INTERNATIONAL BUSINESS MACHINES CORP
Form 10-Q
April 27, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10 - Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED MARCH 31, 2010

1-2360

(Commission file number)

INTERNATIONAL BUSINESS MACHINES CORPORATION

(Exact name of registrant as specified in its charter)

New York	**13-0871985**
(State of incorporation)	(IRS employer identification number)
Armonk, New York	**10504**
(Address of principal executive offices)	(Zip Code)

914-499-1900

(Registrant s telephone number)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of accelerated filer, large accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The registrant has 1,282,347,653 shares of common stock outstanding at March 31, 2010.

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PART I - Financial Information

ITEM 1. Consolidated Financial Statements:

INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF EARNINGS

(UNAUDITED)

(Dollars in millions except per share amounts)	Three Months Ended March 31, 2010	2009
Revenue:		
Services	$ 13,805	$ 13,178
Sales	8,508	7,949
Financing	545	584
Total revenue	22,857	21,711
Cost:		
Services	9,384	9,063
Sales	3,224	2,902
Financing	273	316
Total cost	12,880	12,280
Gross profit	9,976	9,431
Expense and other income:		
Selling, general and administrative	5,677	5,264
Research, development and engineering	1,509	1,480
Intellectual property and custom development income	(261)	(268)
Other (income) and expense	(545)	(304)
Interest expense	82	136
Total expense and other income	6,462	6,309
Income before income taxes	3,515	3,122
Provision for income taxes	914	827
Net income	$ 2,601	$ 2,295
Earnings per share of common stock:		
Assuming dilution	$ 1.97	$ 1.70
Basic	$ 2.00	$ 1.71
Weighted-average number of common shares outstanding: (millions)		
Assuming dilution	1,321.6	1,349.5
Basic	1,301.2	1,344.3

Cash dividend per common share	$	0.55	$	0.50

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(UNAUDITED)

ASSETS

(Dollars in millions)	**At March 31, 2010**	**At December 31, 2009**
Assets:		
Current assets:		
Cash and cash equivalents	$ 12,472	$ 12,183
Marketable securities	1,505	1,791
Notes and accounts receivable trade (net of allowances of $214 in 2010 and $217 in 2009)	9,324	10,736
Short-term financing receivables (net of allowances of $415 in 2010 and $438 in 2009)	13,083	14,914
Other accounts receivable (net of allowances of $9 in 2010 and $15 in 2009)	1,104	1,143
Inventories, at lower of average cost or market:		
Finished goods	555	533
Work in process and raw materials	1,969	1,960
Total inventories	2,524	2,494
Deferred taxes	1,565	1,730
Prepaid expenses and other current assets	4,121	3,946
Total current assets	45,697	48,935
Plant, rental machines and other property	39,018	39,596
Less: Accumulated depreciation	25,178	25,431
Plant, rental machines and other property net	13,841	14,165
Long-term financing receivables (net of allowances of $94 in 2010 and $97 in 2009)	9,542	10,644
Prepaid pension assets	3,289	3,001
Deferred taxes	3,537	4,195
Goodwill	20,889	20,190
Intangible assets net	2,618	2,513
Investments and sundry assets	5,794	5,379
Total assets	$ 105,208	$ 109,022

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

(UNAUDITED)

LIABILITIES AND EQUITY

(Dollars in millions)	At March 31, 2010	At December 31, 2009
Liabilities and equity:		
Current liabilities:		
Taxes	$ 2,775	$ 3,826
Short-term debt	5,014	4,168
Accounts payable	6,345	7,436
Compensation and benefits	3,701	4,505
Deferred income	11,456	10,845
Other accrued expenses and liabilities	5,285	5,223
Total current liabilities	34,575	36,002
Long-term debt	21,305	21,932
Retirement and nonpension postretirement benefit obligations	15,216	15,953
Deferred income	3,456	3,562
Other liabilities	8,506	8,819
Total liabilities	83,059	86,267
Equity:		
IBM stockholders equity:		
Common stock, par value $0.20 per share, and additional paid-in capital	42,665	41,810
Shares authorized: 4,687,500,000		
Shares issued: 2010 - 2,135,047,313		
2009 - 2,127,016,668		
Retained earnings	82,783	80,900
Treasury stock - at cost	(85,238)	(81,243)
Shares: 2010 - 852,699,660		
2009 - 821,679,245		
Accumulated other comprehensive income/(loss)	(18,178)	(18,830)
Total IBM stockholders equity	22,033	22,637
Noncontrolling interests	116	118
Total equity	22,149	22,755
Total liabilities and equity	$ 105,208	$ 109,022

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, (UNAUDITED)

(Dollars in millions)	2010	2009
Cash flow from operating activities:		
Net income	$ 2,601	$ 2,295
Adjustments to reconcile net income to cash provided from operating activities:		
Depreciation	924	917
Amortization of intangibles	286	312
Stock-based compensation	169	137
Net (gain)/loss on asset sales and other	(578)	(298)
Changes in operating assets and liabilities, net of acquisitions/divestitures	1,033	1,024
Net cash provided by operating activities	4,437	4,386
Cash flow from investing activities:		
Payments for plant, rental machines and other property, net of proceeds from dispositions	(758)	(599)
Investment in software	(146)	(161)
Acquisition of businesses, net of cash acquired	(824)	(21)
Divestiture of businesses, net of cash transferred		356
Non-operating finance receivables net	457	387
Purchases of marketable securities and other investments	(1,747)	(922)
Proceeds from disposition of marketable securities and other investments	2,319	912
Net cash used in investing activities	(699)	(48)
Cash flow from financing activities:		
Proceeds from new debt	1,190	913
Payments to settle debt	(2,382)	(3,478)
Short-term borrowings/(repayments) less than 90 days net	1,673	181
Common stock repurchases	(4,017)	(1,765)
Common stock transactions other	885	242
Cash dividends paid	(718)	(675)
Net cash used in financing activities	(3,368)	(4,583)
Effect of exchange rate changes on cash and cash equivalents	(81)	(202)
Net change in cash and cash equivalents	289	(447)
Cash and cash equivalents at January 1	12,183	12,741
Cash and cash equivalents at March 31	$ 12,472	$ 12,294

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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Notes to Consolidated Financial Statements:

1. Basis of Presentation: The accompanying Consolidated Financial Statements and footnotes thereto of the International Business Machines Corporation (IBM and/or the company) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The financial statements and footnotes are unaudited. In the opinion of the company s management, these statements include all adjustments, which are of a normal recurring nature, necessary to present a fair statement of the company s results of operations, financial position and cash flows.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the assets, liabilities, revenue, costs, expenses and accumulated other comprehensive income/(loss) that are reported in the Consolidated Financial Statements and accompanying disclosures. Actual results may be different. See the company s 2009 Annual Report on pages 52 to 54 for a discussion of the company s critical accounting estimates.

Interim results are not necessarily indicative of financial results for a full year. The information included in this Form 10-Q should be read in conjunction with the company s 2009 Annual Report.

Noncontrolling interest amounts in income of $2 million, net of tax, for the three months ended March 31, 2010 and March 31, 2009, respectively, are not presented separately in the Consolidated Statement of Earnings due to immateriality, but are reflected within the other (income) and expense line item. Additionally, changes to noncontrolling interests are presented in Note 10, Equity Activity , on page 25.

Within the financial tables presented, certain columns and rows may not add due to the use of rounded numbers for disclosure purposes. Percentages presented are calculated from the underlying whole-dollar amounts. Certain prior year amounts have been reclassified to conform to the current year presentation. This is annotated where applicable.

2. Accounting Changes: In January 2010, the Financial Accounting Standards Board (FASB) issued additional disclosure requirements for fair value measurements. The guidance requires previous fair value hierarchy disclosures to be further disaggregated by class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. In addition, significant transfers between Levels 1 and 2 of the fair value hierarchy are required to be disclosed. These additional requirements became effective January 1, 2010 for quarterly and annual reporting. These amendments did not have an impact on the consolidated financial results as this guidance relates only to additional disclosures. See Note 4, Fair Value , on pages 11 to 13 for further information. In addition, the fair value disclosure amendments also require more detailed disclosures of the changes in Level 3 instruments. These changes will be effective January 1, 2011 and are not expected to have an impact on the consolidated financial results as this guidance only relates to additional disclosures.

In October 2009, the FASB issued amended revenue recognition guidance for arrangements with multiple deliverables. The new guidance requires the use of management s best estimate of selling price (BESP) for the deliverables in an arrangement when vendor specific objective evidence (VSOE), vendor objective evidence (VOE) or third party evidence (TPE) of the selling price is not available. In addition, excluding specific software revenue guidance, the residual method of allocating arrangement consideration is no longer permitted, and an entity is required to allocate arrangement consideration using the relative selling price method. In accordance with the guidance, the company has elected to early adopt its provisions as of January 1, 2010 on a prospective basis for all new or materially modified arrangements entered into on or after that date. The adoption of this guidance did not have a material impact on the Consolidated Financial Statements.

Also, in October 2009, the FASB issued guidance which amended the scope of existing software revenue recognition guidance. Tangible products containing software components and non-software components that function together to deliver the tangible product s essential functionality are no longer within the scope of software revenue guidance and are accounted for based on other applicable revenue recognition guidance. In addition, the amendments require that hardware components of a tangible product containing software components are always excluded from the software revenue guidance. This guidance must be adopted in the same period that the company adopts the amended guidance for arrangements with multiple deliverables described in the preceding paragraph. Therefore, the company elected to early adopt this guidance as of January 1, 2010 on a prospective basis for all new or materially modified arrangements entered into on or after that date. The adoption of this guidance did not have a material impact on the Consolidated Financial Statements.

See Note 3, Revenue Recognition for Arrangements with Multiple Deliverables, on pages 8 to 11 for the required disclosures and other information related to the adoption of these accounting standards.

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Notes to Consolidated Financial Statements (continued)

In June 2009, the FASB issued amendments to the accounting rules for variable interest entities (VIEs). The new guidance eliminates the quantitative approach previously required for determining the primary beneficiary of a variable interest entity and requires ongoing qualitative reassessments of whether an enterprise is the primary beneficiary. The company adopted these amendments for interim and annual reporting periods beginning on January 1, 2010. The adoption of these amendments did not have a material impact on the Consolidated Financial Statements.

3. Revenue Recognition for Arrangements with Multiple Deliverables: As discussed in Note 2, Accounting Changes, on page 7, effective January 1, 2010 the company adopted on a prospective basis for all new or materially modified arrangements entered into on or after that date the amended accounting guidance for multiple-deliverable revenue arrangements and the amended guidance related to the scope of existing software revenue recognition guidance. The amended guidance does not generally change the units of accounting for the company s revenue transactions. Most of the company s products and services qualify as separate units of accounting.

The company enters into revenue arrangements that may consist of multiple deliverables of its products and services based on the needs of its clients. These arrangements may include any combination of services, software, hardware and/or financing. For example, a client may purchase a server that includes operating system software. In addition, the arrangement may include post-contract support for the software and a contract for post-warranty maintenance service for the hardware. These types of arrangements can also include financing provided by the company. These arrangements consist of multiple deliverables, with the hardware and software delivered in one reporting period and the software support and hardware maintenance services delivered across multiple reporting periods. In another example, a client may outsource the running of its datacenter operations to the company on a long term, multiple year basis and periodically purchase servers and/or software products from the company to upgrade or expand its facility. The outsourcing services are provided on a continuous basis across multiple reporting periods and the hardware and software products are delivered in one reporting period. To the extent that a deliverable in a multiple-deliverable arrangement is subject to specific guidance that deliverable is accounted for in accordance with such specific guidance. Examples of such arrangements may include leased hardware which is subject to specific leasing guidance or software which is subject to specific software revenue recognition guidance 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). For all other deliverables in multiple-deliverable arrangements, the guidance below is applied for separability and allocation. A multiple-deliverable arrangement is separated into more than one unit of accounting if the following criteria are met:

- The delivered item(s) has value to the client on a stand-alone basis; 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 ratably over the contract term 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 a relative selling price 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 selling price. The revenue recognition policies described below are then applied to each unit of accounting, as applicable.

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 on 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 primarily recognized on a straight-line basis over the terms of the contracts. Revenue from time-and-material

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Notes to Consolidated Financial Statements (continued)

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 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 gave rise to the revision become known by management.

Hardware

The company s hardware offerings include the sale or lease of system servers, storage solutions, retail store systems and the sale of semiconductor design and manufacturing services. The company provides warranties for its hardware products that range up to three years, with the majority being either one year or three years. The company also offers installation services for its more complex products.

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 extended warranty contracts, for which the company is obligated to perform, is recorded as deferred income and subsequently recognized on a straight-line basis over the delivery period. 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 subscription and support, which includes unspecified upgrades on a when-and-if-available basis is recognized on a straight-line basis over the period such items are delivered. In multiple-deliverable revenue arrangements that include software that is more than incidental to the products or services as a whole (software multiple-deliverable arrangements), software and software-related elements are accounted for in accordance with software revenue recognition guidance. Software-related elements include software products and services for which a software deliverable is essential to its functionality. Tangible products containing software components and non-software components that function together to deliver the tangible product s essential functionality are no longer within the scope of software revenue recognition guidance and are accounted for based on other applicable revenue recognition guidance.

A software multiple-deliverable 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 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-deliverable 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.

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Notes to Consolidated Financial Statements (continued)

The company s multiple-deliverable arrangements may have a stand-alone software deliverable that is subject to the existing software revenue recognition guidance. The revenue for these multiple deliverable arrangements is allocated to the software deliverable and the non-software deliverables based on the relative selling prices of all of the deliverables in the arrangement using the hierarchy (VSOE,TPE or BESP) in the new amended revenue accounting guidance. In the limited circumstances where the company cannot determine VSOE or TPE of the selling price for all of the deliverables in the arrangement, including the software deliverable, BESP is used for the purposes of performing this allocation.

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.

Determination of Best Estimate of Selling Price

In certain limited instances, the company is not able to establish VSOE for all elements in a multiple deliverable arrangement. When VSOE cannot be established, the company attempts to establish the selling price of each element based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately.

When the company is unable to establish selling price using VSOE or TPE, the company uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the company would transact a sale if the product or service were sold on a stand-alone basis. Due to the fact that the company sells its products and services on a stand-alone basis, and therefore has established VSOE for its products and services offerings, the company expects to use BESP to determine the relative selling price for a product or service in a multiple-deliverable arrangement on an infrequent basis. An example of when BESP would be used is when the company sells a new product, for which VSOE and TPE does not exist, in a multiple deliverable arrangement prior to selling the new product on a stand-alone basis. During the first quarter of 2010, BESP was used in two transactions and the effects of its use were immaterial.

The company determines BESP for a product or service by considering multiple factors including, but not limited to, overall market conditions, including geographic or regional specific market factors, competitive positioning, competitor actions, internal costs, profit objectives and pricing practices. The determination of BESP is a formal process within the company that includes review and approval by the company s management. In addition, the company regularly reviews VSOE and TPE for its products and services, in addition to BESP.

Effect of Adoption

For transactions entered into prior to January 1, 2010, the company recognized revenue based on established revenue recognition guidance as it related to the elements within the arrangement. For the vast majority of the company s arrangements involving multiple deliverables, the fee from the arrangement was allocated to each respective element based on its relative fair value, using VSOE. In the limited circumstances when the company was not able to determine VSOE for all of the elements of the arrangement, but was able to obtain VSOE for any undelivered elements, revenue was allocated using the residual method. Under the residual method, the amount of revenue allocated to delivered elements equaled the total arrangement consideration less the aggregate selling price of any undelivered elements, and no revenue was recognized until all elements without VSOE had been delivered. If VSOE of any undelivered items did not exist, revenue from the entire arrangement was initially deferred and recognized at the earlier of: (i) delivery of those elements for which VSOE did not exist or (ii) when VSOE was established. The residual method and recognition of revenue on a ratable basis were generally used in circumstances where VSOE, as applicable, was unavailable.

The new amended accounting standards for multiple-deliverable revenue arrangements and changes to the scope of existing software revenue recognition guidance if applied to transactions in the year ended December 31, 2009 would not have resulted in a material change to the company s reported revenue for that fiscal year period.

In addition, there would not have been a material impact to revenue, as reported during the quarter ended March 31, 2010, if the transactions entered into or materially modified on or after January 1, 2010 were subject to the previous accounting guidance.

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Notes to Consolidated Financial Statements (continued)

As discussed in Note 2, Accounting Changes, there was no material impact in the quarter ended March 31, 2010 from the adoption of the amended revenue guidance. In terms of the timing and pattern of revenue recognition, the new accounting guidance for revenue recognition is not expected to have a material impact on revenue in periods after the initial adoption.

See the company s 2009 Annual Report, Note A, Significant Accounting Policies, on pages 70 and 71 and Critical Accounting Estimates, on pages 52 and 53 for additional information.

4. <u>Fair Value:</u> Exit prices are used to measure assets and liabilities that fall within the scope of the fair value measurements guidance. Under this guidance, the company is required to classify certain assets and liabilities based on the following fair value hierarchy:

• Level 1 Quoted prices in active markets that are unadjusted and accessible at the measurement date for identical, unrestricted assets or liabilities;

• Level 2 Quoted prices for identical assets and liabilities in markets that are not active, quoted prices for similar assets and liabilities in active markets or financial instruments for which significant inputs are observable, either directly or indirectly; and

• Level 3 Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

The guidance requires the use of observable market data if such data is available without undue cost and effort.

When available, the company uses unadjusted quoted market prices to measure the fair value and classifies such items within Level 1. If quoted market prices are not available, fair value is based upon internally developed models that use current market-based or independently sourced market parameters such as interest rates and currency rates. Items valued using internally generated models are classified according to the lowest level input or value driver that is significant to the valuation.

The determination of fair value considers various factors including interest rate yield curves and time value underlying the financial instruments. For derivatives and debt securities, the company uses a discounted cash flow analysis using discount rates commensurate with the duration of the instrument.

In determining the fair value of financial instruments, the company considers certain market valuation adjustments to the base valuations calculated using the methodologies described below for several parameters that market participants would consider in determining fair value:

- Counterparty credit risk adjustments are applied to financial instruments, taking into account the actual credit risk of a counterparty as observed in the credit default swap market to determine the true fair value of such an instrument.

- Credit risk adjustments are applied to reflect the company s own credit risk when valuing all liabilities measured at fair value. The methodology is consistent with that applied in developing counterparty credit risk adjustments, but incorporates the company s own credit risk as observed in the credit default swap market.

As an example, the fair value of derivatives is derived by a discounted cash flow model using observable market inputs such as known notional value amounts, yield curves, spot and forward exchange rates as well as discount rates. These inputs relate to liquid, heavily traded currencies with active markets which are available for the full term of the derivative.

Certain financial assets are measured at fair value on a nonrecurring basis. These assets include equity method investments that are recognized at fair value at the end of the period to the extent that they are deemed to be other-than-temporarily impaired. Certain assets that are measured at fair value on a recurring basis can be subject to nonrecurring fair value measurements. These assets include public cost method investments that are deemed to be other-than-temporarily impaired. In the event of an other-than-temporary impairment of a financial investment, fair value is measured using a model described above.

Non-financial assets such as property plant and equipment, land, goodwill and intangible assets are also subject to nonrecurring fair value measurements if they are deemed to be impaired. The impairment models used for nonfinancial assets depend on the type of asset. See Note A in the 2009 Annual Report for further information. There were no material impairments of non-financial assets for the quarters ended March 31, 2010 and March 31, 2009.

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Notes to Consolidated Financial Statements (continued)

The following tables present the company s financial assets and financial liabilities that are measured at fair value on a recurring basis at March 31, 2010 and December 31, 2009.

(Dollars in millions) At March 31, 2010	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents(1)				
Time deposits and certificates of deposit	$	$ 4,192	$	$ 4,192
Commercial paper		2,813		2,813
Money market funds	2,274			2,274
U.S. Federal Government securities		100		100
Other securities		73		73
Total	2,274	7,178		9,452
Debt securities current(2)				
Commercial paper		904		904
U.S. Federal Government securities		600		600
Other securities		2		2
Total		1,505		1,505
Debt securities noncurrent(3)	3	6		9
Non-equity method alliance investments(3)	425	8		433
Derivative assets(4)				
Interest rate contracts		510		510
Foreign exchange contracts		616		616
Equity contracts		5		5
Total		1,131		1,131(6)
Total Assets	$ 2,701	$ 9,829	$	$ 12,530(6)
Liabilities:				
Derivative liabilities(5)				
Foreign exchange contracts	$	$ 806	$	$ 806
Total Liabilities	$	$ 806	$	$ 806(6)

(1) Included within cash and cash equivalents in the Consolidated Statement of Financial Position.

(2) Included within marketable securities in the Consolidated Statement of Financial Position.

(3) Included within investments and sundry assets in the Consolidated Statement of Financial Position.

(4) The gross balances of derivative assets contained in prepaid expenses and other current assets, and investments and sundry assets in the Consolidated Statement of Financial Position at March 31, 2010 are $315 million and $815 million, respectively.

(5) The gross balances of derivative liabilities contained within other accrued expenses and liabilities, and other liabilities in the Consolidated Statement of Financial Position at March 31, 2010 are $525 million and $280 million, respectively.

(6) If derivative exposures covered by a qualifying master netting agreement had been netted in the Consolidated Statement of Financial Position, the total derivative asset and liability positions would have been reduced by $472 million each.

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Notes to Consolidated Financial Statements (continued)

(Dollars in millions) At December 31, 2009	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents(1)				
Time deposits and certificates of deposit	$	$ 4,324	$	$ 4,324
Commercial paper		2,099		2,099
Money market funds	2,780			2,780
Other securities		74		74
Total	2,780	6,497		9,277
Debt securities current(2)				
Commercial paper		1,491		1,491
U.S. Federal Government securities		300		300
Total		1,791		1,791
Debt securities noncurrent(3)	3	6		9
Non-equity method alliance investments(3)	366	8		374
Derivative assets(4)				
Interest rate contracts		426		426
Foreign exchange contracts		407		407
Equity contracts		5		5
Total		838		838(6)
Total Assets	$ 3,149	$ 9,140	$	$ 12,289(6)
Liabilities:				
Derivative liabilities(5)				
Interest rate contracts	$	$ 2	$	$ 2
Foreign exchange contracts		1,553		1,553
Total Liabilities	$	$ 1,555	$	$ 1,555(6)

(1) Included within cash and cash equivalents in the Consolidated Statement of Financial Position.

(2) Included within marketable securities in the Consolidated Statement of Financial Position.

(3) Included within investments and sundry assets in the Consolidated Statement of Financial Position.

(4) The gross balances of derivative assets contained within prepaid expenses and other current assets, and investments and sundry assets in the Consolidated Statement of Financial Position at December 31, 2009 are $273 million and $565 million, respectively.

(5) The gross balances of derivative liabilities contained within other accrued expenses and liabilities, and other liabilities in the Consolidated Statement of Financial Position at December 31, 2009 are $906 million and $649 million, respectively.

(6) If derivative exposures covered by a qualifying master netting agreement had been netted in the Consolidated Statement of Financial Position, the total derivative asset and liability positions would have been reduced by $573 million each.

There were no significant transfers between Levels 1 and 2 for the quarter ended March 31, 2010 and for the year ended December 31, 2009.

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Notes to Consolidated Financial Statements (continued)

5. Financial Instruments (excluding derivatives): Cash and cash equivalents, debt and marketable equity securities are recognized and measured at fair value in the company s consolidated 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. 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 are used to estimate fair values:

Loans and Long-term 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.

Long-term Debt

Fair value of publicly-traded long-term debt is based on quoted market prices for the identical liability when traded as an asset in an active market. For other long-term debt for which a quoted market price is not available, an expected present value technique that uses rates currently available to the company for debt with similar terms and remaining maturities is used to estimate fair value. The carrying amount of long-term debt is $21,305 million and $21,932 million and the estimated fair value is $22,261 million and $23,748 million at March 31, 2010 and December 31, 2009, respectively.

Debt and Marketable Equity Securities

The following tables summarize the company s debt and marketable equity securities all of which are considered available-for-sale and recorded at fair value in the Consolidated Statement of Financial Position.

(Dollars in millions) At March 31, 2010	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents*				
Time deposits and certificates of deposit	$ 4,192	$	$ (0)	$ 4,192
Commercial paper	2,813		(0)	2,813
Money market funds	2,274			2,274
U.S. Federal Government securities	100		(0)	100
Other securities	73			73
Total	$ 9,452	$	$ (0)	$ 9,452

Debt securities current**				
Commercial paper	$ 904	$	$ (0)	$ 904
Other securities	2			2
U.S. Federal Government securities	600		(0)	600
Total	$ 1,505	$	$ (0)	$ 1,505
Debt securities noncurrent***				
Other securities	$ 8	$ 1	$ (0)	$ 9
Total	$ 8	$ 1	$ (0)	$ 9
Non-equity method alliance investments***	$ 185	$ 248		