773 million pre-tax) from the sale of half of our interest in Fuji Xerox, a $38 million after-tax gain related to the early retirement of debt, and $21 million of after-tax gains associated with unhedged foreign currency. Unhedged foreign currency exposures are the result of net unhedged positions largely caused by our restricted access to the derivatives markets since the fourth quarter 2000. This limitation has increased our risk to financial volatility associated with currency gains and losses. Further discussion of the restructuring charges and sale of half our interest in Fuji Xerox is included below and in Notes 3 and 5, respectively, to the consolidated financial statements.

The $273 million net loss in 2000 was substantially worse than 1999 net income of $844 million. The 2000 net loss was largely attributable to $339 million of after-tax charges ($475 million pre-tax) for restructuring and asset impairments and our $37 million share of a Fuji Xerox restructuring charge, partially offset by after-tax gains of $119 million ($200 million pre-tax) from the sale of our China operations and $69 million of unhedged foreign currency after-tax gains.

Results of Operations

(in millions except per share amounts)	For the Year Ended		
	2001	2000	1999
	Restated	Restated	Restated
Revenue	$ 17,008	$ 18,751	$ 18,995
Net (loss) income	$ (94)	$ (273)	$ 844
Diluted (loss) earnings per share	$ (0.15)	$ (0.48)	$ 1.17

In 1999, we faced several business challenges, which adversely impacted our performance beginning in the second half of that year and continued into 2001. Many of the business challenges were company specific and included increased sales force turnover, open sales territories and lower sales productivity resulting from the realignment of our sales force from a geographic to an industry structure. Further disruption and incremental costs were associated with the consolidation of our U.S. customer administration centers and changes in our European infrastructure. In addition, there were significant competitive and industry changes, and adverse economic conditions affecting our operations toward the latter part of 2000. These challenges were exacerbated by significant technology and acquisition spending negatively impacting our cash availability, credit rating downgrades, limited access to capital markets and marketplace concerns regarding our liquidity.

To counter these challenges, we implemented actions beginning in mid-2000 to stabilize our sales force and minimize further disruption to our operations. In October 2000, we announced a Turnaround Program designed to help ensure adequate liquidity, re-establish profitability and build a solid foundation for future growth. The Turnaround Program encompassed four major components: (i) asset sales of $2 to $4 billion; (ii) accelerated cost reductions designed to reduce costs by at least $1 billion annually; (iii) the transition of equipment financing to third party vendors and (iv) a focus on our core business of providing document processing systems, solutions and services to our customers. By the end of 2001, we had made significant progress executing this program and achieving these goals.

By year-end 2001, we had completed asset sales of $2.3 billion, comprised of the March 2001 sale of half our ownership interest in Fuji Xerox Co., Ltd. (Fuji Xerox) to Fuji Photo Film Co., Ltd. (FujiFilm) for $1,283 million, the December 2000 sale of our China Operations to Fuji Xerox for $550 million, the April 2001 sale of our Nordic leasing businesses to Resonia AB for approximately $370 million, and in the fourth quarter 2001 the first in a series of asset sales to transfer our office product manufacturing operations to Flextronics for approximately $118 million. We believe the asset sale component of our Turnaround Program has been largely completed.

We also intensified cost reductions to improve our competitiveness. During 2001, we implemented work force resizing and cost reduction actions that we believe will result in approximately $1.1 billion in annualized savings. These savings are expected to result from reducing layers of management, consolidating operations where prudent, reducing administrative and general spending, capturing service productivity savings from our digital products and tightly managing discretionary spending. We are reducing costs in our Office segment by moving to lower cost indirect sales and service channels and by outsourcing our office products manufacturing. Our worldwide employment declined by approximately 13,600 to 78,900 at December 31, 2001. In our ongoing efforts to reduce our cost base, we will continue to implement restructuring actions and incur substantial restructuring charges throughout 2002; although less than the amounts recorded in 2001.

Our transition to third party financing will significantly improve our liquidity while ensuring equipment financing is still provided to our customers. In 2001, we entered into framework agreements with General Electric Capital Corporation (GE Capital) for them to manage our customer administrative functions and become the primary equipment financing provider for Xerox customers in the U.S., Canada, France and Germany. On May 1, 2002, Xerox Capital Services LLC (XCS), our U.S. venture with GE Capital Vendor Financial Services, became operational. XCS manages our customer administration and leasing activities in the U.S., including financing administration, credit approval, order processing, billing and collections. We are currently in the process of completing the negotiation of definitive agreements with GE Capital for the implementation of the Canadian joint venture which is expected in the second half of 2002. These agreements are subject to the completion of due diligence on GE s part as well as the fulfillment of various regulatory requirements.

Ongoing funding for new leases by GE Capital and its affiliates in both the U.S. and Canada is expected to be in place later this year upon development and completion of systems and process modifications. In Europe, a number of initiatives are under way and have been implemented. In Germany, we received a $77 million loan in May 2002 secured by certain finance receivables, as we continue to complete our vendor financing transition this year. In France we are completing due diligence, fulfilling regulatory requirements, consulting with local works councils and expect to complete the agreement with GE Capital in the third quarter 2002. We have fully transitioned our leasing businesses in the Nordic countries, the Netherlands and Italy. Our Nordic leasing business was sold to Resonia AB in April 2001. In the first quarter 2002, we formed a joint venture with De Lage Landen International BV (DLL) in which they provide funding and manage equipment financing for our customers in the Netherlands. In April 2002, we sold our equipment financing operations in Italy for approximately $207 million in cash plus the assumption of $20 million of debt. We have made significant progress in our Developing Markets Operations (DMO), beginning in April 2002, with Banco Itau S.A. in Brazil and collectively with the Capita Corporation de Mexico S.A. de C.V., Organizacion Auxiliar Del Credito and Arrendadora Capita Corporation, S.A. de C.V. in Mexico becoming the primary equipment financing providers in their respective countries. By the end of 2002, we expect that approximately two-thirds of all new financed lease originations will be funded by third parties, through a combination of structures including direct financing, finance receivable securitizations and ongoing secured borrowings.

In addition to the vendor financing agreements, in 2001 and through the first half of 2002, we borrowed approximately $3.1 billion in the U.S., Canada and U.K. from GE Capital through the securitization of certain existing lease contracts. We and GE Capital are parties to a loan agreement dated November 2001 which provides for a series of secured loans in the U.S. up to an aggregate of $2.6 billion. Through June 2002, approximately $1.9 billion of loans have been funded under this GE Capital agreement including a $499 million loan which closed on May 12, 2002.

In line with our strategy to focus on our core business, we announced the disengagement from our worldwide SOHO business in June 2001. By the end of the year, we had sold the remaining equipment inventory and in the fourth quarter achieved profitability in this business through the sale of supplies to our current base of SOHO customers. We expect this profitable supplies revenue stream to decline over time as the equipment is eventually replaced.

Summary of Total Company Results

To understand the trends in our business, we believe that it is helpful to adjust revenue and expense (except for ratios) to exclude the impact of changes in the translation of European and Canadian currencies into U.S. dollars. We refer to this adjustment as pre-currency.

A substantial portion of our consolidated revenues is derived from operations outside of the United States where the U.S. dollar is not the functional currency. We generally do not hedge the translation effect of revenues denominated in currencies where the local currency is the functional currency. When compared with the average of the major European and Canadian currencies on a revenue-weighted basis, the U.S. dollar in 2001 was approximately 3 percent stronger than in 2000. The U.S. dollar was approximately 10 percent stronger in 2000 than in 1999. As a result, foreign currency translation unfavorably impacted revenue growth by approximately one percentage point in 2001 and 3 percentage points in 2000.

Latin American currencies are shown at actual exchange rates for both pre-currency and post-currency reporting, since these countries generally have volatile currency and inflationary environments. In 2001, currency devaluations in Brazil continued to impact our results, as the Brazilian Real devalued 22 percent against the U.S. dollar. The devaluation was 2 percent in 2000 and 35 percent in 1999.

Total revenues of $17.0 billion in 2001 declined 9 percent (8 percent pre-currency) from 2000. Approximately 25 percent of the decline reflected the loss in revenues resulting from the 2000 sale of our China operations and our exit from the SOHO business in the second half of 2001. The remaining revenue decline occurred in all operating segments, but was most pronounced in the Developing Markets segment, which declined by $330 million or 14 percent from 2000 and the Production segment which declined by $433 million or 7 percent from 2000. Revenues in all geographies were impacted by marketplace competition, further weakening of the worldwide economy and our reduced participation in aggressively priced bids and tenders as we focus on improved profitability. We expect total revenues to decline in 2002, reflecting the effects of our exit from the SOHO business, lower equipment population in all geographies, competitive pressures and the weak economic environment, partially offset by the benefit of new product launches in the second half 2002. We expect finance income will decline over time as we transition equipment financing to third parties.

In 2000, revenues of $18.8 billion declined one percent (grew 2 percent pre-currency) from 1999. 2000 revenues declined 5 percent (one percent pre-currency) excluding the beneficial impact of the January 1, 2000 acquisition of the Tektronix, Inc. Color Printing and Imaging Division (CPID). CPID is discussed in Note 4 to the consolidated financial statements. Revenues in 2000 were impacted by a combination of the previously mentioned company specific issues, increased competitive environment and some weaker European and Latin American economies toward the latter part of the year.

Revenues by Type. Revenues and year-over-year changes by type of revenues were as follows:

	Revenues			% Change	
	2001	2000	1999	2001	2000
		Restated ($ in billions)	Restated		
Equipment Sales	$ 4.3	$ 5.3	$ 5.7	(18)%	(9)%
Post Sale and Other Revenue	11.6	12.3	12.1	(6)	2
Financing Income	1.1	1.2	1.2	(3)	(1)
Total Revenues	$ 17.0	$ 18.8	$ 19.0	(9)%	(1)%

Note 1: Post sale and other revenue include service, document outsourcing, rentals, supplies and paper, which represent the revenue streams that follow equipment placement, as well as other revenue not associated with equipment placements, such as royalties.

Note 2: Revenue from document outsourcing arrangements of $3.7, $3.8 and $3.2 billion in 2001, 2000 and 1999, respectively, are included in all revenue categories.

Note 3: Total Sales revenue in the Consolidated Statement of Operations includes equipment sales noted above as well as $3.1, $3.5 and $3.3 billion of supplies and paper and other revenue for 2001, 2000 and 1999, respectively.

2001 equipment sales declined 18 percent (17 percent pre-currency) from 2000. Over one third of the decline was due to our exit from the SOHO business and the sale of our China operations. Equipment sales in North America and Europe declined 5 percent and 21 percent respectively from 2000, reflecting increased marketplace competition, continued economic weakness and pricing pressures in many major market segments. In Europe equipment sales also declined due to our decision to reduce participation in aggressively priced bids and tenders as we reorient our focus from market share to profitable revenue.

2000 equipment sales declined 9 percent (5 percent pre-currency) from 1999 due to the combination of company specific business challenges, including sales force disruption and turnover, increased competition and some weaker economies. Excluding the beneficial impact of the CPID acquisition, 2000 equipment sales declined 12 percent (9 percent pre-currency).

2001 post sale and other revenue declined 6 percent (5 percent pre-currency) or 5 percent (4 percent pre-currency) excluding the impact of the 2000 sale of our China operations. Post sale and other revenue grew 2 percent (5 percent pre-currency) in 2000 including the beneficial impact of the CPID acquisition. Post sale and other revenues have been adversely affected by reduced equipment populations and lower page print volumes.

Financing income declined 3 percent (2 percent pre-currency) in 2001 reflecting lower equipment sales and the initial effects of our transition to third party finance providers. Financing income declined one percent (grew 2 percent pre-currency) in 2000. Financing income is determined by the discount rate that is implicit in the lease agreements with our customers, after determination of the fair value of the services and equipment included in a bundled lease agreement with multiple deliverable elements. Refer to a discussion of our leasing policies above in the Application of Critical Accounting Policies section for more information. Financing income will generally be dependent on the amount of new equipment leases that we enter. We expect finance income will decline over time as we transition equipment financing to third parties.

Total document outsourcing revenues of $3.7 billion declined 2 percent (one percent pre-currency) in 2001 and grew 19 percent in 2000. The backlog of future estimated document outsourcing revenues was approximately $7.6 billion at the end of 2001, a reduction of 7 percent from the end of 2000 and in line with trends experienced elsewhere in our business. Our backlog is determined as the estimated post-sale services and financing to be provided under committed contracts as of a point in time.

Gross Margin

The trend in gross margin was as follows:

	2001	2000	1999
Total Gross Margin(1)	38.2%	37.4%	42.3%
Gross Margin by revenue stream:			
Sales(2)	30.5	31.2	37.2
Service, Outsourcing(2), and Rentals	42.2	41.1	44.7
Finance Income	59.5	57.1	63.0

(1) Includes inventory charges of $42 million and $84 million associated with 2001 and 2000 restructuring actions. These changes impacted 2001 and 2000 total gross margin by 0.2 points and 0.4 points, respectively and sales gross margin by 0.6 points and 1.0 point, respectively.
(2) The equipment sales gross margin for document outsourcing is included in the sales gross margin.

The 2001 gross margin of 38.2 percent increased by 0.8 percentage points from 2000, as improved manufacturing and service productivity more than offset unfavorable mix and competitive price pressures, particularly in the production monochrome business. Gross margin improved during 2001 from 34.7 percent in the first quarter to 40.8 percent in the fourth quarter reflecting the benefits of our cost base restructuring and exit from the SOHO business. We expect the 2002 gross margin will approximate 40 percent, reflecting the beneficial impacts of continuing cost base restructuring, and our SOHO exit, partially offset by competitive price pressures.

2000 gross margin of 37.4 percent was 4.9 percentage points below 1999. Approximately half the decline was the result of production monochrome weakness reflecting initial competitive product entry during a time when our sales force was weakened as we realigned from a geographic to an industry structure. Higher revenue growth in the lower margin document outsourcing business and SOHO inkjet investments to build equipment population also contributed to the decline. Finally, gross margin was also adversely impacted by competitive price pressure, unfavorable transaction currency and temporary pricing actions implemented to reduce inventory on certain products in the latter part of the year. Manufacturing and other productivity improvements only partially offset the above items.

Finance margins reflect interest expense related to our financing operations based on our overall cost of funds, applied against the level of debt required to support the Company s financed receivables.

Research and Development. 2001 Research and development (R&D) spending of $997 million declined 6 percent from 2000 primarily due to the SOHO disengagement. 2001 R&D spending represented approximately 6 percent of total revenues as we continued to invest in technological development, particularly color, to maintain our position in the rapidly changing document processing market. Including CPID, R&D expense grew 4 percent in 2000 reflecting increased program spending primarily for solid ink, solutions and the DocuColor iGen3, a next-generation digital printing press technology which is scheduled to launch in the second half 2002. We believe our R&D remains technologically competitive and is strategically coordinated with Fuji Xerox, which invested $548 million in R&D in 2001, for a combined total of $1,545 million. We are planning to launch five new platforms this year, compared with two per year during the last several years. We expect 2002 R&D spending will represent approximately 5 to 6 percent of revenue, a level that we believe is adequate to remain technologically competitive.

Selling, Administrative and General Expenses.

Selling, administrative and general (SAG) expenses as a percent of revenue were as follows:

	2001	2000	1999
SAG% Revenue	27.8%	29.4%	27.4%

SAG declined $790 million or 14 percent (13 percent pre-currency) in 2001 to $4,728 million reflecting significantly lower labor costs and other benefits derived from our Turnaround Program, temporarily lower advertising and marketing communications spending and reduced SOHO spending, partially offset by increased professional costs related to litigation, SEC issues and related matters. In 2001, SAG represented 27.8 percent of revenue, a 1.6 percentage point improvement from 2000. We expect a mid-single digit decline in 2002 SAG spending as we continue to implement cost cutting actions.

In 2000, SAG increased $314 million or 6 percent (9 percent pre-currency) to $5,518 million. Excluding the CPID acquisition, SAG grew 3 percent (6 percent pre-currency) reflecting increased sales force payscale and incentive compensation, significant transition costs associated with implementation of the European shared services organization, continued effects of the U.S. customer administration issues and significant marketing, advertising and promotional investments for our SOHO inkjet printer initiative.

Bad debt expense, which is included in SAG, was $438 million, $473 million and $386 million in 2001, 2000 and 1999, respectively. Reduced 2001 provisions reflect lower equipment sales partially offset by some reserve increases due to the weakened worldwide economy. Provisions increased in 2000 due to continued resolution of aged billing and receivables issues in the U.S. and Europe resulting from the consolidation of our customer administration centers and infrastructure changes and unsettled business and economic conditions in many Latin American countries. Bad debt provisions as a percent of total revenue were 2.6 percent, 2.5 percent, and 2.0 percent for 2001, 2000 and 1999, respectively.

The agreements with GE Capital in the U.S. and Canada include new approaches to managing most of our customer administrative functions. On May 1, 2002, XCS, our U.S. venture with GE Capital Vendor Financial Services, became operational. XCS manages our customer administration and leasing activities, including financing administration, credit approval, order processing, billing and collections. We will consolidate the operations of XCS in our financial statements and include the XCS headcount with our employee statistics. We are completing the negotiation of definitive agreements with GE Capital for the implementation of the Canadian joint venture which is expected in the second half of 2002. Over time we expect these arrangements will facilitate reduced back office and infrastructure expenses and improve collection discipline. We expect this will improve sales force productivity and customer satisfaction through improved billing practices as well as reduce bad debt expense.

Restructuring Programs. Since early 2000, we have been restructuring our cost base. We have implemented a series of plans to resize our workforce and reduce our cost structure through three restructuring initiatives: the October 2000 Turnaround Program, the June 2001 SOHO disengagement and the March 2000 restructuring action. The execution of these actions and payment of obligations continued through December 31, 2001, with each initiative in various stages of completion. In total, we recorded restructuring provisions of $715 million in 2001 and $475 million in 2000, including $205 million and $64 million of asset impairment charges in 2001 and 2000, respectively. As management continues to evaluate the business, there may be supplemental charges for new plan initiatives as well as changes in estimates to amounts previously recorded as payments are made or actions are completed. We expect to complete the initiatives associated with the programs in 2002 and will have new initiatives going forward under the Turnaround Program. The restructuring programs are discussed below and in Note 3 to the consolidated financial statements.

Turnaround Program: In October 2000, we announced our Turnaround Program and recorded a restructuring provision of $105 million in connection with finalized initiatives. This charge included estimated costs of $71 million for severance associated with the worldwide resizing of our work force and $34 million associated with the disposition of a non-core business. Over half of these charges related to our Production segment with the remainder related to our Office, DMO and Other segments. In 2001, we provided an incremental $403 million, net of reversals, for initiatives for which we had a formal and committed plan. This provision included $339 million for severance and other employee separation costs associated with the resizing of our work force worldwide, $36 million for lease cancellation and other exit costs and $28 million for asset impairments. The aggregate severance and other employee separation costs in 2001 and 2000 of $410 million were for the elimination of approximately 7,800 positions worldwide. The majority of these charges related to our Production and Office segments. The Turnaround Program restructuring reserve balance at December 31, 2001 was $223 million.

SOHO Disengagement: In June 2001, we announced our disengagement from our worldwide SOHO business. In connection with exiting this business, during 2001 we recorded a net charge of $239 million. The charge included provisions for the elimination of approximately 1,200 positions worldwide, the closing of facilities and the write-down of certain assets to net realizable value. The charge consisted of $164 million of asset impairments, $49 million for lease cancellation and other exit costs and $26 million in severance and related costs. During the fourth quarter 2001, we sold our remaining inventory of personal inkjet and xerographic printers, copiers, facsimile machines and multi-function devices which were distributed primarily through retail channels to small offices, home offices and personal users (consumers). We will continue to provide current SOHO customers with service, support and supplies, including the manufacturing of such supplies, during a phase-down period to meet customer commitments, which will result in a declining revenue base over the next few years. The SOHO disengagement restructuring reserve balance at December 31, 2001 was $23 million.

March 2000 and 1998 Restructurings: In March 2000, we recorded a provision of $489 million as part of a worldwide restructuring program including asset impairments of $30 million. During 2001 and 2000, we recorded net changes in estimates for both the March 2000 and the 1998 restructuring programs which reduced restructuring expense by $25 million and $125 million, respectively. As of December 31, 2001, these programs had been substantially completed.

As a direct result of the various restructuring actions, we determined that certain products were not likely to be sold in their product life cycle. For this reason, in 2001 we recorded a $42 million charge to write-down excess and obsolete inventory, $34 million of which resulted from the disengagement from our SOHO operations. In 2000, we recorded a charge of $84 million primarily as a result of the consolidation of distribution centers and warehouses and the exit from certain product lines. These charges are included in Cost of sales in the Consolidated Statement of Operations.

Worldwide employment declined by approximately 13,600 in 2001 to approximately 78,900, largely as a result of our restructuring programs and the transfer of approximately 2,500 employees to Flextronics as part of our office manufacturing outsourcing. Worldwide employment was approximately 92,500 and 94,600 at December 31, 2000 and 1999, respectively.

Other Expenses, Net. Other expenses, net for the three years ended December 31, 2001 were as follows:

	2001	2000	1999
	Restated	Restated (in millions)	Restated
Non-financing interest expense	$ 480	$ 592	$ 407
Currency gains, net	(29)	(103)	(7)
Gain on early extinguishment of debt	(63)		
Amortization of goodwill and intangibles	94	86	50
Business divestiture and asset sale (gains) losses	10	(67)	(78)

Interest income	(101)	(77)	(20)
Year 2000 costs		2	47
All other, net	53	91	108
Total	$ 444	$ 524	$ 507

In 2001, non-financing interest expense was $112 million lower than 2000, reflecting lower interest rates and lower debt levels. Non-financing interest expense in 2001 included net losses of $2 million from the mark-to-market of our remaining interest rate swaps required to be recorded as a result of applying SFAS No. 133. Differences between the contract terms of our interest rate swaps and the underlying related debt restricts hedge accounting treatment in accordance with SFAS No. 133, which requires us to record the mark-to-market valuation of these derivatives directly to earnings. Non-financing interest expense was $185 million higher in 2000 than in 1999 as a result of the CPID acquisition, which resulted in incremental borrowings of $852 million, generally higher debt levels and increased interest rates.

Net currency (gains) losses result from the re-measurement of unhedged foreign currency-denominated assets and liabilities. In 2001, exchange gains on yen debt of $107 million more than offset losses on euro loans of $36 million, a $17 million exchange loss resulting from the peso devaluation in Argentina and other currency exchange losses of $25 million. In 2000, large gains on both the yen and euro loans in the fourth quarter contributed to the $103 million gain. These currency exposures are the result of net unhedged positions largely caused by our restricted access to the derivatives markets since the fourth quarter 2000. Due to the inherent volatility in the interest rate and foreign currency markets, we are unable to predict the amount of the above noted re-measurement and mark-to-market gains or losses in future periods. Such gains or losses could be material to the financial statements in any reporting period.

Goodwill and other intangible asset amortization relates primarily to our acquisitions of the remaining minority interest in Xerox Limited in 1995 and 1997, XL Connect in 1998 and CPID in 2000. Effective January 1, 2002 and in connection with the adoption of SFAS No. 142, we no longer record amortization of goodwill. However, in lieu of amortization, goodwill is tested at least annually for impairment using a fair value methodology. Intangible assets continue to be amortized. Further discussion is provided in Note 1 and Note 22 to the consolidated financial statements.

(Gains) losses on business divestitures and asset sales include the sales of our Nordic leasing business in 2001, the North American paper business and a 25 percent interest in ContentGuard in 2000, and various Xerox Technology Enterprise businesses in 1999, as well as miscellaneous land, buildings and equipment in all years. Further discussion of our divestitures follows and is also contained in Note 5 to the consolidated financial statements.

Interest income is derived primarily from our significant invested cash balances since the latter part of 2000 and from tax audit refunds. 2001 interest income was $24 million higher than 2000 due to higher investment interest resulting from a full year of invested cash balances in 2001, partially offset by lower interest from tax audit refunds. The increases in our invested cash balances reflect our decision, beginning in the second half of 2000, to accumulate cash to maintain financial flexibility rather than continue our historical practice of paying down debt with available cash.

All other, net includes many additional items, none of which are individually significant.

Gain on Affiliate s Sale of Stock. In 2001 and 2000, gain on affiliate s sale of stock of $4 million and $21 million, respectively, reflects our proportionate share of the increase in equity of ScanSoft Inc. (NASDAQ: SSFT) resulting from ScanSoft s issuance of stock in connection with acquisitions. The 2000 gain was partially offset by a $5 million charge reflecting our share of ScanSoft s write-off of in-process research and development associated with one of the acquisitions, which is included in equity in net income of unconsolidated affiliates. ScanSoft, an equity affiliate, is a developer of digital imaging software that enables users to leverage the power of their scanners, digital cameras, and other electronic devices.

Income Taxes and Equity in Net Income of Unconsolidated Affiliates. The effective tax rates were 126.1 percent in 2001, 19.1 percent in 2000 and 34.6 percent in 1999. The difference between the 2001 effective tax rate and the U.S. federal statutory income tax rate of 35 percent relates primarily to the recognition of deferred tax asset valuation allowances resulting from our recoverability assessments, the taxes incurred in connection with the sale of our partial interest in Fuji Xerox and continued losses in low tax jurisdictions. The gain for tax purposes on the sale of Fuji Xerox was disproportionate to the gain for book purposes as a result of a lower tax basis in the investment. Other items favorably impacting the tax rate included a tax audit resolution of approximately $140 million and additional tax benefits arising from prior period restructuring provisions. On a loss basis, the difference between the 2000 effective tax rate of 19.1 percent and the U.S. federal statutory income tax rate of 35 percent relates primarily to continued losses in low tax jurisdictions, the recognition of deferred tax asset valuation allowances resulting from our recoverability assessments and additional tax benefits arising from the favorable resolution of tax audits of approximately $125 million. The 1999 effective tax rate benefited from increases in foreign tax credits as well as a shift in the mix of our worldwide profits, partially offset by the recognition of deferred tax asset valuation allowances. Please refer to Note 15 to the consolidated financial statements for further information. Our effective tax rate will change year to year based on nonrecurring events (such as new Turnaround Program initiatives) as well as recurring factors including the geographical mix of income before taxes. In the normal course of business, we expect that our 2002 effective tax rate will be in the low to mid 40 percent range.

Equity in net income of unconsolidated affiliates is principally related to our 25 percent share of Fuji Xerox income. Equity income was $53 million in 2001, $66 million in 2000 and $48 million in 1999. The 2001 reduction primarily reflects our reduced ownership in Fuji Xerox. The 2000 improvement reflected improved Fuji Xerox operating results and the absence in 2000 of a prior year $21 million unfavorable tax adjustment relating to an increase in Fuji Xerox tax rates. These favorable items were partially offset by our $37 million share of a 2000 Fuji Xerox restructuring charge and reductions in income from several smaller equity investments.

Manufacturing Outsourcing. In October 2001, we announced a manufacturing agreement with Flextronics, a global electronics manufacturing services company. The agreement provides for a five-year supply contract for Flextronics to manufacture certain office equipment and components; the purchase of inventory, property and equipment at a premium over book value; and the assumption of certain liabilities. The premium will be amortized over the life of the five-year supply contract, as we will continue to benefit from the property transferred to Flextronics. Inventory purchased from us by Flextronics remains on our balance sheet until it is sold to an end user with a corresponding liability recognized for the proceeds received. This inventory and the corresponding liability was approximately $27 million at December 31, 2001. In total, the agreement with Flextronics represents approximately 50 percent of our overall worldwide manufacturing operations. In the 2001 fourth quarter, we completed the sales of our plants in Toronto, Canada; Aguascalientes, Mexico and Penang, Malaysia to Flextronics for approximately $118 million, plus the assumption of certain liabilities. The sale is subject to certain closing adjustments. Approximately 2,500 Xerox employees in these operations transferred to Flextronics upon closing. In January 2002, we completed the sale our office manufacturing operations in Venray, the Netherlands and Resende, Brazil for $29 million plus the assumption of certain liabilities. Approximately 1,600 Xerox employees in these operations transferred to Flextronics upon closing. By the end of the third quarter 2002, we anticipate all production at our printed circuit board factories in El Segundo, California and Mitcheldean, England and our customer replaceable unit plant in Utica, New York will be fully transferred to Flextronics facilities which will complete the plans that we announced in October. Included in the 2001 Turnaround Program are restructuring charges of $24 million related to the closing of these facilities.

Divestitures. In December 2001, we sold Delphax Systems and Delphax Systems, Inc. (Delphax) to Check Technology Corporation for $14 million in cash, subject to purchase price adjustments. Delphax designs, manufactures and supplies high-speed electron beam imaging digital printing systems and related parts, supplies and maintenance services. There was no gain or loss recorded related to this sale.

In April 2001, we sold our leasing businesses in the four Nordic countries to Resonia Leasing AB (Resonia) for proceeds of approximately $370 million, which approximated book value. The assets sold included the leasing portfolios in the respective countries, title to the underlying equipment included in the lease portfolios and the transfer of certain employees and systems used in the operations of the businesses. Under terms of the agreement, Resonia will provide on-going exclusive equipment financing to Xerox customers in those countries.

In March 2001, we sold half our ownership interest in Fuji Xerox to FujiFilm for $1,283 million in cash. The sale resulted in a pre-tax gain of $773 million. Income taxes of approximately $350 million related to this transaction were paid in the first quarter 2002. Under the agreement, FujiFilm s ownership interest in Fuji Xerox increased from 50 percent to 75 percent. While Xerox s ownership interest decreased to 25 percent, we retain significant rights as a minority shareholder. All product and technology agreements between Fuji Xerox and us continue, ensuring that the two companies retain uninterrupted access to each other s portfolio of patents, technology and products. With its business scope focused on document processing activities, Fuji Xerox will continue to provide office products to us and collaborate with us on research and development. We maintain our agreement with Fuji Xerox to provide them production publishing and solid ink technology.

In December 2000, we completed the sale of our China operations to Fuji Xerox for $550 million cash and the assumption of $118 million of debt for which we recorded a $200 million pre-tax gain. Revenues from our China operations were $262 million in 2000.

In June 2000, we entered into an agreement to sell our U.S. and Canadian commodity paper product line and customer list, for $40 million. We also entered into an exclusive license agreement for the Xerox brand name. Additionally, we earn commissions on Xerox originated sales of commodity paper as an agent for Georgia Pacific.

In April 2000, we sold a 25 percent ownership interest in our wholly owned subsidiary, ContentGuard, to Microsoft, Inc. for $50 million and recognized a gain of $23 million. An additional gain of $27 million was deferred pending the achievement of certain performance criteria. In May 2002, we paid Microsoft $25 million as the performance criteria had not been achieved. In connection with the sale, ContentGuard also received $40 million from Microsoft for a non-exclusive license of its patents and other intellectual property and a $25 million advance against future royalty income from Microsoft on sales of products incorporating ContentGuard s technology. The license payment is being amortized over the ten year life of the license agreement and the royalty advance will be recognized in income as earned.

Acquisition of the Color Printing and Imaging Division of Tektronix, Inc. In January 2000, we acquired the Color Printing and Imaging Division of Tektronix, Inc. (CPID) for $925 million in cash including $73 million paid by Fuji Xerox for the Asia/Pacific operations of CPID. CPID manufactures and sells color printers, ink and related products and supplies. The acquisition accelerated us to the number two market position in office color printing, improved our reseller and dealer distribution network and provided us with scalable solid ink technology. The acquisition also enabled significant product development and expense synergies with our monochrome printer organization.

Business Performance by Segment.

As discussed in Note 22 to the Consolidated Financial Statements, operating segment information for 2001 has been restated to reflect a change in operating segment structure that was made in 2002. The nature of the changes related primarily to corporate expense and other allocations associated with internal reorganizations made in 2002, as well as decisions concerning direct applicability of certain overhead expenses to the segments. The adjustments increased (decreased) full year 2001 revenues as follows ($ in millions): Production ($16), Office ($16), DMO ($1), SOHO $3 and Other $30. The full year 2001 segment profit was increased (decreased) as follows: Production $12, Office $24, DMO $32, SOHO $2 and Other ($70). However, the operating segment information for 2000 and 1999 has not been adjusted as it was impracticable to do so, and is therefore is not presented on the new basis. We have, however, presented comparative segment information on the old basis for 2001, 2000 and 1999.

In 2001, we realigned our reportable segments to be consistent with how we manage the business and to reflect the markets we serve. Our business segments are as follows: Production, Office, DMO, SOHO, and Other. The table below summarizes our business performance by segment for the three-year period ended December 31, 2001. Revenues and associated percentage changes, along with operating profits and margins by segment are included. Segment operating profit (loss) excludes certain non-segment items, such as restructuring and gains on sales from businesses, as further described in Note 10 to the consolidated financial statements.

Business Segment Performance

Operating segment selected financial information, using the new basis of presentation, for the year ended December 31, 2001 was as follows:

	Revenue	Operating Profit (Loss)(2)	Operating Margin
		($ in millions)	
Production	$ 5,883	$ 466	7.9%
Office	6,910	365	5.3
DMO	2,026	(125)	(6.2)
SOHO	410	(195)	(47.6)
Other	1,779	(143)	(8.0)
Total	$ 17,008	368	2.2
Memo: Color(1)	$ 2,759		

(1) Same as below.
(2) Same as below.

Operating segment selected financial information, using the prior year s basis of presentation, for the years ended December 31, 2001, 2000 and 1999 was as follows:

	2001	2000	1999	% Change 2001	% Change 2000
	Restated	Restated ($ in millions)	Restated		
Revenue					
Production	$ 5,899	$ 6,332	$ 6,933	(7)%	(9)%
Office	6,926	7,060	6,853	(2)	3
DMO	2,027	2,619	2,450	(23)	7
SOHO	407	599	575	(32)	4
Other	1,749	2,141	2,184	(17)	(2)
Total	$ 17,008	$ 18,751	$ 18,995	(9)%	(1)%
Memo: Color(1)	$ 2,762	$ 2,612	$ 1,619	6%	61%
Operating Profit (Loss)(2)					
Production	$ 454	$ 463	$ 1,236		
Office	341	(180)	49		
DMO	(157)	(93)	48		
SOHO	(197)	(293)	(188)		
Other	(73)	225	203		
Total	$ 368	$ 122	$ 1,348		
Operating Margin					
Production	7.7%	7.3%	17.8%		
Office	4.9	(2.5)	0.7		
DMO	(7.7)	(3.6)	2.0		
SOHO	(48.4)	(48.9)	(32.7)		
Other	(4.2)	10.5	9.3		
Total	2.2%	0.7%	7.1%		

(1) Color revenue is included in all segments except Other.
(2) Segment operating profit (loss) includes allocation of certain corporate expenses such as research, finance, business strategy, marketing, legal, and human resources. The Other segment includes certain expenses which have not been allocated to the businesses such as non-financing interest expense.

Basis of presentation:

All operating segment information discussed below is in the context of the prior year s basis of presentation.

Production: Production revenues include production publishing, production printing, color products for the production and graphic arts markets and light-lens copiers over 90 pages per minute sold predominantly through direct sales channels in North America and Europe. Revenues declined 7 percent (6 percent pre-currency) in 2001 and 9 percent (6 percent pre-currency) in 2000. The monochrome production revenue decline reflected competitive product introductions, movement to distributed printing and electronic substitutes, and weakness in the worldwide economy. Revenue from our DocuTech production publishing family, which had been continually refreshed and expanded since its 1990 launch, declined in both 2001 and 2000 reflecting the 1999 introduction of a competitive product. While Xerox remained the market leader, our production publishing market share declined in 2000, but improved significantly in the U.S. in 2001. In production printing, Xerox maintained its strong market leadership in both 2001 and 2000, however, revenue decreased reflecting declines in the transaction printing market.

2001 production color revenues grew 2 percent from 2000 including continued strong DocuColor 2000 series growth, partially offset by declines in older products reflecting introduction of competitive offerings and the effects of the weakened economy in the second half of the year. The DocuColor 2000 series, launched in 2000, at speeds of 45 and 60 pages per minute established an industry standard by producing near-offset quality, full color prints including customized one-to-one printing at a variable cost of less than 10 cents per page. Production color revenues grew significantly in 2000 largely due to the very successful launch of the DocuColor 2000 series. Production revenues represented 35 percent of 2001 revenues compared with 34 percent in 2000.

2001 Production operating profit continued to decline, but significantly less than the rate of decline experienced in 2000. Lower 2001 revenue combined with reduced monochrome gross margin reflecting competitive pressures were only partially offset by a substantial improvement in SAG expenses generated by our Turnaround Program. 2000 operating profit was significantly below 1999 due to lower revenue and gross margin, reflecting increased competition. Expenses increased due to the earlier sales realignment and administrative transition and higher DocuColor iGen3 R&D investments.

Office: Office revenues include our family of Document Centre digital multifunction products, color laser, solid ink and monochrome laser desktop printers, digital and light-lens copiers under 90 pages per minute, and facsimile products sold through direct and indirect sales channels in North America and Europe. 2001 revenues declined 2 percent (one percent pre-currency) from 2000 as strong office color revenue growth was not sufficient to offset monochrome declines. Color revenue growth was driven by the Document Centre Color Series 50 and strong color printer equipment sales including the Phaser 860 solid ink and Phaser 7700 laser printers which use single pass color technology. 2001 monochrome revenues declined as growth in digital multifunction was more than offset by declines in light lens as the market continues to transition to digital technology. This decline was exacerbated further by our reduced participation in very aggressively priced competitive customer bids and tenders in Europe, as we reorient our focus from market share to profitable revenue. These declines were only slightly offset by the very successful North American launch of the Document Centre 490 in September 2001. In 2001, digital multifunction equipment sales represented approximately 91 percent of our monochrome copier equipment sales compared with 82 percent in 2000.

2000 revenues increased 3 percent from 1999 including the January 2000 acquisition of CPID. Excluding CPID, revenues declined 6 percent. Office revenues represented 41 percent of 2001 revenues compared with 38 percent in 2000.

Operating profit in the Office segment increased significantly in 2001 reflecting lower SAG spending, benefiting from our Turnaround Program and improved gross margins. Gross margin improvement includes the benefit of our reduced participation in very aggressively priced European bids and tenders, significantly improved document outsourcing margins, improving Document Centre margins facilitated by favorable mix due to the Document Centre 480 and 490 launches, improved manufacturing and service productivity, and favorable currency. 2000 operating profit was significantly lower than 1999 reflecting lower gross margins, higher R&D spending associated with the CPID acquisition and increased SAG expenses due to the sales realignment, administrative transition and CPID spending.

DMO: DMO includes operations in Latin America, the Middle East, India, Eurasia, Russia and Africa. DMO included our China operation, which generated revenues of $262 million in 2000, prior to the December 2000 sale. In Latin America most equipment transactions are recorded as operating leases. 2001 DMO revenue declined 23 percent from 2000, with approximately 45 percent of the decline due to the sale of our China operation. The balance of the decline was due to lower equipment populations, implementation of a new business model that places greater emphasis on liquidity and profitable revenue rather than market share as well as general economic weakness in many of the countries. Revenues in Brazil, which represented approximately 5 percent of our total revenues in 2001, declined 18 percent from 2000 primarily as a result of an average 22 percent currency devaluation of the Brazilian Real and implementation of the new business model. In 2001, DMO incurred a $157 million loss reflecting lower revenue and gross margins only partially offset by initial cost restructuring benefits. In addition, results were adversely impacted by higher aggregate exchange losses including the Argentinean devaluation.

2000 revenues grew 7 percent reflecting growth in Brazil and most countries outside Latin America. Revenues in Brazil grew 5 percent as an improved economic environment was partially offset by increased competitive activity and lower prices during the latter half of the year as the operation focused on reducing inventory. DMO incurred an $93 million loss in 2000 compared to a profit of $48 in 1999 reflecting lower margins and an increase in SAG expenses, including higher bad debt provisions.

SOHO: We announced our disengagement from our worldwide SOHO business in June 2001 and sold our remaining equipment inventory by the end of the year. SOHO revenues now consist primarily of profitable consumables for the inkjet printers and personal copiers previously sold through indirect channels in North America and Europe. SOHO revenues represented 2 percent of 2001 revenues compared with 3 percent in 2000, and declined 32 percent in 2001 from 2000. Despite a gross margin decline, significant SAG and R&D reductions following our June 2001 disengagement resulted in substantially lower operating losses in 2001 and a return to profitability in the fourth quarter. We expect profits to continue in 2002 as we sell high-margin consumables for the existing equipment population. We also expect SOHO revenues and profits to decline over time as the existing equipment population is replaced.

Other: Other includes revenues and costs associated with paper sales, Xerox Engineering Systems (XES), Xerox Connect, Xerox Technology Enterprises (XTE), our investment in Fuji Xerox, consulting and other services. Other also includes corporate items such as non-financing interest expense and other non-allocated central costs.

2001 revenue declined 18 percent from 2000 and operating losses increased principally reflecting lower paper, XES, Xerox Connect, and XTE revenues, and lower income related to our reduced investment in Fuji Xerox, partially offset by lower net non-financing interest expense. The 2001 operating loss also reflects the additional ESOP funding necessitated by the elimination of the ESOP dividend; higher professional fees related to litigation, SEC issues and related matters; employee retention compensation; and lower pension settlement gains. 2000 results benefited from gains on the sales of our North American paper business, a 25 percent interest in ContentGuard, and a gain on our ScanSoft affiliate s sale of stock.

New Accounting Standards. Effective January 1, 2001, we adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), which requires companies to recognize all derivatives as assets or liabilities measured at their fair value regardless of the purpose or intent of holding them. Gains or losses resulting from changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction. Changes in fair value for derivatives not designated as hedging instruments and for the ineffective portions of hedges are recognized in earnings of the current period. The adoption of SFAS No. 133 resulted in a net cumulative after-tax loss of $2 million in the first quarter Consolidated Statement of Operations and a net cumulative after-tax loss of $19 million in Accumulated Other Comprehensive Income. Further, as a result of recognizing all derivatives at fair value, including the differences between the carrying values and fair values of related hedged assets, liabilities and firm commitments, we recognized a $361 million increase in assets and a $382 million increase in liabilities (amounts have been restated to reflect the effects of the correction of fair value assigned to certain derivative instruments upon adoption of SFAS No. 133 of $42 million. See Note 21 to the Consolidated Financial Statements for additional information).

In 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 141, Business Combinations (SFAS No. 141). SFAS No. 141 requires the use of the purchase method of accounting for business combinations and prohibits the use of the pooling of interests method. We have not historically engaged in transactions that qualify for the use of the pooling of interests method and therefore, this aspect of the new standard will not have an impact on our financial results. SFAS No. 141 also changes the definition of intangible assets acquired in a purchase business combination, providing specific criteria for the initial recognition and measurement of intangible assets apart from goodwill. As a result, the purchase price allocation of future business combinations may be different than the allocation that would have resulted under the previous rules. SFAS No. 141 also requires that upon adoption of Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets (SFAS No. 142), we reclassify the carrying amounts of certain intangible assets into or out of goodwill, based on certain criteria (see the discussion of the impacts of the adoption of SFAS No. 142 below). All business acquisitions initiated after June 30, 2001 must apply provisions of this standard.

SFAS No. 142, also issued in 2001, addresses financial accounting and reporting for acquired goodwill and other intangible assets subsequent to their initial recognition. This statement recognizes that goodwill has an indefinite useful life and will no longer be subject to periodic amortization. However, goodwill will be tested at least annually for impairment, using a fair value methodology, in lieu of amortization. The provisions of this standard also require that amortization of goodwill related to equity method investments be discontinued, and that these goodwill amounts continue to be evaluated for impairment in accordance with Accounting Principles Board Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. The provisions of SFAS No. 142 were adopted on January 1, 2002. Upon adoption of SFAS No. 142, we reclassified $61 of intangible assets related to acquired workforce that was required to be included in goodwill by this standard.

SFAS No. 142 also requires performance of annual and transitional impairment tests on goodwill using a two-step approach. The first step is to identify a potential impairment and the second step is to measure the amount of any impairment loss. During the second quarter of 2002, we completed the first step of the transitional goodwill impairment test. This test required us to compare the carrying value of our reporting units to the fair value of these units. The standard requires that if reporting units fair value is below its carrying value, a potential goodwill impairment exists and we would be required to complete the second step of the transitional impairment test to quantify the amount of the potential goodwill impairment charge. Based on the results of the first step of the transitional impairment test, we have identified potential goodwill impairments in the reporting units included in our DMO operating segment. The second step of the transitional goodwill impairment test requires that the implied fair value of goodwill be estimated by allocating the fair value of a reporting unit to all of the assets and liabilities of that reporting unit. The excess of the fair value of the reporting unit over the amounts allocated to the assets and liabilities represents the implied fair value of the goodwill. Any excess of the carrying amount of reporting unit goodwill over the implied fair value of goodwill will be recorded as a goodwill impairment charge. We are in the process of finalizing the second step of the impairment test and expect to record an impairment charge of $63 million. This non-cash charge will be retroactively recorded as a cumulative effect of change in accounting principle in the first quarter of 2002.

In 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. The Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and associated asset retirement costs. We are required to implement this standard on January 1, 2003. We do not expect this Statement will have a material effect on our financial position or results of operations.

In 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The Statement primarily supercedes FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of. The Statement retains the previously existing accounting requirements related to the recognition and measurement of the impairment of long-lived assets to be held and used, while expanding the measurement requirements of long-lived assets to be disposed of by sale to include discontinued operations. It also expands on the previously existing reporting requirements for discontinued operations to include a component of an entity that either has been disposed of or is classified as held for sale. We implemented this standard on January 1, 2002, and do not expect this Statement will have a material effect on our financial position or results of operations.

On April 1, 2002, we adopted the provisions of Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections (SFAS No. 145). The applicable portion of this Statement rescinds Statement of Financial Accounting Standards No. 4 Reporting Gains and Losses from Extinguishment of Debt which required all gains and losses from extinguishment of debt to be aggregated and, when material, classified as an extraordinary item, net of related income tax effect. Accordingly, any gain or loss on extinguishment of debt that was classified as an extraordinary item in prior periods presented and that does not meet the criteria in APB Opinion No. 30 Reporting the Results of Operations Reporting the Effects of Disposal of a segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions for classification as an extraordinary item, was reclassified. As a result of adopting SFAS No. 145, all the extraordinary gains on extinguishment of debt previously reported in the Consolidated Statements of Operations were reclassified to Other expenses, net. After considering the effects of the restatement as discussed in Note 21 to the Consolidated Financial Statements, the effect of this reclassification in the accompanying Condensed Consolidated Statements of Operations was a decrease to Other expenses, net of $63 and an increase to income taxes of $25, from amounts previously reported, for the year ended December 31, 2001. SFAS No. 145 also amends Statement of Financial Accounting Standards No. 13 Accounting for Leases (SFAS No. 13) to require that certain lease modifications having economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. This portion of SFAS No. 145 did not have any effect on our financial position or results of operations for any periods presented.

Capital Resources and Liquidity

Liquidity, Financial Flexibility and Funding Plans:

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

In addition to the limited access to capital markets which resulted from our credit rating downgrades, we have been unable to access the public capital markets. This is because, as a result of the ongoing SEC investigation since June 2000 and the accounting issues raised by the SEC, the SEC Staff advised us that we could not make any public registered securities offerings. This additional constraint had the effect of limiting our means of raising funds to those of unregistered capital markets offerings and private lending or equity sources. Our credit ratings became even more important, since credit rating agencies often include access to other capital sources in their rating criteria.

During 2000, 2001, and 2002, these rating downgrades, together with the recently concluded review by the SEC, adversely affected our liquidity and financial flexibility, as follows:

Since October 2000, uncommitted bank lines of credit and the unsecured public capital markets have been largely unavailable to us.

On December 1, 2000, Moody s reduced its rating of our senior debt to below investment grade, significantly constraining our ability to enter into new foreign-currency and interest rate derivative agreements, and requiring us to immediately repurchase certain of our then-outstanding derivative agreements for $108 million.

In the fourth quarter 2000, as a result of our lack of access to unsecured bank and public credit sources, we drew down the entire $7.0 billion available to us under our Revolving Credit Agreement (the Old Revolver), primarily to maintain financial flexibility and pay down debt obligations as they came due.

On October 23, 2001, Standard & Poors (S&P) reduced its rating of our senior debt to below investment grade, further constraining our ability to enter into new derivative agreements, and requiring us to immediately repurchase certain of our then-outstanding out-of-the-money interest-rate and cross-currency interest-rate derivative agreements for a total of $148 million.

To minimize the resulting interest and currency exposures from these events, we have subsequently restored some derivative trading, with several counterparties, on a limited basis. However, virtually all such new arrangements either require us to post cash collateral against all out-of-the-money positions, or else have very short terms (e.g., as short as one week). Both of these types of arrangements potentially use more cash than standard derivative arrangements would otherwise require.

On May 1, 2002, Moody s further reduced its rating of our senior debt, requiring us to post additional collateral against certain derivative agreements currently in place. This downgrade also constituted a termination event under our existing $290 million U.S. trade receivable securitization facility, which we are currently renegotiating with the counterparty, as described more fully below.

On June 11 and 21, 2002, S&P lowered and affirmed its rating of our senior unsecured and senior secured debt, which to date has not had any incremental adverse effects on our liquidity.

As of June 26, 2002, our senior and short-term debt ratings and outlooks were as follows:

	Senior Debt Rating	Short Term Debt Rating	Outlook
Moody s	B1	Not Prime	Negative
S&P*	BB-/B+	B*	Negative*
Fitch	BB	B	Stable

* Effective June 11, 2002, S&P lowered our Corporate credit rating, and downgraded our senior debt, to BB- and maintained us on CreditWatch with Negative implications. Upon receipt of commitments from the banks who are party to our New Credit Facility, S&P affirmed the Corporate credit rating and our senior secured debt at BB- with a Negative Outlook, and downgraded our senior unsecured debt to B+.

We expect our limited access to unsecured credit sources to result in higher borrowing costs going forward, and to potentially result in Xerox Corporation having to increase its level of intercompany lending to affiliates and/or to guarantee portions of their debt.

Actions Taken to Address Liquidity Issues:

In the fourth quarter of 2000, as a result of the various factors described above, we began accumulating cash in an effort to maintain financial flexibility, rather than continuing our historical practice of using available cash to voluntarily pay down debt. To the extent possible, and except as otherwise prohibited under the New Credit Facility described below, we expect to continue this practice of accumulating cash for the foreseeable future.

<u>New Credit Facility:</u>

On June 21, 2002, we entered into an Amended and Restated Credit Agreement (the New Credit Facility) with a group of lenders, replacing the Old Revolver. At that time, we permanently repaid $2.8 billion of the $7 billion Revolving Credit Agreement (the Old Revolver). Accordingly, there is currently $4.2 billion outstanding under the New Credit Facility, consisting of three tranches of term loans totaling $2.7 billion and a $1.5 billion revolving facility that includes a $200 million letter of credit sub-facility. The three term loan tranches include a $1.5 billion amortizing Tranche A term loan, a $500 million Tranche B term loan, and a $700 million Tranche C term loan maturing on September 15, 2002. Xerox Corporation is currently, and will remain, the borrower of all of the term loans. The revolving loans are available, without sub-limit, to Xerox Corporation, Xerox Canada Capital Limited (XCCL), Xerox Capital Europe plc (XCE) and other foreign subsidiaries, as requested by us from time to time, that meet certain qualifications. We are required to repay a total of $400 million of the Tranche A loan and $5 million of the Tranche B loan in semi-annual installments in 2003, and a total of $600 million of the Tranche A loan and $5 million of the Tranche B loan in semi-annual installments in 2004. The remaining portions of the Tranche A and Tranche B term loans and the revolving facility contractually mature on April 30, 2005. We could be required to repay portions of the loans earlier than their scheduled maturities upon the occurrence of certain events, as described below. In addition, all loans under the New Credit Facility mature upon the occurrence of a change in control.

Subject to certain limits described in the following paragraph, all obligations under the New Credit Facility are secured by liens on substantially all domestic assets of Xerox Corporation and by liens on the assets of substantially all of our U.S. subsidiaries (excluding Xerox Credit Corporation), and are guaranteed by substantially all of our U.S. subsidiaries. In addition, revolving loans outstanding from time to time to XCE (currently $605 million) are also secured by all of XCE s assets and are also guaranteed on an unsecured basis by certain foreign subsidiaries that directly or indirectly own all of the outstanding stock of XCE. Revolving loans outstanding from time to time to XCCL (currently $300 million) are also secured by all of XCCL s assets and are also guaranteed on an unsecured basis by our material Canadian subsidiaries, as defined (although the guaranties of the Canadian subsidiaries will become secured by their assets in the future if certain events occur).

Under the terms of certain of our outstanding public bond indentures, the outstanding amount of obligations under the New Credit Facility that can be secured by assets (the Restricted Assets) of (i) Xerox Corporation and (ii) our non-financing subsidiaries that have a consolidated net worth of at least $100 million, without triggering a requirement to also secure these indentures, is limited to the excess of (a) 20 percent of our consolidated net worth (as defined in the public bond indentures) over (b) a portion of the outstanding amount of certain other debt that is secured by the Restricted Assets. Accordingly, the amount of the debt secured under the New Credit Facility by the Restricted Assets (the Restricted Asset Security Amount) will vary from time to time with changes in our consolidated net worth. The Restricted Assets secure the Tranche B loan up to the Restricted Asset Security Amount; any Restricted Asset Security Amount in excess of the outstanding Tranche B loan secures, on a ratable basis, the other outstanding loans under the New Credit Facility. The assets of XCE, XCCL and many of the subsidiaries guarantying the New Credit Facility are not Restricted Assets because those entities are not restricted subsidiaries as defined in our public bond indentures. Consequently, the amount of debt under the New Credit Facility secured by their assets is not subject to the foregoing limits.

The New Credit Facility loans generally bear interest at LIBOR plus 4.50 percent, except that the Tranche B loan bears interest at LIBOR plus a spread that varies between 4.00 percent and 4.50 percent depending on the Restricted Asset Security Amount in effect from time to time. Specified percentages of any net proceeds we receive from capital market debt issuances, equity issuances or asset sales during the term of the New Credit Facility must be used to reduce the amounts outstanding under the New Credit Facility, and in all cases any such amounts will first be applied to reduce the Tranche C loan. Once the Tranche C loan has been repaid, or to the extent that such proceeds exceed the outstanding Tranche C loan, any such prepayments arising from debt and equity proceeds will first permanently reduce the Tranche A loans, and any amount remaining thereafter will be proportionally allocated to repay the then-outstanding balances of the revolving loans and the Tranche B loans and to reduce the revolving commitment accordingly. Any such prepayments arising from asset sale proceeds will first be proportionally allocated to permanently reduce any outstanding Tranche A loans and Tranche B loans, and any amounts remaining thereafter will be used to repay the revolving loans and to reduce the revolving commitment accordingly (except that the revolving loan commitment cannot be reduced below $1 billion as a result of such prepayments).

The New Credit Facility contains affirmative and negative covenants including limitations on issuance of debt and preferred stock, certain fundamental changes, investments and acquisitions, mergers, certain transactions with affiliates, creation of liens, asset transfers, hedging transactions, payment of dividends, intercompany loans and certain restricted payments, and a requirement to transfer excess foreign cash, as defined, and excess cash of Xerox Credit Corporation to Xerox Corporation in certain circumstances. The New Credit Facility does not affect our ability to continue to monetize receivables under the agreements with GE Capital and others, which are discussed below. No cash dividends can be paid on our Common Stock for the term of the New Credit Facility. Cash dividends may be paid on preferred stock provided there is then no event of default. In addition to other defaults customary for facilities of this type, defaults on debt of, or bankruptcy of, Xerox Corporation or certain subsidiaries would constitute a default under the New Credit Facility.

The New Credit Facility also contains financial covenants which the Old Revolver did not contain, including:

- Minimum EBITDA (rolling four quarters, as defined)
- Maximum Leverage (total adjusted debt divided by EBITDA, as defined)
- Maximum Capital Expenditures (annual test)
- Minimum Consolidated Net Worth (quarterly test, as defined)

Failure to be in compliance with any material provision of the New Credit Facility could have a material adverse effect on our liquidity, financial position and results of operations.

We expect total fees and expenses incurred in connection with the New Credit Facility to approximate $125 million, the majority of which was paid at closing. These amounts will be deferred and amortized over the three year term of the New Credit Facility.

Turnaround Program:

In 2000 we announced a global Turnaround Program which included initiatives to sell certain assets, improve operations and liquidity, and reduce annual costs by at least $1 billion. Through December 31, 2001, and since that time, we have made significant progress toward these objectives.

With respect to asset sale initiatives:

In the fourth quarter of 2000 we sold our China operations to Fuji Xerox, generating $550 million of cash and transferring $118 million of debt to Fuji Xerox.

In March 2001, we sold half of our interest in Fuji Xerox to Fuji Photo Film Co., Ltd. for $1,283 million in cash.

In the fourth quarter of 2001, we received cash proceeds of $118 million related to the sales to Flextronics of certain of our manufacturing facilities, and in 2002 we received additional net cash proceeds of $29 million related to the sales of additional facilities under that agreement.

With respect to operational and liquidity improvements, we have announced major initiatives with GE Capital and other vendor financing partners, and we have completed several transactions, including (1) implementation of third-party vendor financing programs in the Netherlands, the Nordic countries, Brazil, Mexico, and Italy and (2) monetizations of portions of our existing finance receivables portfolios. We have several other similar transactions currently being negotiated, and we continue to actively pursue alternative forms of financing. These initiatives, when completed, are expected to significantly improve our liquidity going forward.

In connection with general financing initiatives:

During 2001, we retired $374 million of long-term debt through the exchange of 41.1 million shares of our common stock, which increased our net worth by $349 million.

In November 2001, we sold $1,035 million of Convertible Trust Preferred Securities, and placed $229 million of the proceeds in escrow to fund the first three-years distribution requirements. Total proceeds, net of escrowed funds and transaction costs, were $775 million.

In January 2002, we sold $600 million of 9¾ percent Senior Notes and 225 million of 9¾ percent Senior Notes, for cash proceeds totaling $746 million, which is net of fees and original-issue discount. These notes mature on January 15, 2009, and contain several affirmative and negative covenants which are similar to those in the New Credit Facility. Taken as a whole, the Senior Notes covenants are less restrictive than the covenants contained in the New Credit Facility. In addition, our Senior Notes do not contain any financial maintenance covenants or scheduled amortization payments. The Senior Notes covenants (1) restrict certain transactions, including new borrowings, investments and the payment of dividends, unless we meet certain financial measurements and ratios, as defined, and (2) restrict our use of proceeds from certain other transactions including asset sales. In connection with the June 21, 2002 closing of the New Credit Facility, substantially all of our U.S. subsidiaries guaranteed these notes. In order to reduce the immediate cost of this borrowing, we entered into derivative agreements to swap the cash interest obligations under the dollar portion of these notes to LIBOR plus 4.44 percent. We will be required to collateralize any out-of-the-money positions on these swaps.

In connection with vendor financing and related initiatives:

In 2001, we received $885 million in financing from GE Capital, secured by portions of our finance receivable portfolios in the United Kingdom. At December 31, 2001, the remaining balances of these loans totaled $521 million.

In the second quarter 2001, we sold our leasing businesses in four Nordic countries to Resonia Leasing AB for $352 million in cash plus retained interests in certain finance receivables for total proceeds of approximately $370 million. These sales are part of an agreement under which Resonia will provide on-going, exclusive equipment financing to our customers in those countries.

In July 2001, we transferred U.S. lease contracts to a trust, which in turn sold $513 million of floating-rate asset-backed notes. We received cash proceeds of $480 million, net of $3 million of fees, plus a retained interest of $30 million, which we will receive when the notes are repaid, which we expect to occur in August

2003. The transaction was accounted for as a secured borrowing. At December 31, 2001, the remaining debt totaled $395 million.

In September 2001, we announced a U.S. Framework Agreement (the USFA) with GE Capital s Vendor Financial Services group, under which GE Capital will become the primary equipment-financing provider for our U.S. customers. We expect funding under the USFA to be in place in 2002 upon completion of systems and process modifications and development.

In November 2001, we entered into an agreement with GE Capital which provides for a series of loans, secured by certain of our finance receivables in the United States, up to an aggregate of $2.6 billion, provided that certain conditions are met at the time the loans are funded. These conditions, all of which we currently meet, include maintaining a specified minimum debt rating with respect to our senior debt. In the fourth quarter of 2001, we received two secured loans from GE Capital totaling $1,175 million. Cash proceeds of $1,053 million were net of $115 million of escrow requirements and $7 million of fees. At December 31, 2001, the remaining balances of these loans totaled $1,149 million. In March 2002, we received our third secured loan from GE Capital totaling $266 million. Cash proceeds of $229 million were net of $35 million of escrow requirements and $2 million of fees. In May 2002, we received our fourth secured loan from GE Capital, totaling $499 million. Cash proceeds of $496 million were net of $3 million of fees. Through June 26, 2002 approximately $1.9 billion of loans have been funded under this agreement.

In November 2001, we announced a Canadian Framework Agreement (the CFA) with the Canadian division of GE Capital s Vendor Financial Services group, similar to the agreement in the U.S., under which GE Capital will become the primary equipment-financing provider for our Canadian customers. We expect the CFA to be completed in 2002. In February 2002 we received a $291 million loan from GE Capital, secured by certain of our finance receivables in Canada. Cash proceeds of $281 million were net of $8 million of escrow requirements and $2 million of fees.

In December 2001, we announced that we would be forming a joint venture with De Lage Landen International BV (DLL) to manage equipment financing, billing and collections for our customers financed equipment orders in the Netherlands. This joint venture was formed and began funding in the first quarter of 2002. DLL owns 51 percent of the venture and provides the funding to support new customer leases, and we own the remaining 49 percent of this unconsolidated venture.

In December 2001, we announced European framework agreements with GE Capital s European Equipment Finance group, under which GE Capital will become the primary equipment-financing provider for our customers in France and Germany. We expect these agreements to be completed in 2002.

In March 2002, we signed agreements with third parties in Brazil and Mexico, under which those third parties will be our primary equipment financing provider in those countries. Funding under both of these arrangements commenced in the second quarter of 2002.

In April 2002, we sold our leasing business in Italy to a third party for $207 million in cash plus the assumption of $20 million of debt. We can also receive retained interests up to approximately $30 million, based on the occurrence of certain future events. This sale is part of an agreement under which the third-party will provide on-going, exclusive equipment financing to our customers in Italy.

In May 2002, we received an additional loan from GE Capital of $106 million secured by portions of our lease receivable portfolio in the U.K.

In May 2002, we received a $77 million loan from GE Capital, secured by certain of our finance receivables in Germany. Cash proceeds of $65 million were net of $12 million of escrow requirements.

Cash and Debt Positions:

With $4.0 billion of cash and cash equivalents on hand at December 31, 2001, (and approximately $1.8 billion on hand as of June 26, 2002, after giving effect to the refinancing under the New Credit Facility) we believe our liquidity is sufficient to meet current operating cash flow requirements and to satisfy all scheduled debt maturities through December 31, 2002.

As a result of the New Credit Facility discussed above, our debt maturities have changed. Significantly less debt will now mature in 2002 and 2003 than would have become due had the Old Revolver not been refinanced. In addition, a portion of our available cash has been used to retire some of the debt under the Old Revolver. The following represents our aggregate debt maturity schedules by quarter for 2002 and 2003, and reflects the New Credit Facility and related principal payments discussed above (in billions):

	2002	2003
First Quarter	$ 0.7	$ 0.5
Second Quarter	4.0	1.1
Third Quarter	1.0	0.3
Fourth Quarter	0.9	1.3
Full Year	$ 6.6	$ 3.2

Additionally, as discussed throughout this Annual Report, w00000">**2012** 2011 **2012**

Revenue

$130 **$5** $417 **$55**

Operating income (loss)

25 **(1)** 67 **(4)**

Gain on sale of business

8 **571**

Income (loss) before income taxes

25 **7** 67 **567**

Benefit from (provision for) income taxes

(133)	**(2)**	(162)	**(251)**

Income (loss) from discontinued operations

$(108)	**$5**	$(95)	**$316**

Assets and liabilities related to discontinued operations consisted of the following (in millions) at December 31, 2011:

	December 31, 2011
Cash	$ 6
Accounts receivable, net	105
Prepaid expenses and other current assets	14
Property and equipment, net	31
Software products, net	77
Customer base, net	188
Goodwill	929
Assets related to discontinued operations	$ 1,350
Accounts payable	$ 1
Accrued compensation and benefits	24
Other accrued expenses	16
Deferred revenue	106
Deferred income taxes	99
Liabilities related to discontinued operations	$ 246

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Assets and liabilities related to the discontinued operations of HE consisted of the following (in millions) at the closing balance sheet on January 20, 2012:

	January 20, 2012
Cash	$ 7
Accounts receivable, net	90
Prepaid expenses and other current assets	14
Property and equipment, net	31
Software products, net	78
Customer base, net	182
Goodwill	929
Assets related to discontinued operations	$ 1,331
Accounts payable	$ 5
Accrued compensation and benefits	21
Other accrued expenses	9
Deferred revenue	109
Deferred income taxes	96
Liabilities related to discontinued operations	$ 240

3. Intangible Assets and Goodwill:

Trade Name

The trade name intangible asset represents the fair value of the SunGard trade name and is an indefinite-lived asset not subject to amortization. The Company performed its annual impairment test of the SunGard trade name in the third quarter and based on the results of this test, the fair value of the trade name exceeded its carrying value, resulting in no impairment of the trade name. As a result of lower long term projections and from the sale of HE, future cash flows which drive the value of the trade name have decreased, and the amount by which the estimated fair value of the trade name exceeded its carrying value was lower in the current year impairment test compared to prior years. In addition to the projections, a critical assumption considered in the impairment test of the trade name is the implied royalty rate. A 50 basis point decrease in the assumed royalty rate would have resulted in an impairment of the trade name asset of approximately $108 million (100 basis point decrease would result in an impairment of approximately $336 million). A 100 basis point increase in the discount rate would result in an impairment of the trade name asset of approximately $5 million. Furthermore, to the extent that additional businesses are divested in the future, the cash flows supporting the trade name will continue to decline, which may result in impairment charges.

Goodwill

Generally accepted accounting principles in the United States require the Company to perform a goodwill impairment test annually and more frequently when negative conditions or a triggering event arise. In September 2011, the FASB issued amended guidance that simplified how entities test goodwill for impairment. After an assessment of certain qualitative factors, if it is determined to be more likely than not that the fair value of a reporting unit is less than its carrying amount; entities must perform the quantitative analysis of the goodwill impairment test. Otherwise, the quantitative test(s) become optional. As allowed under the amended guidance, the Company chose not to assess the qualitative factors of its reporting units and, instead, performed the two-step quantitative test(s).

The Company completes its annual goodwill impairment test as of July 1 for each of its 11 reporting units. In step one, the estimated fair value of each reporting unit is compared to its carrying value. The Company estimated the fair values of each reporting unit by a combination of (i) estimation of the discounted cash flows of each of the reporting units based on projected earnings in the future (the income approach) and (ii) a comparative analysis of revenue and EBITDA multiples of public companies in similar markets (the market approach). If there is a deficiency (the estimated fair value of a reporting unit is less than its carrying value), a step two test is required. In step two, the amount of any goodwill impairment is measured by comparing the implied fair value of the reporting unit s goodwill to the carrying value of goodwill, with the resulting impairment reflected in operations. The implied fair value is determined in the same manner as the amount of goodwill recognized in a business combination.

Estimating the fair value of a reporting unit requires various assumptions including projections of future cash flows, perpetual growth rates and discount rates. The assumptions about future cash flows and growth rates are based on management s assessment of a number of factors including the reporting unit s recent performance against budget,

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performance in the market that the reporting unit serves, as well as industry and general economic data from third party sources. Discount rate assumptions reflect an assessment of the risk inherent in those future cash flows. Changes to the underlying businesses could affect the future cash flows, which in turn could affect the fair value of the reporting unit. For the July 1, 2012 impairment test, the discount rates and perpetual growth rates used were between 10% and 12% and 3% and 4%, respectively.

Based on the results of the step one tests, the Company determined that the carrying value of the Availability Services North America (AS NA) reporting unit was in excess of its respective fair value and a step two test was required. The primary driver for the decline in the fair value of the AS NA reporting unit compared to the prior year is the decline in the cash flow projections for AS NA when compared to those used in the 2011 goodwill impairment test as a result of decline in the overall outlook of this reporting unit. The Company continues to expect to grow the AS NA business over the long-term, albeit at a slower rate than previously planned.

Prior to completing the step two test, the Company first evaluated certain long-lived assets, primarily the software, customer base and property and equipment, for impairment. In performing the impairment tests for long-lived assets, the Company estimated the undiscounted cash flows for the asset groups over the remaining useful lives of the reporting unit s primary asset and compared that to the carrying value of the asset groups. There was no impairment of the long-lived assets.

In completing the step two test to determine the implied fair value of goodwill and therefore the amount of impairment, management first determined the fair value of the tangible and intangible assets and liabilities. Based on the testing performed, the Company determined that the carrying value of goodwill exceeded its implied fair value and recorded a goodwill impairment charge of $385 million.

The following table summarizes the goodwill impairment charge by reporting unit (in millions):

Segment	Reporting Unit	Net Goodwill balance before impairment	Impairment charge	Goodwill balance after impairment
Availability Services	AS NA	$ 914	$ (385)	$ 529

The Company has one other reporting unit, whose goodwill balance in the aggregate totals $299 million as of September 30, 2012, where the excess of the estimated fair value over the carrying value of the reporting unit was less than 15% of the carrying value. A one hundred basis point decrease in the perpetual growth rate or a one hundred basis point increase in the discount rate would not cause this reporting unit to fail step one and require a step two analysis. However, if this unit fails to achieve expected performance levels in the near term or experiences a downturn in the business below current expectations, goodwill could be impaired.

The Company s remaining reporting units, whose goodwill balances in aggregate total $3.7 billion at September 30, 2012, each had estimated fair values which exceeded the carrying value of the reporting unit by at least 15% as of the July 1, 2012 impairment test.

The following table summarizes changes in goodwill by segment (in millions):

	Cost				Accumulated Impairment			
	FS	AS	Other	Subtotal	AS	Other	Subtotal	Total
Balance at December 31, 2011	$ 3,480	$ 2,239	$ 545	$ 6,264	$ (1,162)	$ (217)	$ (1,379)	$ 4,885
2012 acquisitions	5			5				5
Adjustments related to the LBO and prior year acquisitions	(2)	(2)	(1)	(5)				(5)
Impairment charges					(385)		(385)	(385)
Effect of foreign currency translation	(1)	4		3				3
Balance at September 30, 2012	$ 3,482	$ 2,241	$ 544	$ 6,267	$ (1,547)	$ (217)	$ (1,764)	$ 4,503

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4. Clearing Broker Assets and Liabilities:

Clearing broker assets and liabilities are comprised of the following (in millions):

	December 31, 2011	September 30, 2012
Segregated customer cash and treasury bills	$ 23	**$ 13**
Securities borrowed	157	
Receivables from customers and other	33	**8**
Clearing broker assets	$ 213	**$ 21**
Payables to customers	$ 16	**$ 2**
Securities loaned	145	
Payable to brokers and dealers	18	**5**
Clearing broker liabilities	$ 179	**$ 7**

Segregated customer cash is held by the Company on behalf of customers. Securities borrowed and loaned are collateralized financing transactions which are cash deposits made to or received from other broker/dealers. Receivables from and payables to customers represent amounts due or payable on cash and margin transactions.

The Company is currently winding-down the operations of its stock loan and clearing services business. As a result, the Company expects the balances of clearing broker assets and liabilities will continue to decrease through the remainder of 2012.

5. Debt and Derivatives:

On January 20, 2012, the Company completed the sale of HE and used net cash proceeds (as defined in the Credit Agreement) of $1.22 billion to repay, on a pro-rata basis, outstanding term loans.

On March 2, 2012, SunGard amended its Credit Agreement to, among other things, extend the maturity date of approximately $908 million of tranche A and incremental term loans from February 28, 2014 to February 28, 2017, extend the maturity of the $880 million revolving credit facility commitments from May 11, 2013 to November 29, 2016, and amend certain covenants and other provisions, in order to, among other things, permit the potential spin-off of AS. The tranche B, tranche C and revolving credit facility each have springing maturity provisions which are described in the Company s Credit Agreement as amended and filed with the Company s Form 8-K dated March 2, 2012.

On April 2, 2012, SunGard redeemed for $527 million plus accrued and unpaid interest to the redemption date, all of its outstanding $500 million 10.625% senior notes due 2015 (2015 Notes) under the Indenture dated as of September 29, 2008 among SunGard, the guarantors named therein, and The Bank of New York Mellon, as trustee (as amended or supplemented from time to time, the 2015 Indenture). In conjunction with the redemption of the 2015 Notes, the Company expensed approximately $7 million of unamortized deferred financing costs and the $3 million issue discount.

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Debt consisted of the following at December 31, 2011 and September 30, 2012 (in millions):

	December 31, 2011	September 30, 2012
Senior Secured Credit Facilities:		
Secured revolving credit facility	$	$
Tranche A, effective interest rate of 3.33% and 1.97%	1,386	255
Tranche B, effective interest rate of 4.32% and 4.36%	2,407	1,719
Tranche C, effective interest rate of 4.18%		908
Incremental term loan at 3.78% and 3.72%	479	169
Total Senior Secured Credit Facilities	4,272	3,051
Senior Secured Notes due 2014 at 4.875%, net of discount of $8 and $5	242	245
Senior Notes due 2015 at 10.625%, net of discount of $3 and $-	497	
Senior Notes due 2018 at 7.375%	900	900
Senior Notes due 2020 at 7.625%	700	700
Senior Subordinated Notes due 2015 at 10.25%	1,000	1,000
Secured accounts receivable facility, at 3.79% and 3.72%	200	200
Other, primarily acquisition purchase price and capital lease obligations	18	15
Total debt	7,829	6,111
Short-term borrowings and current portion of long-term debt	(10)	(9)
Long-term debt	$ 7,819	$ 6,102

On November 1, 2012, SunGard successfully issued $1 billion aggregate principal amount of 6.625% Senior Subordinated Notes due 2019 (Senior Subordinated Notes) and used a portion of the proceeds from this offering to repurchase approximately $490 million of its 10.25% Senior Subordinated Notes due 2015 (Existing 10.25% Senior Subordinated Notes). SunGard intends to repurchase or redeem the remaining Existing 10.25% Senior Subordinated Notes in the fourth quarter of 2012. As a result of this transaction, the Company expects to incur a $30 million loss on the extinguishment of debt which will be reflected in the statement of comprehensive income in the fourth quarter of 2012.

On November 1, 2012, SunGard and the guarantors of the Senior Subordinated Notes entered into a registration rights agreement and have agreed that they will (i) file a registration statement with respect to a registered offer to exchange the Senior Subordinated Notes for new notes guaranteed by the guarantors on a senior subordinated unsecured basis, with terms substantially identical in all material respects to the Senior Subordinated Notes, and (ii) use their reasonable best efforts to cause the exchange offer registration statement to be declared effective under the Securities Act of 1933, as amended.

SunGard and the guarantors have agreed to use their reasonable best efforts to cause the exchange offer to be completed or, if required, to have one or more shelf registration statements declared effective, within 360 days after the issue date.

If SunGard fails to satisfy this obligation (a registration default), the annual interest rate on the Senior Subordinated Notes will increase by an additional 0.25% for each subsequent 90-day period during which the registration default continues, up to a maximum additional interest rate of 1.00% per year. If the registration default is corrected, the applicable interest rate will revert to the original level.

The Company uses interest rate swap agreements to manage the amount of its floating rate debt in order to reduce its exposure to variable rate interest payments associated with the Credit Agreement. Each of these swap agreements is designated as a cash flow hedge. SunGard pays a stream of fixed interest payments for the term of the swap, and in turn, receives variable interest payments based on LIBOR. The net receipt or payment from the interest rate swap agreements is included in interest expense. The Company does not enter into interest rate swaps for speculative or trading purposes. A summary of the Company s interest rate swaps follows:

Inception	Maturity

		Notional Amount (in millions)	Interest rate paid	Interest rate received (LIBOR)
February 2010	May 2013	$ 500	1.99%	3-Month
August-September 2012	February 2017	400	0.69%	1-Month
Total / Weighted Average		$ 900	1.41%	

The fair values of interest rate swaps designated as cash flow hedging instruments, included in other accrued expenses on the consolidated balance sheets, are $11 million and $7 million as of December 31, 2011 and September 30, 2012, respectively.

The Company has no ineffectiveness related to its swap agreements. The Company expects to reclassify in the next twelve months approximately $7 million from other comprehensive income (loss) into earnings related to the Company s interest rate swaps based on the borrowing rates at September 30, 2012.

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6. Fair Value Measurements:

The following table summarizes assets and liabilities measured at fair value on a recurring basis at September 30, 2012 (in millions):

	Fair Value Measures Using			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents money market funds	$ 220	$	$	$ 220
Currency forward contracts		7		7
Total	$ 220	$ 7	$	$ 227
Liabilities				
Interest rate swap agreements and other	$	$ 8	$	$ 8

The following table summarizes assets and liabilities measured at fair value on a recurring basis at December 31, 2011 (in millions):

	Fair Value Measures Using			
	Level 1	Level 2	Level 3	Total
Assets				
Cash and cash equivalents money market funds	$ 351	$	$	$ 351
Liabilities				
Interest rate swap agreements and other	$	$ 15	$	$ 15

A Level 1 fair value measure is based upon quoted prices in active markets for identical assets or liabilities. A Level 2 fair value measure is based upon quoted prices for similar assets and liabilities in active markets or inputs that are observable. A Level 3 fair value measure is based upon inputs that are unobservable (for example, cash flow modeling inputs based on assumptions).

Cash and cash equivalents money market funds is recognized and measured at fair value in the Company s financial statements. Fair values of the interest rate swap agreements are calculated using a discounted cash flow model using observable applicable market swap rates and assumptions and are compared to market valuations obtained from brokers.

The Company uses currency forward contracts to manage its exposure to fluctuations in costs caused by variations in Indian Rupee (INR) exchange rates. These INR forward contacts are designated as cash flow hedges. The fair value of these currency forward contracts is determined using currency exchange market rates, obtained from reliable, independent, third party banks, at the balance sheet date. This fair value of forward contracts is subject to changes in currency exchange rates. The Company has no ineffectiveness related to its use of currency forward contracts.

The following table summarizes assets and liabilities measured at fair value on a non-recurring basis at September 30, 2012 (in millions):

	Fair Value Measures Using			Total Gains
	Level 1	Level 2	Level 3	(Losses)
Assets				
Goodwill	$	$	$ 529	$ (385)

The fair value of goodwill is categorized in Level 3, fair value measurement using significant unobservable inputs, and is estimated by a combination of (i) discounted cash flows based on projected earnings in the future (the income approach) and (ii) a comparative analysis of revenue and EBITDA multiples of public companies in similar markets (the market approach). This requires the use of various assumptions including projections of future cash flows, perpetual growth rates and discount rates. The $385 million impairment loss, which is reflected in operations for the three and nine months ended September 30, 2012, relates to AS NA, as discussed in Note 2.

The following table presents the carrying amount and estimated fair value of the Company s debt, including current portion and excluding the interest rate swaps, as of December 31, 2011 and September 30, 2012 (in millions):

	December 31, 2011		**September 30, 2012**	
	Carrying Value	Fair Value	**Carrying Value**	**Fair Value**
Floating rate debt	$ 4,472	$ 4,372	**$ 3,251**	**$ 3,263**
Fixed rate debt	3,357	3,454	**2,860**	**3,003**

The fair value of the Company s floating rate and fixed rate long-term debt (Level 2) is determined using actual market quotes and benchmark yields received from independent vendors.

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7. Equity:

A rollforward of SCC s equity for 2012 follows (in millions):

	SunGard Capital Corp. stockholders				Noncontrolling interest		
	Class L - temporary equity	Class A - temporary equity	Permanent equity	Total	Temporary equity	Permanent equity	Total
Balance at December 31, 2011	$ 47	$ 6	$ (663)	$ (610)	$ 28	$ 2,038	$ 2,066
Net income (loss)			(321)	(321)		186	186
Foreign currency translation			16	16			
Net unrealized gain on derivative instruments			11	11			
Comprehensive income (loss)			(294)	(294)		186	186
Stock compensation expense			29	29			
Termination of put options due to employee terminations and other	(16)	(2)	20	2	(8)	5	(3)
Issuance of common and preferred stock			1	1			
Purchase of treasury stock			(7)	(7)		(2)	(2)
Transfer intrinsic value of vested restricted stock units	15	1	(25)	(9)	9		9
Other			(10)	(10)			
Balance at September 30, 2012	$ 46	$ 5	$ (949)	$ (898)	$ 29	$ 2,227	$ 2,256

A rollforward of SCC s equity for 2011 follows (in millions):

	SunGard Capital Corp. stockholders				Noncontrolling interest		
	Class L - temporary equity	Class A - temporary equity	Permanent equity	Total	Temporary equity	Permanent equity	Total
Balance at December 31, 2010	$ 87	$ 11	$ (330)	$ (232)	$ 54	$ 1,782	$ 1,836
Net income (loss)			(409)	(409)	2	164	166
Foreign currency translation			(6)	(6)			
Net unrealized gain on derivative instruments			7	7			
Comprehensive income (loss)			(408)	(408)	2	164	166
Stock compensation expense			23	23			
Termination of put options due to employee terminations and other	(39)	(5)	45	1	(29)	28	(1)
Issuance of common and preferred stock	(1)		4	3	(1)	1	
Purchase of treasury stock			(2)	(2)		(1)	(1)
Transfer intrinsic value of vested restricted stock units	7	1	(13)	(5)	5		5
Other			(9)	(9)			
Balance at September 30, 2011	$ 54	$ 7	$ (690)	$ (629)	$ 31	$ 1,974	$ 2,005

In the case of termination of employment resulting from disability or death, an employee or his/her estate may exercise a put option which would require the Company to repurchase vested shares at the current fair market value. These common or preferred shares must be classified as temporary equity (between liabilities and equity) on the balance sheet of SCC and SCCII. At vesting or exercise, grant-date intrinsic value or exercise value, respectively, is reclassified to temporary equity. On termination of employment for other than death or disability, the value included in temporary equity is reclassified to permanent equity.

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The components of accumulated other comprehensive income (loss) at December 31, 2011 and September 30, 2012 are as follows (in millions):

	December 31, 2011	**September 30, 2012**
Foreign currency translation	$ (37)	**$ (21)**
Net unrealized gain (loss) on derivative instruments	(9)	**2**
Accumulated other comprehensive income (loss)	$ (46)	**$ (19)**

8. Segment Information:

The Company has three reportable segments: FS, AS and Other. The Company evaluates the performance of its segments based on operating results before interest, income taxes, amortization of acquisition-related intangible assets, stock compensation and certain other costs. The operating results apply to each of SCC, SCCII and SunGard unless otherwise noted. The operating results for each segment follow (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2012**	2011	**2012**
Revenue:				
Financial Systems	$ 680	**$ 640**	$ 2,037	**$ 1,928**
Availability Services	365	**345**	1,095	**1,052**
Other	52	**50**	154	**151**
Total revenue	$ 1,097	**$ 1,035**	$ 3,286	**$ 3,131**
Depreciation and amortization:				
Financial Systems	$ 20	**$ 22**	$ 62	**$ 63**
Availability Services	45	**46**	136	**142**
Other	2	**1**	6	**5**
Corporate		**1**		**1**
Total depreciation and amortization	$ 67	**$ 70**	$ 204	**$ 211**
Operating income (loss):				
Financial Systems (1)	$ 121	**$ 136**	$ 374	**$ 388**
Availability Services (2)	80	**74**	234	**209**
Other	15	**13**	43	**41**
Corporate(3)	(30)	**(11)**	(79)	**(39)**
Other costs (4)	(123)	**(491)**	(382)	**(721)**
Total operating income (loss)	$ 63	**$ (279)**	$ 190	**$ (122)**
Cash paid for property and equipment and software:				
Financial Systems	$ 18	**$ 19**	$ 62	**$ 62**
Availability Services	34	**36**	114	**104**
Other	2	**2**	4	**6**
Corporate	1	**1**	3	**1**
Total cash paid for property and equipment and software	$ 55	**$ 58**	$ 183	**$ 173**

(1) Includes severance of $29 million, $9 million, $33 million and $15 million, respectively.

(2) Includes severance of $9 million, $1 million, $8 million and $2 million, respectively.

(3) Includes executive transition costs and severance of $8 million in the three months ended September 30, 2011 and $16 million in the nine months ended September 30, 2011.

(4) Includes goodwill impairment, stock compensation expense, management fees paid to the Sponsors, other items and amortization of acquisition-related intangible assets of $106 million and $94 million for the three months ended September 30, 2011 and 2012, respectively, and $332 million and $295 million for the nine months ended September 30, 2011 and 2012, respectively.

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Amortization of acquisition-related intangible assets by segment follows (in millions):

	Three Months Ended September 30, 2011	2012	Nine Months Ended September 30, 2011	2012
Amortization of acquisition-related intangible assets:				
Financial Systems (5)	$ 59	**$ 49**	$ 189	**$ 155**
Availability Services	43	**40**	129	**126**
Other	4	**5**	14	**14**
Total amortization of acquisition-related intangible assets	$ 106	**$ 94**	$ 332	**$ 295**

(5) Includes approximately $7 million in the nine months ended September 30, 2011 of impairment charges related to customer base and software.

The FS Segment is organized to align by product offering. FS revenue by these business areas follows (in millions):

	Three Months Ended September 30, 2011	2012	Nine Months Ended September 30, 2011	2012
Capital Markets	$ 236	**$ 228**	$ 728	**$ 691**
Asset Management	120	**113**	343	**339**
Wealth & Retirement Administration	72	**67**	207	**203**
Corporate Liquidity & Energy	68	**65**	202	**197**
Banking	60	**56**	175	**160**
Brokerage	45	**39**	163	**124**
Insurance	45	**41**	126	**122**
Other	34	**31**	93	**92**
Total Financial Systems	$ 680	**$ 640**	$ 2,037	**$ 1,928**

9. Related Party Transactions:

In accordance with the Management Agreement between the Company and affiliates of the Sponsors, the Company recorded $4 million and $3 million of management fees in sales, marketing and administration expenses during the three months ended September 30, 2011 and 2012, respectively. The Company recorded $9 million of management fees in sales, marketing and administration expenses during each of the nine months ended September 30, 2011 and 2012, respectively. At December 31, 2011 and September 30, 2012, $4 million and $3 million, respectively, was included in other accrued expenses.

During the first quarter of 2012, in addition to the fees above, the Company paid to the Sponsors $17.8 million of management fees, which are included in the results of discontinued operations, related to the sale of HE.

In November 2012, one of the Company s Sponsors, Goldman Sachs & Co. and/or its respective affiliates, served as a joint book-running manager in connection with SunGard s 2012 debt offering of Senior Subordinated Notes. In connection with serving in such capacity, Goldman Sachs & Co. was paid less than $1 million for customary fees and expenses.

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10. Supplemental Cash Flow Information:

Supplemental cash flow information for the nine months ended September 30, 2011 and 2012 follows (in millions):

Supplemental information:	Nine Months Ended September 30, 2011	**2012**
Interest paid	$ 367	**$ 321**
Income taxes paid, net of refunds of $20 million and $7 million [(1)]	$ 44	**$ 397**
Acquired businesses:		
Property and equipment	$ 1	**$**
Software products	21	
Customer base	12	**7**
Goodwill	6	**5**
Deferred income taxes	(5)	**(2)**
Purchase price obligations and debt assumed	(1)	
Net current liabilities assumed	1	
Cash paid for acquired businesses, net of cash acquired of $4 and $2 million, respectively	$ 35	**$ 10**

(1) Approximately $344 million is related to the sale of HE and the income tax provision was included in discontinued operations.

11. Supplemental Guarantor Condensed Consolidating Financial Statements:

SunGard s senior unsecured notes are jointly and severally, fully and unconditionally guaranteed on a senior unsecured basis and the senior subordinated notes are jointly and severally, fully and unconditionally guaranteed on an unsecured senior subordinated basis, in each case, subject to certain exceptions, by substantially all wholly owned, domestic subsidiaries of SunGard (collectively, the Guarantors). Each of the Guarantors is 100% owned, directly or indirectly, by SunGard. None of the other subsidiaries of SunGard, either direct or indirect, nor any of the Holding Companies, guarantee the senior notes and senior subordinated notes (Non-Guarantors). The Guarantors and SunGard Holdco LLC also unconditionally guarantee the senior secured credit facilities. The Guarantors are subject to release under certain circumstances as described below.

The indentures evidencing the guarantees provide for a Guarantor to be automatically and unconditionally released and discharged from its guarantee obligations in certain circumstances, including upon the earliest to occur of:

The sale, exchange or transfer of the subsidiary s capital stock or all or substantially all of its assets;

Designation of the Guarantor as an unrestricted subsidiary for purposes of the indenture covenants;

Release or discharge of the Guarantor s guarantee of certain other indebtedness; or

Legal defeasance or covenant defeasance of the indenture obligations when provision has been made for them to be fully satisfied.

The following tables present the financial position, results of operations and cash flows of SunGard (referred to as Parent Company for purposes of this note only), the Guarantor subsidiaries, the Non-Guarantor subsidiaries and Eliminations as of December 31, 2011 and September 30, 2012, and for the three and nine month periods ended September 30, 2011 and 2012 to arrive at the information for SunGard on a consolidated basis. SCC and SCCII are neither parties to nor guarantors of the debt issued as described in the notes to consolidated financial statements included in the Company s Form 10-K for the year ended December 31, 2011.

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(in millions)	Supplemental Condensed Consolidating Balance Sheet December 31, 2011 Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current:					
Cash and cash equivalents	$ 529	$ (15)	$ 353	$	$ 867
Intercompany balances	(5,247)	4,516	731		
Trade receivables, net	2	603[(a)]	329		934
Prepaid expenses, taxes and other current assets	1,461	54	271	(1,456)	330
Assets related to discontinued operations		1,315	37	(2)	1,350
Total current assets	(3,255)	6,473	1,721	(1,458)	3,481
Property and equipment, net		588	305		893
Intangible assets, net	120	2,701	470		3,291
Intercompany balances	250	1	(251)		
Goodwill		3,784	1,101		4,885
Investment in subsidiaries	12,673	2,253		(14,926)	
Total Assets	$ 9,788	$ 15,800	$ 3,346	$ (16,384)	$ 12,550
Liabilities and Stockholder s Equity					
Current:					
Short-term and current portion of long-term debt	$	$ 3	$ 7	$	$ 10
Accounts payable and other current liabilities	296	2,170	887	(1,456)	1,897
Liabilities related to discontinued operations		219	27		246
Total current liabilities	296	2,392	921	(1,456)	2,153
Long-term debt	7,612	2	205		7,819
Intercompany debt	82	19	16	(117)	
Deferred income taxes	337	714	66		1,117
Total liabilities	8,327	3,127	1,208	(1,573)	11,089
Total stockholder s equity	1,461	12,673	2,138	(14,811)	1,461
Total Liabilities and Stockholder s Equity	$ 9,788	$ 15,800	$ 3,346	$ (16,384)	$ 12,550

(a) This balance is primarily comprised of a receivable from the Company s Accounts Receivable Financing subsidiary, which is a non-Guarantor, resulting from the normal, recurring sale of accounts receivable under the receivables facility. In a liquidation, the first $200 million (plus interest) of collections of accounts receivable sold to this subsidiary are due to the receivables facility lender. The remaining balance would be available for collection for the benefit of the Guarantors.

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(in millions)	Supplemental Condensed Consolidating Balance Sheet September 30, 2012				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Assets					
Current:					
Cash and cash equivalents	$ 429	$ (9)	$ 332	$	$ 752
Intercompany balances	(2,970)	2,268	702		
Trade receivables, net	3	559[(a)]	242		804
Prepaid expenses, taxes and other current assets	1,431	133	97	(1,504)	157
Assets related to discontinued operations					
Total current assets	(1,107)	2,951	1,373	(1,504)	1,713
Property and equipment, net		569	293		862
Intangible assets, net	92	2,471	412		2,975
Intercompany balances	247		(247)		
Goodwill		3,446	1,057		4,503
Investment in subsidiaries	8,557	2,079		(10,636)	
Total Assets	$ 7,789	$ 11,516	$ 2,888	$ (12,140)	$ 10,053
Liabilities and Stockholder s Equity					
Current:					
Short-term and current portion of long-term debt	$	$ 1	$ 8	$	$ 9
Accounts payable and other current liabilities	133	2,306	610	(1,504)	1,545
Liabilities related to discontinued operations					
Total current liabilities	133	2,307	618	(1,504)	1,554
Long-term debt	5,895	2	205		6,102
Intercompany debt	83	(4)	(79)		
Deferred income taxes	315	654	65		1,034
Total liabilities	6,426	2,959	809	(1,504)	8,690
Total stockholder s equity	1,363	8,557	2,079	(10,636)	1,363
Total Liabilities and Stockholder s Equity	$ 7,789	$ 11,516	$ 2,888	$ (12,140)	$ 10,053

(a) This balance is primarily comprised of a receivable from the Company s Accounts Receivable Financing subsidiary, which is a non-Guarantor, resulting from the normal, recurring sale of accounts receivable under the receivables facility. In a liquidation, the first $200 million (plus interest) of collections of accounts receivable sold to this subsidiary are due to the receivables facility lender. The remaining balance would be available for collection for the benefit of the Guarantors.

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(in millions)	Supplemental Condensed Consolidating Schedule of Comprehensive Income Three Months Ended September 30, 2011				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Total revenue	$	$ 748	$ 455	$ (106)	$ 1,097
Costs and expenses:					
Cost of sales and administrative expenses	40	556	371	(106)	861
Depreciation and amortization		45	22		67
Amortization of acquisition-related intangible assets		84	22		106
Goodwill impairment charges					
Total costs and expenses	40	685	415	(106)	1,034
Operating income (loss)	(40)	63	40		63
Net interest income (expense)	(120)		(9)		(129)
Other income (expense)	65	23		(88)	
Income (loss) from continuing operations before income taxes	(95)	86	31	(88)	(66)
Benefit from (provision for) income taxes	56	(19)	(10)		27
Income (loss) from continuing operations	(39)	67	21	(88)	(39)
Income (loss) from discontinued operations, net of tax	(108)	25	(4)	(21)	(108)
Net income (loss)	$ (147)	$ 92	$ 17	$ (109)	$ (147)
Comprehensive income (loss)	$ (226)	$ 36	$ (50)	$ 14	$ (226)

(in millions)	Supplemental Condensed Consolidating Schedule of Comprehensive Income Three Months Ended September 30, 2012				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Total revenue	$	$ 725	$ 394	$ (84)	$ 1,035
Costs and expenses:					
Cost of sales and administrative expenses	20	506	323	(84)	765
Depreciation and amortization		48	22		70
Amortization of acquisition-related intangible assets	1	76	17		94
Goodwill impairment charges		385			385
Total costs and expenses	21	1,015	362	(84)	1,314
Operating income (loss)	(21)	(290)	32		(279)
Net interest income (expense)	(94)		(7)		(101)
Other income (expense)	(292)	16		276	
Income (loss) from continuing operations before income taxes	(407)	(274)	25	276	(380)
Benefit from (provision for) income taxes	40	(18)	(9)		13
Income (loss) from continuing operations	(367)	(292)	16	276	(367)
Income (loss) from discontinued operations, net of tax	5	5	9	(14)	5

Net income (loss)	$ (362)	$ (287)	$ 25	$ 262	$ (362)
Comprehensive income (loss)	$ (330)	$ (265)	$ 45	$ 220	$ (330)

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(in millions)	Supplemental Condensed Consolidating Schedule of Comprehensive Income Nine Months Ended September 30, 2011				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Total revenue	$	$ 2,219	$ 1,389	$ (322)	$ 3,286
Costs and expenses:					
Cost of sales and administrative expenses	104	1,652	1,126	(322)	2,560
Depreciation and amortization		137	67		204
Amortization of acquisition-related intangible assets		265	67		332
Goodwill impairment charges					
Total costs and expenses	104	2,054	1,260	(322)	3,096
Operating income (loss)	(104)	165	129		190
Net interest income (expense)	(367)	(1)	(25)		(393)
Other income (expense)	159	72		(233)	(2)
Income (loss) from continuing operations before income taxes	(312)	236	104	(233)	(205)
Benefit from (provision for) income taxes	164	(74)	(33)		57
Income (loss) from continuing operations	(148)	162	71	(233)	(148)
Income (loss) from discontinued operations, net of tax	(95)	38	(2)	(36)	(95)
Net income (loss)	$ (243)	$ 200	$ 69	$ (269)	$ (243)
Comprehensive income (loss)	$ (242)	$ 218	$ 73	$ (291)	$ (242)

(in millions)	Supplemental Condensed Consolidating Schedule of Comprehensive Income Nine Months Ended September 30, 2012				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Total revenue	$	$ 2,170	$ 1,218	$ (257)	$ 3,131
Costs and expenses:					
Cost of sales and administrative expenses	69	1,562	988	(257)	2,362
Depreciation and amortization		144	67		211
Amortization of acquisition-related intangible assets	1	245	49		295
Goodwill impairment charges		385			385
Total costs and expenses	70	2,336	1,104	(257)	3,253
Operating income (loss)	(70)	(166)	114		(122)
Net interest income (expense)	(303)		(21)		(324)
Other income (expense)	(225)	60	2	114	(49)
Income (loss) from continuing operations before income taxes	(598)	(106)	95	114	(495)
Benefit from (provision for) income taxes	147	(68)	(35)		44
Income (loss) from continuing operations	(451)	(174)	60	114	(451)
Income (loss) from discontinued operations, net of tax	316	91	5	(96)	316

Net income (loss)	$	(135)	$	(83)	$	65	$	18	$	(135)
Comprehensive income (loss)	$	(108)	$	(65)	$	80	$	(15)	$	(108)

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(in millions)	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	Supplemental Condensed Consolidating Schedule of Cash Flows Nine Months ended September 30, 2011				
Cash flow from operations:					
Net income (loss)	$ (243)	$ 200	$ 69	$ (269)	$ (243)
Income (loss) from discontinued operations	(95)	38	(2)	(36)	(95)
Income (loss) from continuing operations	(148)	162	71	(233)	(148)
Non cash adjustments	(123)	283	114	233	507
Changes in operating assets and liabilities	(226)	207	22		3
Cash flow from (used in) continuing operations	(497)	652	207		362
Cash flow from (used in) discontinued operations		75	(10)		65
Cash flow from (used in) operations	(497)	727	197		427
Investment activities:					
Intercompany transactions	649	(590)	(59)		
Cash paid for acquired businesses, net of cash acquired		(14)	(21)		(35)
Cash paid for property and equipment and software	(1)	(124)	(58)		(183)
Other investing activities	(3)		1		(2)
Cash provided by (used in) continuing operations	645	(728)	(137)		(220)
Cash provided by (used in) discontinued operations		(7)			(7)
Cash provided by (used in) investment activities	645	(735)	(137)		(227)
Financing activities:					
Intercompany dividends of HE sale proceeds					
Net repayments of long-term debt	(5)		(212)		(217)
Premium paid to retire debt					
Other financing activities	(10)				(10)
Cash provided by (used in) continuing operations	(15)		(212)		(227)
Cash provided by (used in) discontinued operations					
Cash provided by (used in) financing activities	(15)		(212)		(227)
Effect of exchange rate changes on cash			(2)		(2)
Increase (decrease) in cash and cash equivalents	133	(8)	(154)		(29)
Beginning cash and cash equivalents	179	1	598		778
Ending cash and cash equivalents	$ 312	$ (7)	$ 444	$	$ 749

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(in millions)	Supplemental Condensed Consolidating Schedule of Cash Flows Nine Months ended September 30, 2012				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flow from operations:					
Net income (loss)	$ (135)	$ (83)	$ 65	$ 18	$ (135)
Income (loss) from discontinued operations	316	91	5	(96)	316
Income (loss) from continuing operations	(451)	(174)	60	114	(451)
Non cash adjustments	311	658	111	(114)	966
Changes in operating assets and liabilities	(175)	92	(6)		(89)
Cash flow from (used in) continuing operations	(315)	576	165		426
Cash flow from (used in) discontinued operations	(338)	(5)	3		(340)
Cash flow from (used in) operations	(653)	571	168		86
Investment activities:					
Intercompany transactions	2,342	(411)	(160)	(1,771)	
Cash paid for acquired businesses, net of cash acquired		(1)	(9)		(10)
Cash paid for property and equipment and software		(125)	(48)		(173)
Other investing activities	(1)	1	3		3
Cash provided by (used in) continuing operations	2,341	(536)	(214)	(1,771)	(180)
Cash provided by (used in) discontinued operations		1,744	14		1,758
Cash provided by (used in) investment activities	2,341	1,208	(200)	(1,771)	1,578
Financing activities:					
Intercompany dividends of HE sale proceeds		(1,771)		1,771	
Net repayments of long-term debt	(1,742)	(2)			(1,744)
Premium paid to retire debt	(27)				(27)
Other financing activities	(19)				(19)
Cash provided by (used in) continuing operations	(1,788)	(1,773)		1,771	(1,790)
Cash provided by (used in) discontinued operations					
Cash provided by (used in) financing activities	(1,788)	(1,773)		1,771	(1,790)
Effect of exchange rate changes on cash			5		5
Increase (decrease) in cash and cash equivalents	(100)	6	(27)		(121)
Beginning cash and cash equivalents	529	(15)	359		873
Ending cash and cash equivalents	$ 429	$ (9)	$ 332	$	$ 752

During the first quarter of 2012, the Company determined that it had incorrectly accounted for intercompany dividend income and the related eliminations presented in the Supplemental Condensed Consolidating Schedules of Operations in the Company s Form 10-K for the periods ended December 31, 2009, 2010 and 2011. The Company determined that the incorrect presentation resulted in an understatement of income (or overstatement of loss) from continuing operations and net income (loss) for both the Non-Guarantor subsidiaries and the Guarantor subsidiaries. It was further determined that cash flows from operations and cash flows from investment activities for Parent (SunGard), Guarantor subsidiaries and Non-Guarantor subsidiaries were each affected between operating and investing. The Company also identified a misclassification of expense between Guarantor subsidiaries and Non-Guarantor subsidiaries in 2010 totaling $91 million. In addition, the Company also determined that it had incorrectly recorded intercompany transactions between certain Guarantor and Non-Guarantor subsidiaries as a component of net interest income (expense) resulting in an understatement of operating expenses for the Guarantor subsidiaries and an understatement of revenues for the Non-Guarantor subsidiaries. These errors had no impact on the consolidated financial statements of SunGard or any debt covenants and had no impact on the ability of SunGard s subsidiaries to dividend cash to SunGard for debt service requirements. The Company assessed the materiality of these items on previously issued annual and interim financial statements in accordance with SEC Staff Accounting Bulletin No. 99, and concluded that the errors were not material to the consolidated financial statements. The preceding tables for the three and nine months ended September 30, 2011 have been revised to reflect the correction of these errors.

The following is a summary of the impacts of the errors on each of the statements that were included in the Quarterly Report on Form 10-Q for the periods indicated.

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Supplemental Condensed Consolidating Schedule of Operations

(in millions)	Parent Company As Reported	Parent Company As Revised	Guarantor Subsidiaries As Reported	Guarantor Subsidiaries As Revised	Non-Guarantor Subsidiaries As Reported	Non-Guarantor Subsidiaries As Revised	Eliminations As Reported	Eliminations As Revised
Three Months Ended September 30, 2011								
Revenue	$	$	$ 751	$ 748 (c)	$ 359	$ 455 (c)	$	$ (106) (c)
Operating income (loss)	(40)	(40)	168	63 (c)	(67)	40 (c)		
Other income	71	65 (a)	(80)	23 (a)	(51)	(a)	8	(88) (a)
Income (loss) from continuing operations before income taxes	(58)	(95) (a)	100	86 (a)	(118)	31 (a)	8	(88) (a)
Income (loss) from continuing operations	(14)	(39) (a)	44	67 (a)	(79)	21 (a)	8	(88) (a)
Net loss	(147)	(147) (a)	71	92 (a)	(81)	17 (a)	10	(109) (a)
Nine Months Ended September 30, 2011								
Revenue	$	$	$ 2,219	$ 2,219	$ 1,110	$ 1,389 (c)	$	$ (322) (c)
Operating income (loss)	(104)	(104)	487	165 (c)	(196)	129 (c)		
Other income	148	159 (b)	(132)	72 (b)			(18)	(233) (b)
Income (loss) from continuing operations before income taxes	(250)	(312) (b)	254	236 (b)	(194)	104 (b)	(18)	(233) (b)
Income (loss) from continuing operations	(110)	(148) (b)	110	162 (b)	(132)	71 (b)	(18)	(233) (b)
Net loss	(243)	(243)	150	200 (b)	(132)	69 (b)	(18)	(269) (b)

In addition to the change in the presentation of a Financial Systems business as a discontinued operation subsequent to the initial reporting, the changes outlined below have been made in the amounts presented As Revised .

(a) Impact of the correction of intercompany dividends of $32 million, $117 million and $(149) million for Parent, guarantor subsidiaries and non-guarantor subsidiaries, respectively.

(b) Impact of the correction of intercompany dividends of $74 million, $222 million and $(296) million for Parent, guarantor subsidiaries and non-guarantor subsidiaries, respectively.

(c) The correction of the error related to intercompany transactions caused an increase in Non-Guarantor Revenue and an increase in Guarantor Costs of sales and administrative expenses. As the amounts are intercompany charges, the related eliminations also increased by an equal amount. These amounts had previously been reported in the caption Interest income (expense) and correction of the error decreases Interest income for the Non-Guarantor subsidiaries and decreases Interest expense for the Guarantor subsidiaries. The impacts to each of the periods presented in the table above for this error were as follows:

Three months ended September 30, 2011: $106 million;

Nine months ended September 30, 2011: $322 million.

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Supplemental Condensed Consolidating Schedule of Cash Flows

	Parent Company		Guarantor Subsidiaries		Non-Guarantor Subsidiaries		Eliminations	
(in millions)	As Reported	As Revised	As Reported	As Revised	As Reported	As Revised	As Reported	As Revised
Nine Months Ended September 30, 2011								
Cash Flow from Operations:								
Net income (loss)	$ (243)	$ (243)	$ 150	$ 200	$ (132)	$ 69	$ (18)	$ (269)
Income (loss) from continuing operations	(110)	(148)	110	162	(132)	71	(18)	(233)
Non-cash adjustments	(71)	(123)	446	283	115	114	18	233
Changes in operating assets and liabilities	(202)	(226)	277	207	(79)	22		
Cash flow from (used in) continuing operations	(383)	(497)	833	652	(96)	207		
Cash flow from (used in) operations	(383)	(497)	908	727	(98)	197		
Investment activities:								
Intercompany transactions	535	649	(772)	(590)	237	(59)		
Cash provided by (used in) continuing operations	531	645	(910)	(728)	159	(137)		
Cash provided by (used in) operations in investment activities	531	645	(916)	(735)	158	(137)		

The impact of the dividend elimination error is shown above as the difference between As Reported and As Revised Cash flow from (used in) operations and Cash provided by (used in) investment activities. Other captions presented above have been adjusted to reflect both the error.

See Note 11 of Notes to Consolidated Financial Statements included in the Company s Form 10-Q for the three months ended March 31, 2012 for other periods corrected as a result of the errors.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Introduction

The following discussion and analysis supplements management s discussion and analysis in the Company s Annual Report on Form 10-K for the year ended December 31, 2011 and presumes that readers have read or have access to the discussion and analysis in that filing. The following discussion and analysis includes historical and certain forward-looking information that should be read together with the accompanying Consolidated Financial Statements, related footnotes, and the discussion below of certain risks and uncertainties that could cause future operating results to differ materially from historical results or from the expected results indicated by forward-looking statements. The following discussion reflects the results of operations and financial condition of SCC, which are materially the same as the results of operations and financial condition of SCCII and SunGard. Therefore, the discussions provided are applicable to each of SCC, SCCII and SunGard unless otherwise noted.

Except as otherwise noted, all explanations below exclude the impacts from changes in currency translation, which we refer to as constant currency, a non-GAAP measure. We believe presenting our results on a constant currency basis is meaningful for assessing how our underlying businesses have performed due to the fact that we have international operations that are material to our overall operations. As a result, total revenues and expenses are affected by changes in the U.S. Dollar against international currencies. To present this information, current period results for entities reporting in currencies other than U.S. Dollars are converted to U.S. Dollars at the average exchange rate used in the prior year period rather than the actual exchange rates in effect during the current year period. In each of the tables below, we present the percent change based on actual, unrounded results in reported currency and in constant currency. Also, percentages may not add due to rounding.

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Results of Operations:

Three Months Ended September 30, 2012 Compared To Three Months Ended September 30, 2011

The following table sets forth, for the periods indicated, certain amounts included in our Consolidated Statements of Comprehensive Income, the relative percentage that those amounts represent to consolidated revenue (unless otherwise indicated), and the percentage change in those amounts from period to period.

	Three Months Ended September 30, 2011	percent of revenue	Three Months Ended September 30, 2012	percent of revenue	Percent Increase (Decrease) 2012 vs. 2011	Constant Currency Three Months Ended September 30, 2012	Constant Currency percent of revenue	Percent Increase (Decrease) 2012 vs. 2011
(in millions)								
Revenue								
Financial Systems (FS)	$ 680	62%	$ 640	62%	(6)%	$ 655	62%	(4)%
Availability Services (AS)	365	33%	345	33%	(5)%	350	33%	(4)%
Other [1]	52	5%	50	5%	(3)%	50	5%	(3)%
Total	$ 1,097	100%	$ 1,035	100%	(6)%	$ 1,055	100%	(4)%
Costs and Expenses								
Cost of sales and direct operating	$ 465	42%	$ 430	42%	(7)%	$ 438	42%	(6)%
Sales, marketing and administration	295	27%	245	24%	(16)%	252	24%	(14)%
Product development and maintenance	101	9%	90	9%	(12)%	96	9%	(6)%
Depreciation and amortization	67	6%	70	7%	4%	70	7%	4%
Amortization of acquisition-related intangible assets	106	10%	94	9%	(12)%	94	9%	(12)%
Goodwill impairment		%	385	37%		385	36%	
Total	$ 1,034	94%	$ 1,314	127%	27%	$ 1,335	127%	29%
Operating Income								
Financial Systems [2]	$ 121	17.7%	$ 136	21.2%	13%	$ 133	20.3%	10%
Availability Services [2]	80	22.1%	74	21.4%	(8)%	76	21.6%	(6)%
Other [1][2]	15	29.4%	13	26.2%	(14)%	13	26.2%	(14)%
Corporate	(30)	(2.7)%	(11)	(1.0)%	64%	(11)	(1.0)%	64%
Amortization of acquisition-related intangible assets	(106)	(9.7)%	(94)	(9.1)%	12%	(94)	(8.9)%	12%
Goodwill impairment		%	(385)	(37.2)%		(385)	(36.5)%	
Stock compensation expense	(9)	(0.8)%	(9)	(0.9)%	(3)%	(9)	(0.9)%	(3)%
Other costs [3]	(8)	(0.7)%	(3)	(0.3)%	59%	(3)	(0.3)%	59%
Total	$ 63	5.7%	$ (279)	(27.0)%	(547)%	$ (280)	(26.6)%	(548)%

(1) Other includes our Public Sector and K-12 businesses.
(2) Percent of revenue is calculated as a percent of revenue from FS, AS and Other, respectively.
(3) Other costs include management fees paid to the Sponsors, purchase accounting adjustments and certain other costs, partially offset in each year by capitalized software development costs.

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The following table sets forth, for the periods indicated, certain supplemental revenue data, the relative percentage that those amounts represent to total revenue and the percentage change in those amounts from period to period.

Revenue (in millions)	**Three Months Ended September 30, 2011**	**percent of revenue**	**Three Months Ended September 30, 2012**	**percent of revenue**	**Percent Increase (Decrease) 2012 vs. 2011**	**Constant Currency Three Months Ended September 30, 2012**	**percent of revenue**	**Percent Increase (Decrease) 2012 vs. 2011**
Financial Systems								
Services	$ 626	57%	$ 585	56%	(7)%	$ 599	57%	(5)%
License and resale fees	44	4%	47	5%	8%	48	5%	11%
Total products and services	670	61%	632	61%	(6)%	647	61%	(3)%
Reimbursed expenses	10	1%	8	1%	(17)%	8	1%	(16)%
Total	$ 680	62%	$ 640	62%	(6)%	$ 655	62%	(4)%
Availability Services								
Services	$ 358	33%	$ 341	33%	(5)%	$ 346	33%	(4)%
License and resale fees	1	%		%	2%		%	3%
Total products and services	359	33%	341	33%	(5)%	346	33%	(4)%
Reimbursed expenses	6	1%	4	%	(33)%	4	%	(28)%
Total	$ 365	33%	$ 345	33%	(5)%	$ 350	33%	(4)%
Other								
Services	$ 44	4%	$ 43	4%	(2)%	$ 43	4%	(2)%
License and resale fees	7	1%	6	1%	(11)%	6	1%	(11)%
Total products and services	51	5%	49	5%	(3)%	49	5%	(3)%
Reimbursed expenses	1	%	1	%	(4)%	1	%	(4)%
Total	$ 52	5%	$ 50	5%	(3)%	$ 50	5%	(3)%
Total Revenue								
Services	$ 1,028	94%	$ 969	94%	(6)%	$ 988	94%	(4)%
License and resale fees	52	5%	53	5%	5%	54	5%	8%
Total products and services	1,080	98%	1,022	99%	(5)%	1,042	99%	(4)%
Reimbursed expenses	17	2%	13	1%	(22)%	13	1%	(20)%
Total	$ 1,097	100%	$ 1,035	100%	(6)%	$ 1,055	100%	(4)%

Operating Income:

Our total operating margin was (26.6)% for the three months ended September 30, 2012, compared to 5.7% for the three months ended September 30, 2011. The most significant factor impacting the 32.3 margin point decrease in operating margin is the $385 million goodwill impairment charge related to AS NA, which had a (36.5) margin point impact. The more significant factors impacting the remaining 4.2 margin point improvement are a $34 million decrease in severance, which had a 3.1 margin point impact on the operating margin; a 1.1 margin point impact, or $13 million, from the decrease in amortization of acquisition-related intangible assets; and the 0.6 margin point impact, or $5 million, from the increase in software license fee revenue. Excluding the severance charges discussed above, FS improved the total operating margin by 0.6 points due mainly to expense management primarily from reduced external services fees and currency transaction losses. Also excluding the severance charges, degradation of total margin by AS of 1.4 points was due primarily to the decrease in recovery services and professional services revenue.

Financial Systems:

The FS operating margin was 20.3% and 17.7% for the three months ended September 30, 2012 and 2011, respectively. The more significant factors impacting the 2.6 margin point increase in operating margin are a 1.2 margin point impact, or $8 million, from the decrease in external services fees; the 0.9 margin point impact, or $6 million, from the decrease in currency transaction losses; and the 0.7 margin point impact from the $6 million increase in software license fee revenue.

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Availability Services:

The AS operating margin was 21.6% and 22.1% for the three months ended September 30, 2012 and 2011, respectively, a decrease of 0.5 margin points. In North America, recovery services, which typically uses shared resources, had a (2.2) margin point impact on AS operating margin in 2012 due primarily to a $14 million decrease in higher margin recovery services revenue, partially offset by a $5 million decrease in equipment expense. Professional services had a (0.5) margin point impact in 2012 due primarily to a $1 million increase in employment-related expenses on $2 million of lower revenue. A decrease in severance of $8 million had a 2.2 margin point impact in 2012.

Other:

The operating margin from Other was 26.2% and 29.4% for the three months ended September 30, 2012 and 2011, respectively, and operating income decreased $2 million. The operating margin decreased due primarily to unchanged costs on lower revenue.

Revenue:

Total reported revenue decreased $62 million or 6% for the three months ended September 30, 2012 compared to the third quarter of 2011. On a constant currency basis, revenue decreased $42 million, or 4%. The $42 million decrease is due mainly to a $22 million decrease in FS professional services revenue and a $14 million decrease in AS recovery services, partially offset by an increase in FS software license revenue of $5 million. Also, approximately $6 million of the $42 million decrease was due to a decrease in revenue from one of our FS businesses, a legacy broker/dealer (the Broker/Dealer,) which was heavily influenced by service to one very large customer. That customer has since begun to self-clear its broker/dealer operations.

Financial Systems:

FS reported revenue decreased $40 million, or 6%, in the third quarter of 2012 from the prior year period, and decreased $25 million, or 4%, on a constant currency basis. Professional services revenue decreased $22 million, or 15%, due primarily to successful completion of projects during 2011 and relatively lower demand in 2012 driven by economic conditions and related customer budget constraints. One percentage point of the decrease was related to lower revenues from the Broker/Dealer as mentioned above. Reported revenue from license and resale fees included software license revenue of $43 million, an increase of $4 million, or 12%, compared to the same quarter in 2011. On a constant currency basis, software license fees increased $5 million, or 15%, due primarily to an increase in high-value, multi-year license renewal transactions with some scope expansion.

Availability Services:

AS reported revenue decreased $20 million, or 5%, in the third quarter of 2012 from the prior year period. On a constant currency basis, revenue decreased $15 million, or 4%, in the quarter. In North America, which accounts for over 75% of our AS business, revenue decreased 5%, where decreases in recovery services revenue exceeded growth in managed services revenue. Revenue in Europe, primarily from our U.K. operations, decreased 2%, where a decrease in recovery services revenue was partially offset by an increase in managed services revenue. Our recovery services revenue has been declining due to customers shifting from traditional backup and recovery to either in-house solutions or disk-, cloud-based or managed recovery solutions. Separately, in managed services, demand has been increasing for outsourced management of IT operations and applications. We expect these trends to continue in the future.

Other:

Reported revenue and constant currency revenue from Other decreased $2 million, or 3%, for the three months ended September 30, 2012, from the corresponding period in 2011. Reported revenue from license and resale fees included software license revenue of $2 million in the three months ended September 30, 2012, a decrease of approximately $0.5 million from the prior year period.

Costs and Expenses:

Cost of sales and direct operating expenses as a percentage of total revenue was 42% in each of the three-month periods ended September 30, 2012 and 2011 and decreased $27 million. Impacting the period was a $20 million decrease in FS and AS employment-related expenses, including a decrease of $9 million of severance; and a $6 million decrease in AS equipment costs associated with lower equipment leases, equipment and software maintenance and decreased network costs.

Sales, marketing and administration expenses as a percentage of total revenue was 24% and 27% in the three months ended September 30, 2012 and 2011, respectively, and decreased $43 million. Decreases in sales, marketing and administration expenses were due primarily to decreases in corporate and FS employment-related expenses of $22 million due primarily to the impact from severance actions taken in 2011; FS currency transaction losses of $8 million; external services fees of $6 million and FS facilities costs.

Because AS product development and maintenance costs are insignificant, it is more meaningful to measure product development and maintenance expenses as a percentage of revenue excluding AS. For the three months ended September 30, 2012 and 2011, product development and maintenance costs were 13% and 14%, respectively, of revenue excluding AS and decreased $6 million. The decrease is primarily related to a $2 million increase in FS costs capitalized as software assets in the third quarter of 2012 from the prior year period.

Amortization of acquisition-related intangible assets was 9% and 10% of total revenue in the three months ended September 30, 2012 and 2011, respectively, and decreased $12 million. The decrease is due primarily to the $13 million impact of software assets that were fully amortized in the prior year.

We recorded a goodwill impairment charge of $385 million in AS in the three months ended September 30, 2012. See note 3 of Notes to Consolidated Financial Statements for further discussion.

Interest expense was $102 million and $130 million for the three months ended September 30, 2012 and 2011, respectively. The decrease in interest expense was due primarily to the repayment in January 2012 of $1.22 billion of our outstanding term loans as a result of the sale of HE, the early extinguishment in April 2012 of $500 million 10.625% senior notes due 2015 (2015 Notes) and interest rate decreases resulting from the expiration of interest rate swaps in each of February 2011 and 2012.

The effective income tax rates for the three months ended September 30, 2012 and 2011 were 3% and 41%, respectively. The Company s effective tax rate fluctuates from period to period due to changes in the mix of income or losses in jurisdictions with a wide range of tax rates, permanent differences between GAAP and local tax laws, and the timing of recording discrete items. The effective tax rate for the three months ended September 30, 2012 was also impacted by the goodwill impairment charge, which is largely nondeductible, and by the application of the loss limitation guidance, which requires that when the interim period loss before taxes exceeds the forecasted loss before taxes for the annual period, the tax benefit recognized associated with the interim period loss should be limited to the tax benefit associated with the loss expected to be recognized for the annual period.

Accreted dividends on SCCII s cumulative preferred stock were $64 million and $57 million for the three months ended September 2012 and 2011, respectively. The increase in dividends is due to compounding. No dividends have been declared by SCCII.

Nine Months Ended September 30, 2012 Compared To Nine Months Ended September 30, 2011

The following table sets forth, for the periods indicated, certain amounts included in our Consolidated Statements of Comprehensive Income, the relative percentage that those amounts represent to consolidated revenue (unless otherwise indicated), and the percentage change in those amounts from period to period.

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						Constant Currency		
(in millions)	Nine Months Ended September 30, 2011	percent of revenue	Nine Months Ended September 30, 2012	percent of revenue	Percent Increase (Decrease) 2012 vs. 2011	Nine Months Ended September 30, 2012	percent of revenue	Percent Increase (Decrease) 2012 vs. 2011
Revenue								
Financial Systems (FS)	$ 2,037	62%	$ 1,928	62%	(5)%	$ 1,965	62%	(4)%
Availability Services (AS)	1,095	33%	1,052	34%	(4)%	1,065	33%	(3)%
Other [(1)]	154	5%	151	5%	(2)%	151	5%	(2)%
Total	$ 3,286	100%	$ 3,131	100%	(5)%	$ 3,181	100%	(3)%
Costs and Expenses								
Cost of sales and direct operating	$ 1,416	43%	$ 1,321	42%	(7)%	$ 1,340	42%	(5)%
Sales, marketing and administration	842	26%	768	25%	(9)%	785	25%	(7)%
Product development and maintenance	302	9%	273	9%	(10)%	287	9%	(5)%
Depreciation and amortization	204	6%	211	7%	3%	211	7%	3%
Amortization of acquisition-related intangible assets	332	10%	295	9%	(11)%	295	9%	(11)%
Goodwill impairment		%	385	12%		385	12%	
Total	$ 3,096	94%	$ 3,253	104%	5%	$ 3,303	104%	7%
Operating Income								
Financial Systems [(2)]	$ 374	18.3%	$ 388	20.1%	4%	$ 383	19.5%	2%
Availability Services [(2)]	234	21.4%	209	19.9%	(11)%	214	20.1%	(8)%
Other [(1)(2)]	43	28.2%	41	26.8%	(7)%	41	26.8%	(7)%
Corporate	(79)	(2.4)%	(39)	(1.3)%	50%	(39)	(1.2)%	50%
Amortization of acquisition-related intangible assets	(332)	(10.1)%	(295)	(9.4)%	11%	(295)	(9.3)%	11%
Goodwill impairment		%	(385)	(12.3)%		(385)	(12.1)%	
Stock compensation expense	(23)	(0.7)%	(29)	(0.9)%	(27)%	(29)	(0.9)%	(27)%
Other costs [(3)]	(27)	(0.9)%	(12)	(0.4)%	58%	(12)	(0.4)%	58%
Total	$ 190	5.8%	$ (122)	(3.9)%	(165)%	$ (122)	(3.9)%	(165)%

(1) Other includes our Public Sector and K-12 businesses.
(2) Percent of revenue is calculated as a percent of revenue from FS, AS and Other, respectively.
(3) Other costs include management fees paid to the Sponsors, purchase accounting adjustments and certain other costs, partially offset in each year by capitalized software development costs.

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The following table sets forth, for the periods indicated, certain supplemental revenue data, the relative percentage that those amounts represent to total revenue and the percentage change in those amounts from period to period.

Revenue						Constant Currency		
	Nine Months Ended September 30, 2011		Nine Months Ended September 30, 2012		Percent Increase (Decrease) 2012 vs. 2011	Nine Months Ended September 30, 2012		Percent Increase (Decrease) 2012 vs. 2011
(in millions)		percent of revenue		percent of revenue			percent of revenue	
Financial Systems								
Services	$ 1,805	55%	$ 1,750	56%	(3)%	$ 1,780	56%	(1)%
License and resale fees	171	5%	148	5%	(13)%	155	5%	(10)%
Total products and services	1,976	60%	1,898	61%	(4)%	1,935	61%	(2)%
Reimbursed expenses	61	2%	30	1%	(51)%	30	1%	(51)%
Total	$ 2,037	62%	$ 1,928	62%	(5)%	$ 1,965	62%	(4)%
Availability Services								
Services	$ 1,081	33%	$ 1,036	33%	(4)%	$ 1,048	33%	(3)%
License and resale fees	1	%	1	%	30%	1	%	31%
Total products and services	1,082	33%	1,037	33%	(4)%	1,049	33%	(3)%
Reimbursed expenses	13	%	15	%	18%	16	%	23%
Total	$ 1,095	33%	$ 1,052	34%	(4)%	$ 1,065	33%	(3)%
Other								
Services	$ 130	4%	$ 130	4%	(1)%	$ 130	4%	(1)%
License and resale fees	21	1%	19	1%	(7)%	19	1%	(7)%
Total products and services	151	5%	149	5%	(2)%	149	5%	(2)%
Reimbursed expenses	3	%	2	%	(14)%	2	%	(14)%
Total	$ 154	5%	$ 151	5%	(2)%	$ 151	5%	(2)%
Total Revenue								
Services	$ 3,016	92%	$ 2,916	93%	(3)%	$ 2,958	93%	(2)%
License and resale fees	193	6%	168	5%	(13)%	175	6%	(9)%
Total products and services	3,209	98%	3,084	98%	(4)%	3,133	98%	(2)%
Reimbursed expenses	77	2%	47	2%	(39)%	48	2%	(37)%
Total	$ 3,286	100%	$ 3,131	100%	(5)%	$ 3,181	100%	(3)%

Operating Income:

Our total operating margin was (3.9)% for the nine months ended September 30, 2012, compared to 5.8% for the nine months ended September 30, 2011. The most significant factor impacting the 9.7 margin point decrease is the $385 million goodwill impairment charge related to AS NA, which had a (12.1) margin point impact. The more significant factors impacting the remaining 2.4 margin point improvement are a $52 million decrease in severance and corporate executive transition and other employment-related costs, which had a 1.6 margin point impact; a

1.2 margin point impact, or $37 million, from the decrease in amortization of acquisition-related intangible assets; a 0.5 margin point impact, or $16 million, from the decrease in other costs, primarily from capitalizing more software costs in 2012; partially offset by a (0.8) margin point impact from the decrease in the AS margin, which excludes the impact of severance; and a (0.4) margin point impact, or $15 million, from the decrease in software license fee revenue. Excluding the severance charges discussed above, FS improved the total operating margin by 0.2 points due mainly to expense management primarily from reduced external services fees and consultant expenses. Also excluding the severance charges, degradation of total margin by AS of 0.9 points was due primarily to the decrease in recovery services and professional services revenue, partially offset by an increase in revenue from managed services.

Financial Systems:

The FS operating margin was 19.5% and 18.3% for the nine months ended September 30, 2012 and 2011, respectively. The more significant factors impacting the 1.2 margin point change in the operating margin are the 0.8 margin point impact, or $15 million, from the decrease in external services fees; the 0.5 margin point impact, or $9 million, from the decrease in consultant expense; the 0.3 margin point impact from the lower activity level of the Broker/Dealer; partially offset by the (0.6) margin point impact from the $15 million decrease in software license fee revenue.

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Availability Services:

The AS operating margin was 20.1% and 21.4% for the nine months ended September 30, 2012 and 2011, respectively, a decrease of 1.3 margin points. In North America, recovery services, which typically uses shared resources, had a (2.4) margin point impact on AS operating margin in 2012 due primarily to a $43 million decrease in higher margin recovery services revenue, partially offset by a $14 million decrease in equipment expense. Professional services had a (0.3) margin point impact in 2012 due primarily to a $2 million increase in employment-related expenses on $2 million of lower revenue. A decrease in severance of $8 million had a 0.7 margin point impact in 2012. Managed services helped the margin in 2012 by 0.7 margin points due primarily to a $13 million increase in typically lower margin managed services revenue, which uses dedicated resources, and a $2 million decrease in facilities costs, partially offset by a $2 million increase in depreciation and amortization and a $4 million increase in employment-related expenses.

Other:

The operating margin from Other was 26.8% and 28.2% for the nine months ended September 30, 2012 and 2011, respectively. The operating margin decreased 1.4 margin points due primarily to a $3 million decrease in revenue and a $2 million increase in employment-related expenses, partially offset by a $1 million decrease in external services fees.

Revenue:

Total reported revenue decreased $155 million or 5% for the nine months ended September 30, 2012 compared to the third quarter of 2011. On a constant currency basis, revenue decreased $105 million, or 3%. Approximately $53 million of the $105 million decrease, or 1.5 of the three percentage points of decrease, was due to a decrease in revenue from the Broker/Dealer discussed above. The remaining decrease is due mainly to a $42 million decrease in AS recovery services, a $30 million decrease in FS professional services revenue, and a $15 million decrease in FS software license revenue, partially offset by a $13 million increase in AS managed services, an $11 million increase from FS acquisitions, and an $8 million increase in FS processing revenue.

Financial Systems:

FS reported revenue decreased $109 million or 5% in the nine months ended September 30, 2012 from the prior year period, and decreased 4% on a constant currency basis. Three percentage points of the decrease was related to lower revenues from the Broker/Dealer discussed above. Professional services revenue decreased $30 million, or 7%, due primarily to successful completion of projects during 2011 and relatively lower demand in 2012 driven by economic conditions and related customer budget constraints, and was offset in part by a $4 million increase from acquisitions. Reported revenue from license and resale fees included software license revenue of $136 million, a decrease of $21 million, or 13%, compared to the nine months of 2011. On a constant currency basis, software license revenue decreased $15 million, or 9%, due mainly to high-value, multi-year license renewal transactions with some scope expansion recognized in 2011. Also, one deal in 2011 worth $14 million was recognized for which there were no similarly sized transactions in 2012. Processing revenue increased $8 million, or 1%, due mainly to the impact of new business signed in 2011, higher volumes in 2012 and annual rate increases and increased $4 million due to acquisitions.

Availability Services:

AS reported revenue decreased $43 million, or 4%, in the nine months ended September 30, 2012 from the prior year period. On a constant currency basis, revenue decreased 3% in the nine month period ended September 30, 2012. In North America, which accounts for over 75% of our AS business, revenue decreased 4%, where decreases in recovery services revenue exceeded growth in managed services revenue. Revenue in Europe, primarily from our U.K. operations, increased 1%, where an increase in managed services revenue was mostly offset by a decrease in recovery services revenue. Our recovery services revenue has been declining due to customers shifting from traditional backup and recovery to either in-house solutions or disk-, cloud-based or managed recovery solutions. Separately, in managed services, demand has been increasing for outsourced management of IT operations and applications. We expect these trends to continue in the future.

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Other:

Reported revenue and constant currency revenue from Other decreased $3 million, or 2%, for the nine months ended September 30, 2012, from the corresponding period in 2011. Reported revenue from license and resale fees included software license revenue of $6 million in the nine months ended September 30, 2012, a decrease of $1 million from the prior year period.

Costs and Expenses:

Cost of sales and direct operating expenses as a percentage of total revenue was 42% and 43% in the nine months ended September 30, 2012 and 2011, respectively, and decreased $76 million. Impacting the period was a $42 million decrease in reimbursed expenses relating to the operations of the Broker/Dealer businesses due primarily to no longer providing correspondent clearing services for a large, former Broker/Dealer customer that has since begun to self-clear its broker/dealer operations; a $31 million decrease in FS employment-related expenses; a $19 million decrease in AS equipment costs associated with lower equipment leases, equipment and software maintenance and decreased network costs; partially offset by a $7 million increase from FS acquisitions.

Sales, marketing and administration expenses as a percentage of total revenue was 25% and 26% in the nine months ended September 30, 2012 and 2011, and decreased $57 million. Decreases in sales, marketing and administration expenses were due primarily to decreases of $37 million of corporate and FS employment-related expenses mainly as a result of executive transition costs incurred in the second quarter of 2011 and other severance actions taken in 2011; $12 million of external services fees; $10 million of advertising expense and related costs mainly resulting from cost savings initiatives; and $4 million of costs related to the shutdown of the Broker/Dealer professional trading business in 2011; partially offset by increases of $6 million of stock compensation expense.

Because AS product development and maintenance costs are insignificant, it is more meaningful to measure product development and maintenance expenses as a percentage of revenue excluding AS. For the nine months ended September 30, 2012 and 2011, product development and maintenance costs were 13% and 14%, respectively, of revenue excluding AS, respectively, and decreased $15 million. The decrease is primarily related to a $8 million increase in FS costs capitalized as software assets.

Depreciation and amortization was 7% and 6% of total revenue in the nine months ended September 30, 2012 and 2011, respectively, and increased $7 million due mainly to AS capital expenditures over the past twelve months.

Amortization of acquisition-related intangible assets was 9% and 10% of total revenue in the nine months ended September 30, 2012 and 2011, respectively, and decreased $37 million. The decrease is due primarily to the $33 million impact of software assets that were fully amortized in the prior year and $7 million of impairment charges in the prior year period.

We recorded a goodwill impairment charge of $385 million in AS in the nine months ended September 30, 2012. See note 3 of Notes to Consolidated Financial Statements for further discussion.

Interest expense was $325 million and $396 million for the nine months ended September 30, 2012 and 2011, respectively. The decrease in interest expense was due primarily to the repayment in January 2012 of $1.22 billion of our outstanding term loans as a result of the sale of HE, the early extinguishment in April 2012 of the 2015 Notes and interest rate decreases resulting from the expiration of interest rate swaps in each of February 2011 and 2012.

Loss on extinguishment of debt was $51 million and $2 million for the nine months ended September 30, 2012 and 2011, respectively. This increase was due primarily to the partial repayment of term loans in January 2012 and the early extinguishment of the 2015 Notes discussed above.

The effective income tax rates for the nine months ended September 30, 2012 and 2011 were 9% and 28%, respectively. The rate fluctuates from period to period due to changes in the mix of income or losses in jurisdictions with a wide range of tax rates, permanent differences between GAAP and local tax laws and the timing of recording discrete items. The effective tax rate for the nine months ended September 30, 2012 was also impacted by the goodwill impairment charge, which is largely nondeductible, and the application of the loss limitation guidance, which requires that when the interim period loss before taxes exceeds the forecasted loss before taxes for the annual period, the tax benefit recognized associated with the interim period loss should be limited to the tax benefit associated with the loss expected to be recognized for the annual period.

Accreted dividends on SCCII s cumulative preferred stock were $186 million and $166 million for the nine months ended September 30, 2012 and 2011, respectively. The increase in dividends is due to compounding. No dividends have been declared by SCCII.

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Liquidity and Capital Resources:

At September 30, 2012, cash and equivalents were $752 million. Cash flow from continuing operations was $426 million in the nine months ended September 30, 2012 compared to $362 million in the nine months ended September 30, 2011. Impacting cash flow from continuing operations was a $49 million increase in cash earned from operations, defined as operating income adjusted for certain noncash expenses and the cash portion of other income (expense), $44 million less of interest payments made in the nine months ended September 30, 2012 from the prior year period, due primarily to the partial repayment in January 2012 of $1.22 billion of term loans resulting from the sale of HE, the retirement of $500 million 10.625% senior notes due 2015 in April 2012 and the expiration of certain of our interest rate swaps, partially offset by an $18 million increase in income tax payments, net of refunds, and $11 million less cash provided by working capital.

Net cash used by continuing operations in investing activities was $180 million in the nine months ended September 30, 2012, comprised of cash paid for property and equipment and other assets and one business acquired in our FS segment. Net cash used by continuing operations in investing activities was $220 million in the nine months ended September 30, 2011, comprised mainly of cash paid for property and equipment and other assets and five businesses acquired in our FS segment. In January 2012, we sold our HE business for gross proceeds of approximately $1.775 billion less applicable taxes and fees. We expect to pay approximately $450 million of income taxes in 2012 as a result of the HE sale, of which approximately 75% has been paid through the third quarter, and the remainder is expected to be paid in the fourth quarter net of any benefit from continuing operations.

Net cash used by continuing operations in financing activities was $1.79 billion for the nine months ended September 30, 2012, primarily related to repayments of $1.22 billion of term loans resulting from the sale of HE and $527 million related to the early retirement of the 10.625% senior notes due 2015. Net cash provided by continuing operations in financing activities was $227 million for the nine months ended September 30, 2011, primarily related to repayments under the revolving portion of our receivables facility and the partial retirement of $100 million of £-denominated term loans. At September 30, 2012, no amount was outstanding under the revolving credit facility, and $200 million was outstanding under the receivables facility.

On March 2, 2012, SunGard amended its Credit Agreement to, among other things, extend the maturity date of approximately $908 million of tranche A and incremental term loans from February 28, 2014 to February 28, 2017, extend the maturity of $880 million of revolving credit facility commitments from May 11, 2013 to November 29, 2016, and amend certain covenants and other provisions, in order to, among other things, permit the potential spin-off of AS. The tranche B, tranche C and revolving credit facility each have certain springing maturity provisions which are described in the Company s Credit Agreement as amended and filed with the Company s Form 8-K dated March 2, 2012.

On April 2, 2012, SunGard redeemed for $527 million plus accrued and unpaid interest to the redemption date all of its outstanding 10.625% senior notes due 2015 under the Indenture dated as of September 29, 2008 (as amended or supplemented from time to time, the 2015 Indenture) among SunGard, the guarantors named therein, and The Bank of New York Mellon, as trustee.

In July 2012, we sold one of our European consulting businesses for approximately 14 million.

On August 10, 2012, SunGard executed an interest rate swap derivative with a notional amount of $200 million. This swap, which matures on February 28, 2017, is designated as a cash flow hedge, and it effectively swaps floating rate debt (1-month LIBOR) to fixed rate debt of 0.73%. On September 14, 2012, SunGard executed an interest rate swap derivative with a notional amount of $200 million. This swap, which matures on February 28, 2017, is designated as a cash flow hedge, and it effectively swaps floating rate debt (1-month LIBOR) to fixed rate debt of 0.66%.

At September 30, 2012, we have outstanding $6.11 billion in aggregate indebtedness, with additional borrowing capacity of $858 million under the revolving credit facility (after giving effect to outstanding letters of credit). Under the receivables facility, there was an additional borrowing capacity of $39 million at September 30, 2012. Also at September 30, 2012, we have outstanding letters of credit and bid bonds that total approximately $42 million.

On November 1, 2012, SunGard successfully issued $1 billion aggregate principal amount of 6.625% Senior Subordinated Notes due 2019 (Senior Subordinated Notes) and used a portion of the proceeds from this offering to repurchase approximately $490 million of its 10.25% Senior Subordinated Notes due 2015 (Existing 10.25% Senior Subordinated Notes). SunGard intends to repurchase or redeem the remaining Existing 10.25% Senior Subordinated Notes in the fourth quarter of 2012. As a result of this transaction, the Company expects to incur a $30 million loss on the extinguishment of debt which will be reflected in the statement of comprehensive income in the fourth quarter of 2012.

On November 1, 2012, SunGard and the guarantors of the Senior Subordinated Notes entered into a registration rights agreement and have agreed that they will (i) file a registration statement with respect to a registered offer to exchange the Senior Subordinated Notes for new notes guaranteed by the guarantors on a senior subordinated unsecured basis, with terms substantially identical in all material respects to the Senior Subordinated Notes, and (ii) use their reasonable best efforts to cause the exchange offer registration statement to be declared effective under the Securities Act of 1933, as amended.

SunGard and the guarantors have agreed to use their reasonable best efforts to cause the exchange offer to be completed or, if required, to have one or more shelf registration statements declared effective, within 360 days after the issue date.

If SunGard fails to satisfy this obligation (a registration default), the annual interest rate on the Senior Subordinated Notes will increase by an additional 0.25% for each subsequent 90-day period during which the registration default continues, up to a maximum additional interest rate of 1.00% per year. If the registration default is corrected, the applicable interest rate will revert to the original level.

We expect our available cash balances and cash flows from operations, combined with availability under the revolving credit facility and receivables facility, to provide sufficient liquidity to fund our current obligations, projected working capital requirements and capital spending for a period that includes at least the next 12 months.

Covenant Compliance

Adjusted EBITDA is used to determine compliance with certain covenants contained in the indentures governing SunGard s senior notes due 2018 and 2020 and senior subordinated notes due 2015 and in SunGard s senior secured credit facilities. Adjusted EBITDA is defined as EBITDA, which we define as earnings before interest, taxes, depreciation and amortization, further adjusted to exclude certain adjustments permitted in calculating covenant compliance under the indentures and senior secured credit facilities. We believe that the inclusion of supplementary adjustments to EBITDA applied in presenting Adjusted EBITDA are appropriate to provide additional information to investors to demonstrate compliance with the financing covenants.

A breach of covenants in SunGard s senior secured credit facilities that are tied to ratios based on Adjusted EBITDA could result in a default under that agreement and the lenders could elect to declare all amounts borrowed due and payable. Any such acceleration would also result in a default under the indentures. Additionally, under SunGard s debt agreements, our ability to engage in activities such as incurring additional indebtedness, making investments and paying dividends is also tied to ratios based on Adjusted EBITDA.

Adjusted EBITDA is calculated as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,		Last Twelve Months September 30,
	2011	2012	2011	2012	2012
Income (loss) from continuing operations	$ (39)	$ (367)	$ (148)	$ (451)	$ (372)
Interest expense, net	129	101	393	324	452
Taxes	(27)	(13)	(57)	(44)	(105)
Depreciation and amortization	173	164	536	506	676
EBITDA	236	(115)	724	335	651
Goodwill impairment charge		385		385	433
Purchase accounting adjustments [(a)]	3	2	8	7	9
Non-cash charges [(b)]	9	10	23	30	41
Restructuring and other [(c)]	53	16	79	29	45
Acquired EBITDA, net of disposed EBITDA					1
Loss on extinguishment of debt [(d)]			2	51	52
Adjusted EBITDA senior secured credit facilities, senior notes due 2018 and 2020 and senior subordinated notes due 2015	$ 301	$ 298	$ 836	$ 837	$ 1,232

(a) Purchase accounting adjustments include the adjustment of deferred revenue and lease reserves to fair value at the date of the LBO and subsequent acquisitions made by the Company and certain acquisition-related compensation expense.
(b) Non-cash charges include stock-based compensation and loss on the sale of assets.

(c) Restructuring and other charges include severance and related payroll taxes, reserves to consolidate or exit certain facilities, strategic initiative expenses, certain other expenses associated with acquisitions made by the Company, management fees paid to the Sponsors (see Note 9 of Notes to Financial Statements) and franchise and similar taxes reported in operating expenses, partially offset by certain charges relating to the receivables facility.

(d) Loss on extinguishment of debt includes the write-off of deferred financing fees associated with the January 2012 repayment of $1.22 billion of our US$-denominated term loans and the April 2, 2012 retirement of $500 million, 10.625% senior notes due 2015.

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The covenant requirements and actual ratios for the twelve months ended September 30, 2012 are as follows. All covenants are in compliance.

	Covenant Requirements	Actual Ratios
Senior secured credit facilities [1]		
Minimum Adjusted EBITDA to consolidated interest expense ratio	1.95x	3.39x
Maximum total debt to Adjusted EBITDA	5.75x	4.23x
Senior notes due 2018 and 2020 and senior subordinated notes due 2015 [2]		
Minimum Adjusted EBITDA to fixed charges ratio required to incur additional debt pursuant to ratio provisions	2.00x	3.38x

(1) The senior secured credit facilities require us to maintain an Adjusted EBITDA to consolidated interest expense ratio starting at a minimum of 1.95x for the four-quarter period ended December 31, 2011 and increasing over time to 2.10x by the end of 2012 and 2.20x by the end of 2013. Consolidated interest expense is defined in the senior secured credit facilities as consolidated cash interest expense less cash interest income further adjusted for certain non-cash or non-recurring interest expense and the elimination of interest expense and fees associated with SunGard s receivables facility. Beginning with the four-quarter period ending December 31, 2011, we are required to maintain a consolidated total debt to Adjusted EBITDA ratio of 5.75x and decreasing over time to 5.25x by the end of 2012 and to 4.75x by the end of 2013. Consolidated total debt is defined in the senior secured credit facilities as total debt less certain indebtedness and further adjusted for cash and cash equivalents on our balance sheet in excess of $50 million. Failure to satisfy these ratio requirements would constitute a default under the senior secured credit facilities. If our lenders failed to waive any such default, our repayment obligations under the senior secured credit facilities could be accelerated, which would also constitute a default under our indentures.

(2) SunGard s ability to incur additional debt and make certain restricted payments under our indentures, subject to specified exceptions, is tied to an Adjusted EBITDA to fixed charges ratio of at least 2.0x, except that we may incur certain debt and make certain restricted payments and certain permitted investments without regard to the ratio, such as the ability to incur up to an aggregate principal amount of $5.75 billion under credit facilities (inclusive of amounts outstanding under the senior credit facilities from time to time; as of September 30, 2012, we had $3.05 billion outstanding under the term loan facilities and available commitments of $858 million under the revolving credit facility), to acquire persons engaged in a similar business that become restricted subsidiaries and to make other investments equal to 6% of our consolidated assets. Fixed charges is defined in the indentures governing the Senior Notes due 2018 and 2020 and the Senior Subordinated Notes due 2015 as consolidated interest expense less interest income, adjusted for acquisitions, and further adjusted for non-cash interest and the elimination of interest expense and fees associated with the receivables facility.

Certain Risks and Uncertainties

Certain of the matters we discuss in this Report on Form 10-Q may constitute forward-looking statements. You can identify forward-looking statements because they contain words such as believes, expects, may, will, should, seeks, approximately, intends, plans, estim anticipates or similar expressions which concern our strategy, plans or intentions. All statements we make relating to estimated and projected earnings, margins, costs, expenditures, cash flows, growth rates and financial results are forward-looking statements. In addition, we, through our senior management, from time to time make forward-looking public statements concerning our expected future operations and performance and other developments. All of these forward-looking statements are subject to risks and uncertainties that may change at any time, and, therefore, our actual results may differ materially from those we expected. We derive most of our forward-looking statements from our operating budgets and forecasts, which are based upon many detailed assumptions. While we believe that our assumptions are reasonable, we caution that it is very difficult to predict the

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impact of known factors, and, of course, it is impossible for us to anticipate all factors that could affect our actual results. Some of the factors that we believe could affect our results include: general economic and market conditions; the overall condition of the financial services industry, including the effect of any further consolidation among financial services firms; our high degree of leverage; the effect of war, terrorism, natural disasters or other catastrophic events; the effect of disruptions to our systems and infrastructure; the timing and magnitude of software sales; the timing and scope of technological advances; customers taking their information availability solutions in-house; the trend in information availability toward solutions utilizing more dedicated resources; the market and credit risks associated with broker/dealer operations; the ability to retain and attract customers and key personnel; risks relating to the foreign countries where we transact business; the integration and performance of acquired businesses; the ability to obtain patent protection and avoid patent-related liabilities in the context of a rapidly developing legal framework for software and business-method patents; a material weakness in our internal controls; and unanticipated changes in our tax provision or the adoption of new tax legislation. The factors described in this paragraph and other factors that may affect our business or future financial results are discussed in our filings with the Securities and Exchange Commission, including this Form 10-Q. We assume no obligation to update any written or oral forward-looking statement made by us or on our behalf as a result of new information, future events or other factors.

Item 3. Quantitative and Qualitative Disclosures about Market Risk:

We do not use derivative financial instruments for trading or speculative purposes. We have invested our available cash in short-term, highly liquid financial instruments, with a substantial portion having initial maturities of three months or less. When necessary, we have borrowed to fund acquisitions.

At September 30, 2012, we had total debt of $6.11 billion, including $3.25 billion of variable rate debt. We have entered into interest rate swap agreements which fix the interest rates for $900 million of our variable rate debt. Swap agreements expiring in May 2013 with a notional value of $500 million effectively fix our interest rates at 1.99%. Swap agreements expiring in February 2017 with a notional value of $400 million effectively fix our interest rates at 0.69%. Our remaining variable rate debt of $2.35 billion is subject to changes in underlying interest rates, and, accordingly, our interest payments will fluctuate. During the period when all of our interest rate swap agreements are effective, a 1% change in interest rates would result in a change in interest of approximately $24 million per year. Upon the expiration of each interest rate swap agreement in May 2013 and February 2017, a 1% change in interest rates would result in a change in interest of approximately $28 million and $33 million per year, respectively.

Item 4. Controls and Procedures:

Evaluation of Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining a system of disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer s management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow for timely decisions regarding required disclosure.

The Company previously reported a material weakness in internal control over financial reporting related to accounting for deferred income taxes, which was described in Item 9A including Management s Annual Report on Internal Control Over Financial Reporting in the Company s Annual Report on Form 10-K for the year ended December 31, 2011. As a result of this material weakness, which was not remediated as of September 30, 2012, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, concluded that the Company s disclosure controls and procedures were not effective as of September 30, 2012.

Notwithstanding the material weakness in accounting for deferred income taxes, we concluded that the interim financial statements included in this Form 10-Q fairly present, in all material respects, our financial condition, results of operations and cash flows as of and for the periods presented in accordance with generally accepted accounting principles.

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Remediation of Material Control Weakness

The Company is continuing to implement steps to remediate the material weakness discussed above and to improve its internal control over financial reporting related to accounting for deferred income taxes. Specifically, the Company hired a new Vice President of Tax, effective June 1, 2012, and several additional qualified tax personnel have recently joined the Company. The Company is continuing to review all areas of the income tax accounting process, strengthening controls, and increasing the level of certain income tax review activities during the financial close process. The Company is enhancing reporting tools in its existing systems to improve the quality of data used in the analysis of deferred income tax accounts and related disclosures.

Management is committed to improving the Company s internal control processes and has developed and presented to the Audit Committee a plan and timetable for the implementation of the remediation measures described above and is meeting regularly with the Committee to monitor the status of remediation activities. Management believes that the measures described above should remediate the material weakness identified and strengthen the Company s internal control over financial reporting related to accounting for deferred income taxes. As the Company continues to evaluate and improve its internal control over financial reporting related to accounting for deferred income taxes, additional measures to remediate the material weakness or modifications to certain of the remediation procedures described above may be necessary. The Company continues to make progress each quarter and expects to achieve remediation of the material weakness when it completes its year end procedures in connection with filing the Company s Annual Report on Form 10-K for 2012.

Change in Internal Control Over Financial Reporting

Other than changes related to the ongoing remediation of the material weakness in accounting for deferred income taxes, no change in our internal control over financial reporting occurred during our most recent fiscal quarter ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II Other Information:

Item 1. Legal Proceedings: We are presently a party to certain lawsuits arising in the ordinary course of our business. We believe that none of our current legal proceedings will be material to our business, financial condition or results of operations.

Item 1A. Risk Factors: There have been no material changes to SCC s, SCCII s or SunGard s Risk Factors as previously disclosed in their Form 10-K for the year ended December 31, 2011.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds: None.

Item 3. Defaults Upon Senior Securities: None.

Item 4. Mine Safety Disclosures: None.

Item 5. Other Information:

(a) The stockholder of each of SunGard, SCC and SCCII approved, by written consent dated September 12, 2012, the election of the following persons as directors to serve in such capacity until his or her successor is designated and qualified, or until he or she sooner dies, resigns, is removed or becomes disqualified: Chinh Chu, John Connaughton, Russell Fradin, James H. Greene, Jr., Glenn Hutchins, James L. Mann, John Marren, Sanjeev Mehra and Julie Richardson. Subsequently, as previously reported, R. Davis Noell was elected to the boards of directors , on October 2, 2012, succeeding Ms. Richardson.

(b) None.

Item 6. Exhibits:

Number	Document

10.1	Time-Based Restricted Stock Unit Award Agreement dated July 2, 2012 granted to Charles Neral.
10.2	Time-Based Restricted Stock Unit Award Agreement dated September 12, 2012 granted to Charles Neral.
10.3	Performance-Based Restricted Stock Unit Award Agreement dated September 12, 2012 granted to Charles Neral.
12.1	Computation of Ratio of Earnings to Fixed Charges.
31.1	Certification of Russell P. Fradin, Chief Executive Officer of SunGard Capital Corp., SunGard Capital Corp. II and SunGard Data Systems Inc. required by Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002.

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31.2	Certification of Charles J. Neral, Chief Financial Officer of SunGard Capital Corp., SunGard Capital Corp. II and SunGard Data Systems Inc. required by Rule 13a-14(a) or Rule 15d-14(a) and Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Russell P. Fradin, Chief Executive Officer of SunGard Capital Corp., SunGard Capital Corp. II and SunGard Data Systems Inc. required by Rule 13a-14(b) or Rule 15d-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002.
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101	Interactive Data Files for SunGard Capital Corp., SunGard Capital Corp. II and SunGard Data Systems Inc. pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of December 31, 2011 and September 30, 2012, (ii) Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2011 and 2012, (iii) Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2011 and 2012 and (iv) Notes to Consolidated Financial Statements.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

SUNGARD CAPITAL CORP.

SUNGARD CAPITAL CORP. II

SUNGARD DATA SYSTEMS INC.

Dated: November 9, 2012

By: /s/ Charles J. Neral
Charles J. Neral
Senior Vice President-Finance and Chief Financial Officer
(Principal Financial Officer)

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