INTERNATIONAL BUSINESS MACHINES CORP
Form 10-Q
April 24, 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 MARCH 31, 2012

1-2360

(Commission file number)

INTERNATIONAL BUSINESS MACHINES CORPORATION

(Exact name of registrant as specified in its charter)

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

914-499-1900

(Registrant s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section l3 or l5(d) of the Securities Exchange Act of 1934 during the preceding l2 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

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

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

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

The registrant has 1,153,484,394 shares of common stock outstanding at March 31, 2012.

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PART I - Financial Information

ITEM 1. Consolidated Financial Statements:

**INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF EARNINGS
(UNAUDITED)**

(Dollars in millions except per share amounts)	Three Months Ended March 31, 2012	2011
Revenue:		
Services	$ 14,820	$ 14,696
Sales	9,356	9,387
Financing	497	524
Total revenue	24,673	24,607
Cost:		
Services	9,985	10,116
Sales	3,325	3,390
Financing	244	243
Total cost	13,555	13,749
Gross profit	11,118	10,858
Expense and other income:		
Selling, general and administrative	5,886	5,826
Research, development and engineering	1,601	1,587
Intellectual property and custom development income	(255)	(262)
Other (income) and expense	(58)	(202)
Interest expense	110	93
Total expense and other income	7,283	7,041
Income before income taxes	3,836	3,817
Provision for income taxes	769	954
Net income	$ 3,066	$ 2,863
Earnings per share of common stock:		
Assuming dilution	$ 2.61	$ 2.31
Basic	$ 2.65	$ 2.34
Weighted-average number of common shares outstanding: (millions)		
Assuming dilution	1,174.2	1,240.0
Basic	1,159.1	1,222.2
Cash dividend per common share	$ 0.75	$ 0.65

(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)

	Three Months Ended March 31,	
(Dollars in millions)	**2012**	**2011**
Net income	$ 3,066	$ 2,863
Other comprehensive income/(loss), before tax:		
Foreign currency translation adjustments	387	477
Net changes related to available-for-sale securities		
Unrealized gains/(losses) arising during the period	6	(7)
Reclassification of (gains)/losses to net income	(14)	(203)
Subsequent changes in previously impaired securities arising during the period	18	11
Total net changes related to available-for-sale securities	10	(199)
Unrealized gains/(losses) on cash flow hedges		
Unrealized gains/(losses) arising during the period	51	(237)
Reclassification of (gains)/losses to net income	(24)	101
Total unrealized gains/(losses) on cash flow hedges	27	(136)
Retirement-related benefit plans		
Prior service costs/(credits)	0	(1)
Net (losses)/gains arising during the period	(6)	20
Curtailments and settlements	0	9
Amortization of prior service (credits)/cost	(37)	(39)
Amortization of net (gains)/losses	619	473
Total retirement-related benefit plans	576	464
Other comprehensive income/(loss), before tax	1,000	606
Income tax (expense)/benefit related to items of other comprehensive income	(229)	20
Other comprehensive income/(loss)	770	624
Total comprehensive income	$ 3,837	$ 3,487

(Amounts may not add due to rounding)

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

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**INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(UNAUDITED)**

ASSETS

(Dollars in millions)	**At March 31, 2012**	**At December 31, 2011**
Assets:		
Current assets:		
Cash and cash equivalents	$ 11,835	$ 11,922
Marketable securities	500	0
Notes and accounts receivable trade (net of allowances of $272 in 2012 and $256 in 2011)	10,012	11,179
Short-term financing receivables (net of allowances of $282 in 2012 and $311 in 2011)	15,160	16,901
Other accounts receivable (net of allowances of $9 in 2012 and $11 in 2011)	1,669	1,481
Inventories, at lower of average cost or market:		
Finished goods	696	589
Work in process and raw materials	2,058	2,007
Total inventories	2,754	2,595
Deferred taxes	1,617	1,601
Prepaid expenses and other current assets	5,299	5,249
Total current assets	48,847	50,928
Property, plant and equipment	40,441	40,124
Less: Accumulated depreciation	26,496	26,241
Property, plant and equipment net	13,946	13,883
Long-term financing receivables (net of allowances of $58 in 2012 and $38 in 2011)	10,549	10,776
Prepaid pension assets	2,974	2,843
Deferred taxes	3,100	3,503
Goodwill	27,468	26,213
Intangible assets net	3,641	3,392
Investments and sundry assets	4,822	4,895
Total assets	$ 115,347	$ 116,433

(Amounts may not add due to rounding.)

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

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INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)
(UNAUDITED)

LIABILITIES AND EQUITY

(Dollars in millions)	At March 31, 2012	At December 31, 2011
Liabilities:		
Current liabilities:		
Taxes	$ 2,184	$ 3,313
Short-term debt	6,293	8,463
Accounts payable	7,416	8,517
Compensation and benefits	4,370	5,099
Deferred income	13,269	12,197
Other accrued expenses and liabilities	4,677	4,535
Total current liabilities	38,209	42,123
Long-term debt	25,760	22,857
Retirement and nonpension postretirement benefit obligations	17,579	18,374
Deferred income	3,904	3,847
Other liabilities	9,112	8,996
Total liabilities	94,563	96,197
Equity:		
IBM stockholders equity:		
Common stock, par value $0.20 per share, and additional paid-in capital	48,800	48,129
Shares authorized: 4,687,500,000		
Shares issued: 2012 - 2,188,158,632		
2011 - 2,182,469,838		
Retained earnings	107,036	104,857
Treasury stock - at cost	(114,020)	(110,963)
Shares: 2012 - 1,034,674,238		
2011 - 1,019,287,274		
Accumulated other comprehensive income/(loss)	(21,115)	(21,885)
Total IBM stockholders equity	20,701	20,138
Noncontrolling interests	82	97
Total equity	20,783	20,236
Total liabilities and equity	$ 115,347	$ 116,433

(Amounts may not add due to rounding.)

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

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**INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31,**

(UNAUDITED)

(Dollars in millions)	2012	2011*
Cash flows from operating activities:		
Net income	$ 3,066	$ 2,863
Adjustments to reconcile net income to cash provided by operating activities		
Depreciation	847	918
Amortization of intangibles	310	310
Stock-based compensation	168	170
Net (gain)/loss on asset sales and other	(143)	(320)
Changes in operating assets and liabilities, net of acquisitions/divestitures	43	(147)
Net cash provided by operating activities	4,291	3,792
Cash flows from investing activities:		
Payments for property, plant and equipment	(937)	(1,002)
Proceeds from disposition of property, plant and equipment	95	87
Investment in software	(160)	(143)
Acquisition of businesses, net of cash acquired	(1,319)	(51)
Non-operating finance receivables net	636	541
Purchases of marketable securities and other investments	(1,227)	(415)
Proceeds from disposition of marketable securities and other investments	681	1,481
Net cash provided by/(used in) investing activities	(2,230)	498
Cash flows from financing activities:		
Proceeds from new debt	3,906	1,054
Payments to settle debt	(848)	(1,539)
Short-term borrowings/(repayments) less than 90 days net	(2,107)	2,135
Common stock repurchases	(3,015)	(4,045)
Common stock transactions other	619	877
Cash dividends paid	(870)	(795)
Net cash used in financing activities	(2,316)	(2,314)
Effect of exchange rate changes on cash and cash equivalents	167	126
Net change in cash and cash equivalents	(87)	2,102
Cash and cash equivalents at January 1	11,922	10,661
Cash and cash equivalents at March 31	$ 11,835	$ 12,763

* 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
Equity - January 1, 2012	$ 48,129	$ 104,857	$ (110,963)	$ (21,885)	$ 20,138	$ 97	$ 20,236
Net income plus other comprehensive income/(loss)							
Net income		3,066			3,066		3,066
Other comprehensive income/(loss)				770	770		770
Total comprehensive income/(loss)					$ 3,837		$ 3,837
Cash dividends declared common stock		(870)			(870)		(870)
Common stock issued under employee plans (5,688,794 shares)	495				495		495
Purchases (864,073 shares) and sales (1,021,123 shares) of treasury stock under employee plans net		(18)	(54)		(72)		(72)
Other treasury shares purchased, not retired (15,544,014 shares)			(3,003)		(3,003)		(3,003)
Changes in other equity	176				176		176
Changes in noncontrolling interests						(15)	(15)
Equity - March 31, 2012	$ 48,800	$ 107,036	$ (114,020)	$ (21,115)	$ 20,701	$ 82	$ 20,783

(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
Equity - January 1, 2011	$ 45,418	$ 92,532	$ (96,161)	$ (18,743)	$ 23,046	$ 126	$ 23,172
Net income plus other comprehensive income/(loss)							
Net income		2,863			2,863		2,863
Other comprehensive income/(loss)				624	624		624
Total comprehensive income/(loss)					$ 3,487		$ 3,487

Cash dividends declared common stock		(795)			(795)		(795)
Common stock issued under employee plans (7,388,468 shares)	784				784		784
Purchases (528,947 shares) and sales (1,813,043 shares) of treasury stock under employee plans net		(9)	102		93		93
Other treasury shares purchased, not retired (25,465,909 shares)			(4,019)		(4,019)		(4,019)
Changes in other equity	75				75		75
Changes in noncontrolling interests						(22)	(22)
Equity - March 31, 2011	$ 46,278	$ 94,590	$ (100,078)	$ (18,119)	$ 22,671	$ 104	$ 22,776

(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 $3.6 million and $2.6 million, net of tax, for the three months ended March 31, 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 $(15) million and $(22) million for the three months ended March 31, 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 13 for fair value disclosures.

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.

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:

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Notes to Consolidated Financial Statements (continued)

- 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 three months ended March 31, 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.

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Notes to Consolidated Financial Statements (continued)

The following tables present the company s financial assets and financial liabilities that are measured at fair value on a recurring basis at March 31, 2012 and December 31, 2011.

(Dollars in millions) At March 31, 2012	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents(1)				
Time deposits and certificates of deposit	$	$ 1,604	$	$ 1,604
Commercial paper		1,016		1,016
Money market funds	1,171			1,171
U.S. government securities		3,200		3,200
Canada government securities		1,454		1,454
Other securities		1		1
Total	1,171	7,275		8,446(6)
Debt securities - current (2)		500		500(6)
Debt securities - noncurrent (3)	1	7		8
Available-for-sale equity investments(3)	27	32		59
Derivative assets (4)				
Interest rate contracts		756		756
Foreign exchange contracts		393		393
Equity contracts		30		30
Total		1,179		1,179(7)
Total assets	**$** 1,199	$ 8,993	$	$ 10,192(7)
Liabilities:				
Derivative liabilities (5)				
Foreign exchange contracts	$	$ 315	$	$ 315
Equity contracts		4		4
Total liabilities	**$**	$ 319	$	$ 319(7)

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

(2) U.S. 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 March 31, 2012 are $451 million and $728 million, respectively.

(5) The gross balances of derivative liabilities contained within other accrued expenses and liabilities, and other liabilities in the Consolidated Statement of Financial Position at March 31, 2012 are $223 million and $96 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 $230 million each.

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Notes to Consolidated Financial Statements (continued)

(Dollars in millions) At December 31, 2011	Level 1	Level 2	Level 3	Total
Assets:				
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
Total	1,886	6,600		8,486(5)
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
Total		1,300		1,300(6)
Total assets	**$** 1,956	$ 7,921	$	$ 9,877(6)
Liabilities:				
Derivative liabilities (4)				
Foreign exchange contracts	$	$ 523	$	$ 523
Equity contracts		8		8
Total liabilities	**$**	$ 531	$	$ 531(6)

* 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 three months ended March 31, 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 March 31, 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.

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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 $25,760 million and $22,857 million and the estimated fair value is $28,415 million and $27,383 million at March 31, 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 March 31, 2012:	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities noncurrent(1)	$ 7	$ 1	$	$ 8
Available-for-sale equity investments(1)	$ 27	$ 34	$ (2)	$ 59

(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 March 31, 2012, the company believes that unrealized losses on debt and marketable equity securities are temporary and do not represent a need for an other-than-temporary impairment.

Sales of debt and marketable equity securities during the period were as follows:

(Dollars in millions) For the three months ended March 31:	2012	2011
Proceeds	$ 45	$ 315
Gross realized gains (before taxes)	14	203
Gross realized losses (before taxes)	(0)	(0)

The after-tax net unrealized holding gains/(losses) on available-for-sale debt and marketable 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 March 31:	2012	2011
Net unrealized gains/(losses) arising during the period	$ 15	$ 1
Net unrealized (gains)/losses reclassified to net income*	(8)	(124)

* There were no significant writedowns for the three months ended March 31, 2012 and 2011.

The contractual maturities of substantially all available-for-sale debt securities are less than one year at March 31, 2012.

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Notes to Consolidated Financial Statements (continued)

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.

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 March 31, 2012 and December 31, 2011 was $76 million and $131 million, respectively, for which no collateral was posted at March 31, 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 March 31, 2012 and December 31, 2011 was $1,179 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 $230 million and $324 million at March 31, 2012 and December 31, 2011, respectively, of liabilities included in master netting arrangements with those counterparties. Additionally, at March 31, 2012 and December 31, 2011, this exposure was reduced by $483 million and $466 million of collateral, respectively, received by the company.

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 March 31, 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 $422 million and $466 million at March 31, 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 March 31, 2012 or at December 31, 2011. In addition to cash collateral, the company held $61 million in non-cash collateral, primarily in U.S. Treasury securities. Per accounting guidance, non-cash collateral is not recorded on the Statement of Financial Position.

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.

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Notes to Consolidated Financial Statements (continued)

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 March 31, 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 March 31, 2012 and December 31, 2011 was approximately 5.2 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 March 31, 2012 and December 31, 2011.

At March 31, 2012 and December 31, 2011, net losses of approximately $3 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, $5 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 March 31, 2012 and December 31, 2011, the total notional amount of derivative instruments designated as net investment hedges was $4.3 billion and $5.0 billion, respectively. The weighted-average remaining maturity of these instruments at March 31, 2012 and December 31, 2011 was approximately 0.3 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 March 31, 2012 and December 31, 2011, the total notional amount of forward contracts designated as cash flow hedges of forecasted royalty and cost transactions was $11.0 billion and $10.9 billion, respectively, with a weighted-average remaining maturity of 0.7 years and 0.7 years, respectively.

At March 31, 2012 and December 31, 2011, in connection with cash flow hedges of anticipated royalties and cost transactions, the company recorded net gains of $113 million and $88 million (before taxes), respectively, in accumulated other comprehensive income/(loss). Within these amounts $167 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.

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Notes to Consolidated Financial Statements (continued)

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. The maximum length of time over which the company is hedging its exposure to the variability in future cash flows is three years. At March 31, 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 March 31, 2012 and December 31, 2011, the total notional amount of derivative instruments in economic hedges of foreign currency exposure was $14.0 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 March 31, 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 March 31, 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 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 March 31, 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 March 31, 2012 and December 31, 2011 as well as for the three months ended March 31, 2012 and 2011, respectively:

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Notes to Consolidated Financial Statements (continued)

Fair Values of Derivative Instruments in the Consolidated Statement of Financial Position

As of March 31, 2012 and December 31, 2011

	Fair Value of Derivative Assets					Fair Value of Derivative Liabilities				
(Dollars in millions)	Balance Sheet Classification		3/31/2012		12/31/2011	Balance Sheet Classification		3/31/2012		12/31/2011
Designated as hedging instruments:										
Interest rate contracts:	Prepaid expenses and other current assets	$	56	$	50	Other accrued expenses and liabilities	$		$	
	Investments and sundry assets		700		733	Other liabilities				
Foreign exchange contracts:	Prepaid expenses and other current assets		238		407	Other accrued expenses and liabilities		194		273
	Investments and sundry assets		1			Other liabilities		85		155
Fair value of derivative assets		$	996	$	1,190	**Fair value of derivative liabilities**	$	280	$	428
Not designated as hedging instruments:										
Foreign exchange contracts:	Prepaid expenses and other current assets	$	128	$	82	Other accrued expenses and liabilities	$	25	$	84
	Investments and sundry assets		26		21	Other liabilities		11		11
Equity contracts:	Prepaid expenses and other current assets		29		7	Other accrued expenses and liabilities		4		8
Fair value of derivative assets		$	183	$	110	**Fair value of derivative liabilities**	$	39	$	103
Total debt designated as hedging instruments:										
	Short-term debt		N/A		N/A		$		$	
	Long-term debt		N/A		N/A			2,350		1,884
Total		$	1,179	$	1,300		$	2,668	$	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 March 31, 2012 and 2011

(Dollars in millions) For the three months ended March 31:	Consolidated Statement of Earnings Line Item	Gain (Loss) Recognized in Earnings: Recognized on Derivatives(1) 2012	2011	Attributable to Risk Being Hedged(2) 2012	2011
Derivative instruments in fair value hedges:					
Interest rate contracts	Cost of financing	$ (24)	$ (9)	$ 57	$ 52
	Interest expense	(19)	(6)	45	34
Derivative instruments not designated as hedging instruments:(1)					
Foreign exchange contracts	Other (income) and expense	(81)	87	N/A	N/A
Equity contracts	SG&A expense	98	59	N/A	N/A
Total		$ (26)	$ 131	$ 102	$ 86

Gain (Loss) Recognized in Earnings and Other Comprehensive Income

For the three months ended March 31:	Effective Portion Recognized in OCI 2012	2011	Consolidated Statement of Earnings Line Item	Effective Portion Reclassified from AOCI 2012	2011	(Ineffectiveness) and Amounts Excluded from Effectiveness Testing(3) 2012	2011
Derivative instruments in cash flow hedges:							
Interest rate contracts	$	$	Interest expense	$ (2)	$ (2)	$	$
Foreign exchange contracts	51	(237)	Other (income) and expense	20	(47)	1	0
			Cost of sales	5	(34)		
			SG&A expense	2	(17)		
Instruments in net investment hedges(4):							
Foreign exchange contracts	(37)	(151)	Interest expense		0	2	(1)
Total	$ 12	$ (388)		$ 24	$ (101)	$ 3	$ (1)

N/A not applicable

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

(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 months ending March 31, 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 2011 IBM Annual Report, Note A, Significant Accounting Policies, on pages 83 and 84 for additional information on the company s use of derivative financial instruments.

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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 March 31, 2012		At December 31, 2011
Current:				
Net investment in sales-type and direct financing leases	$	3,819	$	3,765
Commercial financing receivables		5,476		7,095
Client loan receivables		4,822		5,195
Installment payment receivables		1,045		846
Total	$	15,160	$	16,901
Noncurrent:				
Net investment in sales-type and direct financing leases	$	5,293	$	5,406
Commercial financing receivables		7		34
Client loan receivables		4,912		4,925
Installment payment receivables		337		410
Total	$	10,549	$	10,776

Net investment in sales-type and direct financing leases relates 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 $730 million and $745 million at March 31, 2012 and December 31, 2011, respectively, and is reflected net of unearned income of $732 million and $733 million and net of the allowance for credit losses of $117 million and $118 million at those dates, respectively.

Commercial financing receivables, net of allowance for credit losses of $39 million and $53 million at March 31, 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 $150 million and $126 million at March 31, 2012 and December 31, 2011, respectively, are loans that are provided by Global Financing primarily to clients to finance the purchase of IBM and non-IBM 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 $33 million and $51 million at March 31, 2012 and December 31, 2011, respectively, are loans that are provided primarily to clients to finance IBM and non-IBM 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.

The company utilizes certain of its financing receivables as collateral for non-recourse borrowings. Financing receivables pledged as collateral for borrowings were $373 million and $324 million at March 31, 2012 and December 31, 2011, respectively.

The company did not have any financing receivables held for sale as of March 31, 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 March 31, 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.

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Notes to Consolidated Financial Statements (continued)

(Dollars in millions) At March 31, 2012	Major Markets	Growth Markets	Total
Financing receivables:			
Lease Receivables	$ 6,446	$ 1,949	$ 8,396
Loan Receivables	8,609	2,726	11,335
Ending balance	$ 15,055	$ 4,675	$ 19,730
Collectively evaluated for impairment	$ 14,901	$ 4,564	$ 19,465
Individually evaluated for impairment	$ 155	$ 111	$ 266
Allowance for credit losses:			
Beginning balance at January 1, 2012			
Lease Receivables	$ 79	$ 40	$ 118
Loan Receivables	125	64	189
Total	$ 203	$ 104	$ 307
Write-offs	(2)	0	(2)
Provision	(2)	5	3
Other	2	1	3
Ending balance at March 31, 2012	$ 202	$ 109	$ 311
Lease Receivables	$ 74	$ 43	$ 117
Loan Receivables	$ 128	$ 66	$ 194
Collectively evaluated for impairment	$ 92	$ 18	$ 109
Individually evaluated for impairment	$ 110	$ 91	$ 202

(Dollars in millions) At December 31, 2011	Major Markets	Growth Markets	Total
Financing receivables:			
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
Allowance for credit losses:			
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.

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.

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Notes to Consolidated Financial Statements (continued)

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

(Dollars in millions)	At March 31, 2012	At December 31, 2011
Major markets	$ 27	$ 46
Growth markets	21	20
Total lease receivables	$ 48	$ 66
Major markets	$ 50	$ 75
Growth markets	22	24
Total loan receivables	$ 71	$ 99
Total receivables	$ 119	$ 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.

	At March 31, 2012		At December 31, 2011	
(Dollars in millions)	Recorded Investment	Related Allowance	Recorded Investment	Related Allowance
Major markets	$ 86	$ 72	$ 110	$ 70
Growth markets	66	53	62	53
Total	$ 151	$ 125	$ 172	$ 123

(Dollars in millions) For the three months ended March 31, 2012:		Average Recorded Investment	Interest Income Recognized*	Interest Income Recognized on Cash Basis
Major markets		$ 98	$ 0	$ 0
Growth markets	&nb			