

INTERNATIONAL BUSINESS MACHINES CORP

Form 10-Q

July 31, 2012

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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 JUNE 30, 2012**

**1-2360**

(Commission file number)

**INTERNATIONAL BUSINESS MACHINES CORPORATION**

(Exact name of registrant as specified in its charter)

**New York**

(State of incorporation)

**13-0871985**

(IRS employer identification number)

**Armonk, New York**

(Address of principal executive offices)

**10504**

(Zip Code)

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**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  No

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  No

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

The registrant has 1,142,774,594 shares of common stock outstanding at June 30, 2012.

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Table of Contents**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 June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Revenue:</b>				
Services	\$ 14,833	\$ 15,246	\$ 29,653	\$ 29,942
Sales	10,426	10,894	19,782	20,281
Financing	523	526	1,021	1,050
<b>Total revenue</b>	<b>25,783</b>	<b>26,666</b>	<b>50,456</b>	<b>51,273</b>
<b>Cost:</b>				
Services	9,785	10,315	19,770	20,431
Sales	3,435	3,698	6,761	7,088
Financing	282	269	526	511
<b>Total cost</b>	<b>13,502</b>	<b>14,282</b>	<b>27,056</b>	<b>28,030</b>
<b>Gross profit</b>	<b>12,281</b>	<b>12,385</b>	<b>23,400</b>	<b>23,243</b>
<b>Expense and other income:</b>				
Selling, general and administrative	5,837	6,030	11,723	11,856
Research, development and engineering	1,587	1,569	3,188	3,156
Intellectual property and custom development income	(289)	(295)	(545)	(557)
Other (income) and expense	(132)	97	(190)	(105)
Interest expense	117	97	226	190
<b>Total expense and other income</b>	<b>7,120</b>	<b>7,500</b>	<b>14,403</b>	<b>14,541</b>
<b>Income before income taxes</b>	<b>5,161</b>	<b>4,885</b>	<b>8,997</b>	<b>8,702</b>
Provision for income taxes	1,280	1,221	2,049	2,175
<b>Net income</b>	<b>\$ 3,881</b>	<b>\$ 3,664</b>	<b>\$ 6,948</b>	<b>\$ 6,526</b>
<b>Earnings per share of common stock:</b>				
Assuming dilution	\$ 3.34	\$ 3.00	\$ 5.95	\$ 5.30
Basic	\$ 3.38	\$ 3.04	\$ 6.02	\$ 5.38
<b>Weighted-average number of common shares outstanding: (millions)</b>				
Assuming dilution	1,161.9	1,221.4	1,168.1	1,230.7
Basic	1,149.0	1,204.8	1,154.1	1,213.5
<b>Cash dividend per common share</b>	<b>\$ 0.85</b>	<b>\$ 0.75</b>	<b>\$ 1.60</b>	<b>\$ 1.40</b>

(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 COMPREHENSIVE INCOME**

(UNAUDITED)

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Net income</b>	\$ 3,881	\$ 3,664	\$ 6,948	\$ 6,526
<b>Other comprehensive income/(loss), before tax</b>				
<b>Foreign currency translation adjustments</b>	(724)	350	(337)	826
<b>Net changes related to available-for-sale securities:</b>				
Unrealized gains/(losses) arising during the period	(3)	(7)	3	(14)
Reclassification of (gains)/losses to net income	(2)	(29)	(16)	(232)
Subsequent changes in previously impaired securities arising during the period	9	0	27	11
<b>Total net changes related to available-for-sale securities</b>	4	(35)	14	(234)
<b>Unrealized gains/(losses) on cash flow hedges:</b>				
Unrealized gains/(losses) arising during the period	68	(217)	119	(454)
Reclassification of (gains)/losses to net income	(111)	227	(135)	327
<b>Total unrealized gains/(losses) on cash flow hedges</b>	(42)	10	(16)	(127)
<b>Retirement-related benefit plans:</b>				
Prior service costs/(credits)	0	(31)	0	(32)
Net (losses)/gains arising during the period	70	585	65	606
Curtailments and settlements	0	4	0	13
Amortization of prior service (credits)/costs	(37)	(39)	(74)	(77)
Amorization of net (gains)/losses	613	458	1,232	932
<b>Total retirement-related benefit plans</b>	647	977	1,223	1,441
<b>Other comprehensive income/(loss), before tax</b>	(115)	1,301	884	1,906
<b>Income tax (expense)/benefit related to items of other comprehensive income</b>	(268)	(292)	(497)	(272)
<b>Other comprehensive income/(loss)</b>	(383)	1,010	387	1,634
<b>Total comprehensive income/(loss)</b>	\$ 3,498	\$ 4,673	\$ 7,335	\$ 8,160

(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 June 30, 2012	At December 31, 2011
<b>Assets:</b>		
Current assets:		
Cash and cash equivalents	\$ 10,864	\$ 11,922
Marketable securities	323	0
Notes and accounts receivable trade (net of allowances of \$264 in 2012 and \$256 in 2011)	10,172	11,179
Short-term financing receivables (net of allowances of \$271 in 2012 and \$311 in 2011)	14,982	16,901
Other accounts receivable (net of allowances of \$11 in 2012 and \$11 in 2011)	1,703	1,481
Inventories, at lower of average cost or market:		
Finished goods	752	589
Work in process and raw materials	2,006	2,007
Total inventories	2,758	2,595
Deferred taxes	1,478	1,601
Prepaid expenses and other current assets	5,113	5,249
Total current assets	47,392	50,928
Property, plant and equipment		
Property, plant and equipment	40,158	40,124
Less: Accumulated depreciation	26,293	26,241
Property, plant and equipment net	13,865	13,883
Long-term financing receivables (net of allowances of \$55 in 2012 and \$38 in 2011)	10,795	10,776
Prepaid pension assets	2,862	2,843
Deferred taxes	2,795	3,503
Goodwill	27,735	26,213
Intangible assets net	3,657	3,392
Investments and sundry assets	4,730	4,895
<b>Total assets</b>	<b>\$ 113,832</b>	<b>\$ 116,433</b>

(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 June 30, 2012	At December 31, 2011
<b>Liabilities:</b>		
Current liabilities:		
Taxes	\$ 2,183	\$ 3,313
Short-term debt	7,669	8,463
Accounts payable	7,482	8,517
Compensation and benefits	4,656	5,099
Deferred income	12,311	12,197
Other accrued expenses and liabilities	4,602	4,535
<b>Total current liabilities</b>	<b>38,903</b>	<b>42,123</b>
Long-term debt	24,766	22,857
Retirement and nonpension postretirement benefit obligations	16,544	18,374
Deferred income	3,889	3,847
Other liabilities	9,166	8,996
<b>Total liabilities</b>	<b>93,269</b>	<b>96,197</b>
<b>Equity:</b>		
IBM stockholders' equity:		
Common stock, par value \$0.20 per share, and additional paid-in capital	49,157	48,129
Shares authorized: 4,687,500,000		
Shares issued: 2012 - 2,192,562,656		
2011 - 2,182,469,838		
Retained earnings	109,928	104,857
Treasury stock - at cost	(117,116)	(110,963)
Shares: 2012 - 1,049,788,062		
2011 - 1,019,287,274		
Accumulated other comprehensive income/(loss)	(21,498)	(21,885)
<b>Total IBM stockholders' equity</b>	<b>20,472</b>	<b>20,138</b>
Noncontrolling interests	92	97
<b>Total equity</b>	<b>20,563</b>	<b>20,236</b>
<b>Total liabilities and equity</b>	<b>\$ 113,832</b>	<b>\$ 116,433</b>

(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 SIX MONTHS ENDED JUNE 30,**

**(UNAUDITED)**

(Dollars in millions)	2012	2011*
<b>Cash flows from operating activities:</b>		
Net income	\$ 6,948	\$ 6,526
Adjustments to reconcile net income to cash provided by operating activities		
Depreciation	1,706	1,816
Amortization of intangibles	627	619
Stock-based compensation	328	332
Net (gain)/loss on asset sales and other	(118)	(383)
Changes in operating assets and liabilities, net of acquisitions/divestitures	(764)	(839)
<b>Net cash provided by operating activities</b>	<b>8,726</b>	<b>8,071</b>
<b>Cash flows from investing activities:</b>		
Payments for property, plant and equipment	(2,135)	(2,061)
Proceeds from disposition of property, plant and equipment	175	336
Investment in software	(320)	(285)
Acquisition of businesses, net of cash acquired	(1,925)	(159)
Divestitures of businesses, net of cash transferred	13	4
Non-operating finance receivables net	686	477
Purchases of marketable securities and other investments	(1,655)	(774)
Proceeds from disposition of marketable securities and other investments	1,247	2,375
<b>Net cash used in investing activities</b>	<b>(3,913)</b>	<b>(86)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from new debt	7,559	3,656
Payments to settle debt	(4,069)	(3,587)
Short-term borrowings/(repayments) less than 90 days net	(2,236)	883
Common stock repurchases	(6,002)	(8,021)
Common stock transactions other	918	1,551
Cash dividends paid	(1,848)	(1,700)
<b>Net cash used in financing activities</b>	<b>(5,678)</b>	<b>(7,217)</b>
Effect of exchange rate changes on cash and cash equivalents	(193)	285
Net change in cash and cash equivalents	(1,058)	1,054
Cash and cash equivalents at January 1	11,922	10,661
<b>Cash and cash equivalents at June 30</b>	<b>\$ 10,864</b>	<b>\$ 11,714</b>

\* Reclassified to conform with 2012 presentation.

(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 CHANGES IN EQUITY**

(UNAUDITED)

(Dollars in millions)	Common Stock and Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total IBM Stockholders Equity	Non- Controlling Interests	Total Equity
<b>Equity - January 1, 2012</b>	\$ 48,129	\$ 104,857	\$ (110,963)	\$ (21,885)	\$ 20,138	\$ 97	\$ 20,236
Net income plus other comprehensive income/(loss)							
Net income		6,948			6,948		6,948
Other comprehensive income/(loss)				387	387		387
Total comprehensive income/(loss)					\$ 7,335		\$ 7,335
Cash dividends declared common stock		(1,848)			(1,848)		(1,848)
Common stock issued under employee plans (10,092,817 shares)	780				780		780
Purchases (1,905,803 shares) and sales (2,034,612 shares) of treasury stock under employee plans net		(29)	(146)		(174)		(174)
Other treasury shares purchased, not retired (30,629,597 shares)			(6,007)		(6,007)		(6,007)
Changes in other equity	248				248		248
Changes in noncontrolling interests						(6)	(6)
<b>Equity - June 30, 2012</b>	\$ 49,157	\$ 109,928	\$ (117,116)	\$ (21,498)	\$ 20,472	\$ 92	\$ 20,563

(Dollars in millions)	Common Stock and Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total IBM Stockholders Equity	Non- Controlling Interests	Total Equity
<b>Equity - January 1, 2011</b>	\$ 45,418	\$ 92,532	\$ (96,161)	\$ (18,743)	\$ 23,046	\$ 126	\$ 23,172
Net income plus other comprehensive income/(loss)							
Net income		6,526			6,526		6,526
Other comprehensive income/(loss)				1,634	1,634		1,634
Total comprehensive income/(loss)					\$ 8,160		\$ 8,160
Cash dividends declared common stock		(1,700)			(1,700)		(1,700)
	1,383				1,383		1,383

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Common stock issued under employee plans (13,794,550 shares)									
Purchases (1,416,882 shares) and sales (3,461,423 shares) of treasury stock under employee plans net		(24)	129			105		105	
Other treasury shares purchased, not retired (49,554,480 shares)			(8,041)			(8,041)		(8,041)	
Changes in other equity	173					173		173	
Changes in noncontrolling interests							(43)	(43)	
<b>Equity - June 30, 2011</b>	\$ 46,975	\$ 97,334	\$ (104,073)	\$ (17,109)	\$ 23,127	\$ 84	\$ 23,210		

(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 of the International Business Machines Corporation (IBM 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 2011 Annual Report on pages 58 to 61 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 2011 Annual Report.

Noncontrolling interest amounts in income of \$2.0 million and \$2.1 million, net of tax, for the three months ended June 30, 2012 and 2011, respectively, and \$5.7 million and \$4.8 million, net of tax, for the six months ended June 30, 2012 and 2011, respectively, are included in the Consolidated Statement of Earnings within the other (income) and expense line item. Additionally, changes to noncontrolling interests which are presented in the Consolidated Statement of Changes in Equity on page 8 were \$(6) million and \$(43) million for the six months ended June 30, 2012 and 2011, respectively.

Within the financial statements and 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 May 2011, the Financial Accounting Standards Board (FASB) issued amended guidance and disclosure requirements for fair value measurements. These amendments did not have a material impact on the consolidated financial results. These changes became effective January 1, 2012 on a prospective basis. See Note 3, Financial Instruments on pages 9 to 14 for fair value disclosures.

In July 2012, the FASB issued amended guidance that simplifies how entities test indefinite-lived intangible assets other than goodwill for impairment. After an assessment of certain qualitative factors, if it is determined to be more likely than not that an indefinite-lived asset is impaired, entities must perform the quantitative impairment test. Otherwise, the quantitative test is optional. The amended guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the company's financial results.

**3. Financial Instruments:**

### **Fair Value Measurements**

Accounting guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Under this guidance, the company is required to classify certain assets and liabilities based on the following fair value hierarchy:

- Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities that can be accessed at the measurement date;
- Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 Unobservable inputs for the asset or liability.

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 in active markets 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.

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**Notes to Consolidated Financial Statements (continued)**

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 utilizing a discounted cash flow model that uses 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 measurement date 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 available-for-sale equity 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, Significant Accounting Policies, on pages 76 to 86 in the company's 2011 Annual Report for further information. There were no material impairments of non-financial assets for the six months ended June 30, 2012 and 2011, respectively.

Accounting guidance permits the measurement of 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 accounting standards. This election is irrevocable. The company does not apply the fair value option to any eligible assets or liabilities.





Table of Contents**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 June 30, 2012 and December 31, 2011.

(Dollars in millions) At June 30, 2012	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Cash equivalents (1)				
Time deposits and certificates of deposit	\$	\$	1,987	\$ 1,987
Commercial paper		1,670		1,670
Money market funds	1,106			1,106
U.S. government securities		960		960
Canada government securities		1,565		1,565
Other securities		7		7
<b>Total</b>	<b>1,106</b>	<b>6,189</b>		<b>7,295(6)</b>
Debt securities - current (2)		323		323(6)
Debt securities - noncurrent (3)	1	7		8
Available-for-sale equity investments (3)	24	41		65
<b>Derivative assets (4)</b>				
Interest rate contracts		784		784
Foreign exchange contracts		548		548
Equity contracts		24		24
<b>Total</b>		<b>1,356</b>		<b>1,356(7)</b>
<b>Total assets</b>	<b>\$ 1,131</b>	<b>\$ 7,916</b>	<b>\$</b>	<b>\$ 9,047(7)</b>
<b>Liabilities:</b>				
<b>Derivative liabilities (5)</b>				
Foreign exchange contracts	\$	\$	505	\$ 505
Equity contracts		7		7
<b>Total liabilities</b>	<b>\$</b>	<b>\$</b>	<b>512</b>	<b>\$ 512(7)</b>

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

(2) Canada government securities reported as 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 June 30, 2012 are \$598 million and \$758 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 June 30, 2012 are \$360 million and \$152 million, respectively.

(6) Available-for-sale securities with carrying values that approximate fair value.

(7) 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 \$376 million each.



Table of Contents**Notes to Consolidated Financial Statements (continued)****(Dollars in millions)**

<b>At December 31, 2011</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets:</b>				
Cash equivalents (1)				
Time deposits and certificates of deposit	\$	\$ 2,082	\$	\$ 2,082
Commercial paper *		777		777
Money market funds	1,886			1,886
U.S. government securities		2,750		2,750
Canada government securities *		983		983
Other securities		8		8
<b>Total</b>	<b>1,886</b>	<b>6,600</b>		<b>8,486(5)</b>
Debt securities - noncurrent (2)	1	7		8
Available-for-sale equity investments (2)	69	14		83
Derivative assets (3)				
Interest rate contracts		783		783
Foreign exchange contracts		510		510
Equity contracts		7		7
<b>Total</b>		<b>1,300</b>		<b>1,300(6)</b>
<b>Total assets</b>	<b>\$ 1,956</b>	<b>\$ 7,921</b>	<b>\$</b>	<b>\$ 9,877(6)</b>
<b>Liabilities:</b>				
Derivative liabilities (4)				
Foreign exchange contracts	\$	\$ 523	\$	\$ 523
Equity contracts		8		8
<b>Total liabilities</b>	<b>\$</b>	<b>\$ 531</b>	<b>\$</b>	<b>\$ 531(6)</b>

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\* Reclassified to conform with 2012 presentation.

- (1) Included within cash and cash equivalents in the Consolidated Statement of Financial Position.
- (2) Included within investments and sundry assets in the Consolidated Statement of Financial Position.
- (3) 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, 2011 are \$546 million and \$754 million, respectively.
- (4) 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, 2011 are \$365 million and \$166 million, respectively.
- (5) Available-for-sale securities with carrying values that approximate fair value.
- (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 \$324 million each.

There were no transfers between Levels 1 and 2 for the six months ended June 30, 2012 and for the year ended December 31, 2011.

**Financial Assets and Liabilities Not Measured at Fair Value**

Short-Term Receivables and Payables

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 (excluding the current portion of long-term debt) are financial liabilities with carrying values that approximate fair value. If measured at fair value in the financial statements, these financial instruments would be classified as Level 3 in the fair value hierarchy.

Loans and Long-term Receivables

Fair values 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. At June 30, 2012 and December 31, 2011, the difference between the carrying amount and estimated fair value for loans and long-term receivables was immaterial. If measured at fair value in the financial statements, these financial instruments would be classified as Level 3 in the fair value hierarchy.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

## 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 \$24,766 million and \$22,857 million and the estimated fair value is \$27,688 million and \$27,383 million at June 30, 2012 and December 31, 2011, respectively. If measured at fair value in the financial statements, long-term debt (including the current portion) would be classified as Level 2 in the fair value hierarchy.

**Debt and Marketable Equity Securities**

The company's cash equivalents and current debt securities are considered available-for-sale and recorded at fair value, which is not materially different from carrying value, in the Consolidated Statement of Financial Position. The following tables summarize the company's noncurrent debt and marketable equity securities which are also considered available-for-sale and recorded at fair value in the Consolidated Statement of Financial Position.

(Dollars in millions) At June 30, 2012:	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities noncurrent(1)	\$ 7	\$ 1	\$	\$ 8
Available-for-sale equity investments(1)	\$ 28	\$ 39	(2) \$	65

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

(Dollars in millions) At December 31, 2011:	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities noncurrent(1)	\$ 7	\$ 1	\$	\$ 8
Available-for-sale equity investments(1)	\$ 58	\$ 27	(2) \$	83

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

Based on an evaluation of available evidence as of June 30, 2012, the company believes that unrealized losses on debt and available-for-sale equity investments are temporary and do not represent a need for an other-than-temporary impairment.

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Sales of debt and available-for-sale equity investments during the period were as follows:

**(Dollars in millions)**

**For the three months ended June 30:**

	<b>2012</b>		<b>2011</b>	
Proceeds	\$	6	\$	87
Gross realized gains (before taxes)		2		29
Gross realized losses (before taxes)		(0)		(0)

**(Dollars in millions)**

**For the six months ended June 30:**

	<b>2012</b>		<b>2011</b>	
Proceeds	\$	51	\$	402
Gross realized gains (before taxes)		16		232
Gross realized losses (before taxes)		(0)		(0)

Table of Contents**Notes to Consolidated Financial Statements (continued)**

The after-tax net unrealized holding gains/(losses) on available-for-sale debt and equity securities that have been included in other comprehensive income/(loss) for the period and the after-tax net (gains)/losses reclassified from accumulated other comprehensive income/(loss) to net income were as follows:

(Dollars in millions)

For the three months ended June 30:	2012	2011**
Net unrealized gains/(losses) arising during the period	\$ 4	\$ (3)
Net unrealized (gains)/losses reclassified to net income*	(1)	(19)

\* There were no writedowns for the three months ended June 30, 2012 and 2011 respectively.

\*\* Reclassified to conform with 2012 presentation.

(Dollars in millions)

For the six months ended June 30:	2012	2011**
Net unrealized gains/(losses) arising during the period	\$ 18	\$ (2)
Net unrealized (gains)/losses reclassified to net income*	(10)	(144)

\* There were no significant writedowns for the six months ended June 30, 2012 and 2011 respectively.

\*\* Reclassified to conform with 2012 presentation.

The contractual maturities of substantially all available-for-sale debt securities are less than one year at June 30, 2012.

**Derivative Financial Instruments**

The company operates in multiple functional currencies and is a significant lender and borrower 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 and commodity 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 better 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 better manage the cash flow volatility arising from foreign exchange rate fluctuations.



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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. 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. The right of set-off that exists under certain of these arrangements enables the legal entities of the company subject to the arrangement to net amounts due to and from the counterparty reducing the maximum loss from credit risk in the event of counterparty default.

The company is also a party to collateral security arrangements with most of its major counterparties. These arrangements require the company to hold or post collateral (cash or U.S. Treasury securities) when the derivative fair values exceed contractually established thresholds. Posting thresholds can be fixed or can vary based on credit default swap pricing or credit ratings received from the major credit agencies. The aggregate fair value of all derivative instruments under these collateralized arrangements that were in a liability position at June 30, 2012 and December 31, 2011 was \$77 million and \$131 million, respectively, for which no collateral was posted at June 30, 2012 and December 31, 2011. Full collateralization of these agreements would be required in the event that the company's credit rating falls below investment grade or if its credit default swap spread exceeds 250 basis points, as applicable, pursuant to the terms of the collateral security arrangements. The aggregate fair value of derivative instruments in net asset positions as of June 30, 2012 and December 31, 2011 was \$1,356 million and \$1,300 million, respectively. This amount represents the maximum exposure to loss at the reporting date as a result of the counterparties failing to perform as contracted. This exposure was reduced by \$376 million and \$324 million at June 30, 2012 and December 31, 2011, respectively, of liabilities included in master netting arrangements with those counterparties. Additionally, at June 30, 2012 and December 31, 2011, this exposure was reduced by \$465 million and \$466 million of cash collateral, respectively, received by the company. In addition to cash collateral, the company held

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**Notes to Consolidated Financial Statements (continued)**

\$93 million in non-cash collateral, in U.S. Treasury securities, at June 30, 2012. Per accounting guidance, non-cash collateral is not recorded on the Statement of Financial Position.

The company does not offset derivative assets against liabilities in master netting arrangements nor does it offset receivables or payables recognized upon payment or receipt of cash collateral against the fair values of the related derivative instruments. No amount was recognized in other receivables at June 30, 2012 or December 31, 2011 for the right to reclaim cash collateral. The amount recognized in accounts payable for the obligation to return cash collateral totaled \$465 million and \$466 million at June 30, 2012 and December 31, 2011, respectively. The company restricts the use of cash collateral received to rehypothecation, and therefore reports it in prepaid expenses and other current assets in the Consolidated Statement of Financial Position. No amount was rehypothecated at June 30, 2012 or at December 31, 2011.

The company may employ 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, expose the company to liquidity risk as the derivatives have an immediate cash flow impact upon maturity which is not offset by a cash flow from the translation of the underlying hedged equity. The company monitors this cash loss potential on an ongoing basis and may discontinue some of these hedging relationships by de-designating or terminating the derivative instrument in order to manage the liquidity risk. Although not designated as accounting hedges, the company may utilize derivatives to offset the changes in the fair value of the de-designated instruments from the date of de-designation until maturity.

In its hedging programs, the company uses forward contracts, futures contracts, interest-rate swaps and cross-currency swaps, depending upon the underlying exposure. The company is not a party to leveraged derivative instruments.

A brief description of the major hedging programs, categorized by underlying risk, follows.

**Interest Rate Risk**

**Fixed and Variable Rate Borrowings**

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 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 issuances into variable-rate debt (i.e., fair value hedges) and to convert specific variable-rate debt issuances into fixed-rate debt (i.e., cash flow hedges). At June 30, 2012 and December 31, 2011, the total notional amount of the company's interest rate swaps was \$5.9 billion and \$5.9 billion, respectively. The weighted-average remaining maturity of these instruments at June 30, 2012 and December 31, 2011 was approximately 5.0 years and 5.5 years, respectively.

### **Forecasted Debt Issuance**

The company is exposed to interest rate volatility on future 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. The company did not have any derivative instruments relating to this program outstanding at June 30, 2012 and December 31, 2011.

At June 30, 2012 and December 31, 2011, net losses of approximately \$1 million and \$5 million (before taxes), respectively, were recorded in accumulated other comprehensive income/(loss) in connection with cash flow hedges of the company's borrowings. Within these amounts, \$2 million and \$6 million of losses are expected to be reclassified to net income within the next 12 months, providing an offsetting economic impact against the underlying transactions.

### **Foreign Exchange Risk**

#### **Long-Term Investments in Foreign Subsidiaries (Net Investment)**

A large portion of the company's foreign currency denominated debt portfolio is designated as a hedge of net investment in foreign subsidiaries to reduce 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 cross-currency swaps and foreign exchange forward contracts for this risk management purpose. At June 30, 2012 and December 31, 2011, the total notional amount of derivative instruments designated as net investment hedges was \$6.7 billion and \$5.0 billion,

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**Notes to Consolidated Financial Statements (continued)**

respectively. The weighted-average remaining maturity of these instruments at June 30, 2012 and December 31, 2011 was approximately 0.2 years and 0.4 years, respectively.

**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 forward contracts 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 four years. At June 30, 2012 and December 31, 2011, the total notional amount of forward contracts designated as cash flow hedges of forecasted royalty and cost transactions was \$11.4 billion and \$10.9 billion, respectively, with a weighted-average remaining maturity of 0.7 years and 0.7 years, respectively.

At June 30, 2012 and December 31, 2011, in connection with cash flow hedges of anticipated royalties and cost transactions, the company recorded net gains of \$69 million and \$88 million (before taxes), respectively, in accumulated other comprehensive income/(loss). Within these amounts \$199 million and \$191 million of gains, respectively, are expected to be reclassified to net income within the next 12 months, providing an offsetting economic impact against the underlying anticipated transactions.

**Foreign Currency Denominated Borrowings**

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. At June 30, 2012 and December 31, 2011, no instruments relating to this program were outstanding.

**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. At June 30, 2012 and December 31, 2011, the total notional amount of derivative instruments in economic hedges of foreign currency exposure was \$14.1 billion and \$13.6 billion, respectively.

### **Equity Risk Management**

The company is exposed to market price changes in certain broad market indices and in the company's own stock primarily related to certain obligations to employees. Changes in the overall value of these employee compensation obligations are recorded in selling, general and administrative (SG&A) expense in the Consolidated Statement of Earnings. Although not designated as accounting hedges, the company utilizes derivatives, including equity swaps and futures, to economically hedge the exposures related to its employee compensation obligations. The derivatives are linked to the total return on certain broad 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. At June 30, 2012 and December 31, 2011, the total notional amount of derivative instruments in economic hedges of these compensation obligations was \$1.1 billion and \$1.0 billion, respectively.

### **Other Risks**

The company may hold warrants to purchase shares of common stock in connection with various 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 did not have any warrants qualifying as derivatives outstanding at June 30, 2012 and December 31, 2011.

The company is exposed to a potential loss if a client fails to pay amounts due under contractual terms. The company utilizes credit default swaps to economically hedge its credit exposures. These derivatives have terms of one year or less. The

Table of Contents**Notes to Consolidated Financial Statements (continued)**

swaps are recorded at fair value with gains and losses reported in other (income) and expense in the Consolidated Statement of Earnings. The company did not have any derivative instruments relating to this program outstanding at June 30, 2012 and December 31, 2011.

The following tables provide a quantitative summary of the derivative and non-derivative instrument related risk management activity as of June 30, 2012 and December 31, 2011 as well as for the three and six months ended June 30, 2012 and 2011, respectively:

**Fair Values of Derivative Instruments in the Consolidated Statement of Financial Position****As of June 30, 2012 and December 31, 2011**

(Dollars in millions)	Fair Value of Derivative Assets			Fair Value of Derivative Liabilities		
	Balance Sheet Classification	6/30/2012	12/31/2011	Balance Sheet Classification	6/30/2012	12/31/2011
<b>Designated as hedging instruments:</b>						
<b>Interest rate contracts:</b>	Prepaid expenses and other current assets	\$ 43	\$ 50	Other accrued expenses and liabilities	\$	\$
	Investments and sundry assets	742	733	Other liabilities		
<b>Foreign exchange contracts:</b>	Prepaid expenses and other current assets	397	407	Other accrued expenses and liabilities	266	273
	Investments and sundry assets			Other liabilities	141	155
<b>Fair value of derivative assets</b>		<b>\$ 1,182</b>	<b>\$ 1,190</b>	<b>Fair value of derivative liabilities</b>	<b>\$ 408</b>	<b>\$ 428</b>
<b>Not designated as hedging instruments:</b>						
<b>Foreign exchange contracts:</b>	Prepaid expenses and other current assets	\$ 134	\$ 82	Other accrued expenses and liabilities	\$ 87	\$ 84
	Investments and sundry assets	16	21	Other liabilities	10	11
<b>Equity contracts:</b>	Prepaid expenses and other current assets	24	7	Other accrued expenses and liabilities	7	8
<b>Fair value of derivative assets</b>		<b>\$ 174</b>	<b>\$ 110</b>	<b>Fair value of derivative liabilities</b>	<b>\$ 104</b>	<b>\$ 103</b>
<b>Total debt designated as hedging instruments:</b>						

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Short-term debt	N/A	N/A	\$	626	\$	
Long-term debt	N/A	N/A		1,690		1,884
<b>Total</b>	\$	1,356	\$	1,300	\$	2,828
					\$	2,415

N/A not applicable

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## Notes to Consolidated Financial Statements (continued)

## The Effect of Derivative Instruments in the Consolidated Statement of Earnings

For the three months ended June 30, 2012 and 2011

(Dollars in millions) For the three months ended June 30:	Consolidated Statement of Earnings Line Item	Gain (Loss) Recognized in Earnings Recognized on Derivatives(1)		Attributable to Risk Being Hedged(2)	
		2012	2011	2012	2011
<b>Derivative instruments in fair value hedges:</b>					
Interest rate contracts	Cost of financing	\$ 80	\$ 68	\$ (47)	\$ (27)
	Interest expense	65	48	(39)	(19)
<b>Derivative instruments not designated as hedging instruments:(1)</b>					
Foreign exchange contracts	Other (income) and expense	(122)	117	N/A	N/A
Equity contracts	SG&A expense	(35)	13	N/A	N/A
Warrants	Other (income) and expense			N/A	N/A
Total		\$ (12)	\$ 246	\$ (86)	\$ (46)

For the three months ended June 30:	Effective Portion Recognized in OCI		Consolidated Statement of Earnings Line Item	Effective Portion Reclassified from AOCI		(Ineffectiveness) and Amounts Excluded from Effectiveness Testing(3)	
	2012	2011		2012	2011	2012	2011
<b>Derivative instruments in cash flow hedges:</b>							
Interest rate contracts	\$	\$	Interest expense	\$ (2)	\$ (2)	\$	\$
Foreign exchange contracts	68	(217)	Other (income) and expense	86	(123)	1	(1)
			Cost of sales	11	(69)		
			SG&A expense	15	(33)		
<b>Instruments in net investment hedges(4):</b>							
Foreign exchange contracts	149	(102)	Interest expense		0	1	(4)
Total	\$ 217	\$ (319)		\$ 111	\$ (227)	\$ 2	\$ (5)

N/A-not applicable

Note: AOCI represents Accumulated other comprehensive income/(loss) in the Consolidated Statement of Changes in Equity.



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- (1) The amount includes changes in clean fair values of the derivative instruments in fair value hedging relationships and the periodic accrual for coupon payments required under these derivative contracts.
- (2) The amount includes basis adjustments to the carrying value of the hedged item recorded during the period and amortization of basis adjustments recorded on de-designated hedging relationships during the period.
- (3) The amount of gain (loss) recognized in income represents ineffectiveness on hedge relationships.
- (4) Instruments in net investment hedges include derivative and non-derivative instruments.

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## Notes to Consolidated Financial Statements (continued)

## The Effect of Derivative Instruments in the Consolidated Statement of Earnings

For the six months ended June 30, 2012 and 2011

(Dollars in millions) For the six months ended June 30:	Consolidated Statement of Earnings Line Item	Gain (Loss) Recognized in Earnings Recognized on Derivatives(1)		Attributable to Risk Being Hedged(2)	
		2012	2011	2012	2011
<b>Derivative instruments in fair value hedges:</b>					
Interest rate contracts	Cost of financing	\$ 56	\$ 60	\$ 8	\$ 24
	Interest expense	45	41	7	16
<b>Derivative instruments not designated as hedging instruments:(1)</b>					
Foreign exchange contracts	Other (income) and expense	(204)	205	N/A	N/A
Equity contracts	SG&A expense	63	72	N/A	N/A
Warrants	Other (income) and expense			N/A	N/A
Total		\$ (40)	\$ 378	\$ 15	\$ 40

For the six months ended June 30:	Effective Portion Recognized in OCI		Consolidated Statement of Earnings Line Item	Effective Portion Reclassified from AOCI		(Ineffectiveness) and Amounts Excluded from Effectiveness Testing(3)	
	2012	2011		2012	2011	2012	2011
<b>Derivative instruments in cash flow hedges:</b>							
Interest rate contracts	\$	\$	Interest expense	\$ (4)	\$ (4)	\$	\$
Foreign exchange contracts	119	(454)	Other (income) and expense	106	(170)	2	0
			Cost of sales	16	(103)		
			SG&A expense	16	(51)		
<b>Instruments in net investment hedges(4):</b>							
Foreign exchange contracts	112	(252)	Interest expense		0	3	(5)
Total	\$ 231	\$ (706)		\$ 134	\$ (328)	\$ 5	\$ (5)

N/A-not applicable

Note: AOCI represents Accumulated other comprehensive income/(loss) in the Consolidated Statement of Changes in Equity.

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- (1) The amount includes changes in clean fair values of the derivative instruments in fair value hedging relationships and the periodic accrual for coupon payments required under these derivative contracts.
- (2) The amount includes basis adjustments to the carrying value of the hedged item recorded during the period and amortization of basis adjustments recorded on de-designated hedging relationships during the period.
- (3) The amount of gain (loss) recognized in income represents ineffectiveness on hedge relationships.
- (4) Instruments in net investment hedges include derivative and non-derivative instruments.

For the three and six months ending June 30, 2012, and 2011, 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), 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.

Refer to the company's 2011 Annual Report, Note A, Significant Accounting Policies, on pages 83 and 84 for additional information on the company's use of derivative financial instruments.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

**4. Financing Receivables:** The following table presents financing receivables, net of allowances for credit losses, including residual values.

(Dollars in millions)	At June 30, 2012		At December 31, 2011	
<b><u>Current:</u></b>				
Net investment in sales-type and direct financing leases	\$	3,762	\$	3,765
Commercial financing receivables		5,441		7,095
Client loan receivables		4,784		5,195
Installment payment receivables		995		846
Total	\$	14,982	\$	16,901
<b><u>Noncurrent:</u></b>				
Net investment in sales-type and direct financing leases	\$	5,195	\$	5,406
Commercial financing receivables		7		34
Client loan receivables		5,139		4,925
Installment payment receivables		454		410
Total	\$	10,795	\$	10,776

Net investment in sales-type and direct financing leases relate principally to the company's systems products and are for terms ranging generally from two to six years. Net investment in sales-type and direct financing leases includes unguaranteed residual values of \$713 million and \$745 million at June 30, 2012 and December 31, 2011, respectively, and is reflected net of unearned income of \$682 million and \$733 million, and net of the allowance for credit losses of \$116 million and \$118 million at those dates, respectively.

Commercial financing receivables, net of allowance for credit losses of \$39 million and \$53 million at June 30, 2012 and December 31, 2011, respectively, 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, net of allowance for credit losses of \$140 million and \$126 million at June 30, 2012 and December 31, 2011, respectively, are loans that are provided by Global Financing primarily to clients to finance the purchase of software and services. Separate contractual relationships on these financing arrangements are for terms ranging generally from one to seven years.

Installment payment receivables, net of allowance for credit losses of \$31 million and \$51 million at June 30, 2012 and December 31, 2011, respectively, are loans that are provided primarily to clients to finance hardware, software and services ranging generally from one to three years.

Client loan receivables and installment payment receivables financing contracts are priced independently at competitive market rates. The company has a history of enforcing the terms of these separate financing agreements.

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The company utilizes certain of its financing receivables as collateral for non-recourse borrowings. Financing receivables pledged as collateral for borrowings were \$368 million and \$324 million at June 30, 2012 and December 31, 2011, respectively.

The company did not have any financing receivables held for sale as of June 30, 2012 and December 31, 2011.

### **Financing Receivables by Portfolio Segment**

The following tables present financing receivables on a gross basis excluding the allowance for credit losses and residual value, by portfolio segment and by class, excluding current commercial financing receivables and other miscellaneous current financing receivables at June 30, 2012 and December 31, 2011. The company determines its allowance for credit losses based on two portfolio segments: lease receivables and loan receivables, and further segments the portfolio via two classes: major markets and growth markets. For additional information on the company's accounting policies for the allowance for credit losses, see the company's 2011 Annual Report beginning on page 85.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

(Dollars in millions) At June 30, 2012	Major Markets	Growth Markets	Total
<b>Financing receivables:</b>			
Lease Receivables	\$ 6,423	\$ 1,836	\$ 8,259
Loan Receivables	8,682	2,879	11,561
Ending balance	\$ 15,105	\$ 4,715	\$ 19,820
Collectively evaluated for impairment	\$ 14,971	\$ 4,610	\$ 19,581
Individually evaluated for impairment	\$ 134	\$ 105	\$ 239
<b>Allowance for credit losses:</b>			
Beginning balance at January 1, 2012			
Lease Receivables	\$ 79	\$ 40	\$ 118
Loan Receivables	125	64	189
Total	\$ 203	\$ 104	\$ 307
Write-offs	(4)	(1)	(5)
Provision	(9)	8	(1)
Other	(2)	(1)	(3)
Ending balance at June 30, 2012	\$ 188	\$ 110	\$ 298
Lease Receivables	\$ 71	\$ 45	\$ 116
Loan Receivables	\$ 117	\$ 65	\$ 182
Collectively evaluated for impairment	\$ 85	\$ 19	\$ 104
Individually evaluated for impairment	\$ 103	\$ 91	\$ 194

(Dollars in millions) At December 31, 2011	Major Markets	Growth Markets	Total
<b>Financing receivables:</b>			
Lease receivables	\$ 6,510	\$ 1,921	\$ 8,430
Loan receivables	9,077	2,552	11,629
Ending balance	\$ 15,587	\$ 4,472	\$ 20,060
Collectively evaluated for impairment	\$ 15,321	\$ 4,370	\$ 19,692
Individually evaluated for impairment	\$ 266	\$ 102	\$ 368
<b>Allowance for credit losses:</b>			
Beginning balance at January 1, 2011			
Lease receivables	\$ 84	\$ 42	\$ 126
Loan receivables	150	76	226
Total	\$ 234	\$ 119	\$ 353
Write-offs	(68)	(16)	(84)
Provision	39	5	44
Other	(1)	(4)	(5)
Ending balance at December 31, 2011	\$ 203	\$ 104	\$ 307
Lease receivables	\$ 79	\$ 40	\$ 118
Loan receivables	\$ 125	\$ 64	\$ 189
Collectively evaluated for impairment	\$ 82	\$ 15	\$ 96
Individually evaluated for impairment	\$ 122	\$ 89	\$ 211

When determining the allowances, financing receivables are evaluated either on an individual or a collective basis. For individually evaluated receivables, the company determines the expected cash flow for the receivable and calculates an 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. In addition, the company records an unallocated reserve that is determined 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, characteristics (lease/loan) and loss history.

Table of Contents**Notes to Consolidated Financial Statements (continued)****Financing Receivables on Non-Accrual Status**

Certain receivables for which the company has recorded a specific reserve may also be placed on non-accrual status. Non-accrual assets are those receivables 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.

The following table presents the recorded investment in financing receivables which are on non-accrual status at June 30, 2012 and December 31, 2011.

(Dollars in millions)	At June 30, 2012		At December 31, 2011	
Major markets	\$	27	\$	46
Growth markets		22		20
Total lease receivables	\$	50	\$	66
Major markets	\$	52	\$	75
Growth markets		28		24
Total loan receivables	\$	80	\$	99
Total receivables	\$	130	\$	165

**Impaired Loans**

The company considers any loan with an individually evaluated reserve as an impaired loan. Depending on the level of impairment, loans will also be placed on non-accrual status (see section Financing Receivables on Non-Accrual Status ).

The following tables present impaired client loan receivables.

(Dollars in millions)	At June 30, 2012		At December 31, 2011	
	Recorded Investment	Related Allowance	Recorded Investment	Related Allowance
Major markets	\$ 76	\$ 65	\$ 110	\$ 70
Growth markets	62	53	62	53
Total	\$ 139	\$ 118	\$ 172	\$ 123



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(Dollars in millions) For the three months ended June 30, 2012:	Average Recorded Investment		Interest Income Recognized*		Interest Income Recognized on Cash Basis
Major markets	\$ 81	\$	0	\$	0
Growth markets	64		0		0
Total	\$ 145	\$	0	\$	0

---

\* Impaired loans are placed on non-accrual status, depending on the level of impairment.

(Dollars in millions) For the three months ended June 30, 2011:	Average Recorded Investment		Interest Income Recognized*		Interest Income Recognized on Cash Basis
Major markets	\$ 147	\$	1	\$	0
Growth markets	99		0		0
Total	\$ 246	\$	1	\$	0

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\* Impaired loans are placed on non-accrual status, depending on the level of impairment.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

(Dollars in millions) For the six months ended June 30 2012:	Average Recorded Investment	Interest Income Recognized*	Interest Income Recognized on Cash Basis
Major markets	\$ 91	\$ 0	\$ 0
Growth markets	63	0	0
Total	\$ 154	\$ 0	\$ 0

---

\* Impaired loans are placed on non-accrual status, depending on the level of impairment

(Dollars in millions) For the six months ended June 30 2011:	Average Recorded Investment	Interest Income Recognized*	Interest Income Recognized on Cash Basis
Major markets	\$ 163	\$ 1	\$ 0
Growth markets	110	0	0
Total	\$ 273	\$ 2	\$ 0

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\* Impaired loans are placed on non-accrual status, depending on the level of impairment

**Credit Quality Indicators**

The company's credit quality indicators, which are based on rating agency data, publicly available information and information provided by customers, are reviewed periodically based on the relative level of risk. The resulting indicators are a numerical rating system that maps to Moody's Investors Service credit ratings as shown below. Moody's does not provide credit ratings to the company on its customers.

The tables below present the gross recorded investment for each class of receivables, by credit quality indicator, at June 30, 2012 and December 31, 2011. Receivables with a credit quality indicator ranging from Aaa to Baa3 are considered investment grade. All others are considered non-investment grade.

(Dollars in millions) At June 30, 2012:	Lease Receivables		Loan Receivables	
	Major Markets	Growth Markets	Major Markets	Growth Markets
Credit Rating:				
Aaa Aa3	\$ 552	\$ 95	\$ 746	\$ 149
A1 A3	1,522	231	2,057	362
Baal Baa3	2,244	644	3,033	1,011
Bal Ba2	1,218	422	1,647	662

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Ba3 B1	542	315	733	495
B2 B3	270	107	366	168
Caa D	75	20	101	32
Total	\$ 6,423	\$ 1,836	\$ 8,682	\$ 2,879

At June 30, 2012, the industries which made up Global Financing's receivables portfolio consist of: Financial (39 percent), Government (15 percent), Manufacturing (14 percent), Retail (9 percent), Services (8 percent), Communications (6 percent) and Other (9 percent).

Table of Contents**Notes to Consolidated Financial Statements (continued)**

(Dollars in millions) At December 31, 2011:	Lease Receivables		Loan Receivables	
	Major Markets	Growth Markets	Major Markets	Growth Markets
Credit Rating:				
Aaa Aa3	\$ 697	\$ 139	\$ 971	\$ 185
A1 A3	1,459	306	2,034	407
Baa1 Baa3	2,334	654	3,255	869
Ba1 Ba2	1,118	457	1,559	607
Ba3 B1	534	252	744	335
B2 B3	260	97	362	129
Caa D	108	15	151	20
Total	\$ 6,510	\$ 1,921	\$ 9,077	\$ 2,552

At December 31, 2011, the industries which make up Global Financing's receivables portfolio consist of: Financial (39 percent), Government (15 percent), Manufacturing (13 percent), Retail (9 percent), Services (7 percent), Communications (6 percent) and Other (11 percent).

**Past Due Financing Receivables**

The company views receivables as past due when payment has not been received after 90 days, measured from billing date.

(Dollars in millions) At June 30, 2012:	Total Past Due > 90 days*	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
Major markets	\$ 9	\$ 6,414	\$ 6,423	\$ 5
Growth markets	13	1,823	1,836	10
Total lease receivables	\$ 22	\$ 8,237	\$ 8,259	\$ 16
Major markets	\$ 26	\$ 8,656	\$ 8,682	\$ 7
Growth markets	30	2,849	2,879	25
Total loan receivables	\$ 56	\$ 11,505	\$ 11,561	\$ 32
Total	\$ 78	\$ 19,742	\$ 19,820	\$ 48

\* Does not include accounts that are fully reserved.

(Dollars in millions) At December 31, 2011:	Total Past Due > 90 days*	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
Major markets	\$ 6	\$ 6,504	\$ 6,510	\$ 6

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Growth markets		9		1,911		1,921		6
Total lease receivables	\$	16	\$	8,415	\$	8,430	\$	12
Major markets	\$	23	\$	9,054	\$	9,077	\$	7
Growth markets		22		2,530		2,552		19
Total loan receivables	\$	46	\$	11,584	\$	11,629	\$	26
Total	\$	62	\$	19,998	\$	20,060	\$	38

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\* Does not include accounts that are fully reserved.

Table of Contents**Notes to Consolidated Financial Statements (continued)****Troubled Debt Restructurings**

The company assessed all restructurings that occurred on or after January 1, 2011 and determined that there were no troubled debt restructurings for the year ended December 31, 2011 and the six months ended June 30, 2012.

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

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Cost	\$ 30	\$ 22	\$ 64	\$ 46
Selling, general and administrative	117	126	236	256
Research, development and engineering	12	14	27	30
Pre-tax stock-based compensation cost	160	162	328	332
Income tax benefits	(56)	(59)	(116)	(120)
Total stock-based compensation cost	\$ 104	\$ 104	\$ 212	\$ 212

The decrease in pre-tax stock-based compensation cost for the three and six months ended June 30, 2012, as compared to the corresponding periods in the prior year, was primarily due to a decrease related to the company's assumption of stock-based awards previously issued by acquired entities of \$1 million and \$3 million, respectively.

As of June 30, 2012, the total unrecognized compensation cost of \$1,411 million related to non-vested awards is expected to be recognized over a weighted-average period of approximately 3 years.

There was no significant capitalized stock-based compensation cost at June 30, 2012 and 2011.

**6. Segments:** The tables on pages 26 and 27 reflect the results of operations of the company's segments consistent with the management and measurement system utilized within the company. Performance measurement is based on pre-tax income. These results are used, in part, by senior management, both in evaluating the performance of, and in allocating resources to, each of the segments.

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## Notes to Consolidated Financial Statements (continued)

## SEGMENT INFORMATION

(Dollars in millions)	Global Services		Software	Systems and Technology	Global Financing	Total Segments
	Global Technology Services	Global Business Services				
<b>For the three months ended June 30, 2012:</b>						
External revenue	\$ 9,995	\$ 4,667	\$ 6,171	\$ 4,259	\$ 517	\$ 25,608
Internal revenue	291	180	776	159	515	1,921
Total revenue	\$ 10,286	\$ 4,847	\$ 6,946	\$ 4,418	\$ 1,032	\$ 27,529
Pre-tax income	\$ 1,757	\$ 803	\$ 2,493	\$ 234	\$ 528	\$ 5,814
Revenue year-to-year change	(2.6)%	(4.4)%	(0.2)%	(9.8)%	(3.2)%	(3.6)%
Pre-tax income year-to-year change	23.7%	7.0%	7.9%	(40.4)%	6.4%	8.3%
Pre-tax income margin	17.1%	16.6%	35.9%	5.3%	51.1%	21.1%
<b>For the three months ended June 30, 2011:</b>						
External revenue	\$ 10,241	\$ 4,866	\$ 6,169	\$ 4,681	\$ 519	\$ 26,476
Internal revenue	320	205	792	218	547	2,082
Total revenue	\$ 10,561	\$ 5,071	\$ 6,961	\$ 4,899	\$ 1,066	\$ 28,558
Pre-tax income	\$ 1,420	\$ 750	\$ 2,310	\$ 393	\$ 496	\$ 5,370
Pre-tax income margin	13.4%	14.8%	33.2%	8.0%	46.5%	18.8%

## Reconciliations to IBM as Reported:

(Dollars in millions)	2012		2011*	
<b>For the three months ended June 30:</b>				
Revenue:				
Total reportable segments	\$	27,529	\$	28,558
Eliminations of internal transactions		(1,921)		(2,082)
Other revenue adjustments		175		191
Total IBM Consolidated	\$	25,783	\$	26,666
Pre-tax income:				
Total reportable segments	\$	5,814	\$	5,370
Amortization of acquired intangible assets		(173)		(159)
Acquisition-related charges		(7)		(4)
Non-operating retirement-related (costs)/income		(94)		12
Eliminations of internal transactions		(343)		(315)
Unallocated corporate amounts		(36)		(18)
Total IBM Consolidated	\$	5,161	\$	4,885

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\* Reclassified to conform with 2012 presentation.



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## Notes to Consolidated Financial Statements (continued)

## SEGMENT INFORMATION

(Dollars in millions)	Global Services		Software	Systems and Technology	Global Financing	Total Segments
	Global Technology Services	Global Business Services				
<b>For the six months ended June 30, 2012:</b>						
External revenue	\$ 20,031	\$ 9,304	\$ 11,770	\$ 8,008	\$ 1,006	\$ 50,120
Internal revenue	584	363	1,615	309	1,000	3,872
Total revenue	\$ 20,615	\$ 9,667	\$ 13,386	\$ 8,317	\$ 2,006	\$ 53,991
Pre-tax income	\$ 3,237	\$ 1,404	\$ 4,438	\$ 130	\$ 1,040	\$ 10,248
Revenue year-to-year change	(0.6)%	(3.1)%	2.2%	(9.2)%	(3.5)%	(1.9)%
Pre-tax income year-to-year change	21.8%	1.0%	9.7%	(75.3)%	2.4%	6.4%
Pre-tax income margin	15.7%	14.5%	33.2%	1.6%	51.8%	19.0%
<b>For the six months ended June 30, 2011:</b>						
External revenue	\$ 20,104	\$ 9,575	\$ 11,478	\$ 8,700	\$ 1,035	\$ 50,892
Internal revenue	627	405	1,621	462	1,044	4,160
Total revenue	\$ 20,732	\$ 9,980	\$ 13,099	\$ 9,162	\$ 2,079	\$ 55,052
Pre-tax income	\$ 2,658	\$ 1,390	\$ 4,045	\$ 525	\$ 1,015	\$ 9,634
Pre-tax income margin	12.8%	13.9%	30.9%	5.7%	48.8%	17.5%

## Reconciliations to IBM as Reported:

(Dollars in millions)	2012		2011*	
<b>For the six months ended June 30:</b>				
Revenue:				
Total reportable segments	\$	53,991	\$	55,052
Eliminations of internal transactions		(3,872)		(4,160)
Other revenue adjustments		336		381
Total IBM Consolidated	\$	50,456	\$	51,273
Pre-tax income:				
Total reportable segments	\$	10,248	\$	9,634
Amortization of acquired intangible assets		(339)		(318)
Acquisition-related charges		(14)		(11)
Non-operating retirement-related (costs)/income		(197)		8
Eliminations of internal transactions		(627)		(624)
Unallocated corporate amounts		(74)		13
Total IBM Consolidated	\$	8,997	\$	8,702

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\* Reclassified to conform with 2011 presentation.

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## Notes to Consolidated Financial Statements (continued)

7. Equity Activity:

## Taxes Related to Items of Other Comprehensive Income

(Dollars in millions)	Before Tax Amount	Tax (Expense)/ Benefit	Net of Tax Amount
<b>For the three months ended June 30, 2012:</b>			
<b>Other comprehensive income/(loss):</b>			
<b>Foreign currency translation adjustments</b>	\$ (724)	\$ (58)	\$ (782)
<b>Net changes related to available-for-sale securities</b>			
Unrealized gains/(losses) arising during the period	\$ (3)	\$ 1	\$ (2)
Reclassification of (gains)/losses to net income	(2)	1	(1)
Subsequent changes in previously impaired securities arising during the period	9	(3)	6
<b>Total net changes related to available-for-sale securities</b>	\$ 4	\$ (1)	\$ 2
<b>Unrealized gains/(losses) on cash flow hedges</b>			
Unrealized gains/(losses) arising during the period	\$ 68	\$ (15)	\$ 53
Reclassification of (gains)/losses to net income	(111)	37	(74)
<b>Total unrealized gains/(losses) on cash flow hedges</b>	\$ (42)	\$ 21	\$ (21)
<b>Retirement-related benefit plans</b>			
Prior service costs/(credits)	0	0	0
Net (losses)/gains arising during the period	70	(26)	45
Curtailments and settlements	0	0	0
Amortization of prior service (credits)/costs	(37)	13	(24)
Amortization of net (gains)/losses	613	(217)	397
<b>Total retirement-related benefit plans</b>	\$ 647	\$ (229)	\$ 418
<b>Other comprehensive income/(loss)</b>	\$ (115)	\$ (268)	\$ (383)

(Dollars in millions)	Before Tax Amount	Tax (Expense)/ Benefit	Net of Tax Amount
<b>For the three months ended June 30, 2011:</b>			
<b>Other comprehensive income/(loss):</b>			
<b>Foreign currency translation adjustments</b>	\$ 350	\$ 39	\$ 389
<b>Net changes related to available-for-sale securities</b>			
Unrealized gains/(losses) arising during the period	\$ (7)	\$ 4	\$ (3)
Reclassification of (gains)/losses to net income	(29)	10	(19)
Subsequent changes in previously impaired securities arising during the period	0	0	0
<b>Total net changes related to available-for-sale securities</b>	\$ (35)	\$ 13	\$ (22)
<b>Unrealized gains/(losses) on cash flow hedges</b>			
Unrealized gains/(losses) arising during the period	\$ (217)	\$ 77	\$ (141)
Reclassification of (gains)/losses to net income	227	(78)	149
<b>Total unrealized gains/(losses) on cash flow hedges</b>	\$ 10	\$ (2)	\$ 8
<b>Retirement-related benefit plans</b>			

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Prior service costs/credits	\$	(31)	\$	11	\$	(20)
Net (losses)/gains arising during the period		585		(204)		382
Curtailments and settlements		4		(1)		2
Amortization of prior service (credits)/costs		(39)		14		(25)
Amortization of net (gains)/losses		458		(164)		294
<b>Total retirement-related benefit plans</b>	\$	977	\$	(344)	\$	634
<b>Other comprehensive income/(loss)</b>	\$	1,301	\$	(292)	\$	1,010

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## Notes to Consolidated Financial Statements (continued)

## Taxes Related to Items of Other Comprehensive Income

(Dollars in millions)				
	Before Tax		Tax	Net of Tax
	Amount		(Expense)/	Amount
			Benefit	
<b>For the six months ended June 30, 2012:</b>				
<b>Other comprehensive income/(loss):</b>				
<b>Foreign currency translation adjustments</b>	\$	(337)	\$ (48)	\$ (385)
<b>Net changes related to available-for-sale securities</b>				
Unrealized gains/(losses) arising during the period	\$	3	\$ (1)	\$ 2
Reclassification of (gains)/losses to net income		(16)	6	(10)
Subsequent changes in previously impaired securities arising during the period		27	(10)	17
<b>Total net changes related to available-for-sale securities</b>	\$	14	\$ (5)	\$ 9
<b>Unrealized gains/(losses) on cash flow hedges</b>				
Unrealized gains/(losses) arising during the period	\$	119	\$ (45)	\$ 74
Reclassification of (gains)/losses to net income		(135)	44	(91)
<b>Total unrealized gains/(losses) on cash flow hedges</b>	\$	(16)	\$ (1)	\$ (17)
<b>Retirement-related benefit plans</b>				
Prior service costs/(credits)		0	0	0
Net (losses)/gains arising during the period		65	(23)	41
Curtailments and settlements		0	0	0
Amortization of prior service (credits)/costs		(74)	27	(47)
Amortization of net (gains)/losses		1,232	(446)	786
<b>Total retirement-related benefit plans</b>	\$	1,223	\$ (443)	\$ 780
<b>Other comprehensive income/(loss)</b>	\$	884	\$ (497)	\$ 387

(Dollars in millions)				
	Before Tax		Tax	Net of Tax
	Amount		(Expense)/	Amount
			Benefit	
<b>For the six months ended June 30, 2011:</b>				
<b>Other comprehensive income/(loss):</b>				
<b>Foreign currency translation adjustments</b>	\$	826	\$ 97	\$ 924
<b>Net changes related to available-for-sale securities</b>				
Unrealized gains/(losses) arising during the period	\$	(14)	\$ 6	\$ (9)
Reclassification of (gains)/losses to net income		(232)	88	(144)
Subsequent changes in previously impaired securities arising during the period		11	(4)	7
<b>Total net changes related to available-for-sale securities</b>	\$	(234)	\$ 89	\$ (145)
<b>Unrealized gains/(losses) on cash flow hedges</b>				
Unrealized gains/(losses) arising during the period	\$	(454)	\$ 153	\$ (301)
Reclassification of (gains)/losses to net income		327	(113)	214
<b>Total unrealized gains/(losses) on cash flow hedges</b>	\$	(127)	\$ 40	\$ (87)
<b>Retirement-related benefit plans</b>				
Prior service costs/(credits)	\$	(32)	\$ 11	\$ (21)
Net (losses)/gains arising during the period		606	(210)	395
Curtailments and settlements		13	(4)	8
Amortization of prior service (credits)/costs		(77)	27	(50)
Amortization of net (gains)/losses		932	(324)	608
<b>Total retirement-related benefit plans</b>	\$	1,441	\$ (500)	\$ 942
<b>Other comprehensive income/(loss)</b>	\$	1,906	\$ (272)	\$ 1,634



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**Notes to Consolidated Financial Statements (continued)**

**8. Retirement-Related Benefits:** The company offers defined benefit pension plans, defined contribution pension plans, as well as nonpension postretirement plans primarily consisting of retiree medical benefits. The following table provides the total retirement-related benefit plans impact on income before income taxes:

(Dollars in millions)					Yr. to Yr. Percent Change
For the three months ended June 30:	2012		2011		
Retirement-related plans cost					
Defined benefit and contribution pension plans cost	\$	459	\$	370	24.0%
Nonpension postretirement plans cost		89		88	2.1
Total	\$	548	\$	458	19.8%

(Dollars in millions)					Yr. to Yr. Percent Change
For the six months ended June 30:	2012		2011		
Retirement-related plans cost					
Defined benefit and contribution pension plans cost	\$	991	\$	802	23.6%
Nonpension postretirement plans cost		174		173	0.2
Total	\$	1,164	\$	975	19.4%

The following table provides the components of the cost/(income) for the company's pension plans:

## Cost/(Income) of Pension Plans

(Dollars in millions)	U.S. Plans		Non-U.S. Plans	
For the three months ended June 30:	2012	2011	2012	2011
Service cost	\$	\$	\$	\$
Interest cost	548	609	444	471
Expected return on plan assets	(1,011)	(1,007)	(573)	(643)
Amortization of prior service costs/(credits)	3	3	(38)	(40)
Recognized actuarial losses	330	198	256	242
Curtailments and settlements			0	1
Multi-employer plans/other costs			23	40
Total net periodic pension (income)/cost of defined benefit plans	(131)	(197)	222	195
Cost of defined contribution plans	212	216	156	156
Total defined benefit and contribution plans cost recognized in the Consolidated Statement of Earnings	\$	81	\$	19
			\$	378
			\$	351

(Dollars in millions)	U.S. Plans		Non-U.S. Plans	
For the six months ended June 30:	2012	2011	2012	2011

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Service cost	\$		\$		\$	224	\$	256
Interest cost		1,098		1,228		894		925
Expected return on plan assets		(2,022)		(2,022)		(1,153)		(1,263)
Amortization of prior service cost/(credits)		5		5		(77)		(80)
Recognized actuarial losses		665		409		515		487
Curtailments and settlements						1		1
Multi-employer plan/other costs						46		74
Total net periodic pension (income)/cost of defined benefit plans		(254)		(379)		449		399
Cost of defined contribution plans		477		481		319		302
Total defined benefit and contribution plans cost recognized in the Consolidated Statement of Earnings	\$	223	\$	101	\$	768	\$	700



Table of Contents**Notes to Consolidated Financial Statements (continued)**

In 2012, the company expects to contribute to its non-U.S. defined benefit plans approximately \$700 million, which is the legally mandated minimum contribution. Total net contributions to the non-U.S. plans in the first six months of 2012 were \$347 million.

The following table provides the components of the cost for the company's nonpension postretirement plans:

## Cost of Nonpension Postretirement Plans

(Dollars in millions)	U.S. Plan		Non-U.S. Plans	
For the three months ended June 30:	2012	2011	2012	2011
Service cost	\$ 9	\$ 9	\$ 2	\$ 3
Interest cost	51	59	16	17
Expected return on plan assets			(2)	(3)
Amortization of prior service costs/(credits)			(1)	(1)
Recognized actuarial losses	10		4	4
Total nonpension postretirement plan cost recognized in Consolidated Statement of Earnings	\$ 70	\$ 68	\$ 19	\$ 20

(Dollars in millions)	U.S. Plan		Non-U.S. Plans	
For the six months ended June 30:	2012	2011	2012	2011
Service cost	\$ 18	\$ 17	\$ 5	\$ 5
Interest cost	100	118	33	34
Expected return on plan assets			(5)	(5)
Amortization of prior service credits			(2)	(2)
Recognized actuarial losses	16		9	7
Total nonpension postretirement plan cost recognized in Consolidated Statement of Earnings	\$ 134	\$ 134	\$ 39	\$ 39

The company received a \$4.3 million subsidy in the second quarter of 2012 and a \$20.8 million subsidy for the first half of 2012 in connection with the Medicare Prescription Drug Improvement and Modernization Act of 2003. A portion of this amount is used by the company to reduce its obligation and expense related to the plan, and the remainder is contributed to the plan to reduce contributions required by the participants. For further information related to the Medicare Prescription Drug Act, see page 134 in the company's 2011 Annual Report.

In the second quarter, the U.S. Congress passed the Surface Transportation Extension Act, also referred to as the Moving Ahead for Progress in the 21st Century Act, which included pension funding stabilization provisions. The company has evaluated the provisions of the new law and expects no material impacts.

**9. Acquisitions/Divestitures:**

Acquisitions: During the six months ended June 30, 2012, the company completed eight acquisitions at an aggregate cost of \$2,205 million.

The Software segment completed seven acquisitions: in the first quarter, Green Hat Software Limited (Green Hat), Emptoris Inc. (Emptoris) and Worklight, Inc. (Worklight), all privately held companies, and DemandTec, Inc. (DemandTec), a publicly held company; and in the second quarter, Varicent Software Inc. (Varicent), Vivisimo Inc. (Vivisimo) and Tealeaf Technology Inc. (Tealeaf), all privately held companies. Systems and Technology (STG) completed the acquisition of Platform Computing Corporation (Platform Computing), a privately held company, in the first quarter. All acquisitions were for 100 percent of the acquired companies.

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The table below reflects the purchase price related to these acquisitions and the resulting purchase price allocations as of June 30, 2012:

(Dollars in millions)	Amortization Life (in yrs.)	Total Acquisitions
Current assets		\$ 261
Fixed assets/noncurrent assets		165
Intangible assets:		
Goodwill	N/A	1,596
Completed technology	7	344
Client relationships	7	186
In-process R&D	N/A	9
Patents/trademarks	1-7	36
Total assets acquired		2,598
Current liabilities		(133)
Noncurrent liabilities		(260)
Total liabilities assumed		(393)
Total purchase price		\$ 2,205

N/A - Not applicable

Each acquisition further complemented and enhanced the company's portfolio of product and services offerings. Green Hat helps customers improve the quality of software applications by enabling developers to use cloud computing technologies to conduct testing of a software application prior to its delivery. Emptoris expands the company's cloud-based analytics offerings that provide supply chain intelligence leading to better inventory management and cost efficiencies. Worklight delivers mobile application management capabilities to clients across a wide range of industries. The acquisition enhances the company's comprehensive mobile portfolio, which is designed to help global corporations leverage the proliferation of all mobile devices from laptops and smartphones to tablets. DemandTec delivers cloud-based analytics software to help organizations improve their price, promotion and product mix within the broad context of enterprise commerce. Varicent's software automates and analyzes data across sales, finance, human resources and IT departments to uncover trends and optimize sales performance and operations. Vivisimo software automates the discovery of big data, regardless of its format or where it resides, providing decision makers with a view of key business information necessary to drive new initiatives. Tealeaf provides a full suite of customer experience management software, which analyzes interactions on websites and mobile devices. Platform Computing's focused technical and distributed computing management software helps clients create, integrate and manage shared computing environments that are used in compute-and-data intensive applications such as simulations, computer modeling and analytics. Purchase price consideration for all acquisitions as reflected in the table above, is paid primarily in cash. All acquisitions are reported in the Consolidated Statement of Cash Flows net of acquired cash and cash equivalents.

The acquisitions were accounted for as business combinations using the acquisition method, and accordingly, the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquired entity 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 work-force, neither of which qualify as an amortizable intangible asset. The overall weighted-average life of the identified amortizable intangible assets acquired is 6.9 years. These identified intangible assets will be amortized on a straight-line basis over their useful lives. Goodwill of \$1,596 million has been assigned to the Software (\$1,370 million), Global Business Services (\$5 million) and Systems and Technology (\$222 million) segments. It is expected that approximately 10 percent of the goodwill will be deductible for tax purposes.

Divestitures: On April 17, 2012, the company announced that it had signed a definitive agreement with Toshiba Tec for the sale of its Retail Store Solutions business to Toshiba Tec. As part of the transaction, Toshiba Tec and the company will sign a multi-year business partner agreement to integrate retail store solutions for Smarter Commerce. The transaction price is \$850 million, and the company will receive approximately \$800 million in cash, net of closing date working capital adjustments. The company will acquire a 19.9 percent ownership for three years in the new holding company that Toshiba Tec will establish for the business. This transaction is subject to regulatory requirements and customary closing conditions and will close in phases, with the initial closing expected in the third quarter of 2012, and subsequent closings expected by the end of

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the year. The company expects to recognize a total pre-tax gain on the sale between \$450 million and \$550 million. The gain will be recognized consistent with the closing schedule for the transaction.

**10. Intangible Assets Including Goodwill:** The following table details the company's intangible asset balances by major asset class:

(Dollars in millions) Intangible asset class	Gross Carrying Amount	At June 30, 2012		Net Carrying Amount
		Accumulated Amortization		
Capitalized software	\$ 1,497	\$ (663)		\$ 834
Client relationships	1,922	(823)		1,099
Completed technology	2,478	(925)		1,552
In-process R&D	31	(2)		29
Patents/trademarks	247	(109)		138
Other(a)	30	(25)		5
<b>Total</b>	<b>\$ 6,204</b>	<b>\$ (2,547)</b>		<b>\$ 3,657</b>

(Dollars in millions) Intangible asset class	Gross Carrying Amount	At December 31, 2011		Net Carrying Amount
		Accumulated Amortization		
Capitalized software	\$ 1,478	\$ (678)		\$ 799
Client relationships	1,751	(715)		1,035
Completed technology	2,156	(745)		1,411
In-process R&D	22	(1)		21
Patents/trademarks	207	(88)		119
Other(a)	29	(22)		7
<b>Total</b>	<b>\$ 5,642</b>	<b>\$ (2,250)</b>		<b>\$ 3,392</b>

(a) Other intangibles are primarily acquired proprietary and non-proprietary business processes, methodologies and systems.

The net carrying amount of intangible assets increased \$265 million during the first half of 2012, primarily due to intangible asset additions resulting from acquisitions, partially offset by amortization. The aggregate intangible amortization expense was \$318 million and \$627 million for the second quarter and first six months of 2012 respectively, versus \$309 million and \$619 million for the second quarter and first six months ended June 30, 2011, respectively. In addition, in the first half of 2012, the company retired \$329 million of fully amortized intangible assets, impacting both the gross carrying amount and accumulated amortization by this amount.

The amortization expense for each of the five succeeding years relating to intangible assets currently recorded in the Consolidated Statement of Financial Position is estimated to be the following at June 30, 2012:

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(Dollars in millions)	Capitalized Software		Acquired Intangibles		Total
2012 (for Q3-Q4)	\$	274	\$	358	\$ 632
2013		376		653	1,029
2014		159		550	709
2015		25		423	447
2016				384	384

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The change in the goodwill balances by reportable segment, for the six months ended June 30, 2012 and for the year ended December 31, 2011 is as follows:

(Dollars in millions) Segment	Balance 01/01/12	Goodwill Additions	Purchase Price Adjustments	Divestitures	Foreign Currency Translation And Other Adjustments	Balance 6/30/12
Global Business Services	\$ 4,313	\$ 5	\$ (0)	\$	\$ (31)	\$ 4,287
Global Technology Services	2,646				(15)	2,631
Software	18,121	1,370	(5)	(3)	(21)	19,462
Systems and Technology	1,133	222	(0)		1	1,355
Total	\$ 26,213	\$ 1,596	\$ (5)	\$ (3)	\$ (67)	\$ 27,735

(Dollars in millions) Segment	Balance 01/01/11	Goodwill Additions	Purchase Price Adjustments	Divestitures	Foreign Currency Translation And Other Adjustments	Balance 12/31/11
Global Business Services	\$ 4,329	\$ 14	\$ (0)	\$ (10)	\$ (20)	\$ 4,313
Global Technology Services	2,704		(1)	(2)	(55)	2,646
Software	16,963	1,277	10	(2)	(127)	18,121
Systems and Technology	1,139		(6)		(0)	1,133
Total	\$ 25,136	\$ 1,291	\$ 2	\$ (13)	\$ (203)	\$ 26,213

Purchase price adjustments recorded in the first six months of 2012 and full year 2011 were related to acquisitions that were completed on or prior to December 31, 2011 or December 31, 2010, respectively, and were still subject to the measurement period that ends at the earlier of 12 months from the acquisition date or when information becomes available. There were no goodwill impairment losses recorded during the first six months of 2012 or the full year of 2011, and the company has no accumulated impairment losses.

**11. Restructuring-Related Liabilities:** The following table provides a roll forward of the current and noncurrent liability balances for special actions taken in the following periods: (1) the second quarter of 2005 associated with Global Services, primarily in Europe, (2) the fourth quarter of 2002 associated with the acquisition of the PricewaterhouseCoopers consulting business, (3) the second quarter of 2002 associated with the Microelectronics Division and the rebalancing of the company's workforce and leased space resources, (4) the 2002 actions associated with the hard disk drive 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.

(Dollars in millions)	Liability as of 01/01/12	Payments	Other Adjustments*	Liability as of 6/30/2012
Current:				