Consolidated Statement of Earnings

International Business Machines Corporation and Subsidiary Companies

($ in millions except per share amounts)

FOR THE YEAR ENDED DECEMBER 31:	NOTES	2007	2006*	2005*
Revenue:				
Services		**$54,057**	$48,328	$47,509
Sales		**42,202**	40,716	41,218
Financing		**2,526**	2,379	2,407
Total Revenue		**98,786**	91,424	91,134
Cost:				
Services		**39,160**	35,065	35,151
Sales		**16,552**	16,882	18,360
Financing		**1,345**	1,182	1,091
Total Cost		**57,057**	53,129	54,602
Gross Profit		**41,729**	38,295	36,532
Expense and Other Income:				
Selling, general and administrative		**22,060**	20,259	21,314
Research, development and engineering	P	**6,153**	6,107	5,842
Intellectual property and custom development income		**(958)**	(900)	(948)
Other (income) and expense		**(626)**	(766)	(2,122)
Interest expense	J&K	**611**	278	220
Total Expense and Other Income		**27,240**	24,978	24,306
Income from Continuing Operations Before Income Taxes		**14,489**	13,317	12,226
Provision for income taxes	O	**4,071**	3,901	4,232
Income from Continuing Operations		**10,418**	9,416	7,994
Discontinued Operations:				
(Loss)/earnings from discontinued operations, net of tax		**(00)**	76	(24)
Income before cumulative effect of change in accounting principle		**10,418**	9,492	7,970
Cumulative effect of change in accounting principle, net of tax**	B	**—**	—	(36)
Net Income		**$10,418**	$ 9,492	$ 7,934
Earnings/(loss) per Share of Common Stock:				
Assuming Dilution:				
Continuing operations	R	**$ 7.18**	$ 6.06	$ 4.91
Discontinued operations	R	**(0.00)**	0.05	(0.01)
Before cumulative effect of change in accounting principle	R	**7.18**	6.11	4.90
Cumulative effect of change in accounting principle**		**—**	—	(0.02)
Total	R	**$ 7.18**	$ 6.11	$ 4.87
Basic:				
Continuing operations	R	**$ 7.32**	$ 6.15	$ 4.99
Discontinued operations	R	**(0.00)**	0.05	(0.02)
Before cumulative effect of change in accounting principle	R	**7.32**	6.20	4.98
Cumulative effect of change in accounting principle**	R	**—**	—	(0.02)
Total	R	**$ 7.32**	$ 6.20	$ 4.96
Weighted-Average Number of Common Shares Outstanding:				
Assuming dilution		**1,450,570,579**	1,553,535,384	1,627,632,662
Basic		**1,423,039,793**	1,530,806,987	1,600,591,264

* *Reclassified to conform with 2007 presentation of new Revenue and Cost categories. See note A, "Basis of Presentation," on page 64 for additional information.*

***Reflects implementation of FASB Interpretation No. 47. See note B, "Accounting Changes," on page 75 for additional information.*

The accompanying notes on pages 64 through 119 are an integral part of the financial statements.

($ in millions except per share amount)

AT DECEMBER 31:	NOTES	2007	2006
Assets			
Current assets:			
Cash and cash equivalents		**$ 14,991**	$ 8,022
Marketable securities	D	**1,155**	2,634
Notes and accounts receivable—trade (net of allowances of $241 in 2007 and $221 in 2006)		**11,428**	10,789
Short-term financing receivables (net of allowances of $296 in 2007 and $307 in 2006)	F	**16,289**	15,095
Other accounts receivable (net of allowances of $13 in 2007 and $15 in 2006)		**1,072**	964
Inventories	E	**2,664**	2,810
Deferred taxes	O	**1,687**	1,806
Prepaid expenses and other current assets		**3,891**	2,539
Total current assets		**53,177**	44,660
Plant, rental machines and other property	G	**38,584**	36,521
Less: Accumulated depreciation	G	**23,503**	22,082
Plant, rental machines and other property—net	G	**15,081**	14,440
Long-term financing receivables	F	**11,603**	10,068
Prepaid pension assets	U	**17,417**	10,629
Goodwill	I	**14,285**	12,854
Intangible assets—net	I	**2,107**	2,202
Investments and sundry assets	H	**6,761**	8,381
Total Assets		**$120,431**	$103,234
Liabilities and Stockholders' Equity			
Current liabilities:			
Taxes	O	**$ 3,673**	$ 4,670
Short-term debt	J&K	**12,235**	8,902
Accounts payable		**8,054**	7,964
Compensation and benefits		**4,645**	4,595
Deferred income		**9,802**	8,587
Other accrued expenses and liabilities		**5,901**	5,372
Total current liabilities		**44,310**	40,091
Long-term debt	J&K	**23,039**	13,780
Retirement and nonpension postretirement benefit obligations	U	**13,582**	13,553
Deferred income		**3,060**	2,502*
Other liabilities	L	**7,970**	4,801*
Total Liabilities		**91,962**	74,728
Contingencies and Commitments	N		
Stockholders' equity:	M		
Common stock, par value $.20 per share and additional paid-in capital		**35,188**	31,271
Shares authorized: 4,687,500,000			
Shares issued (2007—2,057,607,421; 2006—2,008,470,383)			
Retained earnings		**60,640**	52,432
Treasury stock, at cost (shares: 2007—672,373,283; 2006—501,987,771)		**(63,945)**	(46,296)
Accumulated gains and (losses) not affecting retained earnings	M	**(3,414)**	(8,901)
Total Stockholders' Equity		**28,470**	28,506
Total Liabilities and Stockholders' Equity		**$120,431**	$103,234

** Reclassified to conform with 2007 presentation of new Deferred income category, previously combined in Other liabilities.*

The accompanying notes on pages 64 through 119 are an integral part of the financial statements.

Consolidated Statement of Cash Flows

International Business Machines Corporation and Subsidiary Companies

($ in millions)

FOR THE YEAR ENDED DECEMBER 31:	**2007**	2006	2005
Cash Flow from Operating Activities from Continuing Operations:			
Net income	**$ 10,418**	$ 9,492	$ 7,934
Loss/(income) from discontinued operations	**00**	(76)	24
Adjustments to reconcile income from continuing operations to cash provided by operating activities:			
Depreciation	**4,038**	3,907	4,147
Amortization of intangibles	**1,163**	1,076	1,041
Stock-based compensation	**713**	846	1,043
Deferred income taxes	**740**	1,724	2,185
Net gain on asset sales and other	**(89)**	(175)	(1,525)
Change in operating assets and liabilities, net of acquisitions/divestitures:			
Receivables (including financing receivables)	**(1,408)**	(512)	2,219
Retirement related	**(228)**	(850)*	(1,728)*
Inventories	**182**	112	202
Other assets/other liabilities	**706**	(881)**	(91)**
Accounts payable	**(142)**	355	(536)
Net Cash Provided by Operating Activities from Continuing Operations	**16,094**	15,019	14,914
Cash Flow from Investing Activities from Continuing Operations:			
Payments for plant, rental machines and other property	**(4,630)**	(4,362)	(3,842)
Proceeds from disposition of plant, rental machines and other property	**537**	430	1,107
Investment in software	**(875)**	(804)	(792)
Purchases of marketable securities and other investments	**(30,449)**	(28,555)	(4,526)
Proceeds from disposition of marketable securities and other investments	**31,441**	25,542	4,180
Divestiture of businesses, net of cash transferred	**310**	—	932
Acquisition of businesses, net of cash acquired	**(1,009)**	(3,799)	(1,482)
Net Cash Used in Investing Activities from Continuing Operations	**(4,675)**	(11,549)	(4,423)
Cash Flow from Financing Activities from Continuing Operations:			
Proceeds from new debt***	**21,744**	1,444	4,363
Short-term borrowings/(repayments) less than 90 days—net	**1,674**	1,834	(232)
Payments to settle debt***	**(11,306)**	(3,400)	(3,522)
Common stock repurchases+	**(18,828)**	(8,084)	(7,739)
Common stock transactions—other+	**4,123**	1,685	1,233
Cash dividends paid	**(2,147)**	(1,683)	(1,250)
Net Cash Used in Financing Activities from Continuing Operations	**(4,740)**	(8,204)	(7,147)
Effect of exchange rate changes on cash and cash equivalents	**294**	201	(789)
Net cash used in discontinued operations from: Operating activities	**(5)**	(12)	(40)
Net change in cash and cash equivalents	**6,969**	(4,546)	2,515
Cash and cash equivalents at January 1	**8,022**	12,568	10,053
Cash and Cash Equivalents at December 31	**$ 14,991**	$ 8,022	$12,568
Supplemental Data:			
Income taxes paid—net of refunds received	**$ 2,608**	$ 2,068	$ 1,994
Interest paid on debt	**$ 1,485**	$ 1,202++	$ 973++
Capital lease obligations	**$ 57**	$ 36	$ 287
Equity securities received as divestiture consideration+++	**$ —**	$ —	$ 430

* *Reclassified to conform with 2007 presentation combining Pension assets and Pension liabilities into one caption—Retirement related.*

** *Reclassified to conform with 2007 presentation to combine Other than temporary declines in securities and other investments and the Other assets/other liabilities into one caption.*

*** *See note A, "Consolidated Statement of Cash Flows," on page 64 for additional information.*

\+ *Reclassified to conform with 2007 presentation of the new Common stock repurchases and Common stock transactions—other previously combined in Common stock transactions—net.*

++ *Reclassified to conform with 2007 presentation of disclosing interest paid on debt versus total interest paid including net investment hedging activity.*

+++ *Lenovo equity valued at $542 million net of lock-up provisions of $112 million. See note C, "Acquisitions/Divestitures," on page 81 for additional information.*

The accompanying notes on pages 64 through 119 are an integral part of the financial statements.

($ in millions)

	COMMON STOCK AND ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK	ACCUMULATED GAINS AND (LOSSES) NOT AFFECTING RETAINED EARNINGS	TOTAL
2005					
Stockholders' equity, January 1, 2005	$26,673	$38,148	$(31,072)	$(2,061)	$31,688
Net income plus gains and (losses) not affecting retained earnings:					
Net income		7,934			$ 7,934
Gains and (losses) not affecting retained earnings (net of tax):					
Net unrealized gains on cash flow hedge derivatives (net of tax expense of $502)				891	891
Foreign currency translation adjustments (net of tax expense of $345*)				(1,153)	(1,153)
Minimum pension liability adjustment (net of tax expense of $320)				290	290
Net unrealized gains on marketable securities (net of tax expense of $8)				17	17
Total gains and (losses) not affecting retained earnings					45
Subtotal: Net income plus gains and (losses) not affecting retained earnings					$ 7,979
Cash dividends declared—common stock		(1,250)			(1,250)
Common stock issued under employee plans (18,572,017 shares)	2,257				2,257
Purchases (606,697 shares) and sales (2,594,786 shares) of treasury stock under employee plans—net		(98)	197		99
Other treasury shares purchased, not retired (90,237,800 shares)			(7,671)		(7,671)
Decrease in shares remaining to be issued in acquisition	(24)				(24)
Income tax benefits—stock transactions	20				20
Stockholders' equity, December 31, 2005	$28,926	$44,734	$(38,546)	$(2,016)	$33,098

* *Foreign currency translation adjustments are presented gross with associated hedges shown net of tax.*

The accompanying notes on pages 64 through 119 are an integral part of the financial statements.

Consolidated Statement of Stockholders' Equity

International Business Machines Corporation and Subsidiary Companies

($ in millions)

	COMMON STOCK AND ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK	ACCUMULATED GAINS AND (LOSSES) NOT AFFECTING RETAINED EARNINGS	TOTAL
2006					
Stockholders' equity, January 1, 2006	$28,926	$44,734	$(38,546)	$ (2,016)	$33,098
Net income plus gains and (losses) not affecting retained earnings:					
Net income		9,492			$ 9,492
Gains and (losses) not affecting retained earnings (net of tax):					
Net unrealized losses on cash flow hedge derivatives (net of tax benefit of $178)				(342)	(342)
Foreign currency translation adjustments (net of tax benefit of $225*)				1,020	1,020
Minimum pension liability adjustment (net of tax expense of $900)				1,881	1,881
Net unrealized gains on marketable securities (net of tax expense of $34)				53	53
Total gains and (losses) not affecting retained earnings					2,613
Adjustments to initially adopt SFAS No. 158					
Prior service credits/(costs) (net of tax expense of $494)				871	871
Net gains/(losses) (net of tax benefit of $6,028)				(10,371)	(10,371)
Transition assets/(obligations) (net of tax expense of $1)				2	2
Subtotal: Net income plus gains and (losses) not affecting retained earnings and adjustments to adopt SFAS No. 158					$ 2,607
Cash dividends declared—common stock		(1,683)			(1,683)
Common stock issued under employee plans (27,211,279 shares)	2,322				2,322
Purchases (633,769 shares) and sales (3,489,803 shares) of treasury stock under employee plans—net		(111)	272		161
Other treasury shares purchased, not retired (97,564,462 shares)			(8,022)		(8,022)
Decrease in shares remaining to be issued in acquisition	(3)				(3)
Income tax benefits—stock transactions	26				26
Stockholders' equity, December 31, 2006	$31,271	$52,432	$(46,296)	$ (8,901)	$28,506

* *Foreign currency translation adjustments are presented gross with associated hedges shown net of tax.*

The accompanying notes on pages 64 through 119 are an integral part of the financial statements.

($ in millions)

	COMMON STOCK AND ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK	ACCUMULATED GAINS AND (LOSSES) NOT AFFECTING RETAINED EARNINGS	TOTAL
2007					
Stockholders' equity, January 1, 2007	$31,271	$52,432	$(46,296)	$(8,901)	$28,506
Adjustment to initially adopt FIN 48		117			117
Net income plus gains and (losses) not affecting retained earnings:					
Net income		10,418			$10,418
Gains and (losses) not affecting retained earnings (net of tax):					
Net unrealized losses on cash flow hedge derivatives (net of tax benefit of $32)				(123)	(123)
Foreign currency translation adjustments (net of tax benefit of $553*)				726	726
Retirement-related benefit plans:					
Prior service credits (net of tax expense of $31)				44	44
Net gains/(losses) (net of tax expense of $1,913)				3,611	3,611
Amortization of prior service costs/(credits) (net of tax benefit of $50)				(85)	(85)
Amortization of net gains/(losses) (net of tax expense of $654)				1,110	1,110
Amortization of transition assets (net of tax benefit of $1)				(2)	(2)
Net unrealized gains on marketable securities (net of tax expense of $132)				206	206
Total gains and (losses) not affecting retained earnings					5,487
Subtotal: Net income plus gains and (losses) not affecting retained earnings					$15,905
Cash dividends declared — common stock		(2,147)			(2,147)
Common stock issued under employee plans (49,137,038 shares)	4,332				4,332
Purchases (1,282,131 shares) and sales (9,282,055 shares) of treasury stock under employee plans — net		(179)	729		550
Other treasury shares purchased, not retired (178,385,436 shares)	(405)		(18,378)		(18,783)
Decrease in shares remaining to be issued in acquisition	(6)				(6)
Income tax expense — stock transactions	(4)				(4)
Stockholders' equity, December 31, 2007	**$35,188**	**$60,640**	**$(63,945)**	**$(3,414)**	**$28,470**

* *Foreign currency translation adjustments are presented gross with associated hedges shown net of tax.*

The accompanying notes on pages 64 through 119 are an integral part of the financial statements.

Note A. Significant Accounting Policies

Basis of Presentation

In the first quarter of 2007, the International Business Machines Corporation (IBM and/or the company) changed the presentation of revenue and cost in the Consolidated Statement of Earnings to reflect the categories of Services, Sales and Financing. Previously, the presentation included Global Services, Hardware, Software, Global Financing and an Other category. In the past, these categories were aligned with the company's reportable segment presentation of external revenue and cost. However, as the company moves toward delivering solutions which bring integrated software and services capabilities to its clients, the alignment between segments and categories will diverge. Therefore, there are situations where the Global Services segments could include software revenue, and conversely, the Software segment may have services revenue. The change was made to avoid possible confusion between the segment revenue and cost presentation and the required category presentation in the Consolidated Statement of Earnings.

The change only impacts the format for the presentation of the company's revenue and cost in the Consolidated Statement of Earnings and does not reflect any change in the company's reportable segment results or in the company's organizational structure. The periods presented in this Annual Report are reported on a comparable basis. The management discussion and analysis of revenue and gross profit from continuing operations focuses on the segment view, as this is how the business is managed and is the best reflection of the company's operating results and strategy.

On December 31, 2002, the company sold its hard disk drive (HDD) business to Hitachi, Ltd. (Hitachi). The HDD business was part of the Systems and Technology reportable segment. The HDD business was accounted for as a discontinued operation under accounting principles generally accepted in the United States of America (GAAP) and therefore, the HDD results of operations and cash flows have been removed from the company's results of continuing operations and cash flows for all periods presented in this document.

For 2006, Income from discontinued operations, net of tax, is related to tax benefits from tax audit settlements. For 2005, the Loss from discontinued operations, net of tax, is primarily additional costs associated with parts warranty as agreed upon by the company and Hitachi.

Consolidated Statement of Cash Flows

Subsequent to the company's Form 10-Q filing on October 30, 2007 for the quarter ended September 30, 2007, it was determined that "Proceeds from new debt" and "Payments to settle debt" were understated by an equal, offsetting amount of $3,760 million with no impact on the "Net cash used in financing activities from continuing operations" section of the Consolidated Statement of Cash Flows for the nine months ended September 30, 2007.

The company assessed this reporting issue and determined it to be both qualitatively and quantitatively immaterial with respect to the overall Consolidated Statement of Cash Flows and the key categories presented in the statement: Net cash used in operating, investing and financing activities from continuing operations. In the Consolidated Statement of Cash Flows for the year ended December 31, 2007 on page 60, the company has made the adjustments described above. In 2008, the company will present the corrected amounts for the nine months ended September 30, 2007 in its Form 10-Q for the third quarter of 2008.

Principles of Consolidation

The Consolidated Financial Statements include the accounts of IBM and its controlled subsidiaries, which are generally majority owned. The accounts of variable interest entities (VIEs) as defined by Financial Accounting Standards Board (FASB) Interpretation No. 46(R), "Accounting for Variable Interest Entities," (FIN 46(R)), are included in the Consolidated Financial Statements, if required. Investments in business entities in which the company does not have control, but has the ability to exercise significant influence over operating and financial policies, are accounted for using the equity method and the company's proportionate share of income or loss is recorded in Other (income) and expense. The accounting policy for other investments in equity securities is described on page 72 within "Marketable Securities." Equity investments in non-publicly traded entities are primarily accounted for using the cost method. All significant intercompany transactions and accounts have been eliminated in consolidation.

Use of Estimates

The preparation of Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts of assets, liabilities, revenue, costs, expenses and gains and losses not affecting retained earnings that are reported in the Consolidated Financial Statements and accompanying disclosures, including the disclosure of contingent assets and liabilities. These estimates are based on management's best knowledge of current events, historical experience, actions that the company may undertake in the future and on various other assumptions that are believed to be reasonable under the circumstances. As a result, actual results may be different from these estimates. See pages 47 to 49 and page 55 for a discussion of the company's critical accounting estimates.

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Revenue

The company recognizes revenue when it is realized or realizable and earned. The company considers revenue realized or realizable and earned when it has persuasive evidence of an arrangement, delivery has occurred, the sales price is fixed or determinable and collectibility is reasonably assured. Delivery does not occur until products have been shipped or services have been provided to the client, risk of loss has transferred to the client, and either client acceptance has been obtained, client acceptance provisions have lapsed, or the company has objective evidence that the criteria specified in the client acceptance provisions have been satisfied. The sales price is not considered to be fixed or determinable until all contingencies related to the sale have been resolved.

The company recognizes revenue on sales to solution providers, resellers and distributors (herein referred to as "resellers") when the reseller has economic substance apart from the company, credit risk, title and risk of loss to the inventory, the fee to the company is not contingent upon resale or payment by the end user, the company has no further obligations related to bringing about resale or delivery and all other revenue recognition criteria have been met.

The company reduces revenue for estimated client returns, stock rotation, price protection, rebates and other similar allowances. (See Schedule II, "Valuation and Qualifying Accounts and Reserves," included in the company's Annual Report on Form 10-K). Revenue is recognized only if these estimates can be reasonably and reliably determined. The company bases its estimates on historical results taking into consideration the type of client, the type of transaction and the specifics of each arrangement. Payments made under cooperative marketing programs are recognized as an expense only if the company receives from the client an identifiable benefit sufficiently separable from the product sale whose fair value can be reasonably and reliably estimated. If the company does not receive an identifiable benefit sufficiently separable from the product sale whose fair value can be reasonably estimated, such payments are recorded as a reduction of revenue.

Revenue from sales of third-party vendor products or services is recorded net of costs when the company is acting as an agent between the client and vendor and gross when the company is a principal to the transaction. Several factors are considered to determine whether the company is an agent or principal, most notably whether the company is the primary obligor to the client, or has inventory risk. Consideration is also given to whether the company adds meaningful value to the vendor's product or service, was involved in the selection of the vendor's product or service, has latitude in establishing the sales price or has credit risk.

The company reports revenue net of any revenue-based taxes assessed by governmental authorities that are imposed on and concurrent with specific revenue-producing transactions. In addition to the aforementioned general policies, the following are the specific revenue recognition policies for multiple-element arrangements and for each major category of revenue.

MULTIPLE-ELEMENT ARRANGEMENTS

The company enters into multiple-element revenue arrangements, which may include any combination of services, software, hardware and/or financing. To the extent that a deliverable in a multiple-element arrangement is subject to specific guidance such as leased hardware that is subject to Statement of Financial Accounting Standards (SFAS) No. 13, "Accounting for Leases," or software that is subject to the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 97-2, "Software Revenue Recognition," see "Software" on pages 66 and 67 on whether and/or how to separate multiple deliverable arrangements into separate units of accounting (separability) and how to allocate the arrangement consideration among those separate units of accounting (allocation), that deliverable is accounted for in accordance with such specific guidance. For all other deliverables in multiple-element arrangements, the guidance below is applied for separability and allocation. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met:

- *The delivered item(s) has value to the client on a stand-alone basis;*
- *There is objective and reliable evidence of the fair value of the undelivered item(s); and*
- *If the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the company.*

If these criteria are not met, the arrangement is accounted for as one unit of accounting which would result in revenue being recognized on a straight-line basis or being deferred until the earlier of when such criteria are met or when the last undelivered element is delivered. If these criteria are met for each element and there is objective and reliable evidence of fair value for all units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative fair value. There may be cases, however, in which there is objective and reliable evidence of fair value of the undelivered item(s) but no such evidence for the delivered item(s). In those cases, the residual method is used to allocate the arrangement consideration. Under the residual method, the amount of consideration allocated to the delivered item(s) equals the total arrangement consideration less the aggregate fair value of the undelivered item(s). The revenue policies described below are then applied to each unit of accounting, as applicable.

If the allocation of consideration in a profitable arrangement results in a loss on an element (other than service elements as discussed below), that loss is recognized at the earlier of (a) delivery of that element, (b) when the first dollar of revenue is recognized on that element, or (c) when there are no remaining profitable elements in the arrangement to be delivered.

SERVICES

The company's primary services offerings include information technology (IT) datacenter and business process outsourcing, application management services, consulting and systems integration, technology infrastructure and system maintenance, Web hosting and the design and development of complex IT systems to a client's specifications (Design and Build). These services are provided on a time-and-material basis, as a fixed-price contract or as a fixed-price per measure of output contract and the contract terms range from less than one year to over 10 years.

Revenue from IT datacenter and business process outsourcing contracts is recognized in the period the services are provided using either an objective measure of output or a straight-line basis over the term of the contract. Under the output method, the amount of revenue recognized is based on the services delivered in the period.

Revenue from application management services, technology infrastructure and system maintenance and Web hosting contracts is recognized on a straight-line basis over the terms of the contracts. Revenue from time-and-material contracts is recognized as labor hours are delivered and direct expenses are incurred. Revenue related to extended warranty and product maintenance contracts is recognized on a straight-line basis over the delivery period.

Revenue from fixed-price Design and Build contracts is recognized in accordance with SOP No. 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts," under the percentage-of-completion (POC) method. Under the POC method, revenue is recognized based on the labor costs incurred to date as a percentage of the total estimated labor costs to fulfill the contract. If circumstances arise that change the original estimates of revenues, costs, or extent of progress toward completion, revisions to the estimates are made. These revisions may result in increases or decreases in estimated revenues or costs, and such revisions are reflected in income in the period in which the circumstances that give rise to the revision become known by management.

The company performs ongoing profitability analyses of its services contracts accounted for under the POC method in order to determine whether the latest estimates of revenue, costs and profits require updating. If at any time these estimates indicate that the contract will be unprofitable, the entire estimated loss for the remainder of the contract is recorded immediately. For non-POC service contracts, losses are recorded as incurred.

In some of the company's services contracts, the company bills the client prior to recognizing revenue from performing the services. Deferred income of $5,997 million and $5,011 million at December 31, 2007 and 2006, respectively, is included in the Consolidated Statement of Financial Position. The year-to-year increase was driven by growth in the services business and the impacts of currency. In other services contracts, the company performs the services prior to billing the client. Unbilled accounts receivable of $2,192 million and $1,762 million at December 31, 2007 and 2006, respectively, are included in Notes and accounts receivable-trade in the Consolidated Statement of Financial Position. Billings usually occur in the month after the company performs the services or in accordance with specific contractual provisions. Unbilled receivables are expected to be billed and collected within four months.

HARDWARE

Revenue from hardware sales and sales-type leases is recognized when risk of loss has transferred to the client and there are no unfulfilled company obligations that affect the client's final acceptance of the arrangement. Any cost of standard warranties and remaining obligations that are inconsequential or perfunctory are accrued when the corresponding revenue is recognized. Revenue from rentals and operating leases is recognized on a straight-line basis over the term of the rental or lease.

SOFTWARE

Revenue from perpetual (one-time charge) license software is recognized at the inception of the license term if all revenue recognition criteria have been met. Revenue from term (recurring license charge) license software is recognized on a subscription basis over the period that the client is entitled to use the license. Revenue from maintenance, unspecified upgrades on a when-and-if-available basis and technical support is recognized on a straight-line basis over the period such items are delivered. In multiple-element revenue arrangements that include software that is more than incidental to the products or services as a whole (software multiple-element arrangements), software and software-related elements are accounted for in accordance with the following criteria. Software-related elements include software products and services, as well as any non-software deliverable for which a software deliverable is essential to its functionality.

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A software multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met:

- *The functionality of the delivered element(s) is not dependent on the undelivered element(s);*
- *There is vendor-specific objective evidence (VSOE) of fair value of the undelivered element(s). VSOE of fair value is based on the price charged when the deliverable is sold separately by the company on a regular basis and not as part of the multiple-element arrangement; and*
- *Delivery of the delivered element(s) represents the culmination of the earnings process for that element(s).*

If any one of these criteria are not met, the arrangement is accounted for as one unit of accounting which would result in revenue being recognized on a straight-line basis or being deferred until the earlier of when such criteria are met or when the last undelivered element is delivered. If these criteria are met for each element and there is VSOE of fair value for all units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative VSOE of fair value. There may be cases, however, in which there is VSOE of fair value of the undelivered item(s) but no such evidence for the delivered item(s). In these cases, the residual method is used to allocate the arrangement consideration. Under the residual method, the amount of consideration allocated to the delivered item(s) equals the total arrangement consideration less the aggregate VSOE of fair value of the undelivered elements.

FINANCING

Financing income attributable to sales-type leases, direct financing leases and loans is recognized on the accrual basis using the effective interest method. Operating lease income is recognized on a straight-line basis over the term of the lease.

Services Costs

Recurring operating costs for services contracts, including costs related to bid and proposal activities, are recognized as incurred. For fixed price Design and Build contracts, the costs of external hardware and software accounted for under the POC method are deferred and recognized based on the labor costs incurred to date, as a percentage of the total estimated labor costs to fulfill the contract. Certain eligible, nonrecurring costs incurred in the initial phases of outsourcing contracts are deferred and subsequently amortized. These costs consist of transition and setup costs related to the installation of systems and processes and are amortized on a straight-line basis over the expected period of benefit, not to exceed the term of the contract. Additionally, fixed assets associated with outsourcing contracts are capitalized and depreciated on a straight-line basis over the expected useful life of the asset. If an asset is contract specific, then the depreciation period is the shorter of the useful life of the asset or the contract term. Amounts paid to clients in excess of the fair value of acquired assets used in outsourcing arrangements are deferred and amortized on a straight-line basis as a reduction of revenue over the expected period of benefit not to exceed the term of the contract. The company performs periodic reviews to assess the recoverability of deferred contract transition and set up costs. This review is done by comparing the estimated minimum remaining undiscounted cash flows of a contract to the unamortized contract costs. If such minimum undiscounted cash flows are not sufficient to recover the unamortized costs, a loss is recognized.

Deferred services transition and setup costs were $1,881 million and $1,511 million at December 31, 2007 and December 31, 2006, respectively. The primary driver of the increase year to year was the continued growth of the Global Services business. Amortization expense of deferred services transition and setup costs is estimated at December 31, 2007 to be $517 million in 2008, $414 million in 2009, $325 million in 2010, $258 million in 2011, and $367 million thereafter.

Deferred amounts paid to clients in excess of the fair value of acquired assets used in outsourcing arrangements were $202 million and $210 million at December 31, 2007 and December 31, 2006, respectively. Amortization of deferred amounts paid to clients in excess of the fair value of acquired assets is recorded as an offset of revenue and is estimated at December 31, 2007 to be $92 million in 2008, $46 million in 2009, $33 million in 2010, $20 million in 2011, and $11 million thereafter.

In situations in which an outsourcing contract is terminated, the terms of the contract may require the client to reimburse the company for the recovery of unbilled accounts receivable, unamortized deferred costs incurred to purchase specific assets utilized in the delivery of services and to pay any additional costs incurred by the company to transition the services.

Software Costs

Costs that are related to the conceptual formulation and design of licensed programs are expensed as incurred to research, development and engineering expense. Also, for licensed programs, the company capitalizes costs that are incurred to produce the finished product after technological feasibility has been established. Capitalized amounts are amortized using the straight-line method, which is applied over periods ranging up to three years. The company performs periodic reviews to ensure that unamortized program costs remain recoverable from future revenue. Costs to support or service licensed programs are charged to software cost as incurred.

The company capitalizes certain costs that are incurred to purchase or to create and implement internal-use computer software, which includes software coding, installation, testing and certain data conversions. These capitalized costs are amortized on a straight-line basis over two years and are recorded in Selling, general and administrative expense. See note I, "Intangible Assets Including Goodwill," on pages 84 and 85.

Product Warranties

The company offers warranties for its hardware products that range up to three years, with the majority being either one or three years. Estimated costs for warranty terms standard to the deliverable are recognized when revenue is recorded for the related deliverable. The company estimates its warranty costs standard to the deliverable based on historical warranty claim experience and applies this estimate to the revenue stream for products under warranty. Estimated future costs for warranties applicable to revenue recognized in the current period are charged to cost of revenue. The warranty accrual is reviewed quarterly to verify that it properly reflects the remaining obligation based on the anticipated expenditures over the balance of the obligation period. Adjustments are made when actual warranty claim experience differs from estimates. Costs from fixed-price support or maintenance contracts, including extended-warranty contracts, are recognized as incurred.

Changes in the warranty liability balance are presented in the following table:

($ in millions)

	2007	2006
Balance at January 1	**$ 582**	$ 754
Current period accruals	**466**	540
Accrual adjustments to reflect actual experience	**(29)**	49
Charges incurred	**(607)**	(762)
Balance at December 31	**$ 412**	$ 582

The decrease in the balance was primarily driven by a reduction in estimated future costs as a result of the divestiture of the Personal Computing business to Lenovo Group Limited (Lenovo) in April 2005.

Shipping and Handling

Costs related to shipping and handling are recognized as incurred and included in Cost in the Consolidated Statement of Earnings.

Expense and Other Income

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative (SG&A) expense is charged to income as incurred. Expenses of promoting and selling products and services are classified as selling expense and include such items as advertising, sales commissions and travel. General and administrative expense includes such items as compensation, office supplies, non-income taxes, insurance and office rental. In addition, general and administrative expense includes other operating items such as a provision for doubtful accounts, workforce accruals for contractually obligated payments to employees terminated in the ongoing course of business, amortization of certain intangible assets and environmental remediation costs. Certain special actions discussed in note Q, "2005 Actions," on pages 99 and 100 are also included in SG&A expense.

ADVERTISING AND PROMOTIONAL EXPENSE

The company expenses advertising and promotional costs when incurred. Cooperative advertising reimbursements from vendors are recorded net of advertising and promotional expense in the period the related advertising and promotional expense is incurred. Advertising and promotional expense, which includes media, agency and promotional expense, was $1,242 million, $1,195 million and $1,284 million in 2007, 2006 and 2005, respectively, and is recorded in SG&A expense in the Consolidated Statement of Earnings.

RESEARCH, DEVELOPMENT AND ENGINEERING

Research, development and engineering (RD&E) costs are expensed as incurred.

INTELLECTUAL PROPERTY AND CUSTOM DEVELOPMENT INCOME

As part of the company's business model and as a result of the company's ongoing investment in research and development, the company licenses and sells the rights to certain of its intellectual property (IP) including internally developed patents, trade secrets and technological know-how. Certain transfers of IP to third parties are licensing/royalty-based and other transfers are transaction-based sales and other transfers. Licensing/royalty-based fees involve transfers in which the company earns the income over time, or the amount of income is not fixed or determinable until the licensee sells future related products (i.e., variable royalty, based upon licensee's revenue). Sales and other transfers typically include transfers of IP whereby the company has fulfilled its obligations and the fee received is fixed or determinable at the transfer date. The company also enters into cross-licensing arrangements of patents, and income from these arrangements is recorded only to the extent cash is received. Furthermore, the company earns income from certain custom development projects

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for strategic technology partners and specific clients. The company records the income from these projects when the fee is realized or realizable and earned, is not refundable and is not dependent upon the success of the project.

OTHER (INCOME) AND EXPENSE

Other (income) and expense includes interest income (other than from Global Financing external business transactions), gains and losses on certain derivative instruments, gains and losses from securities and other investments, gains and losses from certain real estate transactions, foreign currency transaction gains and losses, gains and losses from the sale of businesses and amounts related to accretion of asset retirement obligations. Certain special actions discussed in note Q, "2005 Actions," on pages 99 and 100 are also included in Other (income) and expense.

Business Combinations and Intangible Assets Including Goodwill

The company accounts for business combinations using the purchase method of accounting and accordingly, the assets and liabilities of the acquired entities are recorded at their estimated fair values at the acquisition date. Goodwill represents the excess of the purchase price over the fair value of net assets, including the amount assigned to identifiable intangible assets. The company does not amortize the goodwill balance. Substantially all of the goodwill is not deductible for tax purposes. The primary drivers that generate goodwill are the value of synergies between the acquired entities and the company and the acquired assembled workforce, neither of which qualifies as an identifiable intangible asset. Identifiable intangible assets with finite lives are amortized over their useful lives. See note C, "Acquisitions/Divestitures," on pages 76 to 82 and note I, "Intangible Assets Including Goodwill," on pages 84 and 85, for additional information. The results of operations of acquired businesses are included in the Consolidated Financial Statements from the acquisition date.

Impairment

Long-lived assets, other than goodwill, are tested for impairment based on undiscounted cash flows and, if impaired, written down to fair value based on either discounted cash flows or appraised values. Goodwill is tested annually for impairment, or sooner when circumstances indicate an impairment may exist, using a fair-value approach at the reporting unit level. A reporting unit is the operating segment, or a business, which is one level below that operating segment (the "component" level) if discrete financial information is prepared and regularly reviewed by management at the segment level. Components are aggregated as a single reporting unit if they have similar economic characteristics.

Depreciation and Amortization

Plant, rental machines and other property are carried at cost and depreciated over their estimated useful lives using the straight-line method. The estimated useful lives of certain depreciable assets are as follows: buildings, 50 years; building equipment, 10 to 20 years; land improvements, 20 years; plant, laboratory and office equipment, two to 15 years; and computer equipment, 1.5 to five years. Leasehold improvements are amortized over the shorter of their estimated useful lives or the related lease term, rarely exceeding 25 years.

Capitalized software costs incurred or acquired after technological feasibility has been established are amortized over periods up to seven years. Capitalized costs for internal-use software are amortized on a straight-line basis over periods up to two years. (See "Software Costs" on page 67 for additional information). Other intangible assets are amortized over periods between three and seven years.

Environmental

The cost of internal environmental protection programs that are preventative in nature are expensed as incurred. When a cleanup program becomes likely, and it is probable that the company will incur cleanup costs and those costs can be reasonably estimated, the company accrues remediation costs for known environmental liabilities. The company's maximum exposure for all environmental liabilities cannot be estimated and no amounts are recorded for environmental liabilities that are not probable or estimable.

Asset Retirement Obligations

Asset retirement obligations (ARO) are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, the company records period-to-period changes in the ARO liability resulting from the passage of time in Interest expense and revisions to either the timing or the amount of the original expected cash flows to the related assets.

Defined Benefit Pension and Nonpension Postretirement Benefit Plans

The funded status of the company's defined benefit pension plans and nonpension postretirement benefit plans (retirement-related benefit plans) is recognized in the Consolidated Statement of Financial Position. The funded status is measured as the difference between the fair value of plan assets and the benefit obligation at December 31, the measurement date. For defined benefit pension plans, the benefit obligation is the projected benefit obligation (PBO), which represents the actuarial present value of benefits

expected to be paid upon retirement based on estimated future compensation levels. For the nonpension postretirement benefit plans, the benefit obligation is the accumulated postretirement benefit obligation (APBO), which represents the actuarial present value of postretirement benefits attributed to employee services already rendered. The fair value of plan assets represents the current market value of cumulative company and participant contributions made to an irrevocable trust fund, held for the sole benefit of participants, which are invested by the trust fund. Overfunded plans, with the fair value of plan assets exceeding the benefit obligation, are aggregated and recorded as a Prepaid pension asset equal to this excess. Underfunded plans, with the benefit obligation exceeding the fair value of plan assets, are aggregated and recorded as a Retirement and nonpension postretirement benefit obligation equal to this excess.

The current portion of the Retirement and nonpension postretirement benefit obligations represents the actuarial present value of benefits payable in the next 12 months exceeding the fair value of plan assets, measured on a plan-by-plan basis. This obligation is recorded in Compensation and benefits in the Consolidated Statement of Financial Position.

Net periodic pension and nonpension postretirement benefit cost/(income) is recorded in the Consolidated Statement of Earnings and includes service cost, interest cost, expected return on plan assets, amortization of prior service costs/(credits) and (gains)/losses previously recognized as a component of Gains and (losses) not affecting retained earnings and amortization of the net transition asset remaining in Accumulated gains and (losses) not affecting retained earnings. Service cost represents the actuarial present value of participant benefits earned in the current year. Interest cost represents the time value of money cost associated with the passage of time. Certain events, such as changes in employee base, plan amendments and changes in actuarial assumptions, result in a change in the benefit obligation and the corresponding change in the Gains and (losses) not affecting retained earnings. The result of these events is amortized as a component of net periodic cost/(income) over the service lives of the participants, provided such amounts exceed thresholds which are based upon the benefit obligation or the value of plan assets. The average service lives of the participants in the IBM Personal Pension Plan, a U.S. defined benefit pension plan, currently approximates 10 years and varies for participants in non-U.S. plans. Net periodic cost/(income) is recorded in Cost, SG&A and RD&E in the Consolidated Statement of Earnings based on the employees' respective function.

(Gains)/losses and prior service costs/(credits) not recognized as a component of net periodic cost/(income) in the Consolidated Statement of Earnings as they arise are recognized as a component of Gains and (losses) not affecting retained earnings in the Consolidated Statement of Stockholders' Equity, net of tax. Those (gains)/losses and prior service costs/(credits) are subsequently recognized as a component of net periodic cost/(income) pursuant to the recognition and amortization provisions of applicable accounting standards. (Gains)/losses arise as a result of differences between actual experience and assumptions or as a result of changes in actuarial assumptions. Prior service costs/(credits) represent the cost of benefit improvements attributable to prior service granted in plan amendments.

The measurement of benefit obligations and net periodic cost/(income) is provided by third-party actuaries based on estimates and assumptions approved by the company's management. These valuations reflect the terms of the plans and use participant-specific information such as compensation, age and years of service, as well as certain assumptions, including estimates of discount rates, expected return on plan assets, rate of compensation increases, interest crediting rates and mortality rates.

Defined Contribution Plans

The company records expense for defined contribution plans for the company's contribution when the employee renders service to the company, essentially coinciding with the cash contributions to the plans. The expense is recorded in Cost, SG&A and RD&E in the Consolidated Statement of Earnings based on the employees' respective function.

Stock-Based Compensation

Stock-based compensation represents the cost related to stock-based awards granted to employees. The company measures stock-based compensation cost at grant date, based on the estimated fair value of the award and recognizes the cost on a straight-line basis (net of estimated forfeitures) over the employee requisite service period. The company estimates the fair value of stock options using a Black-Scholes valuation model. The cost is recorded in Cost, SG&A, and RD&E in the Consolidated Statement of Earnings based on the employees' respective function.

The company records deferred tax assets for awards that result in deductions on the company's income tax returns, based on the amount of compensation cost recognized and the statutory tax rate in the jurisdiction in which it will receive a deduction. Differences between the deferred tax assets recognized for financial reporting purposes and the actual tax deduction reported on the income tax return are recorded in Additional Paid-In Capital (if the tax deduction exceeds the deferred tax asset) or in the Consolidated Statement of Earnings (if the deferred tax asset exceeds the tax deduction and no additional paid-in capital exists from previous awards).

See note T, "Stock-Based Compensation," on pages 102 to 105 for additional information.

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Income Taxes

Income tax expense is based on reported income before income taxes. Deferred income taxes reflect the tax effect of temporary differences between asset and liability amounts that are recognized for financial reporting purposes and the amounts that are recognized for income tax purposes. These deferred taxes are measured by applying currently enacted tax laws. Valuation allowances are recognized to reduce deferred tax assets to the amount that will more likely than not be realized. In assessing the need for a valuation allowance, management considers all available evidence including past operating results, estimates of future taxable income and the feasibility of ongoing tax planning strategies. When the company changes its determination as to the amount of deferred tax assets that can be realized, the valuation allowance is adjusted with a corresponding impact to income tax expense in the period in which such determination is made.

The company recognizes tax liabilities when, despite the company's belief that its tax return positions are supportable, the company believes that certain positions may not be fully sustained upon review by tax authorities. Benefits from tax positions are measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement. The current portion of tax liabilities is included in Taxes and the noncurrent portion of tax liabilities is included in Other Liabilities in the Consolidated Statement of Financial Position. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences impact income tax expense in the period in which such determination is made. Interest and penalties, if any, related to accrued liabilities for potential tax assessments are included in income tax expense.

Translation of Non-U.S. Currency Amounts

Assets and liabilities of non-U.S. subsidiaries that have a local functional currency are translated to U.S. dollars at year-end exchange rates. Translation adjustments are recorded in Accumulated gains and (losses) not affecting retained earnings in the Consolidated Statement of Stockholders' Equity. Income and expense items are translated at weighted-average rates of exchange prevailing during the year.

Inventories, Plant, rental machines and other property—net, and other non-monetary assets and liabilities of non-U.S. subsidiaries and branches that operate in U.S. dollars are translated at approximate exchange rates prevailing when the company acquired the assets or liabilities. All other assets and liabilities denominated in a currency other than U.S. dollars are translated at year-end exchange rates with the transaction gain or loss recognized in Other (income) and expense. Cost of sales and depreciation are translated at historical exchange rates. All other income and expense items are translated at the weighted-average rates of exchange prevailing during the year. These translation gains and losses are included in Net income for the period in which exchange rates change.

Derivatives

All derivatives are recognized in the Consolidated Statement of Financial Position at fair value and are reported in Prepaid expenses and other current assets, Investments and sundry assets, Other accrued expenses and liabilities or Other liabilities. Classification of each derivative as current or noncurrent is based upon whether the maturity of the instrument is less than or greater than 12 months. To qualify for hedge accounting in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," and SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—An Amendment of FASB Statements No. 133 and 140" (collectively, "SFAS No. 133"), the company requires that the instruments be effective in reducing the risk exposure that they are designated to hedge. For instruments that hedge cash flows, hedge effectiveness criteria also require that it be probable that the underlying transaction will occur. Instruments that meet established accounting criteria are formally designated as hedges. These criteria demonstrate that the derivative is expected to be highly effective at offsetting changes in fair value or cash flows of the underlying exposure both at inception of the hedging relationship and on an ongoing basis. The method of assessing hedge effectiveness and measuring hedge ineffectiveness is formally documented at hedge inception. The company assesses hedge effectiveness and measures hedge ineffectiveness at least quarterly throughout the designated hedge period.

The company applies hedge accounting in accordance with SFAS No. 133, whereby the company designates each derivative as a hedge of: (1) the fair value of a recognized financial asset or liability or of an unrecognized firm commitment ("fair value" hedge); (2) the variability of anticipated cash flows of a forecasted transaction or the cash flows to be received or paid related to a recognized financial asset or liability ("cash flow" hedge); or (3) a hedge of a long-term investment ("net investment" hedge) in a foreign operation. In addition, the company may enter into derivative contracts that economically hedge certain of its risks, even though hedge accounting does not apply or the company elects not to apply hedge accounting under SFAS No. 133. In these cases, there exists a natural hedging relationship in which changes in the fair value of the derivative, which are recognized currently in Net income, act as an economic offset to changes in the fair value of the underlying hedged item(s).

Changes in the fair value of a derivative that is designated as a fair value hedge, along with offsetting changes in the fair value of the underlying hedged exposure, are recorded in earnings each period. For hedges of interest rate risk, the fair value adjustments are recorded as adjustments to Interest expense and Cost of Financing in the Consolidated Statement of Earnings. For hedges of currency risk associated with recorded financial assets or liabilities, derivative fair

value adjustments are recognized in Other (income) and expense in the Consolidated Statement of Earnings. Changes in the fair value of a derivative that is designated as a cash flow hedge are recorded, net of applicable taxes, in the Accumulated gains and (losses) not affecting retained earnings, a component of Stockholders' equity. When Net income is affected by the variability of the underlying cash flow, the applicable offsetting amount of the gain or loss from the derivative that is deferred in Stockholders' equity is released to Net income and reported in Interest expense, Cost, SG&A expense or Other (income) and expense in the Consolidated Statement of Earnings based on the nature of the underlying cash flow hedged. Effectiveness for net investment hedging derivatives is measured on a spot-to-spot basis. The effective portion of changes in the fair value of net investment hedging derivatives and other non-derivative financial instruments designated as net investment hedges are recorded as foreign currency translation adjustments, net of applicable taxes, in the Accumulated gains and (losses) not affecting retained earnings section of the Consolidated Statement of Stockholders' Equity. Changes in the fair value of the portion of a net investment hedging derivative excluded from the effectiveness assessment are recorded in Interest expense.

When the underlying hedged item ceases to exist, all changes in the fair value of the derivative are included in Net income each period until the instrument matures. When the derivative transaction ceases to exist, a hedged asset or liability is no longer adjusted for changes in its fair value except as required under other relevant accounting standards. Derivatives that are not designated as hedges, as well as changes in the fair value of derivatives that do not effectively offset changes in the fair value of the underlying hedged item throughout the designated hedge period (collectively, "ineffectiveness"), are recorded in Net income each period and are reported in Other (income) and expense.

The company reports cash flows arising from derivative financial instruments designated as fair value or cash flow hedges consistent with the classification of cash flows from the underlying hedged items that these derivatives are hedging. Accordingly, the cash flows associated with derivatives designated as fair value or cash flow hedges are classified in Cash flows from operating activities in the Consolidated Statement of Cash Flows. Cash flows from derivatives designated as net investment hedges and derivatives that do not qualify as hedges are reported in investing activities. For currency swaps designated as hedges of foreign currency denominated debt (included in the company's debt risk management program as addressed in note K, "Derivatives and Hedging Transactions," on pages 88 to 91), cash flows directly associated with the settlement of the principal element of these swaps are reported in Payments to settle debt in the Cash flow from financing activities section of the Consolidated Statement of Cash Flows.

Financial Instruments

In determining the fair value of its financial instruments, the company uses a variety of methods and assumptions that are based on market conditions and risks existing at each balance sheet date. For the majority of financial instruments, including most derivatives, long-term investments and long-term debt, standard market conventions and techniques such as discounted cash flow analysis, option pricing models, replacement cost and termination cost are used to determine fair value. Dealer quotes are used for the remaining financial instruments.

All methods of assessing fair value result in a general approximation of value, and such value may never actually be realized.

Cash Equivalents

All highly liquid investments with maturities of three months or less at the date of purchase are considered to be cash equivalents.

Marketable Securities

Debt securities included in Current assets represent securities that are expected to be realized in cash within one year of the balance sheet date. Long-term debt securities that are not expected to be realized in cash within one year and alliance equity securities that are within the scope of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," are included in Investments and sundry assets. Those securities are considered available for sale and are reported at fair value with unrealized gains and losses, net of applicable taxes, recorded in Accumulated gains and (losses) not affecting retained earnings within Stockholders' equity. Realized gains and losses are calculated based on the specific identification method. Other-than-temporary declines in market value from original cost are charged to Other (income) and expense in the period in which the loss occurs. In determining whether an other-than-temporary decline in the market value has occurred, the company considers the duration that, and extent to which, fair value of the investment is below its cost. Realized gains and losses also are included in Other (income) and expense in the Consolidated Statement of Earnings.

Inventories

Raw materials, work in process and finished goods are stated at the lower of average cost or market. In accordance with SFAS No. 95, "Statement of Cash Flows," cash flows related to the sale of inventories are reflected in Net cash provided by operating activities from continuing operations in the Consolidated Statement of Cash Flows.

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Allowance for Uncollectible Receivables

TRADE

An allowance for uncollectible trade receivables is estimated based on a combination of write-off history, aging analysis and any specific, known troubled accounts.

FINANCING

Financing receivables include sales-type leases, direct financing leases and loans. The methodologies that the company uses to calculate both its specific and its unallocated reserves, which are applied consistently to its different portfolios are as follows:

Specific—The company reviews all financing account receivables considered at risk on a quarterly basis. The review primarily consists of an analysis based upon current information available about the client, such as financial statements, news reports and published credit ratings, as well as the current economic environment, collateral net of repossession cost and prior collection history. For loans that are collateral dependent, impairment is measured using the fair value of the collateral when foreclosure is probable. Using this information, the company determines the expected cash flow for the receivable and calculates a recommended estimate of the potential loss and the probability of loss. For those accounts in which the loss is probable, the company records a specific reserve.

Unallocated—The company records an unallocated reserve that is calculated by applying a reserve rate to its different portfolios, excluding accounts that have been specifically reserved. This reserve rate is based upon credit rating, probability of default, term, asset characteristics and loss history.

Receivable losses are charged against the allowance when management believes the uncollectibility of the receivable is confirmed. Subsequent recoveries, if any, are credited to the allowance.

Certain receivables for which the company recorded specific reserves may also be placed on non-accrual status. Non-accrual assets are those receivables (impaired loans or non-performing leases) with specific reserves and other accounts for which it is likely that the company will be unable to collect all amounts due according to original terms of the lease or loan agreement. Income recognition is discontinued on these receivables. Cash collections are first applied as a reduction to principal outstanding. Any cash received in excess of principal payments outstanding is recognized as interest income. Receivables may be removed from non-accrual status, if appropriate, based upon changes in client circumstances.

Estimated Residual Values of Lease Assets

The recorded residual values of the company's lease assets are estimated at the inception of the lease to be the expected fair value of the assets at the end of the lease term. The company periodically reassesses the realizable value of its lease residual values. Any anticipated increases in specific future residual values are not recognized before realization through remarketing efforts. Anticipated decreases in specific future residual values that are considered to be other-than-temporary are recognized immediately upon identification and are recorded as an adjustment to the residual-value estimate. For sales-type and direct financing leases, this reduction lowers the recorded net investment and is recognized as a loss charged to financing income in the period in which the estimate is changed, as well as an adjustment to unearned income to reduce future-period financing income.

Common Stock

Common stock refers to the $.20 par value capital stock as designated in the company's Certificate of Incorporation. Treasury stock is accounted for using the cost method. When treasury stock is reissued, the value is computed and recorded using a weighted-average basis.

Earnings per Share of Common Stock

Earnings per share of common stock—basic is computed by dividing Net income by the weighted average number of common shares outstanding for the period. Earnings per share of common stock, assuming dilution, reflects the maximum potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock and would then share in the Net income of the company. See note R, "Earnings Per Share of Common Stock," on page 101 for additional information.

Note B. Accounting Changes

New Standards to be Implemented

In February 2008, the FASB issued FASB Staff Position (FSP) Financial Accounting Standard (FAS) 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Its Related Interpretive Accounting Pronouncements That Address Leasing Transactions," and FSP FAS 157-2, "Effective Date of FASB Statement No. 157." FSP FAS 157-1 removes leasing from the scope of SFAS No. 157, "Fair Value Measurements." FSP FAS 157-2 delays the effective date of SFAS No. 157 from 2008 to 2009 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). See SFAS No. 157 discussion on page 74.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations," which will become effective in 2009 via prospective application to new business combinations. This Statement requires that the acquisition method of accounting be applied to a broader set of business combinations, amends the definition of a business combination, provides a definition of a business, requires an acquirer to recognize an acquired business at its fair value at the acquisition date and requires the assets and liabilities assumed in a business combination to be measured and recognized at their fair values as of the acquisition date (with limited exceptions). The company will adopt this Statement in fiscal year 2009 and its effects on future periods will depend on the nature and significance of any acquisitions subject to this Statement.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51." This Statement requires that the noncontrolling interest in the equity of a subsidiary be accounted for and reported as equity, provides revised guidance on the treatment of net income and losses attributable to the noncontrolling interest and changes in ownership interests in a subsidiary and requires additional disclosures that identify and distinguish between the interests of the controlling and noncontrolling owners. Pursuant to the transition provisions of SFAS No. 160, the company will adopt the Statement in fiscal year 2009 via retrospective application of the presentation and disclosure requirements. The company does not expect the adoption of this Statement to have a material effect on the Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115," which will become effective in 2008. SFAS No. 159 permits entities to measure eligible financial assets, financial liabilities and firm commitments at fair value, on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other generally accepted accounting principles. The fair value measurement election is irrevocable and subsequent changes in fair value must be recorded in earnings. The company will adopt this Statement in fiscal year 2008 and does not expect the adoption of this Statement to have a material effect on the Consolidated Financial Statements.

In September 2006, the FASB finalized SFAS No. 157 which will become effective in 2008 except as amended by FSP FAS 157-1 and FSP FAS 157-2 as previously described. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements; however, it does not require any new fair value measurements. The provisions of SFAS No. 157 will be applied prospectively to fair value measurements and disclosures for financial assets and financial liabilities and nonfinancial assets and nonfinancial liabilities recognized or disclosed at fair value in the financial statements on at least an annual basis beginning in the first quarter of 2008. While the company does not expect the adoption of this Statement to have a material impact on its Consolidated Financial Statements at this time, the company will monitor any additional implementation guidance that is issued that addresses the fair value measurements for certain financial assets, such as private market pension plan assets, and nonfinancial assets and nonfinancial liabilities not disclosed at fair value in the financial statements on at least an annual basis.

Standards Implemented

In the first quarter of 2007, the company adopted SFAS No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140," that provides guidance on accounting for separately recognized servicing assets and servicing liabilities. In accordance with the provisions of SFAS No. 156, separately recognized servicing assets and servicing liabilities must be initially measured at fair value, if practicable. Subsequent to initial recognition, the company may use either the amortization method or the fair value measurement method to account for servicing assets and servicing liabilities within the scope of this Statement. The adoption of this Statement did not have a material effect on the Consolidated Financial Statements.

In the first quarter of 2007, the company adopted SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments—an amendment of FASB Statements No. 133 and 140," which permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation in accordance with the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The adoption of this Statement did not have a material effect on the Consolidated Financial Statements.

The company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109" (FIN 48) on January 1, 2007. FIN 48 clarifies the accounting and reporting for uncertainties in income tax law. This Interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. See note O, "Taxes," on pages 97 to 99 for additional information, including the effects of adoption on the Consolidated Statement of Financial Position.

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Effective December 31, 2006, the company adopted SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106 and 132(R)," which requires the recognition of the funded status of the retirement-related benefit plans in the Consolidated Statement of Financial Position and the recognition of the changes in that funded status in the year in which the changes occur through Gains and (losses) not affecting retained earnings, net of applicable tax effects. The provisions of SFAS No. 158 were adopted pursuant to the transition provisions therein. The company measures defined benefit plan assets and obligations as of December 31 and SFAS No. 158 did not affect the company's existing valuation practices. The adoption of SFAS No. 158 had no impact on the company's existing debt covenants, credit ratings or financial flexibility. See note U, "Retirement-Related Benefits," on pages 105 to 116 for additional information, including the incremental effect of adoption on the Consolidated Statement of Financial Position.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 108, codified as SAB Topic 1.N, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB No. 108 describes the approach that should be used to quantify the materiality of a misstatement and provides guidance for correcting prior-year errors. The company early adopted SAB No. 108 in the third quarter of 2006 and accordingly, follows SAB No. 108 requirements when quantifying financial statement misstatements. The adoption of SAB No. 108 did not require any changes to the Consolidated Financial Statements.

In the third quarter of 2006, the company adopted FSP FIN 46(R)-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)." FSP FIN No. 46(R)-6 clarifies that the variability to be considered in applying FASB Interpretation 46(R) shall be based on an analysis of the design of the variable interest entity. The adoption of this FSP did not have a material effect on the Consolidated Financial Statements.

In the first quarter of 2006, the company adopted SFAS No. 154, "Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3." SFAS No. 154 changed the requirements for the accounting for and reporting of a voluntary change in accounting principle. The adoption of this statement did not affect the Consolidated Financial Statements in fiscal years 2007 and 2006. Its effects on future periods will depend on the nature and significance of any future accounting changes subject to this Statement.

Beginning January 2006, the company adopted SFAS No. 151, "Inventory Costs—an amendment of ARB No. 43, Chapter 4." SFAS No. 151 requires certain abnormal expenditures to be recognized as expenses in the current period versus being capitalized in inventory. It also requires that the amount of fixed production overhead allocated to inventory be based on the normal capacity of the production facilities. The adoption of this Statement did not have a material effect on the Consolidated Financial Statements.

Effective January 1, 2005, the company adopted the provisions of SFAS No. 123(R), "Share-Based Payment." The company elected to adopt the modified retrospective application method provided by SFAS No. 123(R) and accordingly, financial statement amounts for the periods presented herein reflect results as if the fair value method of expensing had been applied from the original effective date of SFAS No. 123. See note A, "Significant Accounting Policies," on page 70 and note T, "Stock-Based Compensation," on pages 102 to 105 for additional information.

In March 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143" (FIN 47). FIN 47 clarifies that conditional AROs meet the definition of liabilities and should be recognized when incurred if their fair values can be reasonably estimated. The company implemented FIN 47 at December 31, 2005 and recorded conditional AROs of approximately $85 million. These conditional AROs relate to the company's contractual obligations to remove leasehold improvements in certain non-U.S. locations thereby restoring leased space to its original condition. Upon implementation of FIN 47, the company recorded a $36 million charge (net of income tax benefit of $21 million) which was reported as a cumulative effect of a change in accounting principle in the 2005 Consolidated Statement of Earnings. The company's accounting policy for AROs is described in note A, "Significant Accounting Policies," on page 69.

The pro forma effect of retroactively applying FIN 47 for the year 2005 was:

($ in millions except per share amounts)

FOR THE YEAR ENDED DECEMBER 31:	2005
Pro forma amounts assuming accounting change is applied retroactively:	
Pro forma net income	$7,964
Pro forma earnings per share of common stock—assuming dilution	$ 4.89
Pro forma earnings per share of common stock—basic	$ 4.98
ARO liabilities at December 31, 2005	$ 85

As of December 31, 2005, the company was unable to estimate the range of settlement dates and the related probabilities for certain asbestos remediation AROs. These conditional AROs are primarily related to the encapsulated structural fireproofing that is not subject to abatement unless the buildings are demolished and non-encapsulated asbestos that the company would remediate only if it performed major renovations of certain existing buildings. Because these conditional obligations have indeterminate settlement dates, the company could not develop a reasonable estimate of their fair values. The company will continue to assess its ability to estimate fair values at each future reporting date. The related liability will be recognized once sufficient additional information becomes available.

In June 2005, the FASB issued FSP No. FAS 143-1, "Accounting for Electronic Equipment Waste Obligations," (FSP FAS 143-1) that provides guidance on how commercial users and producers of electronic equipment should recognize and measure asset retirement obligations associated with the European Directive 2002/96/EC on Waste Electrical and Electronic Equipment (the "Directive"). In 2005, the company adopted FSP FAS 143-1 in those European Union (EU) member countries that transposed the Directive into country-specific laws. Its adoption did not have a material effect on the Consolidated Financial Statements. The effect of applying FSP FAS 143-1 in the remaining countries in future periods is not expected to have a material effect on the Consolidated Financial Statements.

In the third quarter of 2005, the company adopted SFAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29." SFAS No. 153 requires that exchanges of productive assets be accounted for at fair value unless fair value cannot be reasonably determined or the transaction lacks commercial substance. The adoption of SFAS No. 153 did not have a material effect on the Consolidated Financial Statements.

Note C. Acquisitions/Divestitures

Acquisitions

2007

In 2007, the company completed 12 acquisitions at an aggregate cost of $1,144 million.

The Software segment completed six acquisitions: in the first quarter, Consul Risk Management International BV and Vallent Corporation, both privately held companies. Four acquisitions were completed in the third quarter: Watchfire Corporation, WebDialogs Inc. and Princeton Softech Inc., all privately held companies, and DataMirror Corporation, a publicly held company. Each acquisition further complemented and enhanced the software product portfolio.

Global Technology Services completed four acquisitions: in the first quarter, Softek Storage Solutions Corporation (Softek) and DM Information Systems, Ltd. (DMIS), both privately held companies. Two acquisitions were completed in the fourth quarter: Novus Consulting Group, Inc. and Serbian Business Systems, both privately held companies. Softek augments the company's unified data mobility offerings and worldwide delivery expertise for managing data in storage array, host and virtualized IT environments. DMIS will enhance and complement the Technology Service offerings. Novus CG, a storage solution company, will provide improved access to business information, enable stronger regulatory and corporate compliance and improve overall information technology performance. Serbian Business Systems establishes the company's maintenance and technical support services business in Serbia.

Global Business Services completed one acquisition in the fourth quarter: IT Gruppen AS, which will add to the company's presence in the retail and media sectors.

Systems and Technology completed one acquisition in the fourth quarter: XIV, Ltd., a privately held company focused on storage systems technology.

Purchase price consideration was paid in cash. These acquisitions are reported in the Consolidated Statement of Cash Flows net of acquired cash and cash equivalents.

The table on page 77 reflects the purchase price related to these acquisitions and the resulting purchase price allocations as of December 31, 2007.

During the fourth quarter of 2007, the company entered into a definitive agreement to acquire Cognos, Inc. The acquisition of Cognos, Inc., a publicly held company, was completed in January 2008. The acquisition of Cognos, Inc. supports the Information on Demand strategy and will provide the company with a strong entry in the Business Intelligence market.

The closing of the Telelogic AB acquisition, announced in the second quarter of 2007, is conditioned upon satisfactory completion of regulatory reviews in the European Union. Regulatory reviews in the U.S. have been completed.

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($ in millions)

2007 ACQUISITIONS	AMORTIZATION LIFE (IN YEARS)	ACQUISITIONS
Current assets		$ 184
Fixed assets/noncurrent		31
Intangible assets:		
Goodwill	N/A	999
Completed technology	3 to 7	93
Client relationships	3 to 7	91
Other	2 to 5	17
Total assets acquired		1,415
Current liabilities		(136)
Noncurrent liabilities		(135)
Total liabilities assumed		(271)
Total purchase price		$1,144

N/A—Not applicable

The acquisitions were accounted for as purchase transactions, and accordingly, the assets and liabilities of the acquired entities were recorded at their estimated fair values at the date of acquisition. The primary items that generated the Goodwill are the value of the synergies between the acquired companies and IBM and the acquired assembled workforce, neither of which qualify as an amortizable intangible asset. Substantially all of the Goodwill is not deductible for tax purposes. The overall weighted-average life of the identified amortizable intangible assets acquired is 5.4 years. With the exception of Goodwill, these identified intangible assets will be amortized over their useful lives. Goodwill of $999 million was assigned to the Software ($639 million), Global Business Services ($14 million), Global Technology Services ($76 million) and Systems and Technology ($269 million) segments.

See note A, "Significant Accounting Policies," on page 69 for further description of the company's accounting policies related to business combinations and intangible assets, including Goodwill.

2006

In 2006, the company completed 13 acquisitions at an aggregate cost of $4,817 million, which was paid in cash. The cost of these acquisitions are reported in the Consolidated Statement of Cash Flows net of acquired cash and cash equivalents. The tables on page 79 represent the purchase price allocations for all of the 2006 acquisitions. The Micromuse Inc., FileNet Corporation, Internet Security Systems, Inc. and MRO Software, Inc. acquisitions are shown separately given their significant purchase prices.

Micromuse, Inc.—On February 15, 2006, the company acquired 100 percent of the outstanding common shares of Micromuse, Inc. for cash consideration of $862 million. Micromuse is a leading provider of network management software used by banks, telecommunications carriers, governments, retailers and other organizations to monitor and manage their sophisticated technology infrastructures. The software helps customers manage increasingly complex IT systems that support the proliferation of voice, data and video traffic due to the growing adoption of voice over IP (VoIP)-based audio and video services delivered over the Internet. The combination of Micromuse's software and the company's IT services management technology can provide a comprehensive approach to help customers reduce the complexity of their IT environments, lower operational costs and address compliance mandates. Micromuse was integrated into the Software segment upon acquisition and Goodwill, as reflected in the table on page 79, has been entirely assigned to the Software segment. The overall weighted-average useful life of the intangible assets purchased, excluding Goodwill, is 4.0 years.

In the fourth quarter of 2006, as a result of completing the integration of Micromuse's legal and intercompany structure into the company's legal structure, the company recorded an increase in current assets and current liabilities with a corresponding offset in Goodwill totaling $137 million. These increases relate to an increase in both Deferred tax assets and Current tax liabilities. These adjustments are reflected in the table on page 79.

FileNet Corporation—On October 12, 2006, the company acquired 100 percent of the outstanding common shares of FileNet Corporation for cash consideration of $1,609 million. FileNet is a leading provider of business process and content management solutions that help companies simplify critical and everyday decision making processes and give organizations a competitive advantage. The FileNet acquisition enhances the company's ability to meet increasing client demand for a combination of content- and process-centric business process management capabilities, which is driven by changing governance and compliance mandates, as well as the need to integrate content-centric business processes with enterprise applications. The company has integrated its business process management and service oriented architecture (SOA) technologies with the FileNet platform to allow customers to access content wherever it may reside and use it in the context of business processes. FileNet was integrated into the Software segment upon acquisition and Goodwill, as reflected in the table on page 79, has been entirely assigned to the Software segment. The overall weighted-average useful life of the intangible assets purchased, excluding Goodwill, is 5.9 years.

Internet Security Systems, Inc.—On October 20, 2006, the company acquired 100 percent of the outstanding common shares of Internet Security Systems, Inc. (ISS) for cash consideration of $1,368 million. ISS provides security solutions to thousands of the world's leading companies and governments, helping to proactively protect against Internet threats across networks, desktops and servers. ISS software, appliances and services monitor and manage network vulnerabilities and rapidly respond in advance of potential threats. The acquisition advances the company's strategy to utilize IT services, software and consulting expertise to automate labor-based processes into standardized, software-based services that can help clients optimize and transform their businesses. ISS was integrated into the Global Technology Services segment upon acquisition and Goodwill, as reflected in the table on page 79, has been entirely assigned to the Global Technology Services segment. The overall weighted-average useful life of the intangible assets purchased, excluding Goodwill, is 5.6 years.

MRO Software Inc.—On October 5, 2006, the company acquired 100 percent of the outstanding common shares of MRO Software, Inc. for cash consideration of $739 million. MRO's asset and service management software and consulting services are used by many of the world's top companies to effectively manage how they buy, maintain and retire assets—such as production equipment, facilities, transportation and information technology hardware and software—in a wide variety of industries including utilities, manufacturing, energy, pharmaceutical and telecommunications. The acquisition builds upon the company's strategy to leverage business consulting, IT services and software to develop repeatable tools that help clients optimize and transform their business. MRO was integrated into the Software, Global Technology Services and Global Business Services segments upon acquisition and Goodwill, as reflected in the table on page 79, has been assigned to the Software segment for $337 million, Global Technology Services segment for $49 million and Global Business Services segment for $122 million. The overall weighted-average useful life of the intangible assets purchased, excluding Goodwill, is 5.6 years.

Other Acquisitions—The company acquired nine additional companies that are presented as Other Acquisitions in the table on page 79. Three of the acquisitions were Global Services-related companies: two were integrated into the Global Technology Services segment: Viacore, Inc. and Palisades Technology Partners, LLP; the third, Valchemy, Inc., was integrated into the Global Business Services segment. Six of the acquisitions were software-related companies that were integrated into the Software segment: Cims Lab; Language Analysis Systems, (LAS) Inc.; Buildforge; Unicorn Solutions, Inc.; Rembo Technology; and Webify Solutions. The purchase price allocations resulted in aggregate Goodwill of $211 million, of which $161 million was assigned to the Software segment and $51 million was assigned to the Global Technology Services segment. The overall weighted-average useful life of the intangible assets purchased in these acquisitions, excluding Goodwill, is 3.4 years.

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($ in millions)

2006 ACQUISITIONS	AMORTIZATION LIFE (IN YEARS)	MICROMUSE, INC. ORIGINAL AMOUNT DISCLOSED IN FIRST QTR. 2006	MICROMUSE, INC. PURCHASE ADJUSTMENTS*	MICROMUSE, INC. TOTAL ALLOCATION	FILENET CORPORATION
Current assets		$ 201	$ 56	$ 257	$ 681
Fixed assets/noncurrent		8	—	8	69
Intangible assets:					
Goodwill	N/A	694	137	831	894
Completed technology	3 to 5	46	—	46	73
Client relationships	3 to 7	46	—	46	194
Other identifiable intangible assets	2 to 4	4	—	4	55
In-process R&D		1	—	1	3
Total assets acquired		1,000	193	1,193	1,969
Current liabilities		(89)	(193)	(282)	(252)
Noncurrent liabilities		(49)	—	(49)	(108)
Total liabilities assumed		(138)	(193)	(331)	(360)
Total purchase price		$ 862	$ —	$ 862	$1,609

* *Adjustments primarily relate to acquisition costs, deferred taxes and other accruals.*

N/A—Not applicable

($ in millions)

2006 ACQUISITIONS	AMORTIZATION LIFE (IN YEARS)	INTERNET SECURITY SYSTEMS, INC.	MRO SOFTWARE, INC.	OTHER ACQUISITIONS
Current assets		$ 309	$ 227	$ 28
Fixed assets/noncurrent		62	20	4
Intangible assets:				
Goodwill	N/A	967	508	211
Completed technology	3 to 5	135	71	8
Client relationships	3 to 7	60	42	22
Other identifiable intangible assets	2 to 4	21	4	4
In-process R&D		3	—	—
Total assets acquired		1,557	872	277
Current liabilities		(92)	(69)	(24)
Noncurrent liabilities		(97)	(64)	(13)
Total liabilities assumed		(189)	(133)	(37)
Total purchase price		$1,368	$ 739	$240

N/A—Not applicable

2005

In 2005, the company completed 16 acquisitions at an aggregate cost of $2,022 million, which was paid in cash. The cost of these acquisitions are reported in the Consolidated Statement of Cash Flows net of acquired cash and cash equivalents. The table on page 80 represents the purchase price allocations for all of the 2005 acquisitions. The Ascential Corporation (Ascential) acquisition is shown separately given its significant purchase price.

Ascential—On April 29, 2005, the company acquired 100 percent of the outstanding common shares of Ascential for cash consideration of $1,140 million. Ascential is a provider of enterprise data integration software used to help build enterprise data warehouses, power business intelligence systems, consolidate enterprise applications, create and manage master repositories of critical business information and enable on demand data access. Ascential complements and strengthens the company's information and integration offerings and further extends the company's ability to enable clients to become on demand

businesses by providing a single, agile infrastructure for delivering accurate, consistent, timely and coherent information. Ascential was integrated into the Software segment upon acquisition and Goodwill, as reflected in the table below, has been entirely assigned to the Software segment. The overall weighted-average useful life of the intangible assets purchased, excluding Goodwill, is 3.9 years.

Other Acquisitions—The company acquired 15 additional companies that are presented as Other Acquisitions in the table below. Four of the acquisitions were technology services-related companies that were integrated into the Global Technology Services segment: Network Solutions; Classic Blue; Corio; and Equitant. One of the acquisitions, HealthLink, was integrated into the Global Business Services segment. Nine of the acquisitions were software-related companies that were integrated into the Software segment: iPhrase; Data Power Technology, Inc.; Bowstreet; Collation Inc.; DWL; Isogon Corporation; PureEdge Solutions, Inc.; SRD; and Gluecode. One acquisition, Meiosys, was integrated into the Systems and Technology segment. The purchase price allocations resulted in aggregate Goodwill of $791 million, of which $456 million was assigned to the Software segment; $239 million was assigned to the Global Technology Services segment; $62 million was assigned to the Global Business Services segment and $34 million was assigned to the Systems and Technology segment. The overall weighted-average useful life of the intangible assets purchased, excluding Goodwill, is 3.1 years.

($ in millions)

		ASCENTIAL			
2005 ACQUISITIONS	AMORTIZATION LIFE (IN YEARS)	ORIGINAL AMOUNT DISCLOSED IN SECOND QTR. 2005	PURCHASE ADJUSTMENTS*	TOTAL ALLOCATION	OTHER ACQUISITIONS
Current assets		$ 526	$ (1)	$ 525	$ 137
Fixed assets/noncurrent		20	—	20	28
Intangible assets:					
Goodwill	N/A	639	1	640	791
Completed technology	3	56	—	56	35
Client relationships	5	46	—	46	22
Other identifiable intangible assets	1–5	—	—	—	5
In-process R&D		—	—	—	1
Total assets acquired		1,287	—	1,287	1,019
Current liabilities		(112)	(4)	(116)	(89)
Noncurrent liabilities		(35)	4	(31)	(48)
Total liabilities assumed		(147)	—	(147)	(137)
Total purchase price		$1,140	$—	$1,140	$ 882

* *Adjustments primarily relate to acquisition costs, deferred taxes and other accruals.*

N/A—Not applicable

Divestitures

2007

In January 2007, the company announced an agreement with Ricoh Company Limited ("Ricoh"), a publicly traded company, to form a joint venture company based on the Printing System Division (a division of the Systems and Technology segment).

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The company initially created a wholly owned subsidiary, InfoPrint Solutions Company, LLC (InfoPrint), by contributing specific assets and liabilities from its printer business. The Printing Systems Division generated approximately $1 billion of revenue in 2006. The InfoPrint portfolio includes solutions for production printing for enterprises and commercial printers as well as solutions for office workgroup environments and industrial segments. On June 1, 2007 ("closing date"), the company divested 51 percent of its interest in InfoPrint to Ricoh. The company will divest its remaining 49 percent ownership to Ricoh quarterly over the next three years from the closing date. At December 31, 2007, the company's ownership in InfoPrint was 40.8 percent.

The total consideration the company agreed to on January 24, 2007 (the date the definitive agreement was signed) was $725 million which was paid in cash to the company on the closing date. The cash received was consideration for the initial 51 percent acquisition of InfoPrint by Ricoh as well as a prepayment for the remaining 49 percent to be acquired and certain royalties and services to be provided by the company to InfoPrint. Final consideration for this transaction will be determined at the end of the three-year period based upon the participation in the profits and losses recorded by the equity partners. The company evaluated its ownership and participation in InfoPrint under the requirements of FIN 46(R). The company concluded that InfoPrint met the requirements of a variable interest entity, the company is not the primary beneficiary of the entity and that deconsolidation of the applicable net assets was appropriate. The company's investment in InfoPrint will be accounted for under the equity method of accounting.

The company will provide maintenance services for one year, certain hardware products for three years and other information technology and business process services to InfoPrint for up to five years. The company assessed the fair value of these arrangements, and, as a result, deferred $274 million of the proceeds. This amount will be recorded as revenue, primarily in the company's services segments, as services are provided to InfoPrint.

The royalty agreements are related to the use of certain of the company's trademarks for up to 10 years. The company assessed the fair value of these royalty agreements, and, as a result, deferred $116 million of the proceeds. This amount will be recognized as Intellectual property and custom development income as it is earned in subsequent periods.

Net assets contributed, transaction related expenses and provisions were $90 million, resulting in an expected total pre-tax gain of $245 million, of which $81 million was recorded in Other (income) and expense in the Consolidated Statement of Earnings in the second quarter of 2007.

The deferred pre-tax gain of $164 million at the closing date was primarily related to: (1) the transfer of the company's remaining 49 percent interest in InfoPrint to Ricoh, and, (2) the transfer of certain maintenance services employees to InfoPrint. The company will recognize this amount over a three year period as the remaining ownership interest is divested and the employees are transferred. The pre-tax gain will be recorded in Other (income) and expense in the Consolidated Statement of Earnings.

As discussed below and on page 82, the company divested its Personal Computing Business to Lenovo in 2005. A portion of the total consideration received in that transaction included Lenovo equity. This equity was subject to specific lock-up provisions. These restrictions were modified in 2006 as discussed below.

In 2007, the company divested 523 million shares of Lenovo common stock with proceeds approximating $204 million. At December 31, 2007 the company's equity in Lenovo represented 4.8 percent of ordinary voting shares and 8.8 percent of total ownership.

For the year ended December 31, 2007, the company recorded a pre-tax gain of $30 million related to the divestiture. This amount was primarily due to a reversal of an indemnity provision recorded at the closing.

2006

As discussed above, a portion of the total consideration received in the Personal Computing business divestiture included Lenovo equity. This equity was subject to specific lock-up provisions at closing.

In the second quarter of 2006, the company and Lenovo agreed to revise these restrictions such that the company can now fully divest its shares in Lenovo after November 1, 2007 versus the prior lock-up expiration date of May 1, 2008. As a result of the change in the lock-up restrictions, the company considers all Lenovo shares to be within the scope of SFAS No. 115 and has classified them as available-for-sale.

On August 4, 2006, the company signed an agreement with a financial institution to establish a structure, with the institution acting as agent, to facilitate the company's disposition of Lenovo shares from time to time, after their release from the lock-up provisions. At December 31, 2006, the company had not divested any shares through the financial institution.

For the year ended December 31, 2006, the company recorded a pre-tax gain of $45 million related to the divestiture. This amount was primarily due to a reversal of an indemnity provision recorded at the closing.

2005

On April 30, 2005 (closing date), the company completed the divestiture of its Personal Computing business to Lenovo, a publicly traded company on the Hong Kong Stock Exchange. The total consideration that the company agreed to on December 7, 2004 (the date the definitive agreement was signed) was $1,750 million which included $650 million in cash, $600 million in Lenovo equity (valued at the December 6, 2004 closing price) and the transfer of approximately $500 million of net liabilities. At the closing date, total consideration

was valued at $1,725 million, comprised of: $650 million in cash, $542 million in Lenovo equity and $533 million in net liabilities transferred. Transaction related expenses and provisions were $628 million, resulting in a net pre-tax gain of $1,097 million which was recorded in Other (income) and expense in the Consolidated Statement of Earnings in the second quarter of 2005. In addition, the company paid Lenovo $138 million in cash primarily to assume additional liabilities outside the scope of the original agreement. This transaction had no impact on Income from Continuing Operations. Total net cash proceeds, less the deposit received at the end of 2004 for $25 million, related to these transactions were $487 million.

The equity received at the closing date represented 9.9 percent of ordinary voting shares and 18.9 percent of total ownership in Lenovo. Subsequent to the closing date, Lenovo's capital structure changed due to new third-party investments. As a result, the company's equity at June 30, 2005 represented 9.9 percent of ordinary voting shares and 17.05 percent of total ownership in Lenovo. The equity securities have been accounted for under the cost method of accounting. The equity is subject to specific lock-up provisions that restrict the company from divesting the securities. These restrictions apply to specific equity tranches and expire over a three-year period from the closing date. The Lenovo equity was valued at $542 million at the closing date and is recorded in Investments and sundry assets in the Consolidated Statement of Financial Position. In addition, the company recorded an equity deferral of $112 million to reflect the value of the lock-up provisions. This deferral was recorded as a contra-investment in Investments and sundry assets.

As part of the agreements with Lenovo, the company will provide certain services. These services include marketing support, information technology, human resources support and learning services. These service arrangements are primarily for periods of three years or less and can be terminated earlier by Lenovo. The company estimated the fair value of these service arrangements, and, as a result, has deferred $262 million of the transaction gain. This amount will be recorded as revenue, primarily in the Global Services segments, as services are provided to Lenovo. The deferred amount was recorded in Deferred income in the Consolidated Statement of Financial Position.

The company also recorded direct and incremental expenses and related provisions of $254 million associated with the divestiture, consisting of $74 million for certain indemnities; $64 million for employee-related charges; $40 million in real estate and information technology costs; $20 million in transaction expenses; $22 million of goodwill; and $34 million in other expenses. The company, as part of the agreement, retained the right and will be given a preference to provide maintenance, warranty and financing services to Lenovo. The company retained the warranty liability for all Personal Computing business products sold prior to the closing date. Lenovo will have the right to use certain IBM Trademarks under a Trademark License Agreement for a term of five years. In addition, the company entered into an arm's-length supply agreement with Lenovo for a term of five years, designed to provide the company with computers for its internal use.

In the third quarter of 2005, as a result of the third-party investments previously described, Lenovo was required to repurchase the first equity tranche at a specified share price. The equity repurchase resulted in the receipt of $152 million of cash and a pre-tax gain of $17 million. As a result of this transaction, the company's equity in Lenovo at September 30, 2005 represented 9.9 percent of ordinary voting shares and 14.88 percent of total ownership.

Also, in the second half of the year, the company received an additional $23 million of cash from Lenovo related to working capital adjustments, net of expenses related to employee matters. These transactions were consistent with the company's previous estimates. Overall, including the gain on the equity sale recorded in the third quarter, the company recorded an additional net pre-tax gain of $11 million; the resulting net pre-tax gain for the year ending December 31, 2005 is $1,108 million.

In addition, at December 31, 2005, the deferred income balance related to the services arrangements previously discussed is $169 million.

Note D. Financial Instruments (excluding derivatives)

Fair Value of Financial Instruments

Cash and cash equivalents, marketable securities and derivative financial instruments are recognized and measured at fair value in the company's financial statements. Notes and other accounts receivable and other investments are financial assets with carrying values that approximate fair value. Accounts payable, other accrued expenses and short-term debt are financial liabilities with carrying values that approximate fair value. The carrying amount of long-term debt is approximately $23.0 billion and $13.8 billion and the estimated fair value is $26.5 billion and $16.2 billion at December 31, 2007 and 2006, respectively.

In the absence of quoted prices in active markets, considerable judgment is required in developing estimates of fair value. Estimates are not necessarily indicative of the amounts the company could realize in a current market transaction. The following methods and assumptions were used to estimate fair values:

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LOANS AND FINANCING RECEIVABLES

Estimates of fair value are based on discounted future cash flows using current interest rates offered for similar loans to clients with similar credit ratings for the same remaining maturities.

RESTRICTED SECURITIES

The fair value of restricted securities was estimated based on a quoted price for an identical unrestricted security, adjusted to reflect the effect of the restriction.

LONG-TERM DEBT

For publicly-traded debt, estimates of fair value are based on market prices. For other debt, fair value is estimated based on rates currently available to the company for debt with similar terms and remaining maturities.

Marketable Securities*

The following table summarizes the company's marketable securities, all of which are considered available-for-sale, and alliance investments.

($ in millions)

	FAIR VALUE	
AT DECEMBER 31:	**2007**	2006
Marketable securities — current:		
Time deposits and other obligations	**$1,155**	$2,634
Marketable securities — noncurrent:**		
Time deposits and other obligations	**$ 530**	$ 359
Non-U.S. government securities and other fixed-term obligations	**1**	2
Total	**$ 531**	$ 361
Non-equity method alliance investments**	**$ 879**	$ 628

* *Gross unrealized gains (before taxes) on marketable securities were $7 million and $19 million at December 31, 2007 and 2006, respectively. Gross unrealized gains (before taxes) on alliance investments were $545 million and $178 million at December 31, 2007 and 2006, respectively. Gross unrealized losses (before taxes) on marketable securities were immaterial to the Consolidated Financial Statements at December 31, 2007 and 2006. Gross unrealized losses (before taxes) on alliance investments were $18 million at December 31, 2007 and immaterial to the Consolidated Financial Statements at December 31, 2006. See note M, "Stockholders' Equity Activity," on page 93 for net change in unrealized gains and losses on marketable securities.*

** *Included within Investments and sundry assets in the Consolidated Statement of Financial Position. See note H, "Investments and Sundry Assets," on page 84.*

Note E. Inventories

($ in millions)

AT DECEMBER 31:	**2007**	2006
Finished goods	**$ 668**	$ 506
Work in process and raw materials	**1,996**	2,304
Total	**$2,664**	$2,810

Note F. Financing Receivables

($ in millions)

AT DECEMBER 31:	**2007**	2006
Current:		
Net investment in sales-type leases	**$ 4,746**	$ 4,590
Commercial financing receivables	**6,263**	5,814
Client loan receivables	**4,652**	4,196
Installment payment receivables	**629**	496
Total	**$16,289**	$15,095
Noncurrent:		
Net investment in sales-type leases	**$ 6,085**	$ 5,471
Commercial financing receivables	**113**	32
Client loan receivables	**4,931**	4,214
Installment payment receivables	**474**	351
Total	**$11,603**	$10,068

Net investment in sales-type leases is for leases that relate principally to the company's equipment and are for terms ranging from two to seven years. Net investment in sales-type leases includes unguaranteed residual values of $915 million and $854 million at December 31, 2007 and 2006, respectively, and is reflected net of unearned income of $1,016 million and $1,005 million and of allowance for uncollectible accounts of $127 million and $135 million at those dates, respectively. Scheduled maturities of minimum lease payments outstanding at December 31, 2007, expressed as a percentage of the total, are approximately: 2008, 50 percent; 2009, 30 percent; 2010, 15 percent; 2011, 5 percent; and 2012 and beyond, 1 percent.

Commercial financing receivables relate primarily to inventory and accounts receivable financing for dealers and remarketers of IBM and non-IBM products. Payment terms for inventory and accounts receivable financing generally range from 30 to 90 days.

Client loan receivables relate to loans that are provided by Global Financing primarily to the company's clients to finance the purchase of the company's software and services. Separate contractual relationships on these financing arrangements are for terms ranging from two to seven years. Each financing contract is priced independently at competitive market rates. The company has a history of enforcing the terms of these separate financing agreements.

The company utilizes certain of its financing receivables as collateral for non-recourse borrowings. Financing receivables pledged as collateral for borrowings were $258 million and $304 million at December 31, 2007 and 2006, respectively. These borrowings are included in note J, "Borrowings," on pages 85 to 88.

The company did not have any financing receivables held for sale as of December 31, 2007 and 2006.

Note G. Plant, Rental Machines and Other Property

($ in millions)

AT DECEMBER 31:	2007	2006
Land and land improvements	**$ 701**	$ 693
Buildings and building improvements	**8,498**	8,243
Plant, laboratory and office equipment	**25,273**	23,907
	34,471	32,843
Less: Accumulated depreciation	**21,625**	20,441
Plant and other property—net	**12,847**	12,401
Rental machines	**4,113**	3,678
Less: Accumulated depreciation	**1,878**	1,640
Rental machines—net	**2,235**	2,038
Total—net	**$15,081**	$14,440

Note H. Investments and Sundry Assets

($ in millions)

AT DECEMBER 31:	2007	2006
Deferred taxes*	**$1,513**	$3,880
Deferred transition and setup costs and other deferred arrangements**	**1,475**	1,232
Alliance investments:		
Equity method	**271**	416
Non-equity method	**879**	628
Long-term deposits	**285**	228
Derivatives—noncurrent+	**259**	213
Marketable securities	**531**	361
Prepaid software	**221**	146
Other assets	**1,327**	1,277
Total	**$6,761**	$8,381

* *The decrease was primarily due to the year-end remeasurement of pension assets.*

** *Deferred transition and set-up costs and other deferred arrangements are related to Global Services client arrangements. Also see note A, "Significant Accounting Policies," on page 67 for additional information.*

\+ *See note K, "Derivatives and Hedging Transactions," on pages 88 to 91 for the fair value of all derivatives reported in the Consolidated Statement of Financial Position.*

Note I. Intangible Assets Including Goodwill

Intangible Assets

The following table details the company's intangible asset balances by major asset class:

($ in millions)

	AT DECEMBER 31, 2007		
INTANGIBLE ASSET CLASS	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET CARRYING AMOUNT
Capitalized software	**$1,926**	**$ (826)**	**$1,100**
Client-related	**1,054**	**(495)**	**559**
Completed technology	**536**	**(194)**	**342**
Strategic alliances	**103**	**(103)**	**—**
Patents/trademarks	**128**	**(61)**	**67**
Other*	**154**	**(115)**	**39**
Total	**$3,901**	**$(1,794)**	**$2,107**

* *Other intangibles are primarily acquired proprietary and nonproprietary business processes, methodologies and systems, and impacts from currency translation.*

($ in millions)

	AT DECEMBER 31, 2006		
INTANGIBLE ASSET CLASS	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET CARRYING AMOUNT
Capitalized software	$1,871	$ (837)	$1,034
Client-related	1,038	(424)	614
Completed technology	500	(128)	372
Strategic alliances	104	(89)	15
Patents/trademarks	112	(29)	83
Other*	264	(179)	84
Total	$3,888	$(1,686)	$2,202

* *Other intangibles are primarily acquired proprietary and nonproprietary business processes, methodologies and systems, and impacts from currency translation.*

The company amortizes intangible assets over their estimated useful lives unless such lives are deemed indefinite. Amortizable intangible assets are tested for impairment based on undiscounted cash flows, and, if impaired, written down to fair value based on either discounted cash flows or appraised values. Intangible assets with indefinite lives are tested annually for impairment and written down to fair value as required. No impairment of intangible assets has been recorded during any of the periods presented.

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The net carrying amount of intangible assets decreased by $95 million for the year ended December 31, 2007, primarily due to the amortization of acquired intangibles, partially offset by net increases in capitalized software.

Total amortization was $1,163 million and $1,076 million for the years ended December 31, 2007 and 2006, respectively. The aggregate amortization expense for acquired intangibles (excluding capitalized software) was $367 million and $316 million for the years ended December 31, 2007 and 2006, respectively. In addition, in 2007 the company retired $1,066 million of fully amortized intangible assets, impacting both the gross carrying amount and accumulated amortization for this amount.

The future amortization expense for each of the five succeeding years related to all intangible assets that are currently recorded in the Consolidated Statement of Financial Position is estimated to be as follows at December 31, 2007:

($ in millions)

	CAPITALIZED SOFTWARE	ACQUIRED INTANGIBLES	TOTAL
2008	$670	$324	$995
2009	338	266	604
2010	92	174	266
2011	—	124	124
2012	—	57	57

Goodwill

The changes in the carrying amount of goodwill, by reportable segment, for the year ended December 31, 2007, are presented in the table below. There was no impairment of goodwill recorded in 2007:

($ in millions)

SEGMENT	BALANCE JANUARY 1, 2007	GOODWILL ADDITIONS	PURCHASE PRICE ADJUSTMENTS	DIVESTITURES	FOREIGN CURRENCY TRANSLATION ADJUSTMENTS	**BALANCE DECEMBER 31, 2007**
Global Business Services	$ 3,811	$ 14	$ (5)	$—	$221	**$ 4,041**
Global Technology Services	2,700	77	27	—	110	**2,914**
Systems and Technology	214	269	—	—	1	**484**
Software	6,129	639	54	—	24	**6,846**
Total	$12,854	$999	$76	$—	$356	**$14,285**

Note J. Borrowings

Short-Term Debt

($ in millions)

AT DECEMBER 31:	**2007**	2006
Commercial paper	**$ 5,831**	$3,779
Short-term loans	**2,714**	2,355
Long-term debt—current maturities	**3,690**	2,768
Total	**$12,235**	$8,902

The weighted-average interest rates for commercial paper at December 31, 2007 and 2006, were 4.4 percent and 5.3 percent, respectively. The weighted-average interest rates for short-term loans were 4.8 percent and 3.0 percent at December 31, 2007 and 2006, respectively.

Long-Term Debt

PRE-SWAP BORROWING

($ in millions)

AT DECEMBER 31:	MATURITIES	2007	2006*
U.S. Dollar Notes and Debentures (average interest rate at December 31, 2007):**			
4.48%	2008–2011	**$12,295*****+**	$ 7,137
5.34%	2012–2013	**3,545+**	2,047
5.69%	2014–2018	**3,026**	26
8.375%	2019	**750**	750
7.00%	2025	**600**	600
6.22%	2027	**469**	469
6.50%	2028	**313**	313
5.875%	2032	**600**	600
7.00%	2045	**150**	150
7.125%	2096	**850**	850
		22,598	12,942
Other Currencies (average interest rate at December 31, 2007, in parentheses):			
Euros (3.4%)	2008–2013	**2,466**	2,234
Japanese yen (2.2%)	2010–2014	**767**	796
Swiss francs (1.5%)	2008	**442**	410
Other (2.7%)	2008–2013	**89**	66
		26,362	16,448
Less: Net unamortized discount		**65**	64
Add: SFAS No. 133 fair value adjustment++		**432**	164
		26,729	16,548
Less: Current maturities		**3,690**	2,768
Total		**$23,039**	$13,780

* *Reclassified to conform with 2007 presentation.*

** *As part of the company's 2002 acquisition of PricewaterhouseCoopers' Global Business Consulting and Technology Services Unit, the company issued convertible notes bearing interest at a stated rate of 3.43 percent with a face value of approximately $328 million to certain of the acquired PricewaterhouseCoopers' Global Business Consulting and Technology Services Unit partners. The notes were convertible into 4,764,543 shares of IBM common stock at the option of the holders at any time based on a fixed conversion price of $68.81 per share of the company's common stock. As of December 31, 2007, all of the shares have been issued.*

*** *On January 29, 2008, IBM International Group Capital LLC, which is an indirect, 100 percent-owned finance subsidiary of the company, issued $3.5 billion of 18-month floating rate notes. These proceeds will be utilized to reduce the 364-day bridge loan associated with the 2007 accelerated share repurchase transaction. (See note M, "Stockholders' Equity," on pages 92 and 93 for additional information.) As such, the 2007 amount includes $3.5 billion of the bridge loan balance which has been reclassified to long-term debt in accordance with SFAS No. 6, "Classification of Short-Term Obligations Expected to be Refinanced".*

\+ *$4.1 billion in debt securities issued by IBM International Group Capital LLC, as defined in Rule 3-10(b) of Regulation S-X is included in 2008-2011 ($2.6 billion) and 2012-2013 ($1.5 billion). Debt securities issued by IBM International Group Capital LLC are fully and unconditionally guaranteed by the company.*

\+\+ *In accordance with the requirements of SFAS No. 133, the portion of the company's fixed rate debt obligations that is hedged is reflected in the Consolidated Statement of Financial Position as an amount equal to the sum of the debt's carrying value plus an SFAS No. 133 fair value adjustment representing changes in the fair value of the hedged debt obligations attributable to movements in benchmark interest rates.*

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Post-Swap Borrowing (Long-Term Debt, Including Current Portion)

($ in millions)

	2007		2006	
AT DECEMBER 31:	**AMOUNT**	**AVERAGE RATE**	AMOUNT	AVERAGE RATE
Fixed-rate debt*	**$10,922**	**5.48%**	$ 8,758	5.25%
Floating-rate debt**	**15,807**	**4.76%**	7,790	6.30%
Total	**$26,729**		$16,548	

* *Includes $2,600 million in 2007 and $1,500 million in 2006 of notional interest rate swaps that effectively convert floating-rate long-term debt into fixed-rate debt. (See note K, "Derivatives and Hedging Transactions," on pages 88 to 91).*

***Includes $9,606 million in 2007 and $6,616 million in 2006 of notional interest rate swaps that effectively convert the fixed-rate long-term debt into floating-rate debt.*

Pre-swap annual contractual maturities of long-term debt outstanding at December 31, 2007, are as follows:

($ in millions)

2008	$ 3,705
2009	8,373
2010	2,212
2011	1,670
2012	2,996
2013 and beyond	7,406
Total	$26,362

Interest on Debt

($ in millions)

FOR THE YEAR ENDED DECEMBER 31:	**2007**	2006	2005
Cost of Financing	**$ 811**	$ 692	$ 525
Interest expense*	**753**	398	327
Net investment hedging activity*	**(142)**	(120)	(107)
Interest capitalized	**9**	11	16
Total interest paid and accrued	**$1,431**	$ 981	$ 761

* *Reclassified to conform with 2007 presentation to disclose changes in the fair value of the portion of a net investment hedging derivative excluded from the effectiveness assessment. See note A, "Significant Accounting Policies," on pages 71 and 72 under "Derivatives" for additional information.*

Refer to the related discussion on page 118 in note V, "Segment Information," for total interest expense of the Global Financing segment. See note K, "Derivatives and Hedging Transactions," on pages 88 to 91 for a discussion of the use of currency and interest rate swaps in the company's debt risk management program.

Lines of Credit

On June 28, 2007, the company extended by one year its five-year $10 billion Credit Agreement (the "Credit Agreement") with JPMorgan Chase Bank, N.A., as Administrative Agent, and Citibank, N.A., as Syndication Agent amending the company's existing five-year $10 billion Credit Agreement (the "Existing Agreement") dated June 28, 2006. The Existing Agreement was not otherwise due to expire until June 28, 2011. The total expense recorded by the company related to these facilities was $6.2 million in 2007, $7.4 million in 2006 and $8.9 million in 2005. The amended Credit Agreement permits the company and its Subsidiary Borrowers to borrow up to $10 billion on a revolving basis. Borrowings of the Subsidiary Borrowers will be unconditionally backed by the company. The company may also, upon the agreement of either existing Lenders, or of the additional banks not currently party to the Credit Agreement, increase the commitments under the Credit Agreement up to an additional $2.0 billion. Subject to certain terms of the Credit Agreement, the company and Subsidiary Borrowers may borrow, prepay and reborrow amounts under the Credit Agreement at any time during the Credit Agreement. Interest rates on borrowings under the Credit Agreement will be based on prevailing market interest rates, as further described in the Credit Agreement. The Credit Agreement contains customary representations and warranties, covenants, events of default, and indemnification provisions. The company believes that circumstances that might give rise to breach of these covenants or an event of default, as specified in the Credit Agreement are remote. The company's other lines of credit, most of which are uncommitted, totaled approximately $9,992 million and $9,429 million at December 31, 2007 and 2006, respectively. Interest rates and other terms of borrowing under these lines of credit vary from country to country, depending on local market conditions.

($ in millions)

AT DECEMBER 31:	2007	2006
Unused lines:		
From the committed global credit facility	**$ 9,792**	$ 9,875
From other committed and uncommitted lines	**7,895**	7,215
Total unused lines of credit	**$17,687**	$17,090

Note K. Derivatives and Hedging Transactions

The company operates in multiple functional currencies and is a significant borrower and lender in the global markets. In the normal course of business, the company is exposed to the impact of interest rate changes and foreign currency fluctuations, and to a lesser extent equity price changes and client credit risk. The company limits these risks by following established risk management policies and procedures, including the use of derivatives, and, where cost effective, financing with debt in the currencies in which assets are denominated. For interest rate exposures, derivatives are used to align rate movements between the interest rates associated with the company's lease and other financial assets and the interest rates associated with its financing debt. Derivatives are also used to manage the related cost of debt. For foreign currency exposures, derivatives are used to limit the effects of foreign exchange rate fluctuations on financial results.

As a result of the use of derivative instruments, the company is exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. To mitigate the counterparty credit risk, the company has a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors, and maintains strict dollar and term limits that correspond to each institution's credit rating. The company's established policies and procedures for mitigating credit risk on principal transactions include reviewing and establishing limits for credit exposure and continually assessing the creditworthiness of counterparties. Master agreements with counterparties include master netting arrangements as further mitigation of credit exposure to counterparties. These arrangements permit the company to net amounts due from the company to a counterparty with amounts due to the company from a counterparty reducing the maximum loss from credit risk in the event of counterparty default.

The company employs derivative instruments to hedge the volatility in stockholders' equity resulting from changes in currency exchange rates of significant foreign subsidiaries of the company with respect to the U.S. dollar. These instruments, designated as net investment hedges in accordance with SFAS No. 133, expose the company to liquidity risk as the derivatives have an immediate cash flow impact upon maturity which is not offset by the translation of the underlying hedged equity. The company has established cash loss limits to monitor and manage this liquidity risk. In 2007, the company expended $258 million, all in the fourth quarter, related to maturities of net investment hedges. At December 31, 2007, the company had liabilities of $937 million, representing the fair value of derivative instruments in qualifying net investment hedge relationships. Of this amount, $495 million is expected to mature in fiscal 2008. The weighted-average remaining maturity of all derivative instruments designated as net investment hedges is approximately 1.5 years.

In its hedging programs, the company uses forward contracts, futures contracts, interest-rate swaps and currency swaps, depending upon the underlying exposure. The company does not use derivatives for trading or speculative purposes, nor is it a party to leveraged derivatives.

A brief description of the major hedging programs follows.

Debt Risk Management

The company issues debt in the global capital markets, principally to fund its financing lease and loan portfolio. Access to cost-effective financing can result in interest rate and/or currency mismatches with the underlying assets. To manage these mismatches and to reduce overall interest cost, the company uses interest-rate swaps to convert specific fixed-rate debt into variable-rate (or "floating-rate") debt (i.e., fair value hedges) and to convert specific variable-rate debt into fixed-rate debt (i.e., cash flow hedges).

The company is exposed to exchange rate volatility on foreign currency denominated debt. To manage this risk, the company employs cross-currency swaps to convert fixed-rate foreign currency denominated debt to fixed-rate debt denominated in the functional currency of the borrowing entity. These swaps are accounted for as cash flow hedges.

The company is exposed to interest rate volatility on forecasted debt issuances. To manage this risk, the company may use forward starting interest-rate swaps to lock in the rate on the interest payments related to the forecasted debt issuance. These swaps are accounted for as cash flow hedges.

At December 31, 2007 and 2006, the weighted-average remaining maturity of all swaps in the debt risk management program was approximately five years.

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Long-Term Investments in Foreign Subsidiaries (Net Investment)

A significant portion of the company's foreign currency denominated debt portfolio is designated as a hedge of net investment which reduces the volatility in stockholders' equity caused by changes in foreign currency exchange rates in the functional currency of major foreign subsidiaries with respect to the U.S. dollar. The company also uses currency swaps and foreign exchange forward contracts for this risk management purpose, as well as a component of its debt management program. The currency effects of these hedges (approximately $880 million losses in 2007, $350 million losses in 2006 and $570 million gains in 2005, net of tax) were reflected in the Accumulated gains and (losses) not affecting retained earnings section of the Consolidated Statement of Stockholders' Equity, thereby offsetting a portion of the translation adjustment of the applicable foreign subsidiaries' net assets.

Anticipated Royalties and Cost Transactions

The company's operations generate significant nonfunctional currency, third-party vendor payments and intercompany payments for royalties and goods and services among the company's non-U.S. subsidiaries and with the parent company. In anticipation of these foreign currency cash flows and in view of the volatility of the currency markets, the company selectively employs foreign exchange forward contracts to manage its currency risk. These forwards are accounted for as cash flow hedges. The maximum length of time over which the company is hedging its exposure to the variability in future cash flows is approximately four years. At December 31, 2007, the weighted-average remaining maturity of these derivative instruments was approximately 281 days, as compared to 216 days at December 31, 2006.

Anticipated Commodity Purchase Transactions

In connection with the purchase of electricity for anticipated manufacturing requirements, the company selectively employs forward contracts to manage its price risk. The forwards are accounted for as cash flow hedges. The company does not have any derivative instruments relating to this program outstanding at December 31, 2007.

Subsidiary Cash and Foreign Currency Asset/ Liability Management

The company uses its Global Treasury Centers to manage the cash of its subsidiaries. These centers principally use currency swaps to convert cash flows in a cost-effective manner. In addition, the company uses foreign exchange forward contracts to economically hedge, on a net basis, the foreign currency exposure of a portion of the company's nonfunctional currency assets and liabilities. The terms of these forward and swap contracts are generally less than one year. The changes in the fair values of these contracts and of the underlying hedged exposures are generally offsetting and are recorded in Other (income) and expense in the Consolidated Statement of Earnings.

Equity Risk Management

The company is exposed to equity price changes related to certain obligations to employees. These equity exposures are primarily related to market price movements in certain broad equity market indices and in the company's common stock. Changes in the overall value of these employee compensation obligations are recorded in SG&A expense in the Consolidated Statement of Earnings. Although not designated as accounting hedges, the company utilizes equity derivatives, including equity swaps and futures, to economically hedge the exposures related to certain employee compensation obligations. The derivatives are linked to the total return on certain broad equity market indices or the total return on the company's common stock. They are recorded at fair value with gains or losses also reported in SG&A expense in the Consolidated Statement of Earnings.

Other Derivatives

The company holds warrants in connection with certain investments that are deemed derivatives because they contain net share or net cash settlement provisions. The company records the changes in the fair value of these warrants in Other (income) and expense in the Consolidated Statement of Earnings.

The company is exposed to a potential loss if a client fails to pay amounts due under contractual terms ("credit risk"). The company utilizes credit default swaps to economically hedge its credit exposures. These derivatives have remaining terms of one year or less. The swaps are recorded at fair value with gains and losses reported in Other (income) and expense in the Consolidated Statement of Earnings.

To economically hedge its foreign exchange exposure not covered by any of the previously discussed programs, the company also uses certain forward and option contracts that are not designated as accounting hedges. These derivatives are recorded at fair value with gains and losses reported in Other (income) and expense in the Consolidated Statement of Earnings.

The following tables summarize the net fair value of the derivative instruments and the carrying value of foreign currency denominated debt designated as a hedge of net investment at December 31, 2007 and 2006 (included in the Consolidated Statement of Financial Position).

($ in millions)

AT DECEMBER 31, 2007	HEDGE DESIGNATION FAIR VALUE	CASH FLOW	NET INVESTMENT	NON-HEDGE/ OTHER
Derivatives—net asset/(liability):				
Debt risk management	$167	$ 291	$ —	$ 50
Long-term investments in foreign subsidiaries (“net investments”)	—	—	(937)	—
Anticipated royalties and cost transactions	—	(203)	—	—
Anticipated commodity purchase transactions	—	—	—	—
Subsidiary cash and foreign currency asset/liability management	—	—	—	(56)
Equity risk management	—	—	—	30
Other derivatives	—	—	—	6
Total derivatives	167[a]	88[b]	(937)[c]	30[d]
Debt:				
Long-term investments in foreign subsidiaries (“net investments”)	—	—	(2,787)[e]	—
Total	**$167**	**$ 88**	**$(3,724)**	**$ 30**

[a] Comprises assets of $181 million and liabilities of $14 million.

[b] Comprises assets of $526 million and liabilities of $438 million.

[c] Comprises liabilities of $937 million.

[d] Comprises assets of $90 million and liabilities of $60 million.

[e] Represents foreign currency denominated debt formally designated as a hedge of net investment.

($ in millions)

AT DECEMBER 31, 2006	HEDGE DESIGNATION FAIR VALUE	CASH FLOW	NET INVESTMENT	NON-HEDGE/ OTHER
Derivatives—net asset/(liability):				
Debt risk management	$(139)	$110	$ —	$(96)
Long-term investments in foreign subsidiaries (“net investments”)	—	—	(165)	—
Anticipated royalties and cost transactions	—	(84)	—	—
Anticipated commodity purchase transactions	—	(2)	—	—
Subsidiary cash and foreign currency asset/liability management	—	—	—	(14)
Equity risk management	—	—	—	40
Other derivatives	—	—	—	10
Total derivatives	(139)[a]	24[b]	(165)[c]	(60)[d]
Debt:				
Long-term investments in foreign subsidiaries (“net investments”)	—	—	(2,529)[e]	—
Total	$(139)	$ 24	$(2,694)	$(60)

[a] Comprises assets of $1 million and liabilities of $140 million.

[b] Comprises assets of $293 million and liabilities of $269 million.

[c] Comprises assets of $42 million and liabilities of $207 million.

[d] Comprises assets of $74 million and liabilities of $134 million.

[e] Represents foreign currency denominated debt formally designated as a hedge of net investment.

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Accumulated Derivative Gains or Losses

At December 31, 2007, in connection with its cash flow hedges of anticipated royalties and cost transactions, the company recorded net losses of $136 million, net of tax, in Accumulated gains and (losses) not affecting retained earnings. Of this amount, $174 million of losses are expected to be reclassified to Net income within the next year, providing an offsetting economic impact against the underlying anticipated transactions. At December 31, 2007, losses of approximately $91 million, net of tax, were recorded in Accumulated gains and (losses) not affecting retained earnings in connection with cash flow hedges of the company's borrowings. Of this amount, $67 million of losses are expected to be reclassified to Net income within the next year, providing an offsetting economic impact against the underlying transactions.

The following table summarizes activity in the Accumulated gains and (losses) not affecting retained earnings section of the Consolidated Statement of Stockholders' Equity related to all derivatives classified as cash flow hedges:

($ in millions, net of tax)

	DEBIT/(CREDIT)
December 31, 2004	$ 653
Net losses reclassified into earnings from equity during 2005	(104)
Changes in fair value of derivatives in 2005	(787)
December 31, 2005	(238)
Net gains reclassified into earnings from equity during 2006	205
Changes in fair value of derivatives in 2006	138
December 31, 2006	104
Net losses reclassified into earnings from equity during 2007	(116)
Changes in fair value of derivatives in 2007	239
December 31, 2007	**$ 227**

For the years ending December 31, 2007, 2006 and 2005, there were no significant gains or losses recognized in earnings representing hedge ineffectiveness or excluded from the assessment of hedge effectiveness (for fair value hedges and cash flow hedges), or associated with an underlying exposure that did not or was not expected to occur (for cash flow hedges); nor are there any anticipated in the normal course of business.

Note L. Other Liabilities

($ in millions)

AT DECEMBER 31:	2007	2006*
Deferred taxes	**$1,064**	$ 665
Income tax reserves**	**2,107**	—
Executive compensation accruals	**1,058**	934
Restructuring actions	**631**	640
Workforce reductions	**476**	435
Disability benefits	**734**	626
Derivatives liabilities	**534**	235
Asset retirement obligations	**114**	106
Noncurrent warranty accruals	**157**	176
Environmental accruals	**231**	221
Other	**864**	764
Total	**$7,970**	$4,801

* *Reclassified to conform with 2007 presentation as the Deferred income category is now displayed as a separate line on the Consolidated Statement of Financial Position. Also, Asset retirement obligations is a separate category in 2007 and the 2006 Other category has been adjusted accordingly.*

** *Income tax reserve amounts classified as noncurrent as a result of 2007 implementation of FIN 48. See note O, "Taxes," on pages 97 to 99 for additional information.*

In response to changing business needs, the company periodically takes workforce reduction actions to improve productivity, cost competitiveness and to rebalance skills. The noncurrent contractually obligated future payments associated with these activities are reflected in the Workforce reductions caption in the previous table.

In addition, the company executed certain special actions as follows: (1) the second quarter of 2005 (discussed in note Q, "2005 Actions," on pages 99 and 100), (2) the second quarter of 2002 associated with the Microelectronics Division and rebalancing of both the company's workforce and leased space resources, (3) the fourth quarter of 2002 associated with the acquisition of the PricewaterhouseCoopers consulting business, (4) the 2002 actions associated with the HDD business for reductions in workforce, manufacturing capacity and space, (5) the actions taken in 1999, and (6) the actions that were executed prior to 1994.

The following table provides a roll forward of the current and noncurrent liabilities associated with these special actions. The current liabilities presented in the table are included in Other accrued expenses and liabilities in the Consolidated Statement of Financial Position.

($ in millions)

	LIABILITY AS OF DEC. 31, 2006	PAYMENTS	OTHER ADJUSTMENTS*	**LIABILITY AS OF DEC. 31, 2007**
Current:				
Workforce	$163	$(154)	$121	**$130**
Space	88	(99)	41	**30**
Other	6	—	1	**7**
Total Current	$257	$(253)	$164	**$167**
Noncurrent:				
Workforce	$531	$ —	$ 26	**$557**
Space	109	—	(35)	**74**
Total Noncurrent	$640	$ —	$ (9)	**$631**

* *The Other adjustments column in the table above principally includes the reclassification of noncurrent to current and foreign currency translation adjustments. Also, in 2007, $81 million was included in Other adjustments to record previously unrecognized actuarially calculated gains/losses related to long-term retirement benefits in Europe.*

The workforce accruals primarily relate to the Global Services business. The remaining liability relates to terminated employees who are no longer working for the company who were granted annual payments to supplement their incomes in certain countries. Depending on the individual country's legal requirements, these required payments will continue until the former employee begins receiving pension benefits or dies. Included in the December 31, 2007 workforce accruals above is $46 million associated with the HDD divestiture discussed in note A, "Significant Accounting Policies," on page 64. The space accruals are for ongoing obligations to pay rent for vacant space that could not be sublet or space that was sublet at rates lower than the committed lease arrangement. The length of these obligations varies by lease with the longest extending through 2020. Other accruals are primarily the remaining liabilities (other than workforce or space) associated with the HDD divestiture.

The company employs extensive internal environmental protection programs that primarily are preventive in nature. The company also participates in environmental assessments and cleanups at a number of locations, including operating facilities, previously owned facilities and Superfund sites. The company's maximum exposure for all environmental liabilities cannot be estimated and no amounts have been recorded for non-ARO environmental liabilities that are not probable or estimable. The total amounts accrued for non-ARO environmental liabilities, including amounts classified as current in the Consolidated Statement of Financial Position, that do not reflect actual or anticipated insurance recoveries, were $261 million and $252 million at December 31, 2007 and 2006, respectively. Estimated environmental costs are not expected to materially affect the consolidated financial position or consolidated results of the company's operations in future periods. However, estimates of future costs are subject to change due to protracted cleanup periods and changing environmental remediation regulations.

Note M. Stockholders' Equity Activity

The authorized capital stock of IBM consists of 4,687,500,000 shares of common stock, $.20 par value, of which 1,385,234,138 shares were outstanding at December 31, 2007 and 150,000,000 shares of preferred stock, $.01 par value, none of which were outstanding at December 31, 2007.

Stock Repurchases

From time to time, the Board of Directors authorizes the company to repurchase IBM common stock. The company repurchased 178,385,436 common shares at a cost of $18,783 million, 97,564,462 common shares at a cost of $8,022 million and 90,237,800 common shares at a cost of $7,671 million in 2007, 2006 and 2005, respectively.

Included in the 2007 repurchases highlighted above, in May, IBM International Group (IIG), a wholly owned foreign subsidiary of the company repurchased 118.8 million shares of common stock for $12.5 billion under accelerated share repurchase (ASR) agreements with three banks.

Pursuant to the ASR agreements, executed on May 25, 2007, IIG paid an initial purchase price of $105.18 per share for the repurchase. The initial purchase price is subject to adjustment based on the volume weighted-average price of IBM common stock over a settlement period of three months for each of the banks. The adjustment will also

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reflect certain other amounts including the banks' carrying costs, compensation for ordinary dividends declared by the company during the settlement period and interest benefits for receiving the $12.5 billion payment in advance of the anticipated purchases by each bank of shares in the open market during the respective settlement periods. The adjustment amount can be settled in cash, registered shares or unregistered shares at IIG's option. Under the ASR agreements, IIG will have a separate settlement with each of the three banks. The first settlement occurred on September 6, 2007, resulting in a settlement payment to the bank of $151.8 million. The second settlement occurred on December 5, 2007, resulting in a settlement payment to the bank of $253.1 million. The amounts were paid in cash at the election of IIG in accordance with the provisions of the ASR agreements and were recorded as adjustments to Stockholders' equity in the Consolidated Statement of Financial Position on the settlement dates.

The remaining settlement is expected to occur in March 2008, and any amounts to be paid or received by IIG under any of the settlement alternatives in connection with the price adjustment will be recorded as an adjustment to Stockholders' equity in the Consolidated Statement of Financial Position on the settlement date.

The estimated fair value of the cash settlement and share settlement alternatives under the ASR agreements as of December 31, 2007 would result in the payment of approximately $33 million or 0.3 million registered shares or unregistered shares, by IIG. In comparison, each $1 increase in the volume weighted-average share price would increase these estimates by approximately $40 million or approximately 0.3 million registered and unregistered shares under the cash settlement and share settlement alternatives, respectively. IIG cannot be required to deliver more than 119 million shares if it elects the share settlement options for the remaining settlement, regardless of the volume weighted-average share price.

On December 3, 2007, the company announced that it planned to repurchase up to $1.0 billion of its outstanding common stock in open market transactions by the end of February 2008. These repurchases, originally planned for March and April of 2008, are in addition to the $12.5 billion ASR discussed previously.

The company issued 9,282,055 treasury shares in 2007, 3,489,803 treasury shares in 2006 and 2,594,786 treasury shares in 2005, as a result of exercises of stock options by employees of certain recently acquired businesses and by non-U.S. employees. At December 31, 2007, $1,210 million of Board authorized repurchases was still available. The company plans to purchase shares on the open market or in private transactions from time to time, depending on market conditions. In connection with the issuance of stock as part of the company's stock-based compensation plans, 1,282,131 common shares at a cost of $134 million, 633,769 common shares at a cost of $52 million and 606,697 common shares at a cost of $52 million in 2007, 2006 and 2005, respectively, were remitted by employees to the company in order to satisfy minimum statutory tax withholding requirements. Such amounts are included in the Treasury stock balance in the Consolidated Statement of Financial Position and the Consolidated Statement of Stockholders' Equity.

Accumulated Gains and (Losses) Not Affecting Retained Earnings (Net of Tax)

($ in millions)

			Retirement-Related Benefit Plans			
	Net Unrealized Gains/(Losses) on Cash Flow Hedge Derivatives	Foreign Currency Translation Adjustments*	Minimum Pension Liability Adjustments	Prior Service Costs/(Credits), Net Gains/(Losses) and Transition Assets, Net of Amortization	Net Unrealized Gains on Marketable Securities	Accumulated Gains/(Losses) Not Affecting Retained Earnings
December 31, 2005	$ 238	$1,908	$(4,229)	$ —	$ 67	$(2,016)
Change for period	(342)	1,020	1,881	—	53	2,613
Adoption of SFAS No. 158	—	—	2,348	(11,846)	—	(9,498)
December 31, 2006	(104)	2,929	—	(11,846)	119	(8,901)
Change for period	(123)	726	—	4,678	206	5,487
December 31, 2007	**$(227)**	**$3,655**	**$ —**	**$ (7,168)**	**$325**	**$(3,414)**

* *Foreign currency translation adjustments are presented gross with associated hedges shown net of tax.*

Net Change in Unrealized Gains on Marketable Securities (Net of Tax)

($ in millions)

For the period ended December 31:	**2007**	2006
Net unrealized gains arising during the period	**$246**	$77
Less: Net gains included in net income for the period	**40***	24*
Net change in unrealized gains on marketable securities	**$206**	$53

* *Includes writedowns of $6.4 million and $2.9 million in 2007 and 2006, respectively.*

Note N. Contingencies and Commitments

Contingencies

The company is involved in a variety of claims, demands, suits, investigations and proceedings that arise from time to time in the ordinary course of its business, including actions with respect to contracts, intellectual property (IP), product liability, employment, benefits, securities, and environmental matters. These actions may be commenced by a number of different parties, including competitors, partners, clients, current or former employees, government and regulatory agencies, stockholders and representatives of the locations in which the company does business. The following is a summary of some of the more significant legal matters involving the company.

The company is a defendant in an action filed on March 6, 2003 in state court in Salt Lake City, Utah by The SCO Group (SCO v. IBM). The company removed the case to Federal Court in Utah. Plaintiff is an alleged successor in interest to some of AT&T's Unix IP rights, and alleges copyright infringement, unfair competition, interference with contract and breach of contract with regard to the company's distribution of AIX and Dynix and contribution of code to Linux. The company has asserted counterclaims, including breach of contract, violation of the Lanham Act, unfair competition, intentional torts, unfair and deceptive trade practices, breach of the General Public License that governs open source distributions, promissory estoppel and copyright infringement. In October 2005, the company withdrew its patent counterclaims in an effort to simplify and focus the issues in the case and to expedite their resolution. Motions for summary judgment were heard in March 2007, and the court has not yet issued its decision. On August 10, 2007, the court in another suit, The SCO Group, Inc. v. Novell, Inc., issued a decision and order determining, among other things, that Novell is the owner of UNIX and UnixWare copyrights, and obligating SCO to recognize Novell's waiver of SCO's claims against IBM and Sequent for breach of UNIX license agreements. At the request of the court in SCO v. IBM, on August 31, 2007, each of the parties filed a status report with the court concerning the effect of the August 10th Novell ruling on the SCO v. IBM case, including the pending motions. On September 14, 2007, plaintiff filed for bankruptcy protection, and all proceedings in this case were stayed.

On November 29, 2006, the company filed a lawsuit against Platform Solutions, Inc. (PSI) in the United States District Court for the Southern District of New York. IBM filed its amended complaint on August 17, 2007 and asserted claims for patent infringement, trade secret misappropriation, copyright infringement, tortious interference and breach of contract in connection with PSI's development and marketing of a computer system that PSI says is compatible with IBM's S/390 and System z architectures. IBM also sought a declaratory judgment that its refusal to license its patents to PSI and certain of its software for use on PSI systems does not violate the antitrust laws. IBM seeks damages and injunctive relief. On September 21, 2007, PSI answered the amended complaint and asserted counterclaims against IBM for alleged monopolization and attempted monopolization, tying, violations of New York and California statutes proscribing unfair competition, tortious interference with the acquisition of PSI by a third party and promissory estoppel. PSI also sought declaratory judgments of noninfringement of IBM's patents and patent invalidity. In October 2007, PSI filed a complaint with the European Commission claiming that the company's alleged refusal to do business with PSI violated European competition law. The company responded to this complaint in December. On January 11, 2008, the court in the New York lawsuit permitted T3 Technologies, a reseller of PSI computer systems, to intervene as a counterclaim-plaintiff, and the court also permitted the company to file a second amended complaint adding patent infringement claims against T3. Discovery is proceeding and the court has ordered that the case be ready for trial after December 1, 2008.

In May 2005, the Louisiana Supreme Court denied the company's motion to review and reverse a Louisiana state court's certification of a nationwide class in a case filed against the company in 1995. The class consists of certain former employees who left the company in 1992, and their spouses, claiming damages based on the company's termination of an education assistance program. On July 3, 2007, the company and the plaintiffs filed a proposed class settlement agreement with the 19th Judicial District Court for the Parish of East Baton Rouge, Louisiana, where the legal action was filed. On October 1, 2007, the Court gave its final approval of the proposed settlement pursuant to which IBM paid certain amounts to eligible individuals who took or would have taken an education course within a specified period after departing the company. As part of the settlement, IBM also made contributions to support engineering education for women and minorities. Class members did not file an appeal of the Court's order approving the settlement prior to the mid-December 2007 deadline.

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In October 2003, a purported collective action lawsuit was filed against IBM in the United States District Court for the Northern District of California by 10 former IBM employees alleging, on behalf of themselves and allegedly similarly situated former employees, that the company engaged in a pattern and practice of discriminating against employees on the basis of age when it terminated employees, both in connection with reductions in force and individualized determinations (Syverson v. IBM). Initially, the District Court dismissed the lawsuit on the basis of release agreements signed by all the plaintiffs. On appeal, the Ninth Circuit reversed the trial court's finding that the release barred these claims, and in January 2007, after denial of IBM's petition for rehearing, the matter was returned to the trial court for further proceedings. On October 3, 2007, the court dismissed with prejudice plaintiffs' claim for relief under the Older Workers Benefit Protection Act, and dismissed with leave to amend plaintiffs' claim asserting disparate impact age discrimination with respect to individualized terminations. On November 6, 2007, plaintiffs filed a Third Amended Complaint, amending the disparate impact claim. IBM filed its answer on November 26, 2007.

In July 2005, two lawsuits were filed in the United States District Court for the Southern District of New York related to the company's disclosures concerning first-quarter 2005 earnings and the expensing of equity compensation. Pursuant to an Order from the Court dated March 28, 2006, the two lawsuits were consolidated into a single action captioned "In re International Business Machines Corp. Securities Litigation." Plaintiffs filed a corrected consolidated amended complaint dated May 19, 2006, in which they named the company and IBM's Senior Vice President and Chief Financial Officer as defendants and alleged that defendants made certain misrepresentations and omissions in violation of Section 10(b), and Rule 10b-5 thereunder, and Section 20(a) of the Securities Exchange Act of 1934. On September 20, 2006, the Court denied a Motion to Dismiss that was filed by IBM. On March 12, 2007, the plaintiffs' class was certified; class notifications were mailed on or about May 30, 2007.

In January 2004, the Seoul District Prosecutors Office in South Korea announced it had brought criminal bid-rigging charges against several companies, including IBM Korea and LG IBM (a joint venture between IBM Korea and LG Electronics, which has since been dissolved, effective January, 2005) and had also charged employees of some of those entities with, among other things, bribery of certain officials of government-controlled entities in Korea and bid rigging. IBM Korea and LG IBM cooperated fully with authorities in these matters. A number of individuals, including former IBM Korea and LG IBM employees, were subsequently found guilty and sentenced. IBM Korea and LG IBM were also required to pay fines. Debarment orders were imposed at different times, covering a period of no more than a year from the date of issuance, which barred IBM Korea from doing business directly with certain government-controlled entities in Korea. All debarment orders have since expired and when they were in force did not prohibit IBM Korea from selling products and services to business partners who sold to government-controlled entities in Korea. In addition, the U.S. Department of Justice and the SEC have both contacted the company in connection with this matter.

The company is a defendant in a civil lawsuit brought in Tokyo District Court by Tokyo Leasing Co., Ltd., which seeks to recover losses that it allegedly suffered after IXI Co., Ltd. initiated civil rehabilitation (bankruptcy) proceedings in Japan and apparently failed to pay Tokyo Leasing amounts for which Tokyo Leasing now seeks to hold IBM and others liable. The claims in this suit include tort and breach of contract.

The company is a defendant in numerous actions filed after January 1, 2008 in Supreme Court for the State of New York, county of Broome, on behalf of hundreds of plaintiffs. The complaints allege causes of action for negligence and recklessness, private nuisance, and trespass. Plaintiffs in these cases seek medical monitoring and claim damages in unspecified amounts for a variety of personal injuries and property damages allegedly arising out of the presence of groundwater contamination and vapor intrusion of groundwater contaminants into certain structures in which plaintiffs reside or resided, or conducted business, allegedly resulting from the release of chemicals into the environment by the company at its former manufacturing and development facility in Endicott. These complaints also seek punitive damages in an unspecified amount.

The company is party to, or otherwise involved in, proceedings brought by U.S. federal or state environmental agencies under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), known as "Superfund," or laws similar to CERCLA. Such statutes require potentially responsible parties to participate in remediation activities regardless of fault or ownership of sites. The company is also conducting environmental investigations, assessments or remediations at or in the vicinity of several current or former operating sites globally pursuant to permits, administrative orders or agreements with country, state or local environmental agencies, and is involved in lawsuits and claims concerning certain current or former operating sites.

The company is also subject to ongoing tax examinations and governmental assessments in various jurisdictions. Along with many other U.S. companies doing business in Brazil, the company is involved in various challenges with Brazilian authorities regarding non-income tax assessments and non-income tax litigation matters. These matters principally relate to claims for taxes on the importation of computer software. The total amounts related to these matters are approximately $2.1 billion, including amounts currently in litigation and other amounts. In addition, the company has received an income tax assessment from Mexican authorities relating to the deductibility of certain warranty payments. In response, the company has filed an appeal in the Mexican Federal Fiscal court. The total potential amount related to this matter for all applicable years is approximately $500 million. The company believes it will prevail on these matters and that these amounts are not meaningful indicators of liability.

In accordance with SFAS No. 5, "Accounting for Contingencies," (SFAS No. 5), the company records a provision with respect to a claim, suit, investigation or proceeding when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Claims and proceedings are reviewed at least quarterly and provisions are taken or adjusted to reflect the impact and status of settlements, rulings, advice of counsel and other information pertinent to a particular matter. Any recorded liabilities for the previously discussed items, including any changes to such liabilities for the year ended December 31, 2007, were not material to the Consolidated Financial Statements. Based on its experience, the company believes that the damage amounts claimed in the matters previously referred to are not a meaningful indicator of the potential liability. Claims, suits, investigations and proceedings are inherently uncertain and it is not possible to predict the ultimate outcome of the matters previously discussed. While the company will continue to defend itself vigorously in all such matters, it is possible that the company's business, financial condition, results of operations or cash flows could be affected in any particular period by the resolution of one or more of these matters.

Whether any losses, damages or remedies finally determined in any such claim, suit, investigation or proceeding could reasonably have a material effect on the company's business, financial condition, results of operations or cash flows will depend on a number of variables, including the timing and amount of such losses or damages; the structure and type of any such remedies; the significance of the impact any such losses, damages or remedies may have on the Consolidated Financial Statements; and the unique facts and circumstances of the particular matter which may give rise to additional factors.

Commitments

The company's extended lines of credit to third-party entities include unused amounts of $3,702 million and $2,895 million at December 31, 2007 and 2006, respectively. A portion of these amounts was available to the company's business partners to support their working capital needs. In addition, the company has committed to provide future financing to its clients in connection with client purchase agreements for approximately $3,654 million and $2,496 million at December 31, 2007 and 2006, respectively. The change over the prior year is due to increased signings of long-term IT infrastructure arrangements in which financing is committed by the company to fund a client's future purchases from the company.

The company has applied the provisions of FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Guarantees of Indebtedness of Others," to its agreements that contain guarantee or indemnification clauses. These provisions expand those required by SFAS No. 5, by requiring a guarantor to recognize and disclose certain types of guarantees, even if the likelihood of requiring the guarantor's performance is remote. The following is a description of arrangements in which the company is the guarantor.

The company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in the context of contracts entered into by the company, under which the company customarily agrees to hold the other party harmless against losses arising from a breach of representations and covenants related to such matters as title to assets sold, certain IP rights, specified environmental matters, third-party performance of non-financial contractual obligations and certain income taxes. In each of these circumstances, payment by the company is conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the company to challenge the other party's claims. Further, the company's obligations under these agreements may be limited in terms of time and/or amount, and in some instances, the company may have recourse against third parties for certain payments made by the company.

It is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of the company's obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the company under these agreements have not had a material effect on the company's business, financial condition or results of operations.

In addition, the company guarantees certain loans and financial commitments. The maximum potential future payment under these financial guarantees was $23 million and $32 million at December 31, 2007 and 2006, respectively. The fair value of the guarantees recognized in the Consolidated Statement of Financial Position is not material.

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Note O. Taxes

($ in millions)

FOR THE YEAR ENDED DECEMBER 31:	2007	2006	2005
Income from continuing operations before income taxes:			
U.S. operations	**$ 7,667**	$ 7,277	$ 7,450
Non-U.S. operations	**6,822**	6,040	4,776
Total income from continuing operations before income taxes	**$14,489**	$13,317	$12,226

The continuing operations provision for income taxes by geographic operations is as follows:

($ in millions)

FOR THE YEAR ENDED DECEMBER 31:	2007	2006	2005
U.S. operations	**$2,280**	$2,413	$2,988
Non-U.S. operations	**1,791**	1,488	1,244
Total continuing operations provision for income taxes	**$4,071**	$3,901	$4,232

The components of the continuing operations provision for income taxes by taxing jurisdiction are as follows:

($ in millions)

FOR THE YEAR ENDED DECEMBER 31:	2007	2006	2005
U.S. federal:			
Current	**$1,085**	$ 602	$ 521
Deferred	**683**	1,326	1,811
	1,768	1,928	2,332
U.S. state and local:			
Current	**141**	11	80
Deferred	**(19)**	198	183
	122	209	263
Non-U.S:			
Current	**2,105**	1,564	1,446
Deferred	**76**	200	191
	2,181	1,764	1,637
Total continuing operations provision for income taxes	**4,071**	3,901	4,232
Provision for social security, real estate, personal property and other taxes	**3,832**	3,461	3,501
Total taxes included in income from continuing operations	**$7,903**	$7,362	$7,733

A reconciliation of the statutory U.S. federal tax rate to the company's continuing operations effective tax rate is as follows:

FOR THE YEAR ENDED DECEMBER 31:	2007	2006	2005
Statutory rate	**35%**	35%	35%
Foreign tax differential	**(6)**	(5)	(5)
State and local	**1**	1	1
"Act" repatriation*	**—**	—	4
Other	**(2)**	(2)	—
Effective rate	**28%**	29%	35%

* *American Jobs Creation Act of 2004, which permitted the repatriation of non-U.S. earnings at a reduced tax rate.*

The effect of tax law changes on deferred tax assets and liabilities did not have a material impact on the company's effective tax rate.

The significant components of deferred tax assets and liabilities that are recorded in the Consolidated Statement of Financial Position were as follows:

Deferred Tax Assets

($ in millions)

AT DECEMBER 31:	2007	2006
Stock-based and other compensation	**$ 2,920**	$ 3,147
Retirement-related benefits	**2,505**	3,002
Capitalized research and development	**1,050**	1,355
Federal/state tax loss/state credit carryforwards	**772**	299
Bad debt, inventory and warranty reserves	**647**	724
Deferred income	**645**	506
Foreign tax loss/credit carryforwards	**498**	390
Capital loss carryforwards	**9**	131
Other	**1,962**	1,802
Gross deferred tax assets	**11,008**	11,356
Less: valuation allowance	**772**	510
Net deferred tax assets	**$10,236**	$10,846

Deferred Tax Liabilities

($ in millions)

AT DECEMBER 31:	2007	2006
Retirement-related benefits	**$4,964**	$2,906
Leases	**1,635**	1,385
Software development costs	**462**	505
Other	**1,334**	1,340
Gross deferred tax liabilities	**$8,395**	$6,136

For income tax return purposes, the company has available foreign, domestic and capital loss carryforwards, the tax effect of which is $799 million, as well as state tax credit carryforwards of approximately $480 million. Substantially all of these carryforwards are available for at least two years or are available for 10 years or more.

The company has certain foreign tax loss carryforwards that have not been reflected in the gross deferred tax asset balance. These losses, the potential tax benefit of which is approximately $1.1 billion, have not been recorded in the Consolidated Statement of Financial Position as the company has not determined if it will claim these losses. The company is currently evaluating whether to claim these losses and expects to make a decision within the next 12 months.

The valuation allowance at December 31, 2007, principally applies to certain foreign and state loss carryforwards, and state credit carryforwards, that, in the opinion of management, are more likely than not to expire unutilized. However, to the extent that tax benefits related to these carryforwards are realized in the future, the reduction in the valuation allowance will reduce income tax expense. The year-to-year increase of $262 million was primarily driven by an additional allowance related to the recognition of certain state tax credit carryforwards not previously recorded as deferred tax assets.

The company adopted the provisions of FIN 48 on January 1, 2007. The cumulative effect of adopting FIN 48 was a decrease in tax reserves and an increase of $117 million to the January 1, 2007 Retained earnings balance. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

($ in millions)

Balance at January 1, 2007	$2,414
Additions based on tax positions related to the current year	745
Additions for tax positions of prior years	195
Reductions for tax positions of prior years (including impacts due to a lapse in statute)	(144)
Settlements	(116)
Balance at December 31, 2007	**$3,094**

The liability at December 31, 2007 of $3,094 can be reduced by $496 million of offsetting tax benefits associated with the correlative effects of potential transfer pricing adjustments, state income taxes and timing adjustments. The net amount of $2,598, if recognized, would favorably affect the company's effective tax rate.

Interest and penalties related to income tax liabilities are included in income tax expense. During the year ended December 31, 2007, the company recognized $85 million in interest and penalties. The company has $195 million for the payment of interest and penalties accrued at December 31, 2007 and had $126 million accrued on January 1, 2007 upon adoption of FIN 48.

During the first quarter of 2007, the U.S. Internal Revenue Service (IRS) commenced its audit of the company's U.S. income tax returns for 2004 and 2005. The company anticipates that this audit will be completed by the end of 2008.

Within the next 12 months, the company believes it is reasonably possible that the total amount of unrecognized tax benefits associated with certain positions may be significantly reduced. The potential decrease in the amount of unrecognized tax benefits is primarily associated with the possible resolution of the company's U.S. income tax audit for 2004 and 2005. Specific positions that may be resolved, and that may significantly reduce the related amount of unrecognized tax benefits, include various transfer pricing matters and claims for tax incentives, as well as various other foreign tax matters. The company estimates that the unrecognized tax benefits at December 31, 2007 could be reduced by approximately $800 million.

In December 2006, the company and the IRS reached resolution of the company's U.S. income tax audit for 2001 through 2003. The settlement of this audit resulted in a decrease in the 2006 effective tax rate of 3 points due to the release of previously recorded tax reserves.

In the fourth quarter of 2006, as a continuation of its global strategy, the company aligned, through an intercompany transfer, certain non-U.S. intellectual property rights with existing non-U.S. rights currently owned by one of the company's non-U.S. manufacturing subsidiaries. This transfer resulted in a one-time increase in the 2006 effective tax rate of 4 points.

With limited exception, the company is no longer subject to U.S. federal, state and local or non-U.S. income tax audits by taxing authorities for years through 2001. The years subsequent to 2001 contain matters that could be subject to differing interpretations of applicable tax laws and regulations as it relates to the amount and/or timing of income, deductions and tax credits. Although the outcome of tax audits is always uncertain, the company believes that adequate amounts of tax and interest have been provided for any adjustments that are expected to result for these years.

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The company has not provided deferred taxes on $18.8 billion of undistributed earnings of non-U.S. subsidiaries at December 31, 2007, as it is the company's policy to indefinitely reinvest these earnings in non-U.S. operations. However, the company periodically repatriates a portion of these earnings to the extent that it does not incur an additional U.S. tax liability. Quantification of the deferred tax liability, if any, associated with indefinitely reinvested earnings is not practicable.

For additional information on the company's effective tax rate, as well as the cash tax rate, refer to the "Looking Forward" section of the Management Discussion on page 43.

Note P. Research, Development and Engineering

RD&E expense was $6,153 million in 2007, $6,107 million in 2006 and $5,842 million in 2005.

The company incurred expense of $5,754 million in 2007, $5,682 million in 2006 and $5,379 million in 2005 for scientific research and the application of scientific advances to the development of new and improved products and their uses, as well as services and their application. Within these amounts, software-related expense was $3,037 million, $2,842 million and $2,689 million in 2007, 2006 and 2005, respectively. In addition, included in the expense was a charge of $7 million and $1 million in 2006 and 2005, respectively, for acquired in-process R&D.

Expense for product-related engineering was $399 million, $425 million and $463 million in 2007, 2006 and 2005, respectively.

Note Q. 2005 Actions

In May 2005, management announced its plans to implement a series of restructuring actions designed to improve the company's efficiencies, strengthen its client-facing operations and capture opportunities in high-growth markets. The company's actions primarily included voluntary and involuntary workforce reductions, with the majority impacting the Global Services segments, primarily in Europe, as well as costs incurred in connection with the vacating of leased facilities. These actions were in addition to the company's ongoing workforce reduction and rebalancing activities that occur each quarter. The total charges expected to be incurred in connection with all second-quarter 2005 initiatives is approximately $1,771 million ($1,765 million of which has been recorded cumulatively through December 31, 2007). Approximately $1,631 million of the total charges require cash payments, of which approximately $1,453 million have been made as of December 31, 2007 and $73 million are expected to be made over the next 12 months.

Total pre-tax restructuring activity was as follows:

($ in millions)

	PRE-TAX CHARGES RECORDED IN SECOND-QTR. 2005	ASSET IMPAIRMENTS	LIABILITY RECORDED IN SECOND-QTR. 2005	PAYMENTS	OTHER**	LIABILITY AS OF DEC. 31, 2005
Workforce reductions	$1,574	$—	$1,574	$(1,013)	$(107)	$454
Vacant space	141	—	141	(53)	(5)	83
Asset impairments	95	95	—	—	—	—
Total restructuring activity for second-quarter 2005 actions	$1,810*	$95	$1,715	$(1,066)	$(112)	$537+

* *$1,574 million recorded in SG&A expense and $236 million recorded in Other (income) and expense in the Consolidated Statement of Earnings.*

** *Consists of foreign currency translation adjustments ($38 million), net balance sheet reclassifications ($41 million) and reversals of previously recorded liabilities ($34 million) for changes in the estimated cost of employee terminations and vacant space, offset by approximately $1 million of accretion expense. The reversals were recorded primarily in SG&A expense.*

\+ *$391 million recorded as a current liability in Accounts payable and accruals and $146 million as a noncurrent liability in Other liabilities in the Consolidated Statement of Financial Position.*

($ in millions)

	LIABILITY AS OF DEC. 31, 2005	PAYMENTS	OTHER*	LIABILITY AS OF DEC. 31, 2006	PAYMENTS	OTHER+	**LIABILITY AS OF DEC. 31, 2007**
Workforce reductions	$454	$(264)	$10	$199	$(65)	$11	**$145**
Vacant space	83	(37)	1	47	(21)	—	**27**
Total restructuring activity for second-quarter 2005 actions	$537	$(302)	$11	$247**	$(86)	$11	**$171**++

* *Consists of foreign currency translation adjustments ($37 million), net balance sheet reclassifications ($2 million), accretion expense ($7 million) and reversals of previous recorded liabilities ($35 million) for changes in the estimated cost of employee terminations and vacant space. These reversals, net of accretion expense, were primarily recorded in SG&A expense.*

** *$92 million recorded as a current liability in Accounts payable and accruals and $155 million as a noncurrent liability in Other liabilities in the Consolidated Statement of Financial Position.*

+ *Consists of foreign currency translation adjustments ($20 million) and accretion expense ($6 million), partially offset by adjustments to previously recorded liabilities ($13 million) for changes in the estimated cost of employee terminations and vacant space and net balance sheet reclassification of $2 million. The adjustments and accretion expense were primarily recorded in SG&A expense.*

++ *$73 million recorded as a current liability in Accounts payable and accruals and $98 million as a noncurrent liability in Other liabilities in the Consolidated Statement of Financial Position.*

Charges incurred for the workforce reductions consisted of severance/termination benefits for approximately 16,000 employees (14,500 of which were for the incremental second-quarter 2005 actions). All separations were substantially completed by March 31, 2006. The noncurrent portion of the liability associated with the workforce reductions relates to terminated employees who were granted annual payments to supplement their income in certain countries. Depending on individual country legal requirements, these required payments will continue until the former employee begins receiving pension benefits or is deceased. Cash payments made through December 31, 2007 associated with the workforce reductions were $1,342 million.

The vacant space accruals are primarily for ongoing obligations to pay rent for vacant space, offset by estimated sublease income, over the respective lease term of the company's lease agreements. The length of these obligations varies by lease with the longest extending through 2013.

In connection with the company's restructuring activities initiated in the second quarter of 2005, the company recorded pre-tax impairment charges for certain real estate assets of approximately $95 million during the year ended December 31, 2005. The principal component of such impairment charges resulted from the sale of a facility in Yasu-City, Japan, which closed during the third quarter of 2005. In connection with this sale, the company recorded an impairment charge to write the asset down to its fair value in the second quarter.

These restructuring activities had the following effect on the company's reportable segments.

($ in millions)

	TOTAL PRE-TAX CHARGES EXPECTED TO BE INCURRED	CUMULATIVE PRE-TAX CHARGES RECORDED FOR 2ND-QTR. 2005 INITIATIVES*
Global Technology Services	$ 722	$ 719
Global Business Services	444	444
Systems and Technology	132	132
Software	98	98
Global Financing	16	16
Total reportable segments	1,412	1,408
Unallocated corporate amounts	360	357
Total	$1,771	$1,765

* *Includes $13 million and $35 million for reversals of previously recorded charges for the years ended December 31, 2007 and 2006, respectively, due to changes in the estimated cost of employee terminations and vacant space. These adjustments were primarily recorded in SG&A expense.*

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Note R. Earnings Per Share of Common Stock

The following table presents the computation of basic and diluted earnings per share of common stock:

FOR THE YEAR ENDED DECEMBER 31:	2007	2006	2005
Weighted-average number of shares on which earnings per share calculations are based:			
Basic	**1,423,039,793**	1,530,806,987	1,600,591,264
Add—incremental shares under stock compensation plans	**22,730,971**	18,074,331	21,757,121
Add—incremental shares associated with Accelerated Share Repurchase agreements	**1,891,095**	—	—
Add—incremental shares associated with convertible notes	**1,362,191**	3,273,706	3,791,228
Add—incremental shares associated with contingently issuable shares	**1,546,529**	1,380,360	1,493,049
Assuming dilution	**1,450,570,579**	1,553,535,384	1,627,632,662

($ in millions except per share amounts)

	2007	2006	2005
Basic:			
Income from continuing operations	**$10,418**	$9,416	$7,994
(Loss)/income from discontinued operations	**(00)**	76	(24)
Cumulative effect of change in accounting principle*	**—**	—	(36)
Net income from total operations on which basic earnings per share is calculated	**$10,418**	$9,492	$7,934
Assuming dilution:			
Income from continuing operations	**$10,418**	$9,416	$7,994
Net loss applicable to contingently issuable shares liability	**—**	—	(2)
(Loss)/income from discontinued operations	**(00)**	76	(24)
Cumulative effect of change in accounting principle*	**—**	—	(36)
Net income from total operations on which diluted earnings per share is calculated	**$10,418**	$9,492	$7,932
Earnings/(loss) per share of common stock:			
Assuming dilution:			
Continuing operations	**$ 7.18**	$ 6.06	$ 4.91
Discontinued operations	**(0.00)**	0.05	(0.01)
Before cumulative effect of change in accounting principle	**7.18**	6.11	4.90
Cumulative effect of change in accounting principle*	**—**	—	(0.02)
Total assuming dilution	**$ 7.18**	$ 6.11	$ 4.87
Basic:			
Continuing operations	**$ 7.32**	$ 6.15	$ 4.99
Discontinued operations	**(0.00)**	0.05	(0.02)
Before cumulative effect of change in accounting principle	**7.32**	6.20	4.98
Cumulative effect of change in accounting principle*	**—**	—	(0.02)
Total basic	**$ 7.32**	$ 6.20	$ 4.96

* *Reflects implementation of FASB Interpretation No. 47. See note B, "Accounting Changes," on page 75 for additional information.*

Weighted-average stock options to purchase 62,782,516 common shares in 2007, 157,942,283 common shares in 2006 and 165,615,293 common shares in 2005 were outstanding, but were not included in the computation of diluted earnings per share because the exercise price of the options was greater than the average market price of the common shares for the full year, and therefore, the effect would have been antidilutive.

Note S. Rental Expense and Lease Commitments

Rental expense from continuing operations, including amounts charged to inventories and fixed assets, and excluding amounts previously reserved, was $1,364 million in 2007, $1,263 million in 2006 and $1,345 million in 2005. Rental expense in agreements with rent holidays and scheduled rent increases is recorded on a straight-line basis over the

lease term. Contingent rentals are included in the determination of rental expense as accruable. The table below depicts gross minimum rental commitments from continuing operations under noncancelable leases, amounts related to vacant space associated with infrastructure reductions and restructuring actions taken through 1993, and in 1999, 2002 and 2005 (previously reserved), sublease income commitments and capital lease commitments. These amounts reflect activities primarily related to office space, as well as manufacturing facilities.

($ in millions)

	2008	2009	2010	2011	2012	BEYOND 2012
Operating lease commitments:						
Gross minimum rental commitments (including Vacant space below)	$1,220	$1,106	$852	$636	$507	$753
Vacant space	$ 37	$ 32	$ 24	$ 23	$ 20	$ 63
Sublease income commitments	$ 75	$ 54	$ 43	$ 25	$ 15	$ 13
Capital lease commitments	$ 88	$ 68	$ 66	$ 22	$ 14	$ 38

Note T. Stock-Based Compensation

Stock-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized over the employee requisite service period. See note A, "Significant Accounting Policies," on page 70 for additional information.

The following table presents total stock-based compensation cost included in the Consolidated Statement of Earnings:

($ in millions)

FOR THE YEAR ENDED DECEMBER 31:	2007	2006	2005
Cost	**$ 166**	$ 216	$ 330
Selling, general and administrative*	**480**	541	606
Research, development and engineering	**68**	89	107
Other (income) and expense**	**(1)**	—	(8)
Pre-tax stock-based compensation cost	**713**	846	1,035
Income tax benefits	**(248)**	(305)	(349)
Total stock-based compensation cost	**$ 464**	$ 541	$ 686

* *Includes $7 million of credits recorded during the year ended December 31, 2005, as a result of awards forfeited in connection with the second-quarter 2005 workforce resource actions.*

** *Reflects the one-time effects of the divestiture of the Personal Computing business in the second quarter of 2005 and the divestiture of the Printing Systems business in the second quarter of 2007.*

Total unrecognized compensation cost related to non-vested awards at December 31, 2007 and 2006 was $1,101 million and $1,238 million, respectively, and is expected to be recognized over a weighted-average period of approximately three years.

There was no significant capitalized stock-based compensation cost at December 31, 2007, 2006 and 2005.

Incentive Awards

Stock-based incentive awards are provided to employees under the terms of the company's plans (the "Plans"). The Plans are administered by the Executive Compensation and Management Resources Committee of the Board of Directors (the "Committee"). Awards under the Plans principally include at-the-money stock options, restricted stock units, performance stock units, stock appreciation rights or any combination thereof. The nonmanagement members of the IBM Board of Directors also received stock options under a director stock option plan through December 31, 2006. The director stock option plan was terminated effective January 1, 2007.

The amount of shares originally authorized to be issued under the company's existing Plans was 274.1 million at December 31, 2007 and 2006. In addition, certain incentive awards granted under previous plans, if and when those awards were canceled, could be reissued under the company's existing Plans. As such, 46.7 million and 45.9 million additional awards were considered authorized to be issued under the company's existing Plans as of December 31, 2007 and 2006, respectively. There were 34.8 million and 51.6 million option awards outstanding (which were included in the total options outstanding at December 31, 2007 and 2006, respectively) under previous plans that, if and when canceled, would increase the number of authorized shares. There were 131.4 million and 131.8 million unused shares available to be granted under the Plans as of December 31, 2007 and 2006, respectively.

Under the company's long-standing practices and policies, all stock option awards are approved prior to or on the date of grant. The exercise price of at-the-money stock options is the average of the high and low market price on the date of grant. The options approval process specifies the individual receiving the grant, the number of options

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or the value of the award, the exercise price or formula for determining the exercise price and the date of grant. All option awards for senior management are approved by the Committee. All option awards for employees other than senior management are approved by senior management pursuant to a series of delegations that were approved by the Committee. The grants made pursuant to these delegations are reviewed periodically with the Committee. Options that are awarded as part of annual total compensation for senior management and other employees are made on specific cycle dates scheduled in advance. With respect to option awards given in connection with promotions or new hires, the company's policy requires approval of such awards prior to the grant date, which is typically the date of the promotion or the date of hire. The exercise price of these options is the average of the high and low market price on the date of grant.

STOCK OPTIONS

Stock options are awards which allow the employee to purchase shares of the company's stock at a fixed price. Stock options are granted at an exercise price equal to or greater than the company's stock price on the date of grant. These awards, which generally vest 25 percent per year, are fully vested four years from the date of grant and have a contractual term of 10 years. The company also has a stock-based program for its senior executives, designed to drive improved performance and increase the ownership executives have in the company. These executives have the opportunity to receive at-the-money stock options by agreeing to defer a certain percentage of their annual incentive compensation into IBM equity, where it is held for three years or until retirement. In 2005, this program was expanded to cover all executives of the company. Options under this program become fully vested three years from the date of grant and have a contractual term of 10 years.

The plan element permitting deferral of annual incentive compensation into IBM equity and receiving at-the-money stock options was terminated at December 31, 2006.

The company estimates the fair value of stock options using the Black-Scholes valuation model, consistent with the provisions of SFAS No. 123(R), "Share-Based Payment" (SFAS No. 123(R)) and SAB No. 107. Key inputs and assumptions used to estimate the fair value of stock options include the grant price of the award, the expected option term, volatility of the company's stock, the risk-free rate and the company's dividend yield. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by employees who receive equity awards, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by the company.

The fair value of each stock option grant was estimated at the date of grant using a Black-Scholes option pricing model. The following table presents the weighted-average assumptions used in the valuation and the resulting weighted-average fair value per option granted:

FOR THE YEAR ENDED DECEMBER 31:	**2007**	2006	2005
Option term (years)*	**5**	5	5
Volatility**	**23.1%**	26.2%	34.7%
Risk-free interest rate (zero coupon U.S. treasury note)	**4.5%**	4.9%	4.0%
Dividend yield	**1.4%**	1.3%	0.9%
Weighted-average fair value per option granted	**$26**	$23	$29

* *The Option term is the number of years that the company estimates, based upon history, that options will be outstanding prior to exercise or forfeiture.*

***The company's estimates of expected volatility are principally based on daily price changes of the company's stock over the expected option term, as well as the additional requirements included in the provisions of SFAS No. 123(R) and the guidance provided by SAB No. 107.*

The following table summarizes option activity under the Plans during the years ended December 31, 2007, 2006 and 2005:

	2007		2006		2005	
	WTD. AVG. EXERCISE PRICE	**NO. OF SHARES UNDER OPTION**	WTD. AVG. EXERCISE PRICE	NO. OF SHARES UNDER OPTION	WTD. AVG. EXERCISE PRICE	NO. OF SHARES UNDER OPTION
Balance at January 1	**$ 95**	**207,663,223**	$ 91	236,070,040	$ 89	249,347,906
Options granted	**103**	**1,087,381**	85	2,013,623	100	13,016,765
Options exercised	**77**	**(46,961,380)**	53	(21,685,948)	47	(11,690,186)
Options canceled/expired	**106**	**(4,127,967)**	100	(8,734,492)	97	(14,604,445)
Balance at December 31	**$100**	**157,661,257**	$ 95	207,663,223	$ 91	236,070,040
Exercisable at December 31	**$100**	**144,092,169**	$ 95	177,318,905	$ 92	176,962,180

During the year ended December 31, 2007, the company did not grant any stock options with exercise prices greater than the stock price at the date of grant. During the years ended December 31, 2006 and 2005, the company granted approximately 0.5 million and 12.5 million stock options, respectively, with exercise prices greater than the stock price at the date of grant. These stock options had weighted-average exercise prices of $91 and $100 for the years ended December 31, 2006 and 2005, respectively, and are included in the table above.

The shares under option at December 31, 2007 were in the following exercise price ranges:

	OPTIONS OUTSTANDING			
EXERCISE PRICE RANGE	WTD. AVG. EXERCISE PRICE	NUMBER OF SHARES UNDER OPTION	AGGREGATE INTRINSIC VALUE	WTD. AVG. REMAINING CONTRACTUAL LIFE (IN YEARS)
$34–$60	$ 51	3,535,698	$ 200,389,187	—*
$60–$85	77	31,399,013	987,276,354	5
$85–$105	98	64,129,462	648,821,490	5
$105 and over	117	58,597,084	37,137,467	3
	$100	157,661,257	$1,873,624,498	4

	OPTIONS EXERCISABLE			
EXERCISE PRICE RANGE	WTD. AVG. EXERCISE PRICE	NUMBER OF SHARES UNDER OPTION	AGGREGATE INTRINSIC VALUE	WTD. AVG. REMAINING CONTRACTUAL LIFE (IN YEARS)
$34–$60	$ 51	3,535,698	$ 200,389,187	—*
$60–$85	76	29,754,378	945,466,395	5
$85–$105	98	53,103,839	542,234,878	4
$105 and over	117	57,698,254	35,220,308	3
	$100	144,092,169	$1,723,310,768	4

* *Weighted average remaining contractual life is less than one year.*

In connection with various acquisition transactions, there were an additional 2.1 million options outstanding at December 31, 2007, as a result of the company's assumption of options granted by the acquired entities. The weighted-average exercise price of these options was $79 per share.

EXERCISES OF EMPLOYEE STOCK OPTIONS

The total intrinsic value of options exercised during the years ended December 31, 2007, 2006 and 2005 was $1,414 million, $727 million and $470 million, respectively. The total cash received from employees as a result of employee stock option exercises for the years ended December 31, 2007, 2006 and 2005 was approximately $3,619 million, $1,149 million and $550 million, respectively. In connection with these exercises, the tax benefits realized by the company for the years ended December 31, 2007, 2006 and 2005 were $481 million, $242 million and $148 million, respectively.

The company settles employee stock option exercises primarily with newly issued common shares and, occasionally, with treasury shares. Total treasury shares held at December 31, 2007 and 2006 were approximately 672 million and 502 million shares, respectively.

STOCK AWARDS

In addition to stock options, the company grants its employees stock awards. These awards are made in the form of Restricted Stock Units (RSUs), including Retention Restricted Stock Units (RRSUs), or Performance Stock Units (PSUs). RSUs are stock awards granted to employees that entitle the holder to shares of common stock as the award vests, typically over a two- to five-year period. The fair value of the awards is determined and fixed on the grant date based on the company's stock price. During the year ended December 31, 2006, the company modified its equity compensation plans to increase awards of RSUs compared to stock options. RSUs awarded during the year ended December 31, 2005 were not material when compared to the value of stock options awarded during that year.

The following table summarizes RSU activity under the Plans during the years ended December 31, 2007 and 2006:

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	2007		2006	
	WTD. AVG. GRANT PRICE	NUMBER OF UNITS	WTD. AVG. GRANT PRICE	NUMBER OF UNITS
Balance at January 1	**$ 84**	**10,217,258**	$83	6,813,698
RSUs granted	**104**	**4,929,141**	85	4,831,227
RSUs released	**77**	**(2,747,110)**	76	(1,037,927)
RSUs canceled/forfeited	**88**	**(511,543)**	85	(389,740)
Balance at December 31	**$ 94**	**11,887,746**	$84	10,217,258

The remaining weighted-average contractual term of RSUs at December 31, 2007 and 2006 is the same as the period over which the remaining cost of the awards will be recognized, which is approximately three years. The fair value of RSUs granted during the years ended December 31, 2007 and 2006 was $513 million and $410 million, respectively. The total fair value of RSUs vested and released during the years ended December 31, 2007 and 2006 was $213 million and $79 million. As of December 31, 2007 and 2006, there was $740 million and $501 million, respectively, of unrecognized compensation cost related to nonvested RSUs. The company received no cash from employees as a result of employee vesting and release of RSUs for the years ended December 31, 2007 and 2006.

PSUs are stock awards where the number of shares ultimately received by the employee depends on the company's performance against specified targets and typically vest over a three-year period. The fair value of each PSU is determined on the grant date, based on the company's stock price, and assumes that performance targets will be achieved. Over the performance period, the number of shares of stock that will be issued is adjusted upward or downward based upon the probability of achievement of performance targets. The ultimate number of shares issued and the related compensation cost recognized as expense will be based on a comparison of the final performance metrics to the specified targets. The fair value of PSUs granted during the years ended December 31, 2007 and 2006 was $116 million and $104 million, respectively. Total fair value of PSUs vested and released during the years ended December 31, 2007 and 2006 was $88 million and $67 million, respectively.

In connection with employee vesting and release of RSUs and PSUs, the tax benefits realized by the company for the years ended December 31, 2007 and 2006 were $133 million and $59 million, respectively.

IBM Employees Stock Purchase Plan

The company maintains an Employees Stock Purchase Plan (ESPP). The ESPP enables eligible participants to purchase full or fractional shares of IBM common stock through payroll deductions of up to 10 percent of eligible compensation. Eligible compensation includes any compensation received by the employee during the year. The ESPP provides for offering periods during which shares may be purchased and continues as long as shares remain available under the ESPP, unless terminated earlier at the discretion of the Board of Directors. Individual ESPP participants are restricted from purchasing more than $25,000 of common stock in one calendar year or 1,000 shares in an offering period.

Prior to April 1, 2005, the ESPP was considered compensatory under the provisions of SFAS No. 123(R). The share price paid by an employee prior to April 1, 2005 was the lesser of 85 percent of the average market price on the first business day of each offering period or 85 percent of the average market price on the last business day of each pay period. Effective April 1, 2005, the company modified the terms of the plan whereas eligible participants may purchase full or fractional shares of IBM common stock under the ESPP at a five-percent discount off the average market price on the day of the purchase. In accordance with the provisions of SFAS No. 123(R), effective April 1, 2005, the ESPP is not considered compensatory.

Employees purchased 4.0 million, 5.8 million and 6.7 million shares under the ESPP during the years ended December 31, 2007, 2006 and 2005, respectively. Cash dividends declared and paid by the company on its common stock also include cash dividends on the company stock purchased through the ESPP. Dividends are paid on full and fractional shares and can be reinvested in the ESPP. The company stock purchased through the ESPP is considered outstanding and is included in the weighted-average outstanding shares for purposes of computing basic and diluted earnings per share.

Approximately 16.3 million, 20.3 million and 26.2 million shares were available for purchase under the ESPP at December 31, 2007, 2006 and 2005, respectively.

Note U. Retirement-Related Benefits

Description of Plans

IBM sponsors defined benefit pension plans and defined contribution plans that cover substantially all regular employees, a supplemental retention plan that covers certain U.S. executives and nonpension postretirement benefit plans primarily consisting of retiree medical and dental benefits for eligible retirees and dependents. These benefits form an important part of the company's total compensation and benefits program that is designed to attract and retain highly skilled and talented employees.

U.S. PLANS

Defined Benefit Pension Plans

IBM Personal Pension Plan

IBM provides U.S. regular, full-time and part-time employees hired prior to January 1, 2005 with noncontributory defined benefit pension benefits via the IBM Personal Pension Plan (PPP). The PPP consists of a tax-qualified (qualified) plan and a non-tax qualified (non-qualified) plan. The qualified plan is funded by company contributions to an irrevocable trust fund, which is held for the sole benefit of participants and beneficiaries. The non-qualified plan, which is unfunded, provides benefits in excess of IRS limitations for qualified plans.

Benefits provided to the PPP participants are calculated using benefit formulas that vary based on the participant. Pension benefits are calculated using one of two methods based upon specified criteria used to determine each participant's eligibility. The first method uses a five-year, final pay formula that determines benefits based on salary, years of service, mortality and other participant-specific factors. The second method is a cash balance formula that calculates benefits using a percentage of employees' annual salary, as well as an interest crediting rate.

Benefit accruals under the PPP ceased effective January 1, 2008 for all participants.

U.S. Supplemental Executive Retention Plan

The company also sponsors a non-qualified U.S. Supplemental Executive Retention Plan (SERP). The SERP, which is unfunded, provides benefits to eligible U.S. executives based on average earnings, years of service and age at termination of employment. Effective July 1, 1999, the company replaced the then-effective SERP with the current SERP. Some participants in the previous SERP will still be eligible for benefits under that prior plan if those benefits are greater than the benefits provided under the current plan.

Benefit accruals under the SERP ceased effective January 1, 2008 for all participants.

Defined Contribution Plans

IBM Savings Plan

U.S. regular, full-time and part-time employees are eligible to participate in the IBM Savings Plan, which is a qualified defined contribution plan under section 401(k) of the Internal Revenue Code. For participants hired prior to January 1, 2005, the company matches 50 percent of their contributions up to the first 6 percent of eligible compensation. For participants hired or rehired on or after January 1, 2005, who have completed one year of service, the company matches 100 percent of their contributions up to the first 6 percent of eligible compensation. These participants participate in the 401(k) Pension Program offered through the IBM Savings Plan. The company's matching contributions vest immediately and participants are always fully vested in their own contributions. All contributions, including the company match, are made in cash, in accordance with the participants' investment elections. There are no minimum amounts that must be invested in company stock, and there are no restrictions on transferring amounts out of the company stock to another investment choice.

Effective January 1, 2008, the IBM Savings Plan, including the 401(k) Pension Program, became the IBM 401(k) Plus Plan. Under the IBM 401(k) Plus Plan, eligible employees will receive a dollar-for-dollar match of up to 6 percent of eligible compensation for employees hired prior to January 1, 2005 and up to 5 percent of eligible compensation for employees hired on or after January 1, 2005. In addition, under the IBM 401(k) Plus Plan, eligible employees will receive automatic contributions from the company equal to 1, 2 or 4 percent of employees' eligible compensation based on their eligibility to participate in the PPP as of December 31, 2007. If an employee was hired on or after January 1, 2005, the employee would be eligible to receive automatic contributions and matching contributions after the completion of one year of service.

IBM Executive Deferred Compensation Plan

The company also maintains an unfunded, non-qualified, defined contribution plan, the IBM Executive Deferred Compensation Plan (EDCP), which allows eligible executives to defer compensation and to receive company matching contributions under the applicable IBM Savings Plan formula (depending on the date of hire, as described earlier), with respect to amounts in excess of IRS limits for qualified plans. Amounts contributed to the EDCP as a result of deferred compensation, as well as company matching contributions, are recorded as liabilities. Deferred compensation amounts may be directed by participants into an account that replicates the return that would have been received had the amounts been invested in similar IBM Savings Plan investment options. The company matching contributions are directed to participant accounts and change in value each reporting period based on changes in the company's stock price.

Effective January 1, 2008, the EDCP was replaced with a new non-qualified deferred compensation plan, the IBM Excess 401(k) Plus Plan (Excess Plan). All employees whose eligible compensation is expected to exceed the IRS compensation limit are eligible to participate in the Excess Plan. The purpose of the Excess Plan is to provide benefits that would be provided under the qualified IBM 401(k) Plus Plan if the compensation limits did not apply. The Excess Plan, like the EDCP, will provide employees with the opportunity to save for retirement on a tax-deferred basis.

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Nonpension Postretirement Benefit Plan

U.S. Nonpension Postretirement Plan
The company sponsors a defined benefit nonpension postretirement benefit plan that provides medical and dental benefits to eligible U.S. retirees and eligible dependents, as well as life insurance for eligible U.S. retirees. Effective July 1, 1999, the company established a Future Health Account (FHA) for employees who were more than five years away from retirement eligibility. Employees who were within five years of retirement eligibility are covered under the company's prior retiree health benefits arrangements. Under either the FHA or the prior retiree health benefit arrangements, there is a maximum cost to the company for retiree health benefits.

Effective January 1, 2004, new hires, as of that date or later, are not eligible for company subsidized postretirement benefits.

NON-U.S. PLANS

Most subsidiaries and branches outside the United States sponsor defined benefit and/or defined contribution plans that cover substantially all regular employees. The company deposits funds under various fiduciary-type arrangements, purchases annuities under group contracts or provides reserves for these plans. Benefits under the defined benefit plans are typically based either on years of service and the employee's compensation (generally during a fixed number of years immediately before retirement) or on annual credits. The range of assumptions that are used for the non-U.S. defined benefit plans reflects the different economic environments within various countries.

In addition, certain of the company's non-U.S. subsidiaries sponsor defined benefit nonpension postretirement benefit plans that provide medical and dental benefits to eligible non-U.S. retirees and eligible dependents, as well as life insurance for certain eligible non-U.S. retirees. However, most of the non-U.S. retirees are covered by local government sponsored and administered programs.

Plan Financial Information

SUMMARY OF FINANCIAL INFORMATION

The following table presents a summary of the total retirement-related benefits net periodic cost recorded in the Consolidated Statement of Earnings:

($ in millions)

	U.S. PLANS			NON-U.S. PLANS			TOTAL		
FOR THE YEAR ENDED DECEMBER 31:	**2007**	2006	2005	**2007**	2006	2005	**2007**	2006	2005
Significant defined benefit pension plans*	**$ 368**	$ 456	$ 381	**$ 620**	$ 639	$ 729	**$ 988**	$1,095	$1,110
Other defined benefit pension plans**	**105**	93	125	**202**	85	136	**307**	178	261
SERP	**23**	20	9	**—**	—	—	**23**	20	9
Total defined benefit pension plans cost	**$ 496**	$ 569	$ 515	**$ 822**	$ 724	$ 865	**$1,318**	$1,293	$1,380
IBM Savings Plan and Non-U.S. Plans	**$ 390**	$ 358	$ 331	**$ 478**	$ 377	$ 337	**$ 868**	$ 735	$ 668
EDCP	**12**	11	10	—	—	—	**12**	11	10
Total defined contribution plans cost	**$ 402**	$ 370	$ 341	**$ 478**	$ 377	$ 337	**$ 880**	$ 747	$ 678
Nonpension postretirement benefit plans cost	**$ 342**	$ 335	$ 332	**$ 57**	$ 53	$ 47	**$ 399**	$ 388	$ 379
Total retirement-related benefits net periodic cost	**$1,240**	$1,274	$1,188	**$1,357**	$1,154	$1,249	**$2,597**	$2,428	$2,437

* *Significant defined benefit pension plans consist of the qualified portion of the PPP in the U.S. and the material non-U.S. Plans. See page 108 for a list of significant plans.*

** *Other defined benefit pension plans consist of the non-qualified portion of the PPP in the U.S. and the non-material non-U.S. plans.*

The following table presents a summary of the total projected benefit obligation (PBO) for defined benefit plans, accumulated postretirement benefit obligation (APBO) for nonpension postretirement benefit plans (benefit obligations), fair value of plan assets and the associated funded status recorded in the Consolidated Statement of Financial Position:

($ in millions)

	BENEFIT OBLIGATIONS		FAIR VALUE OF PLAN ASSETS		FUNDED STATUS**	
AT DECEMBER 31:	**2007**	2006	**2007**	2006	**2007**	2006
U.S. Plans:						
Overfunded plans:						
Qualified portion of the PPP	**$46,323**	$46,498	**$57,191**	$52,913	**$ 10,868**	$ 6,415
Underfunded plans:						
Non-qualified portion of the PPP	**$ 1,135**	$ 1,123	**$ —**	$ —	**$ (1,135)**	$ (1,123)
SERP	**215**	217	**—**	—	**(215)**	(217)
Nonpension postretirement benefit plan	**5,472**	5,773	**504**	47	**(4,968)**	(5,726)
Total underfunded U.S. Plans	**$ 6,822**	$ 7,113	**$ 504**	$ 47	**$ (6,318)**	$ (7,066)
Non-U.S. Plans*:						
Overfunded plans:						
Qualified defined benefit pension plans	**$29,031**	$25,613	**$35,504**	$29,766	**$ 6,473**	$ 4,153
Underfunded plans:						
Qualified defined benefit pension plans	**$ 6,777**	$ 9,076	**$ 5,566**	$ 7,866	**$ (1,211)**	$ (1,210)
Non-qualified defined benefit pension plans	**5,007**	4,765	**—**	—	**(5,007)**	(4,765)
Nonpension postretirement benefit plans	**851**	637	**—**	—	**(851)**	(637)
Total underfunded non-U.S. plans	**$12,635**	$14,478	**$ 5,566**	$ 7,866	**$ (7,069)**	$ (6,612)
Total overfunded plans	**$75,354**	$72,111	**$92,695**	$82,679	**$ 17,341**	$ 10,568
Total underfunded plans*	**$19,457**	$21,591	**$ 6,070**	$ 7,913	**$(13,387)**	$(13,678)

* *Excludes non-material non-U.S. defined benefit pension plans; see following section for a list of significant plans.*

** *Funded status was recognized in the Consolidated Statement of Financial Position as follows: Asset amounts as Prepaid pension assets; (Liability) amounts as Compensation and benefits (current liability) and Retirement and nonpension postretirement benefit obligations (noncurrent liability).*

DEFINED BENEFIT PENSION AND NONPENSION POSTRETIREMENT BENEFIT PLAN FINANCIAL INFORMATION

The following represents financial information for the company's significant retirement-related benefit plans. The significant defined benefit pension plans consist of the qualified portion of the PPP in the U.S. and material non-U.S. pension plans, including plans in Germany, the United Kingdom, Japan, the Netherlands, Canada, Switzerland and Spain. The significant nonpension postretirement benefit plan represents the U.S. nonpension postretirement benefit plan.

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The following table presents the components of net periodic cost of the significant retirement-related benefit plans recognized in Consolidated Statement of Earnings:

($ in millions)

	SIGNIFICANT DEFINED BENEFIT PENSION PLANS						NONPENSION POSTRETIREMENT BENEFIT PLAN		
	U.S. PLAN			NON-U.S. PLANS			U.S. PLAN		
FOR THE YEAR ENDED DECEMBER 31:	**2007**	2006	2005	**2007**	2006	2005	**2007**	2006	2005
Service cost	**$ 746**	$ 769	$ 682	**$ 570**	$ 596	$ 694	**$ 69**	$ 62	$ 45
Interest cost	**2,585**	2,454	2,463	**1,767**	1,585	1,635	**311**	306	324
Expected return on plan assets	**(3,703)**	(3,613)	(3,672)	**(2,500)**	(2,298)	(2,245)	**—**	—	—
Amortization of transition assets	**—**	—	—	**(3)**	(6)	(6)	**—**	—	—
Amortization of prior service costs/(credits)	**61**	61	61	**(125)**	(108)	8	**(62)**	(62)	(62)
Recognized actuarial losses	**679**	785	567	**911**	870	578	**24**	29	25
Plan amendments/curtailments/settlements	**—**	—	280	**—**	—	65	**—**	—	—
Total net periodic cost	**$ 368**	$ 456	$ 381	**$ 620**	$ 639	$ 729	**$342**	$335	$332

The following table presents the changes in benefit obligations and plan assets of the significant retirement-related benefit plans:

($ in millions)

	SIGNIFICANT DEFINED BENEFIT PENSION PLANS				NONPENSION POSTRETIREMENT BENEFIT PLAN	
	U.S. PLAN		NON-U.S. PLANS		U.S. PLAN	
	2007	2006	**2007**	2006	**2007**	2006
Change in benefit obligation:						
Benefit obligation at beginning of year	**$46,498**	$46,405	**$39,454**	$36,643	**$ 5,773**	$ 5,892
Service cost	**746**	769	**570**	596	**69**	62
Interest cost	**2,585**	2,454	**1,767**	1,585	**311**	306
Plan participants' contributions	**—**	—	**66**	57	**—**	—
Acquisitions/divestitures, net	**5**	—	**85**	10	**—**	—
Actuarial losses/(gains)	**(465)**	(283)	**(2,324)**	(600)	**(203)**	8
Benefits paid from trust	**(3,046)**	(2,847)	**(1,616)**	(1,454)	**—**	—
Direct benefit payments	**—**	—	**(367)**	(311)	**(442)**	(486)
Foreign exchange impact	**—**	—	**3,177**	3,616	**—**	—
Medicare subsidy	**—**	—	**—**	—	**(36)**	(9)
Plan amendments/curtailments/settlements	**—**	—	**3**	(688)	**—**	—
Benefit obligation at end of year	**$46,323**	$46,498	**$40,815**	$39,454	**$ 5,472**	$ 5,773
Change in plan assets:						
Fair value of plan assets at beginning of year	**$52,913**	$48,542	**$37,632**	$31,148	**$ 47**	$ 66
Actual return on plan assets	**7,324**	7,218	**1,468**	3,016	**15**	3
Employer contributions	**—**	—	**447**	1,769	**893**	438
Acquisitions/divestitures, net	**—**	—	**52**	(78)	**—**	—
Plan participants' contributions	**—**	—	**66**	57	**199**	185
Benefits paid from trust	**(3,046)**	(2,847)	**(1,616)**	(1,454)	**(650)**	(645)
Foreign exchange impact	**—**	—	**3,021**	3,174	**—**	—
Fair value of plan assets at end of year	**$57,191**	$52,913	**$41,070**	$37,632	**$ 504**	$ 47
Funded status at end of year	**$10,868**	$ 6,415	**$ 255**	$ (1,822)	**$(4,968)**	$(5,726)
Accumulated benefit obligation	**$46,323**	$46,421	**$39,396**	$38,088	**N/A**	N/A

N/A—Not applicable

The following table presents the funded status recognized in the Consolidated Statement of Financial Position for the company's significant retirement-related benefit plans:

($ in millions)

	Significant Defined Benefit Pension Plans				Nonpension Postretirement Benefit Plan	
	U.S. Plan		Non-U.S. Plans		U.S. Plan	
At December 31:	**2007**	2006	**2007**	2006	**2007**	2006
Prepaid pension assets	**$10,868**	$6,415	**$ 6,473**	$ 4,153	**$ —**	$ —
Current liabilities, Compensation and benefits	**—**	—	**(304)**	(269)	**—**	(487)
Noncurrent liabilities, Retirement and nonpension postretirement benefit obligations	**—**	—	**(5,914)**	(5,706)	**(4,968)**	(5,239)
Funded status—net	**$10,868**	$6,415	**$ 255**	$(1,822)	**$(4,968)**	$(5,726)

The following table presents the pre-tax net loss and prior service costs/(credits) recognized in Gains and (losses) not affecting retained earnings and the changes in pre-tax net loss, prior service costs/(credits) and transition assets recognized in Accumulated gains and (losses) not affecting retained earnings for the company's significant retirement-related benefit plans:

($ in millions)

	Significant Defined Benefit Pension Plans		Nonpension Postretirement Benefit Plan
For the year ended December 31, 2007:	U.S. Plan	Non-U.S. Plans	U.S. Plan
Net loss at January 1	$ 6,944	$11,298	$ 935
Current period net gain	(4,086)	(1,337)	(254)
Amortization of net loss included in net periodic cost	(679)	(911)	(24)
Net loss at December 31	$ 2,179	$ 9,050	$ 657
Prior service costs/(credits) at January 1	$ 61	$ (1,269)	$(177)
Current period prior service costs	—	51	—
Amortization of prior service (costs)/credits included in net periodic cost	(61)	125	62
Prior service credits at December 31	$ —	$ (1,093)	$(115)
Transition assets at January 1	$ —	$ (4)	$ —
Amortization of transition assets included in net periodic cost	—	3	—
Transition assets at December 31	$ —	$ (1)	$ —
Total recognized in Accumulated gains and (losses) not affecting retained earnings*	$ 2,179	$ 7,956	$ 542

* *See note M, "Stockholders' Equity Activity," on page 93 for the total net-of-tax change in the Accumulated gains and (losses) not affecting retained earnings and the Consolidated Statement of Stockholders' Equity for components of net periodic cost, including the related tax effects, recognized in Gains and (losses) not affecting retained earnings for the company's retirement-related benefit plans.*

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The following table presents the estimated net loss, estimated prior service credits and estimated transition assets of the company's significant retirement-related benefit plans that will be amortized from Accumulated gains and (losses) not affecting retained earnings into net periodic cost/(income) and recorded in the Consolidated Statement of Earnings in 2008:

($ in millions)

	SIGNIFICANT DEFINED BENEFIT PENSION PLANS		POSTRETIREMENT BENEFIT PLAN
	U.S. PLAN	NON-U.S. PLANS	U.S. PLAN
Net loss	$281	$ 600	$ 10
Prior service credits	—	(134)	(62)
Transition assets	—	1	—

No significant amendments of the U.S. retirement-related benefit plans or significant non-U.S. defined benefit pension plans occurred during the years ended December 31, 2007, 2006 and 2005 that would have a material effect on the Consolidated Statement of Earnings.

In 2006, the company redesigned certain non-U.S. defined benefit pension plans that resulted in a reduction to the PBO of $688 million. The majority of the reduction was attributed to modified plans in the United Kingdom, Switzerland and the Netherlands.

In December 2005, the company approved amendments to the PPP and the SERP, which provided that participants would no longer accrue benefits under these plans beginning January 1, 2008, resulting in a curtailment charge of $267 million that was recorded in the Consolidated Statement of Earnings for the year ended December 31, 2005.

ASSUMPTIONS USED TO DETERMINE PLAN FINANCIAL INFORMATION

Underlying both the measurement of benefit obligations and net periodic cost are actuarial valuations. These valuations use participant-specific information such as salary, age and years of service, as well as certain assumptions, the most significant of which include estimates of discount rates, expected return on plan assets, rate of compensation increases, interest crediting rates and mortality rates. The company evaluates these assumptions, at a minimum, annually, and makes changes as necessary.

The following table presents the assumptions used to measure the net periodic cost and the year-end benefit obligations for significant retirement-related benefit plans:

	SIGNIFICANT DEFINED BENEFIT PENSION PLANS						NONPENSION POSTRETIREMENT BENEFIT PLAN		
	U.S. PLAN			NON-U.S. PLANS			U.S. PLAN		
	2007	2006	2005	**2007**	2006	2005	**2007**	2006	2005
Weighted-average assumptions used to measure net periodic cost for the year ended December 31:									
Discount rate	**5.75%**	5.50%	5.75%	**4.40%**	4.20%	4.70%	**5.75%**	5.50%	5.75%
Expected long-term return on plan assets	**8.00%**	8.00%	8.00%	**7.00%**	7.10%	7.10%	**N/A**	N/A	N/A
Rate of compensation increase	**4.00%**	4.00%	4.00%	**2.90%**	3.00%	3.00%	**N/A**	N/A	N/A
Weighted-average assumptions used to measure benefit obligations at December 31:									
Discount rate	**6.00%**	5.75%	5.50%	**5.40%**	4.40%	4.20%	**6.00%**	5.75%	5.50%
Rate of compensation increase*	**N/A**	4.00%	4.00%	**3.00%**	2.90%	3.00%	**N/A**	N/A	N/A

** Rate of compensation increase is not applicable to the PPP as benefit accruals ceased for all participants beginning January 1, 2008.*

N/A—Not applicable

Discount Rate

The discount rate assumptions used for the retirement-related benefit plans accounting reflect the yields available on high-quality, fixed income debt instruments. For the U.S. discount rate assumptions, a portfolio of corporate bonds is constructed with maturities that match the expected timing of the benefit obligation payments. In the non-U.S., where markets for high-quality long-term bonds are not generally as well developed, long-term government bonds are used as a base, to which a credit spread is added to simulate corporate bond yields at these maturities in the jurisdiction of each plan, as the benchmark for developing the respective discount rates.

For the PPP, the changes in discount rate assumptions impacted both net periodic cost and the PBO. For purposes of measuring the net periodic cost for the years ended December 31, 2007, 2006 and 2005, the changes in discount rate assumptions resulted in a decrease in the 2007 net periodic cost of $92 million and an increase in the 2006 and 2005 net periodic cost of $94 million and $90 million, respectively. For purposes of measuring the PBO, the changes in discount rate assumptions resulted in a decrease in the PBO of $1,185 million and $1,240 million at December 31, 2007 and 2006, respectively.

For the significant non-U.S. defined benefit pension plans, the changes in discount rate assumptions resulted in an increase in the 2007 and 2006 net periodic cost of $30 million and $274 million, respectively. Changes in discount rate assumptions had no material impact on the 2005 net periodic cost.

For the U.S. nonpension postretirement benefit plan, the changes in discount rate assumptions had no material impact on net periodic cost for the years ended December 31, 2007, 2006 and 2005 and on the APBO at December 31, 2007 and 2006.

Expected Long-Term Returns on Plan Assets

The expected long-term return on plan assets assumption takes into account long-term expectations for future returns, investment strategy and the market-related value of plan assets. The market-related value of plan assets is a calculated value, in accordance with accounting guidance, that recognizes changes in the fair value of plan assets in a systematic manner over five years. The rates of expected return are developed by the company in conjunction with external advisors, are calculated using an arithmetic average and are tested for reasonableness against the historical return average by asset category, usually over a 10-year period. The use of expected long-term returns on plan assets may result in recognized pension income that is greater or less than the actual returns of those plan assets in any given year. Over time, however, the expected long-term returns are designed to approximate the actual long-term returns and therefore result in a pattern of income and expense recognition that more closely matches the pattern of the services provided by the employees. Differences between actual and expected returns are recognized over five years in the expected return on plan assets line in net periodic cost and also as a component of net loss or gain in the Accumulated gains and (losses) not affecting retained earnings, which is recognized over the service lives of the employees in the plan, provided such amounts exceed thresholds which are based upon the obligation or the value of plan assets, as provided by accounting standards.

For the PPP, the expected long-term return on plan assets of 8.00 percent remained constant for the years ended December 31, 2007, 2006 and 2005 and, consequently, had no incremental impact on net periodic cost.

For the material non-U.S. defined benefit pension plans, the changes in the expected long-term return on plan assets resulted in an increase in the 2007, 2006 and 2005 net periodic cost of $50 million, $18 million and $140 million, respectively.

For the U.S. nonpension postretirement benefit plan, the company maintains a nominal, highly liquid trust fund balance to ensure payments are made timely. As a result, for the years ended December 31, 2007, 2006 and 2005, the expected long-term return on plan assets and the actual return on those assets were not material.

Rate of Compensation Increases and Mortality Rate

The rate of compensation increases is determined by the company, based upon its long-term plans for such increases. Mortality rate assumptions are based on life expectancy and death rates for different types of participants. Mortality rates are periodically updated based on actual experience. Changes to defined benefit pension plans mortality rate assumptions increased the 2007 and 2006 net periodic cost approximately $80 million and $55 million, respectively, and increased the 2007 benefit obligation approximately $790 million. Changes to the rate of compensation increases had no material impact on the 2007 net periodic cost and reduced the 2006 net periodic cost approximately $32 million. Changes to the rate of compensation increases or to mortality rate assumptions had no material impact on the 2005 net periodic cost and on benefit obligations at December 31, 2006.

Interest Crediting Rate

Benefits for certain participants in the PPP are calculated using a cash balance formula. An assumption underlying this formula is an interest crediting rate, which impacts both net periodic cost and the PBO. This assumption provides a basis for projecting the expected interest rate that participants will earn on the benefits that they are expected to receive in the following year and is based on the average from August to October of the one-year U.S. Treasury Constant Maturity yield plus one percent.

For the PPP, the change in the interest crediting rate to 6.0 percent for the year ended December 31, 2007 from 5.0 percent for the year ended December 31, 2006 resulted in an increase in the 2007 net periodic cost of $125 million. The change in the interest crediting rate to 5.0 percent for the year ended December 31, 2006 from 3.1 percent for the year ended December 31, 2005 resulted in an increase in the 2006 net periodic cost of $170 million. The change in the interest crediting rate to 3.1 percent for the year ended December 31, 2005 from 2.3 percent for the year ended December 31, 2004 resulted in an increase in the 2005 net periodic cost of $55 million.

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Healthcare Cost Trend Rate

For nonpension postretirement benefit plan accounting, the company reviews external data and its own historical trends for healthcare costs to determine the healthcare cost trend rates. However, the healthcare cost trend rate has an insignificant effect on plan costs and obligations as a result of the terms of the plan which limit the company's obligation to the participants. The company assumes that the healthcare cost trend rate for 2008 will be 8 percent. In addition, the company assumes that the same trend rate will decrease to 5 percent over the next six years. A one percentage point increase or decrease in the assumed healthcare cost trend rate would not have a material effect on the 2007, 2006 and 2005 net periodic cost or the benefit obligations as of December 31, 2007 and 2006.

PLAN ASSETS

Defined Benefit Pension Plans

The company's defined benefit pension plans' asset allocations at December 31, 2007 and 2006 and target allocation for 2008, by asset category, are as follows:

U.S. Plan (Actual Allocations)

	PLAN ASSETS AT DECEMBER 31:		2008 TARGET ALLOCATION
	2007	2006	
Asset Category:			
Equity securities*	**46.9%**	63.9%	47%
Debt securities	**44.6**	31.2	43
Real Estate*	**5.4**	3.9	4
Other	**3.1**	1.0	6
Total	**100.0%**	100.0%	100%

* *See the following discussion regarding certain private market assets, and future funding commitments thereof, that are not as liquid as the publicly traded securities.*

Material Non-U.S. Plans (Weighted-Average)

	PLAN ASSETS AT DECEMBER 31:		2008 TARGET ALLOCATION
	2007	2006	
Asset Category:			
Equity securities	**58.0%**	62.7%	57%
Debt securities	**37.8**	34.8	39
Real estate	**1.9**	2.1	2
Other	**2.3**	0.4	2
Total	**100.0%**	100.0%	100%

The investment objectives of the PPP portfolio are designed to generate returns that will enable the PPP to meet its future obligations. The precise amount for which these obligations will be settled depends on future events, including the retirement dates and life expectancy of the plans' participants. The obligations are estimated using actuarial assumptions, based on the current economic environment. The PPP portfolio's investment strategy balances the requirement to generate returns, using potentially higher yielding assets such as equity securities, with the need to control risk in the PPP portfolio with less volatile assets, such as fixed-income securities. Risks include, among others, inflation, volatility in equity values and changes in interest rates that could cause the plans to become underfunded, thereby increasing their dependence on contributions from the company. Within each asset class, careful consideration is given to balancing the portfolio among industry sectors, geographies, interest rate sensitivity, dependence on economic growth, currency and other factors that affect investment returns. During 2007, the company modified the asset allocation of the PPP portfolio primarily by reducing public equity securities, by increasing debt securities from 33 percent to 43 percent of total plan assets, and by increasing the duration of debt securities and increasing the use of derivatives, including interest rate swaps in debt securities to further mitigate the effects of future interest rate changes on the overfunded level of the PPP. These changes were designed to reduce the potential negative impact that equity markets or interest rates might have on the funded status of the PPP. These changes did not impact the expected long-term return on plan assets assumption, which remained at 8.00 percent for 2008. The effect on expected long-term return on plan assets of increasing the duration of debt securities substantially offset the effect of reducing public equity securities. Derivatives are also used to hedge currency, adjust portfolio duration and reduce specific market risks.

The assets are managed by professional investment firms, as well as by investment professionals who are employees of the company. They are bound by mandates and are measured against specific benchmarks. Among these managers, consideration is given, but not limited to, balancing security concentration, issuer concentration, investment style and reliance on particular active and passive investment strategies. Market liquidity risks are tightly controlled, with only a modest percentage of the PPP portfolio invested in private market assets consisting of private equities and private real estate investments, which are less liquid than publicly traded securities. The PPP portfolio included private market assets comprising approximately 12.0 percent and 10.2 percent of total assets at December 31, 2007 and 2006, respectively. The target allocation for private market assets in 2008 is 12.0 percent. As of December 31, 2007, the PPP portfolio had $3,621 million in commitments for future private market investments to be made over a number of years. These commitments are expected to be funded from plan assets. Other assets in the PPP portfolio include commodities and non-traditional investments designed to further diversify the returns of the PPP portfolio.

Equity securities include IBM common stock of $111 million, representing 0.2 percent of total PPP plan assets at December 31, 2007 and $159 million, representing 0.3 percent of total PPP plan assets at December 31, 2006.

Outside the U.S., the investment objectives are similar, subject to local regulations. In some countries, a higher percentage allocation to fixed income securities is required. In others, the responsibility for managing the investments typically lies with a board that may include up to 50 percent of members elected by employees and retirees. This can result in slight differences compared with the strategies previously described. Generally, these non-U.S. funds do not invest in illiquid assets and their use of derivatives is usually limited to currency hedging, adjusting portfolio durations and reducing specific market risks. There was no significant change in the investment strategies of these plans during either 2007 or 2006.

EXPECTED CONTRIBUTIONS

Defined Benefit Pension Plans

It is the company's general practice to fund amounts for pensions sufficient to meet the minimum requirements set forth in applicable employee benefits laws and local tax laws. From time to time, the company contributes additional amounts as it deems appropriate.

The company contributed approximately $447 million and $1,769 million in cash to the material non-U.S. plans during the years ended December 31, 2007 and 2006, respectively.

In 2008, the company is not legally required to make any contributions to the PPP. However, depending on market conditions, or other factors, the company may elect to make discretionary contributions to the qualified portion of the PPP during the year.

The Pension Protection Act of 2006 (the Act), enacted into law in 2006, is a comprehensive reform package that, among other provisions, increases pension funding requirements for certain U.S. defined benefit plans, provides guidelines for measuring pension plan assets and pension obligations for funding purposes and raises tax deduction limits for contributions to retirement-related benefit plans. The additional funding requirements by the Act apply to plan years beginning after December 31, 2007. The adoption of the Act is not expected to have a material effect on the company's minimum mandatory contributions to its PPP. No mandatory contribution is required for the PPP in 2008.

In 2008, the company estimates contributions to its non-U.S. plans to be approximately $613 million, which will be mainly contributed to defined benefit pension plans in Japan, the Netherlands, Spain, Switzerland, Sweden and the United Kingdom. These 2008 contributions represent the legally mandated minimum contributions. The company could elect to contribute more than the legally mandated amount based on market conditions or other factors.

Nonpension Postretirement Benefit Plan

The company made a $500 million voluntary cash contribution to the U.S. nonpension postretirement benefit plan during the year ended December 31, 2007. This advanced funding was made in addition to ongoing contributions of $347 million for the year ended December 31, 2007, which were utilized to pay current year benefits. The $500 million contribution will be used to fund benefit payments in future periods.

EXPECTED BENEFIT PAYMENTS

Defined Benefit Pension Plan Expected Payments

The following table presents the total expected benefit payments to defined benefit pension plan participants. These payments have been estimated based on the same assumptions used to measure the plans' PBO at December 31, 2007 and include benefits attributable to estimated future compensation increases.

($ in millions)

	QUALIFIED U.S. PLAN PAYMENTS	NON-QUALIFIED U.S. PLAN PAYMENTS	QUALIFIED NON-U.S. PLANS PAYMENTS	NON-QUALIFIED NON-U.S. PLANS PAYMENTS	TOTAL EXPECTED BENEFIT PAYMENTS
2008	$ 3,138	$ 81	$ 1,765	$ 359	$ 5,343
2009	3,188	83	1,815	354	5,440
2010	3,237	86	1,834	356	5,513
2011	3,273	90	1,882	357	5,602
2012	3,314	93	1,922	359	5,688
2013–2017	17,108	500	10,260	1,881	29,749

The 2008 expected benefit payments to defined benefit pension plan participants not covered by the respective plan assets (underfunded plans) represent a component of Compensation and benefits, within Current liabilities, in the Consolidated Statement of Financial Position.

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Nonpension Postretirement Benefit Plan Expected Payments

The following table reflects the total expected benefit payments to nonpension postretirement benefit plan participants, as well as the expected receipt of the company's share of the Medicare subsidy described below. These payments have been estimated based on the same assumptions used to measure the plan's APBO at December 31, 2007.

($ in millions)

	U.S. PLAN PAYMENTS	LESS: IBM SHARE OF EXPECTED MEDICARE SUBSIDY	NET EXPECTED BENEFIT PAYMENTS
2008	$ 499	$34	$ 465
2009	488	38	450
2010	476	41	435
2011	466	43	423
2012	457	—	457
2013–2017	2,280	—	2,280

The 2008 expected benefit payments to nonpension postretirement benefit plan participants represents a component of Retirement and nonpension postretirement benefit obligation in the Consolidated Statement of Financial Position.

Medicare Prescription Drug Act

In connection with the Medicare Prescription Drug Improvement and Modernization Act of 2003, the company is expected to continue to receive a federal subsidy of approximately $267 million to subsidize the prescription drug coverage provided by the U.S. nonpension postretirement benefit plan, which is expected to extend until 2011. Approximately $156 million of the subsidy will be used by the company to reduce its obligation and cost related to the U.S. nonpension postretirement benefit plan. The company will contribute the remaining subsidy of $111 million to the plan in order to reduce contributions required by the participants. The company received a total subsidy of $46 million and $27 million during the years ended December 31, 2007 and 2006, respectively, which was utilized to reduce the company contributions for prescription drug-related coverage.

The company has included the impact of its portion of the subsidy in the determination of net periodic cost and APBO for the U.S. nonpension postretirement benefit plan at and for the years ended December 31, 2007 and 2006. The impact of the subsidy resulted in a reduction in APBO of approximately $139 million and $154 million at December 31, 2007 and 2006, respectively. The impact of the subsidy resulted in a reduction in the 2007 and 2006 net periodic cost of $36 million and $40 million, respectively. The subsidy had no impact on the 2005 net periodic cost.

Implementation of SFAS No. 158

As highlighted in note B, "Accounting Changes," on page 75, effective December 31, 2006, the company adopted the provisions of SFAS No. 158. In note A, "Significant Accounting Policies," on pages 69 and 70, the requirements of SFAS No. 158 are discussed in detail. The following table presents the incremental effect of applying SFAS No. 158 on the Consolidated Statement of Financial Position at December 31, 2006:

($ in millions)

	BEFORE APPLICATION OF SFAS NO. 158	ADJUSTMENTS*	AFTER APPLICATION OF SFAS NO. 158
Prepaid pension assets	$ 24,003	$(13,374)	$ 10,629
Investments and sundry assets (deferred taxes)	$ 4,245	$ 4,136	$ 8,381
Total Assets	$112,473	$ (9,240)	$103,234
Current liabilities:			
Compensation and benefits	$ 3,605	$ 990	$ 4,595
Noncurrent liabilities:			
Retirement and nonpension postretirement obligations	$ 12,888	$ 665	$ 13,553
Other liabilities (deferred taxes)	$ 8,701	$ (1,397)	$ 7,304
Total Liabilities	$ 74,470	$ 258	$ 74,728
Accumulated gains and (losses) not affecting retained earnings, net of tax	$ 597	$ (9,498)	$ (8,901)
Total Stockholders' equity	$ 38,004	$ (9,498)	$ 28,506

* *Adjustments are primarily comprised of previously unrecognized gains/(losses), prior service credits/(costs) and transition assets/(obligations).*

At December 31, 2006, the company recorded prior service credits/(costs), net gains/(losses) and transition assets/(obligations) in the Stockholders' equity section of the Consolidated Statement of Financial Position, net of tax, of $871 million, $(10,371) million and $2 million, respectively.

In addition, the minimum pension liability of $2,348 million was eliminated upon the adoption of SFAS No. 158.

Other Plan Information

The following table presents information for significant defined benefit pension plans with accumulated benefit obligations (ABO) in excess of plan assets. For a more detailed presentation of the funded status of the company's significant defined benefit pension plans, see table on page 109.

($ in millions)

	2007		2006	
AT DECEMBER 31:	BENEFIT OBLIGATION	PLAN ASSETS	BENEFIT OBLIGATION	PLAN ASSETS
Plans with PBO in excess of plan assets	**$13,134**	**$ 5,566**	$15,181	$ 7,866
Plans with ABO in excess of plan assets	**12,776**	**5,566**	14,027	7,093
Plans with assets in excess of PBO	**75,354**	**92,695**	72,111	82,679

Note V. Segment Information

The company uses business insight and its broad range of IT capabilities to create client- and industry-specific information solutions. The company operates primarily in a single industry using several segments that create value by offering solutions that include, either singularly or in some combination, services, software, hardware and financing.

The company's major operations comprise a Global Technology Services segment; a Global Business Services segment; a Software segment; a predominantly hardware product segment—Systems and Technology; and a Global Financing segment. The segments represent components of the company for which separate financial information is available that is utilized on a regular basis by the chief executive officer in determining how to allocate the company's resources and evaluate performance. The segments are determined based on several factors, including client base, homogeneity of products, technology, delivery channels and similar economic characteristics.

Information about each segment's business and the products and services that generate each segment's revenue is located in the "Description of Business" section of the Management Discussion on pages 19 and 20, and "Segment Details," on pages 23 to 27.

In the second quarter of 2005, the company sold its Personal Computing business which was previously a part of the Personal Systems Group. The two remaining units of the Personal Systems Group, Retail Store Solutions and Printing Systems, were combined with the Systems and Technology segment. Personal Computing Division financial results are displayed as part of the segment disclosures for 2005, in a manner consistent with the segment disclosures.

Segment revenue and pre-tax income include transactions between the segments that are intended to reflect an arm's-length transfer price. Hardware and software that is used by the Global Technology Services segment in outsourcing engagements is primarily sourced internally from the Systems and Technology and Software segments. For the internal use of IT services, Global Technology Services and Global Business Services recover cost, as well as a reasonable fee, reflecting the arm's-length value of providing the services. The Global Services segments enter into arm's-length leases and loans at prices equivalent to market rates with the Global Financing segment to facilitate the acquisition of equipment used in services engagements. All internal transaction prices are reviewed annually, and reset if appropriate.

The company utilizes globally integrated support organizations to realize economies of scale and efficient use of resources. As a result, a considerable amount of expense is shared by all of the segments. This expense represents sales coverage, marketing and support functions such as Accounting, Treasury, Procurement, Legal, Human Resources and Billing and Collections. Where practical, shared expenses are allocated based on measurable drivers of expense, e.g., headcount. When a clear and measurable driver cannot be identified, shared expenses are allocated on a financial basis that is consistent with the company's management system; e.g., advertising is allocated based on the gross profits of the segments. The unallocated corporate amounts arising from certain divestitures, indirect infrastructure reductions, miscellaneous tax items and the unallocated corporate expense pool are recorded in Net income but are not allocated to the segments.

The following tables reflect the results of continuing operations of the segments and the Personal Computing Division consistent with the company's management system. These results are not necessarily a depiction that is in conformity with GAAP; e.g., employee retirement plan costs are developed using actuarial assumptions on a country-by-country basis and allocated to the segments based on headcount. Different amounts could result if actuarial assumptions that are unique to the segment were used. Performance measurement is based on income before income taxes (pre-tax income). These results are used, in part, by management, both in evaluating the performance of, and in allocating resources to, each of the segments.

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Management System Segment View

($ in millions)

FOR THE YEAR ENDED DECEMBER 31:	GLOBAL SERVICES SEGMENTS: GLOBAL TECHNOLOGY SERVICES	GLOBAL SERVICES SEGMENTS: GLOBAL BUSINESS SERVICES	SYSTEMS AND TECHNOLOGY	SOFTWARE	GLOBAL FINANCING	PERSONAL COMPUTING DIVISION	TOTAL SEGMENTS
2007:							
External revenue	**$36,103**	**$18,041**	**$21,317**	**$19,982**	**$2,502**	**$ —**	**$ 97,944**
Internal revenue	**1,636**	**1,193**	**998**	**2,416**	**1,482**	**—**	**7,726**
Total revenue	**$37,739**	**$19,234**	**$22,315**	**$22,398**	**$3,984**	**$ —**	**$105,670**
Pre-tax income	**$ 3,557**	**$ 2,064**	**$ 2,153**	**$ 6,002**	**$1,386**	**$ —**	**$ 15,163**
Revenue year-to-year change	**10.7%**	**10.9%**	**(3.6)%**	**9.7%**	**2.4%**	**—**	**6.9%**
Pre-tax income year-to-year change	**8.2%**	**21.0%**	**23.8%**	**9.3%**	**(4.7)%**	**—**	**10.8%**
Pre-tax income margin	**9.4%**	**10.7%**	**9.6%**	**26.8%**	**34.8%**	**—**	**14.3%**
2006:							
External revenue	$32,322	$15,969	$21,970	$18,161	$2,365	$ —	$ 90,787
Internal revenue	1,763	1,373	1,168	2,249	1,527	—	8,080
Total revenue	$34,086	$17,341	$23,138	$20,409	$3,892	$ —	$ 98,867
Pre-tax income	$ 3,288	$ 1,706	$ 1,739	$ 5,493	$1,455	$ —	$ 13,682
Revenue year-to-year change	1.4%	0.6%	4.7%	8.5%	(0.4)%	NM	0.3%
Pre-tax income year-to-year change	25.6%	116.9%	(7.6)%	14.9%	(8.1)%	NM	19.1%
Pre-tax income margin	9.6%	9.8%	7.5%	26.9%	37.4%	NM	13.8%
2005:							
External revenue	$31,501	$15,906	$20,981	$16,830	$2,401	$2,876	$ 90,495
Internal revenue	2,102	1,339	1,118	1,979	1,506	33	8,077
Total revenue	$33,603	$17,245	$22,099	$18,809	$3,907	$2,909	$ 98,572
Pre-tax income/(loss)	$ 2,619	$ 786	$ 1,883	$ 4,779	$1,583	$ (165)	$ 11,485
Revenue year-to-year change	3.5%	(1.9)%	4.9%	4.8%	0.3%	NM	(5.0)%
Pre-tax income year-to-year change	(10.9)%	(28.9)%	(7.9)%	19.1%	8.6%	NM	(0.6)%
Pre-tax income margin	7.8%	4.6%	8.5%	25.4%	40.5%	NM	11.7%

NM—Not meaningful

RECONCILIATIONS OF IBM AS REPORTED

($ in millions)

FOR THE YEAR ENDED DECEMBER 31:	2007	2006	2005
Revenue:			
Total reportable segments	**$105,670**	$98,867	$98,572
Other revenue and adjustments	**842**	637	639
Elimination of internal revenue	**(7,726)**	(8,080)	(8,077)
Total IBM consolidated revenue	**$ 98,786**	$91,424	$91,134

($ in millions)

FOR THE YEAR ENDED DECEMBER 31:	2007	2006	2005
Pre-Tax Income:			
Total reportable segments	**$15,163**	$13,682	$11,485
Elimination of internal transactions	**(194)**	(171)	(168)
Unallocated corporate amounts	**(480)**	(194)	909
Total IBM consolidated pre-tax income from continuing operations	**$14,489**	$13,317	$12,226

Within pre-tax income from continuing operations, unallocated corporate amounts in 2007 include the gain from the divestiture of the printing business and the interest expense associated with the incremental debt to support the ASR; 2005 includes the gain from the sale of the Personal Computing business to Lenovo, the impact of the legal settlement with Microsoft Corporation, pension curtailment related charges and unallocated charges related to the restructuring actions.

Immaterial Items

INVESTMENT IN EQUITY ALLIANCES AND EQUITY ALLIANCES GAINS/(LOSSES)

The investments in equity alliances and the resulting gains and (losses) from these investments that are attributable to the segments did not have a material effect on the financial position or the financial results of the segments.

Segment Assets and Other Items

Global Technology Services assets are primarily accounts receivable, plant, property and equipment including those associated with the segment's outsourcing business, goodwill, acquired intangible assets, deferred services arrangement transition costs and maintenance parts inventory. Global Business Services assets are primarily goodwill and accounts receivable. Software segment assets are mainly goodwill, intangible assets and accounts receivable. Systems and Technology assets are primarily plant, property and equipment, manufacturing inventory and accounts receivable. The assets of the Global Financing segment are primarily financing receivables and fixed assets under operating leases.

To accomplish the efficient use of the company's space and equipment, it usually is necessary for several segments to share plant, property and equipment assets. Where assets are shared, landlord ownership of the assets is assigned to one segment and is not allocated to each user segment. This is consistent with the company's management system and is reflected accordingly in the table below. In those cases, there will not be a precise correlation between segment pre-tax income and segment assets.

Similarly, the depreciation amounts reported by each segment are based on the assigned landlord ownership and may not be consistent with the amounts that are included in the segments' pre-tax income. The amounts that are included in pre-tax income reflect occupancy charges from the landlord segment and are not specifically identified by the management reporting system. Capital expenditures that are reported by each segment also are consistent with the landlord ownership basis of asset assignment.

The Global Financing segment amounts for Interest income and Interest expense reflect the interest income and interest expense associated with the Global Financing business, including the intercompany financing activities discussed on page 51, as well as the income from investment in cash and marketable securities. The explanation of the difference between Cost of Financing and Interest expense for segment presentation versus presentation in the Consolidated Statement of Earnings is included on page 54 of the Management Discussion.

Management System Segment View

($ in millions)

	GLOBAL SERVICES SEGMENTS						
FOR THE YEAR ENDED DECEMBER 31:	GLOBAL TECHNOLOGY SERVICES	GLOBAL BUSINESS SERVICES	SYSTEMS AND TECHNOLOGY	SOFTWARE	GLOBAL FINANCING	PERSONAL COMPUTING DIVISION	TOTAL SEGMENTS
2007:							
Assets	**$16,157**	**$7,226**	**$7,338**	**$10,042**	**$37,586**	**$—**	**$78,348**
Depreciation/amortization of intangibles	**1,714**	**122**	**894**	**684**	**2,034**	**—**	**5,448**
Capital expenditures/investments in intangibles	**1,803**	**61**	**840**	**559**	**2,432**	**—**	**5,694**
Interest income	**—**	**—**	**—**	**—**	**2,421**	**—**	**2,421**
Interest expense	**—**	**—**	**—**	**—**	**966**	**—**	**966**
2006:							
Assets	$14,483	$6,517	$7,437*	$ 9,262	$33,945	$—	$71,643*
Depreciation/amortization of intangibles	1,575	136	1,024	632	1,691	—	5,058
Capital expenditures/investments in intangibles	1,714	43	777	423	2,514	—	5,470
Interest income	—	—	—	—	2,265	—	2,265
Interest expense	—	—	—	—	792	—	792
2005:							
Assets	$11,809	$6,229	$7,810*	$ 6,485	$31,165	$—	$63,498*
Depreciation/amortization of intangibles	1,663	160	1,272	672	1,923	17	5,707
Capital expenditures/investments in intangibles	1,635	21	642	389	2,273	18	4,978
Interest income	—	—	—	—	2,183	—	2,183
Interest expense	—	—	—	—	617	—	617

* *Reclassified to conform with 2007 presentation.*

RECONCILIATIONS OF IBM AS REPORTED

($ in millions)

AT DECEMBER 31:	2007	2006*	2005*
Assets:			
Total reportable segments	**$ 78,348**	$ 71,643	$ 63,498
Elimination of internal transactions	**(5,964)**	(5,347)	(4,503)
Unallocated amounts:			
Cash and marketable securities	**16,007**	10,191	12,381
Notes and accounts receivable	**3,639**	3,743	3,282
Deferred tax assets	**2,664**	5,299	3,311
Plant, other property and equipment	**3,098**	3,091	3,069
Pension assets	**17,397**	10,614	20,613
Other	**5,242**	4,001	4,097
Total IBM consolidated	**$120,431**	$103,234	$105,748

* *Reclassified to conform with 2007 presentation.*

Revenue by Classes of Similar Products or Services

For the Software, Global Business Services, Global Financing and Personal Computing Division segments, the data on page 117 represents the revenue contributions from the products or services that are contained in the segments and that are basically similar in nature. The following table provides external revenue for similar classes of products or services within the Systems and Technology and Global Technology Services segments. Systems and Technology segment's Technology original equipment manufacturer (OEM) hardware comprises revenue primarily from the sale of semiconductors. Technology Services comprise Systems and Technology's circuit design business for its OEM clients, as well as the component design services, strategic outsourcing of clients' design team work and technology and manufacturing consulting services associated with the Engineering and Technology Services Division. Systems and Technology segment's Storage comprises revenue from disk storage systems and tape subsystems. The following table is presented on a continuing operations basis.

($ in millions)

	CONSOLIDATED		
FOR THE YEAR ENDED DECEMBER 31:	2007	2006*	2005*
Global Technology Services:			
Services	**$29,212**	$26,281	$25,633
Maintenance	**6,670**	5,986	5,868
Software	**221**	56	—
Systems and Technology:			
Servers	**$13,348**	$13,171	$13,009
Storage	**3,738**	3,558	3,345
Technology OEM	**2,589**	2,930	2,391
Retail Store Solutions	**872**	761	627
Technology Services	**383**	499	473
Printing Systems	**386**	1,050	1,136

* *Reclassified to conform with 2007 presentation.*

Major Clients

No single client represents 10 percent or more of the company's total revenue.

Geographic Information

The following provides information for those countries that are 10 percent or more of the specific category.

REVENUE*

($ in millions)

FOR THE YEAR ENDED DECEMBER 31:	2007	2006	2005
United States	**$36,511**	$35,917	$34,951
Japan	**9,632**	9,638	10,753
Other countries	**52,643**	45,869	45,430
Total	**$98,786**	$91,424	$91,134

* *Revenues are attributed to countries based on location of client.*

NET PLANT, PROPERTY AND EQUIPMENT

($ in millions)

AT DECEMBER 31:	2007	2006	2005
United States	**$ 6,592**	$ 6,708	$ 6,907
Japan	**890**	844	922
Other countries	**5,365**	4,849	4,327
Total	**$12,847**	$12,401	$12,156

Note W. Subsequent Events

On January 29, 2008, the company announced that the Board of Directors approved a quarterly dividend of $0.40 per common share. The dividend is payable March 10, 2008 to shareholders of record on February 8, 2008.

On January 29, 2008, IBM International Group Capital LLC, an indirect, wholly owned subsidiary of the company, issued $3.5 billion of 18-month floating rate notes. The proceeds will be utilized to reduce the 364-day bridge loan associated with the 2007 ASR. (See pages 31 and 32 for additional information.)

On January 31, 2008, the company completed the acquisition of Cognos, Inc, a publicly held company, for approximately $5.0 billion in cash.

On February 26, 2008, the company announced that the Board of Directors authorized $15 billion in additional funds for use in the company's common stock repurchase program.