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, 2010

1-2360

(Commission file number)

INTERNATIONAL BUSINESS MACHINES CORPORATION

(Exact name of registrant as specified in its charter)

New York	**13-0871985**
(State of incorporation)	(IRS employer identification number)
Armonk, New York	**10504**

(Address of principal executive offices) (Zip Code)

914-499-1900

(Registrant s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 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 No o

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

Large accelerated filer 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 1,261,278,072 shares of common stock outstanding at June 30, 2010.

Table of Contents

Index

	Page
Part I - Financial Information:	
Item 1. Consolidated Financial Statements:	
Consolidated Statement of Earnings for the three and six months ended June 30, 2010 and 2009	3
Consolidated Statement of Financial Position at June 30, 2010 and December 31, 2009	4
Consolidated Statement of Cash Flows for the six months ended June 30, 2010 and 2009	6
Notes to Consolidated Financial Statements	7
Item 2. Management s Discussion and Analysis of Results of Operations and Financial Condition	37
Item 4. Controls and Procedures	71
Part II - Other Information:	72
Item 1. Legal Proceedings	72
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds and Issuer Repurchases of Equity Securities	72
Item 5. Other Information	72
Item 6. Exhibits	73

Table of Contents

Part I - Financial Information

Item 1. Consolidated Financial Statements:

INTERNATIONAL BUSINESS MACHINES CORPORATION AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF EARNINGS

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in millions except per share amounts)	**2010**	**2009**	**2010**	**2009**
Revenue:				
Services	$ 13,824	$ 13,479	$ 27,629	$ 26,656
Sales	9,349	9,198	17,857	17,147
Financing	550	574	1,095	1,158
Total revenue	23,724	23,250	46,581	44,962
Cost:				
Services	9,328	9,145	18,712	18,208
Sales	3,313	3,221	6,537	6,123
Financing	273	303	546	618
Total cost	12,915	12,669	25,795	24,949
Gross profit	10,809	10,581	20,785	20,012
Expense and other income:				
Selling, general and administrative	5,061	5,115	10,737	10,379
Research, development and engineering	1,475	1,434	2,984	2,914
Intellectual property and custom development income	(297)	(302)	(558)	(570)
Other (income) and expense	(95)	(28)	(640)	(331)
Interest expense	90	101	172	237
Total expense and other income	6,234	6,319	12,695	12,628
Income before income taxes	4,575	4,262	8,090	7,385
Provision for income taxes	1,190	1,159	2,103	1,986
Net income	$ 3,386	$ 3,103	$ 5,987	$ 5,398
Earnings per share of common stock:				
Assuming dilution	$ 2.61	$ 2.32	$ 4.57	$ 4.02
Basic	$ 2.65	$ 2.34	$ 4.64	$ 4.04
Weighted-average number of common shares outstanding: (millions)				
Assuming dilution	1,296.7	1,336.9	1,309.2	1,343.2
Basic	1,278.6	1,326.1	1,289.9	1,335.2

Cash dividend per common share	$ 0.65	$ 0.55	$ 1.20	$ 1.05

(Amounts may not add due to rounding.)

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

Table of Contents

INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(UNAUDITED)

ASSETS

(Dollars in millions)	At June 30, 2010	At December 31, 2009
Assets:		
Current assets:		
Cash and cash equivalents	$ 10,325	$ 12,183
Marketable securities	1,916	1,791
Notes and accounts receivable trade (net of allowances of $291 in 2010 and $217 in 2009)	9,051	10,736
Short-term financing receivables (net of allowances of $376 in 2010 and $438 in 2009)	13,301	14,914
Other accounts receivable (net of allowances of $11 in 2010 and $15 in 2009)	1,140	1,143
Inventories, at lower of average cost or market:		
Finished goods	493	533
Work in process and raw materials	2,102	1,960
Total inventories	2,595	2,494
Deferred taxes	1,444	1,730
Prepaid expenses and other current assets	5,124	3,946
Total current assets	44,895	48,935
Plant, rental machines and other property	38,292	39,596
Less: Accumulated depreciation	24,758	25,431
Plant, rental machines and other property net	13,534	14,165
Long-term financing receivables (net of allowances of $84 in 2010 and $97 in 2009)	9,185	10,644
Prepaid pension assets	3,575	3,001
Deferred taxes	3,122	4,195
Goodwill	20,544	20,190
Intangible assets net	2,526	2,513
Investments and sundry assets	6,038	5,379
Total assets	$ 103,420	$ 109,022

(Amounts may not add due to rounding.)

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

Table of Contents

INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

(UNAUDITED)

LIABILITIES AND EQUITY

(Dollars in millions)	At June 30, 2010	At December 31, 2009
Liabilities:		
Current liabilities:		
Taxes	$ 2,895	$ 3,826
Short-term debt	5,633	4,168
Accounts payable	7,233	7,436
Compensation and benefits	4,022	4,505
Deferred income	10,671	10,845
Other accrued expenses and liabilities	4,539	5,223
Total current liabilities	34,993	36,002
Long-term debt	21,017	21,932
Retirement and nonpension postretirement benefit obligations	14,598	15,953
Deferred income	3,341	3,562
Other liabilities	8,295	8,819
Total liabilities	82,244	86,267
Equity:		
IBM stockholders equity:		
Common stock, par value $0.20 per share, and additional paid-in capital	43,522	41,810
Shares authorized: 4,687,500,000		
Shares issued: 2010 2,145,080,210		
2009 2,127,016,668		
Retained earnings	85,323	80,900
Treasury stock - at cost	(89,276)	(81,243)
Shares: 2010 883,802,138		
2009 821,679,245		
Accumulated other comprehensive income/(loss)	(18,510)	(18,830)
Total IBM stockholders equity	21,059	22,637
Noncontrolling interests	117	118
Total equity	21,176	22,755
Total liabilities and equity	$ 103,420	$ 109,022

(Amounts may not add due to rounding.)

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

5

Table of Contents

INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30,

(UNAUDITED)

(Dollars in millions)	2010	2009
Cash flow from operating activities:		
Net income	$ 5,987	$ 5,398
Adjustments to reconcile net income to cash provided from operating activities:		
Depreciation	1,823	1,853
Amortization of intangibles	570	618
Stock-based compensation	320	269
Net (gain)/loss on asset sales and other	(590)	(340)
Changes in operating assets and liabilities, net of acquisitions/divestitures	93	1,330
Net cash provided by operating activities	8,203	9,127
Cash flow from investing activities:		
Payments for plant, rental machines and other property, net of proceeds from dispositions	(1,586)	(1,304)
Investment in software	(287)	(319)
Acquisition of businesses, net of cash acquired	(1,009)	(100)
Divestiture of businesses, net of cash transferred	0	356
Non-operating finance receivables net	282	487
Purchases of marketable securities and other investments	(3,883)	(2,330)
Proceeds from disposition of marketable securities and other investments	3,838	1,314
Net cash used in investing activities	(2,645)	(1,897)
Cash flow from financing activities:		
Proceeds from new debt	2,501	1,969
Payments to settle debt	(3,744)	(5,040)
Short-term borrowings/(repayments) less than 90 days net	1,973	(934)
Common stock repurchases	(8,121)	(3,436)
Common stock transactions other	1,827	522
Cash dividends paid	(1,551)	(1,407)
Net cash used in financing activities	(7,114)	(8,326)
Effect of exchange rate changes on cash and cash equivalents	(301)	33
Net change in cash and cash equivalents	(1,858)	(1,063)
Cash and cash equivalents at January 1	12,183	12,741
Cash and cash equivalents at June 30	$ 10,325	$ 11,678

(Amounts may not add due to rounding.)

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

Table of Contents

Notes to Consolidated Financial Statements:

1. Basis of Presentation: The accompanying Consolidated Financial Statements and footnotes thereto 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 2009 Annual Report on pages 52 to 54 for a discussion of the company s critical accounting estimates.

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

Noncontrolling interest amounts in income of $1.0 million and $0.4 million, net of tax, for the three months ended June 30, 2010 and 2009, respectively, and $2.8 million for both the six months ended June 30, 2010 and 2009 are not presented separately in the Consolidated Statement of Earnings due to immateriality, but are reflected within the other (income) and expense line item. Additionally, changes to noncontrolling interests are presented in Note 10, Equity Activity , on pages 27 and 28.

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

2. Accounting Changes: In July 2010, the Financial Accounting Standards Board (FASB) issued amendments to the disclosure requirements about the credit quality of financing receivables and the allowance for credit losses. The purpose of the additional disclosures is to enable users of financial statements to better understand the nature of credit risk inherent in an entity s portfolio of financing receivables and how that risk is analyzed. For end of period balances, the new disclosures are required to be made in all interim and annual periods ending on or after December 15, 2010. For activity during a reporting period, the disclosures are required to be made in all interim and annual periods after January 1, 2011. These changes will not have an impact on the consolidated financial results as this guidance only relates to additional disclosures.

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

instruments. These changes will be effective January 1, 2011 and will not have an impact on the consolidated financial results as this guidance only relates to additional disclosures.

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

Also, in October 2009, the FASB issued guidance which amended the scope of existing software revenue recognition guidance. Tangible products containing software components and non-software components that function together to deliver the tangible product s essential functionality are no longer within the scope of software revenue guidance and are accounted for based on other applicable revenue recognition guidance. In addition, the amendments require that hardware components of a tangible product containing software components are always excluded from the software revenue guidance. This guidance must be adopted in the same period that the company adopts the amended guidance for arrangements with multiple

Table of Contents

Notes to Consolidated Financial Statements (continued)

deliverables described in the preceding paragraph. Therefore, the company elected to early adopt this guidance as of January 1, 2010 on a prospective basis for all new or materially modified arrangements entered into on or after that date. The adoption of this guidance did not have a material impact on the Consolidated Financial Statements.

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

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

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

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

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

If these criteria are not met, the arrangement is accounted for as one unit of accounting which would result in revenue being recognized ratably over the contract term or being deferred until the earlier of when such criteria are met or when the last undelivered element is delivered. If these criteria are met for each element and there is a relative selling price for all units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting based on each unit s relative selling price. The revenue recognition policies described below are then applied to each unit of accounting, as applicable.

Services

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

Table of Contents

Notes to Consolidated Financial Statements (continued)

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

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

Revenue from fixed-price design and build contracts is recognized under the percentage-of-completion (POC) method. Under the POC method, revenue is recognized based on the labor costs incurred to date as a percentage of the total estimated labor costs to fulfill the contract. If circumstances arise that change the original estimates of revenues, costs, or extent of progress toward completion, revisions to the estimates are made. These revisions may result in increases or decreases in estimated revenues or costs, and such revisions are reflected in income in the period in which the circumstances that gave rise to the revision become known by management.

Hardware

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

Revenue from hardware sales and sales-type leases is recognized when risk of loss has transferred to the client and there are no unfulfilled company obligations that affect the client s final acceptance of the arrangement. Any cost of standard warranties and remaining obligations that are inconsequential or perfunctory are accrued when the corresponding revenue is recognized. Revenue from extended warranty contracts, for which the company is obligated to perform, is recorded as deferred income and subsequently recognized on a straight-line basis over the delivery period. Revenue from rentals and operating leases is recognized on a straight-line basis over the term of the rental or lease.

Software

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

software products and services for which a software deliverable is essential to its functionality. Tangible products containing software components and non-software components that function together to deliver the tangible product s essential functionality are no longer within the scope of software revenue recognition guidance and are accounted for based on other applicable revenue recognition guidance.

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

- The functionality of the delivered element(s) is not dependent on the undelivered element(s);

- There is VSOE of fair value of the undelivered element(s). VSOE of fair value is based on the price charged when the deliverable is sold separately by the company on a regular basis and not as part of the multiple-deliverable arrangement; and

- Delivery of the delivered element(s) represents the culmination of the earnings process for that element(s).

If any one of these criteria are not met, the arrangement is accounted for as one unit of accounting which would result in revenue being recognized on a straight-line basis or being deferred until the earlier of when such criteria are met or when the

Table of Contents

Notes to Consolidated Financial Statements (continued)

last undelivered element is delivered. If these criteria are met for each element and there is VSOE of fair value for all units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting based on each unit s relative VSOE of fair value. There may be cases, however, in which there is VSOE of fair value of the undelivered item(s) but no such evidence for the delivered item(s). In these cases, the residual method is used to allocate the arrangement consideration. Under the residual method, the amount of consideration allocated to the delivered item(s) equals the total arrangement consideration less the aggregate VSOE of fair value of the undelivered elements.

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

Financing

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

Determination of Best Estimate of Selling Price

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

When the company is unable to establish selling price using VSOE or TPE, the company uses BESP in its allocation of arrangement consideration. The objective of BESP is to determine the price at which the company would transact a sale if the product or service were sold on a stand-alone basis. Due to the fact that the company sells its products and services on a stand-alone basis, and therefore has established VSOE for its products and services offerings, the company expects to use BESP to determine the relative selling price for a product or service in a multiple-deliverable arrangement on an infrequent basis. An example of when BESP would be used is when the company sells a new product, for which VSOE and TPE does not exist, in a multiple deliverable arrangement prior to selling the new product on a stand-alone basis. During the second quarter and six month period ended June 30, 2010, BESP was used in seven and nine transactions, respectively, and the effects of its use were immaterial.

The company determines BESP for a product or service by considering multiple factors including, but not limited to, overall market conditions, including geographic or regional specific market factors, competitive positioning, competitor actions, internal costs, profit objectives and pricing

practices. The determination of BESP is a formal process within the company that includes review and approval by the company s management. In addition, the company regularly reviews VSOE and TPE for its products and services, in addition to BESP.

Effect of Adoption

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

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

Table of Contents

Notes to Consolidated Financial Statements (continued)

In addition, there would not have been a material impact to revenue, as reported during the three and six months ended June 30, 2010, if the transactions entered into or materially modified on or after January 1, 2010 were subject to the previous accounting guidance.

As discussed in Note 2, Accounting Changes, on pages 7 and 8 there was no material impact in the second quarter or the first six months of 2010, respectively, from the adoption of the amended revenue recognition guidance. In terms of the timing and pattern of revenue recognition, the new accounting guidance for revenue recognition is not expected to have a material impact on revenue in future periods.

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

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

- Level 1 Quoted prices in active markets that are unadjusted and accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 Quoted prices for identical assets and liabilities in markets that are not active, quoted prices for similar assets and liabilities in active markets or financial instruments for which significant inputs are observable, either directly or indirectly; and
- Level 3 Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

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

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

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

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

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

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

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

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

Table of Contents

Notes to Consolidated Financial Statements (continued)

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 70 to 79 in the 2009 Annual Report for further information. There were no material impairments of non-financial assets for the six months ended June 30, 2010 and June 30, 2009.

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, 2010 and December 31, 2009.

(Dollars in millions) **At June 30, 2010**	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents(1)				
Time deposits and certificates of deposit	$	$ 3,057	$	$ 3,057
Commercial paper		2,273		2,273
Money market funds	1,520			1,520
U.S. Federal Government securities		934		934
Other securities		14		14
Total	1,520	6,278		7,798
Debt securities current(2)				
Time deposits and certificates of deposit		313		313
Commercial paper		1,101		1,101
U.S. Federal Government securities		500		500
Other securities		1		1
Total		1,916		1,916
Debt securities noncurrent(3)	1	6		7
Non-equity method alliance investments(3)	344	6		350
Derivative assets(4)				
Interest rate contracts		677		677
Foreign exchange contracts		1,482		1,482
Equity contracts		3		3
Total		2,162		2,162(6)
Total Assets	$ 1,865	$ 10,367	$	$ 12,232
Liabilities:				
Derivative liabilities(5)				
Foreign exchange contracts	$	$ 655	$	$ 655
Equity contracts		33		33
Total Liabilities	$	$ 688	$	$ 688(6)

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

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

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

(4) The gross balances of derivative assets contained in prepaid expenses and other current assets, and investments and sundry assets in the Consolidated Statement of Financial Position at June 30, 2010 are $861 million and $1,301 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, 2010 are $471 million and $217 million, respectively.

(6) If derivative exposures covered by a qualifying master netting agreement had been netted in the Consolidated Statement of Financial Position, the total derivative asset and liability positions would have been reduced by $438 million each.

Table of Contents

Notes to Consolidated Financial Statements (continued)

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

(1) Included within cash and cash equivalents in the Consolidated Statement of Financial Position.
(2) Included within marketable securities in the Consolidated Statement of Financial Position.
(3) Included within investments and sundry assets in the Consolidated Statement of Financial Position.
(4) The gross balances of derivative assets contained within prepaid expenses and other current assets, and investments and sundry assets in the Consolidated Statement of Financial Position at December 31, 2009 are $273 million and $565 million, respectively.
(5) The gross balances of derivative liabilities contained within other accrued expenses and liabilities, and other liabilities in the Consolidated Statement of Financial Position at December 31, 2009 are $906 million and $649 million, respectively.
(6) If derivative exposures covered by a qualifying master netting agreement had been netted in the Consolidated Statement of Financial Position, the total derivative asset and liability positions would have been reduced by $573 million each.

There were no significant transfers between Levels 1 and 2 for the six months ended June 30, 2010 and for the year ended December 31, 2009.

Table of Contents

Notes to Consolidated Financial Statements (continued)

5. Financial Instruments (excluding derivatives): Cash and cash equivalents, debt and marketable equity securities are recognized and measured at fair value in the company s consolidated financial statements. Notes and other accounts receivable and other investments are financial assets with carrying values that approximate fair value. Accounts payable, other accrued expenses and short-term debt are financial liabilities with carrying values that approximate fair value. In the absence of quoted prices in active markets, considerable judgment is required in developing estimates of fair value. Estimates are not necessarily indicative of the amounts the company could realize in a current market transaction. The following methods and assumptions are used to estimate fair values:

Loans and Long-term Receivables

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.

Long-term Debt

Fair value of publicly-traded long-term debt is based on quoted market prices for the identical liability when traded as an asset in an active market. For other long-term debt for which a quoted market price is not available, an expected present value technique that uses rates currently available to the company for debt with similar terms and remaining maturities is used to estimate fair value. The carrying amount of long-term debt is $21,017 million and $21,932 million and the estimated fair value is $22,612 million and $23,748 million at June 30, 2010 and December 31, 2009, respectively.

Debt and Marketable Equity Securities

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

(Dollars in millions) At June 30, 2010	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents*				
Time deposits and certificates of deposit	$ 3,057	$	$ (0)	$ 3,057
Commercial paper	2,273		(0)	2,273
Money market funds	1,520			1,520
U.S. Federal Government securities	934		(0)	934
Other securities	14			14
Total	$ 7,798	$	$ (0)	$ 7,798

Debt securities current**								
Commercial paper	$	1,101	$		$	(0)	$	1,101
Time deposits and certificates of deposit		313				(0)		313
Other securities		1						1
U.S. Federal Government securities		500				(0)		500
Total	$	1,916	$		$	(0)	$	1,916
Debt securities noncurrent***								
Other securities	$	6	$	1	$		$	7
Total	$	6	$	1	$		$	7
Non-equity method alliance investments***	$	177	$	176	$	(3)	$	350

* Included within cash and cash equivalents in the Consolidated Statement of Financial Position.
** Reported as marketable securities within the Consolidated Statement of Financial Position.
*** Included within investments and sundry assets in the Consolidated Statement of Financial Position.

Table of Contents

Notes to Consolidated Financial Statements (continued)

(Dollars in millions) At December 31, 2009	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents*				
Time deposits and certificates of deposit	$ 4,324	$ 0	$	$ 4,324
Commercial paper	2,099		(0)	2,099
Money market funds	2,780			2,780
Other securities	74			74
Total	$ 9,277	$ 0	$ (0)	$ 9,277
Debt securities current**				
Commercial paper	$ 1,491	$	$ (0)	1,491
U.S. Federal Government securities	300	0		300
Total	$ 1,791	$ 0	$ (0)	$ 1,791
Debt securities noncurrent***				
Other securities	$ 9	$ 0	$ (0)	$ 9
Total	$ 9	$ 0	$ (0)	$ 9
Non-equity method alliance investments***	$ 183	$ 201	$ (10)	$ 374

* Included within cash and cash equivalents in the Consolidated Statement of Financial Position.
** Reported as marketable securities within the Consolidated Statement of Financial Position.
*** Included within investments and sundry assets in the Consolidated Statement of Financial Position.

Based on an evaluation of available evidence as of June 30, 2010, 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.

Proceeds from sales of debt securities and marketable equity securities were approximately $4 million and $13 million for the second quarter and first six months of 2010, respectively. The gross realized gains (before taxes) on these sales totaled $1 million and $5 million for the second quarter and first six months of 2010, respectively. The gross realized losses (before taxes) on these sales were less than $1 million in the second quarter and first six months of 2010. Proceeds from the sales of debt securities and marketable equity securities were approximately $6 million and $11 million in the second quarter and first six months of 2009, respectively. The gross realized losses (before taxes) on these sales totaled $12 million and $21 million in the second quarter and first six months of 2009, respectively. The company determines the cost of the securities sold based on the specific identification method.

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

(Dollars in millions) For the three months ended June 30:	2010	2009
Net unrealized gains/(losses) arising during the period	$ (46)	$ 35
Less: Net (losses)/gains included in net income for the period*	1	(7)
Net unrealized gains/(losses) on marketable securities	$ (47)	$ 42

* Includes writedowns of $0.1 million and $0.1 million for the three months ended June 30, 2010 and 2009, respectively.

(Dollars in millions) For the six months ended June 30:		2010		2009
Net unrealized gains/(losses) arising during the period	$	(6)	$	23
Less: Net (losses)/gains included in net income for the period*		(0)		(13)
Net unrealized gains/(losses) on marketable securities	$	(6)	$	36

* Includes writedowns of $3.2 million and $0.1 million for the six months ended June 30, 2010 and 2009, respectively.

The contractual maturities of substantially all available-for-sale debt securities are less than one year at June 30, 2010.

Table of Contents

Notes to Consolidated Financial Statements (continued)

6. Financing Receivables: The following table presents financing receivables, net of allowances for doubtful accounts, including residual values.

(Dollars in millions)		At June 30, 2010		At December 31, 2009
Current:				
Net investment in sales-type and direct financing leases	$	3,850	$	4,105
Commercial financing receivables		4,631		5,604
Client loan receivables		4,188		4,475
Installment payment receivables		632		730
Total	$	13,301	$	14,914
Noncurrent:				
Net investment in sales-type and direct financing leases	$	4,604	$	5,331
Commercial financing receivables		48		58
Client loan receivables		4,064		4,759
Installment payment receivables		469		496
Total	$	9,185	$	10,644

Net investment in sales-type and direct financing leases is for leases that 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 $794 million and $849 million at June 30, 2010 and December 31, 2009, respectively, and is reflected net of unearned income of $779 million and $905 million and of allowance for doubtful accounts receivable of $149 million and $159 million at those dates, respectively.

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

Client loan receivables 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 two to seven years. Each financing contract is priced independently at competitive market rates. The company has a history of enforcing the terms of these separate financing agreements.

The company utilizes certain of its financing receivables as collateral for non-recourse borrowings. Financing receivables pledged as collateral for borrowings were $264 million and $271 million at June 30, 2010 and December 31, 2009, respectively.

The company did not have any financing receivables held for sale as of June 30, 2010 and December 31, 2009.

7. Derivatives and Hedging Transactions: 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

Table of Contents

Notes to Consolidated Financial Statements (continued)

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, 2010 and December 31, 2009 was $173 million and $779 million, respectively, for which the company has posted collateral of $0 million and $37 million, respectively. 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, 2010 and December 31, 2009 was $2,162 million and $838 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 is reduced by $438 million and $573 million at June 30, 2010 and December 31, 2009, respectively, of liabilities included in master netting arrangements with those counterparties. Additionally, at June 30, 2010, this exposure is reduced by $661 million of collateral 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. At June 30, 2010, there were no amounts recognized in other receivables for the right to reclaim cash collateral. At December 31, 2009, $37 million was recorded in prepaid expenses and other current assets for the right to reclaim cash collateral. The amounts recognized in accounts payable for the obligation to return cash collateral totaled $661 million at June 30, 2010. The company had no obligation to return cash collateral at December 31, 2009. 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. At June 30, 2010, no collateral was rehypothecated.

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 the cash loss potential on an ongoing basis and may discontinue some of these hedging relationships by de-designating the derivative instrument to manage this liquidity risk. Although not designated as accounting hedges, the company may utilize derivatives to offset the changes in 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, 2010 and December 31, 2009, the total notional amount of the company s interest rate swaps was $7.5 billion and $9.1 billion, respectively.

Forecasted Debt Issuance

The company is exposed to interest rate volatility on forecasted debt issuances. To manage this risk, the company may use forward starting interest-rate swaps to lock in the rate on the interest payments related to the forecasted debt issuance. These swaps are accounted for as cash flow hedges. The company did not have any derivative instruments relating to this program outstanding at June 30, 2010 and December 31, 2009.

Table of Contents

Notes to Consolidated Financial Statements (continued)

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 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, 2010 and December 31, 2009, the total notional amount of derivative instruments designated as net investment hedges was $2.4 billion and $1.0 billion, respectively. The weighted-average remaining maturity of these instruments at June 30, 2010 and December 31, 2009 was approximately 0.6 years and 1.6 years, respectively.

In addition, at June 30, 2010 and December 31, 2009, the company had liabilities of $289 million and $318 million, respectively, representing the fair value of derivative instruments that were previously designated in qualifying net investment hedging relationships but were de-designated prior to June 30, 2010 and December 31, 2009, respectively; of these amounts $170 million and $94 million are expected to mature over the next twelve months, respectively. The notional amount of these instruments at June 30, 2010 and December 31, 2009 was $2.1 billion and $2.3 billion, respectively, including original and offsetting transactions.

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 approximately four years. At June 30, 2010 and December 31, 2009, the total notional amount of forward contracts designated as cash flow hedges of forecasted royalty and cost transactions was $16.6 billion and $18.7 billion, with a weighted-average remaining maturity of 1.1 years and 1.3 years, respectively.

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 approximately 3.5 years. At June 30, 2010 and December 31, 2009, the total notional amount of cross-currency swaps designated as cash flow hedges of foreign currency denominated debt was $0.2 billion and $0.3 billion, respectively.

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 two years. 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, 2010 and December 31, 2009, the total notional amount of derivative instruments in economic hedges of foreign currency exposure was $13.1 billion and $13.1 billion, respectively.

Table of Contents

Notes to Consolidated Financial Statements (continued)

Equity Risk Management

The company is exposed to market price changes primarily related to certain obligations to employees. These exposures are primarily related to market price movements in certain broad market indices and in the company s own stock. 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, 2010 and December 31, 2009, the total notional amount of derivative instruments in economic hedges of these compensation obligations was $0.8 billion and $0.8 billion, respectively.

Other Risks

The company holds 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 amount of shares to be purchased under these agreements was immaterial at June 30, 2010 and December 31, 2009. The company records the changes in the fair value of these warrants in other (income) and expense in the Consolidated Statement of Earnings.

The company is exposed to a potential loss if a client fails to pay amounts due under contractual terms. 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 June 30, 2010 and December 31, 2009.

The following tables provide a quantitative summary of the derivative and non-derivative instrument related risk management activity as of June 30, 2010 and December 31, 2009 as well as for the three months and six months ended June 30, 2010 and 2009, respectively:

Table of Contents

Notes to Consolidated Financial Statements (continued)

Fair Value of Derivative Instruments

As of June 30, 2010

(Dollars in millions)	Fair value of derivative assets			Fair value of derivative liabilities		
	Designated as hedging instruments	Not designated as hedging instruments	Total	Designated as hedging instruments	Not designated as hedging instruments	Total
Interest rate contracts:						
Prepaid expenses and other current assets	$ 13	$ -	$ 13	$ -	$ -	$ -
Investments and sundry assets	664	-	664	-	-	-
Other liabilities	-	-	-	-	-	-
Foreign exchange contracts:						
Prepaid expenses and other current assets	739	106	845	-	-	-
Investments and sundry assets	614	23	637	-	-	-
Other accrued expenses and liabilities	-	-	-	190	247	437
Other liabilities	-	-	-	93	125	218
Equity contracts:						
Prepaid expenses and other current assets	-	3	3	-	-	-
Other accrued expenses and liabilities	-	-	-	-	33	33
Fair value of derivative assets and liabilities	$ 2,030	$ 132	$ 2,162	$ 283	$ 405	$ 688
Total debt designated as hedging instruments:						
Short-term debt	NA	NA	NA	$ -	$ -	$ -
Long-term debt	NA	NA	NA	2,362	-	2,362
Total			$ 2,162			$ 3,050

NA not applicable

Table of Contents

Notes to Consolidated Financial Statements (continued)

Fair Value of Derivative Instruments

As of December 31, 2009

(Dollars in millions)	Fair value of derivative assets			Fair value of derivative liabilities		
	Designated as hedging instruments	Not designated as hedging instruments	Total	Designated as hedging instruments	Not designated as hedging instruments	Total
Interest rate contracts:						
Prepaid expenses and other current assets	$ 43	$ -	$ 43	$ -	$ -	$ -
Investments and sundry assets	383	-	383	-	-	-
Other liabilities	-	-	-	2	-	2
Foreign exchange contracts:						
Prepaid expenses and other current assets	74	151	225	-	-	-
Investments and sundry assets	156	26	182	-	-	-
Other accrued expenses and liabilities		-	-	602	304	906
Other liabilities	-	-	-	423	224	647
Equity contracts:						
Prepaid expenses and other current assets	-	5	5	-	-	-
Other accrued expenses and liabilities	-	-	-	-	0	0
Fair value of derivative assets and liabilities	$ 656	$ 182	$ 838	$ 1,027	$ 528	$ 1,555
Total debt designated as hedging instruments:						
Short-term debt	NA	NA	NA	$ 1,440	$ -	$ 1,440
Long-term debt	NA	NA	NA	2,618	-	2,618
Total			$ 838			$ 5,613

NA not applicable

Table of Contents

Notes to Consolidated Financial Statements (continued)

The Effect of Derivative Instruments on the Consolidated Statement of Earnings

For the three months ended June 30, 2010 and 2009

(Dollars in millions)

	Consolidated Statement of Earnings line item	Gain (loss) recognized in earnings: Recognized on derivatives (2)		Gain (loss) recognized in earnings: Attributable to risk being hedged (3)	
		2010	**2009**	**2010**	**2009**
Derivative instruments in fair value hedges:					
Interest rate contracts	Cost of financing	$ 185	$ (138)	$ (142)	$ 177
	Interest expense	109	(84)	(84)	108
Derivative instruments not designated as hedging instruments: (1)					
Foreign exchange contracts	Other (income) and expense	(177)	(69)	NA	NA
Equity contracts	SG&A expense	(63)	74	NA	NA
Total		$ 54	$ (217)	$ (226)	$ 285

	Gain (loss) recognized in earnings and other comprehensive income: Effective portion recognized in AOCI		Consolidated Statement of Earnings line item	Effective portion reclassified from AOCI to earnings		(Ineffectiveness) and amounts excluded from effectiveness testing (4)	
	2010	**2009**		**2010**	**2009**	**2010**	**2009**
Derivative instruments in cash flow hedges:							
Interest rate contracts	$ -	$ -	Interest income	$ (2)	$ (2)	$ -	$ -
Foreign exchange contracts	760	(909)	Other (income) and expense	40	80	(1)	2
			Cost of sales	6	43	-	-
			SG&A expense	6	32	-	-
Derivative instruments in net investment hedges:							
Foreign exchange contracts	340	(239)	Interest expense	0	-	(1)	3
Total	$ 1,100	$ (1,148)		$ 50	$ 153	$ (2)	$ 5

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

(1) See Note 7 for additional information on the company s purpose for entering into derivatives not designated as hedging instruments and its overall risk management strategies.
(2) 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.
(3) 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.

(4) The amount of gain (loss) recognized in income represents ineffectiveness on hedge relationships.

Table of Contents

Notes to Consolidated Financial Statements (continued)

The Effect of Derivative Instruments on the Consolidated Statement of Earnings

For the six months ended June 30, 2010 and 2009

(Dollars in millions)

		Gain (loss) recognized in earnings			
	Consolidated Statement of Earnings line item	**Recognized on derivatives (2)**		**Attributable to risk being hedged (3)**	
		2010	**2009**	**2010**	**2009**
Derivative instruments in fair value hedges:					
Interest rate contracts	Cost of financing	$ 256	$ (184)	$ (166)	$ 250
	Interest expense	150	(117)	(98)	159
Derivative instruments not designated as hedging instruments: (1)					
Foreign exchange contracts	Other (income) and expense	(305)	(242)	NA	NA
Equity contracts	SG&A expense	(42)	47	NA	NA
Total		$ 59	$ (496)	$ (264)	$ 409

	Gain (loss) recognized in earnings and other comprehensive income						
	Effective portion recognized in AOCI		**Consolidated Statement of Earnings line item**	**Effective portion reclassified from AOCI to earnings**		**(Ineffectiveness) and amounts excluded from effectiveness testing (4)**	
	2010	**2009**		**2010**	**2009**	**2010**	**2009**
Derivative instruments in cash flow hedges:							
Interest rate contracts	$ -	$ (0)	Interest income	$ (4)	$ (11)	$ -	$ -
Foreign exchange contracts	1,390	(130)	Other (income) and expense	(14)	204	(7)	2
			Cost of sales	(83)	102	-	-
			SG&A expense	(45)	68	-	-
Derivative instruments in net investment hedges:							
Foreign exchange contracts	587	(44)	Interest expense	0	-	(1)	2
Total	$ 1,977	$ (174)		$ (146)	$ 363	$ (8)	$ 4

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

(1) See Note 7 for additional information on the company s purpose for entering into derivatives not designated as hedging instruments and its overall risk management strategies.
(2) 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.
(3) 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.
(4) The amount of gain (loss) recognized in income represents ineffectiveness on hedge relationships.

Table of Contents

Notes to Consolidated Financial Statements (continued)

At June 30, 2010 and June 30, 2009, in connection with cash flow hedges of anticipated royalties and cost transactions, the company recorded net gains of $817 million and net losses $402 million (before taxes), respectively, in accumulated other comprehensive income/(loss). Within these amounts $450 million of gains and $182 million of losses, respectively, are expected to be reclassified to net income within the next twelve months, providing an offsetting economic impact against the underlying anticipated transactions. At June 30, 2010 and June 30, 2009, net losses of approximately $17 million and net losses of approximately $16 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 $9 million and $6 million of losses, respectively, are expected to be reclassified to net income within the next twelve months, providing an offsetting economic impact against the underlying transactions.

For the six months ending June 30, 2010, and June 30, 2009, 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.

During July 2010, the company unwound certain of its multi-year cash flow hedges (approximately $3.7 billion notional amount), resulting in a cash inflow of $257 million which will be reflected in the company s third quarter operating cash flows. This gain will be reclassified from accumulated other comprehensive income/(loss) to net income over a multi-year period consistent with the original maturity dates of these hedges.

Refer to the 2009 IBM Annual Report, Note A, Significant Accounting Policies on pages 76 and 77 for additional information on the company s use of derivative instruments.

8. 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:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in millions)	**2010**	**2009**	**2010**	**2009**
Cost	$ 24	$ 22	$ 49	$ 46
Selling, general and administrative	116	99	249	199
Research, development and engineering	12	11	24	23
Other (income) and expense*	(1)		(1)	
Pre-tax stock-based compensation cost	151	132	320	269
Income tax benefits	(55)	(46)	(117)	(94)
Total stock-based compensation cost	$ 96	$ 86	$ 203	$ 175

* Reflects the one-time effects of the sale of the Product Lifecycle Management activities.

The increase in pre-tax stock-based compensation cost for the three months ended June 30, 2010, as compared to the corresponding period in the prior year, was principally the result of an increase related to restricted and performance-based stock units ($18 million). The increase in pre-tax stock-based compensation cost for the six months ended June 30, 2010, as compared to the corresponding period in the prior year, was principally the result of an increase related to restricted and performance-based stock units ($67 million), partially offset by a reduction in the level of stock option grants ($16 million).

As of June 30, 2010, the total unrecognized compensation cost of $1,257 million related to non-vested awards is expected to be recognized over a weighted-average period of approximately 2.5 years.

There were no significant capitalized stock-based compensation costs at June 30, 2010 and 2009.

9. Segments: The following tables reflect the results of operations of the segments consistent with the company s management and measurement system. These results are not necessarily a depiction that is in conformity with GAAP. 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.

Table of Contents

Notes to Consolidated Financial Statements (continued)

SEGMENT INFORMATION

(UNAUDITED)

	Global Services					
(Dollars in millions)	Global Technology Services	Global Business Services	Software	Systems and Technology	Global Financing	Total Segments
For the three months ended June 30, 2010:						
External revenue	$ 9,234	$ 4,483	$ 5,277	$ 3,985	$ 544	$ 23,523
Internal revenue	332	197	690	202	431	1,852
Total revenue	$ 9,566	$ 4,680	$ 5,967	$ 4,187	$ 975	$ 25,376
Pre-tax income	$ 1,422	$ 683	$ 1,988	$ 221	$ 463	$ 4,777
Revenue year-to-year change	1.2%	2.6%	3.2%	2.2%	(3.9)%	1.9%
Pre-tax income year-to-year change	1.2%	12.3%	7.4%	(33.8)%	(0.5)%	2.4%
Pre-tax income margin	14.9%	14.6%	33.3%	5.3%	47.4%	18.8%
For the three months ended June 30, 2009:						
External revenue	$ 9,108	$ 4,338	$ 5,166	$ 3,855	$ 568	$ 23,035
Internal revenue	343	223	614	244	447	1,870
Total revenue	$ 9,451	$ 4,562	$ 5,780	$ 4,098	$ 1,014	$ 24,905
Pre-tax income	$ 1,405	$ 608	$ 1,852	$ 333	$ 465	$ 4,663
Pre-tax income margin	14.9%	13.3%	32.0%	8.1%	45.8%	18.7%

Reconciliations to IBM as Reported:

(Dollars in millions)	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009
Revenue:		
Total reportable segments	$ 25,376	$ 24,905
Eliminations/other	(1,652)	(1,655)
Total IBM Consolidated	$ 23,724	$ 23,250
Pre-tax income:		
Total reportable segments	$ 4,777	$ 4,663
Eliminations/other	(202)	(401)*
Total IBM Consolidated	$ 4,575	$ 4,262

* Includes a provision for losses related to a joint venture investment.

Table of Contents

Notes to Consolidated Financial Statements (continued)

SEGMENT INFORMATION

(UNAUDITED)

	Global Services					
(Dollars in millions)	**Global Technology Services**	**Global Business Services**	**Software**	**Systems and Technology**	**Global Financing**	**Total Segments**
For the six months Ended June 30, 2010:						
External revenue	$ 18,540	$ 8,893	$ 10,296	$ 7,370	$ 1,081	$ 46,181
Internal revenue	652	400	1,448	376	834	3,710
Total revenue	$ 19,192	$ 9,293	$ 11,743	$ 7,746	$ 1,916	$ 49,891
Pre-tax income	$ 2,387	$ 1,128	$ 4,040	$ 51	$ 890	$ 8,496
Revenue year-to-year change	3.5%	1.1%	7.4%	3.2%	(3.4)%	3.6%
Pre-tax income year-to-year change	(4.9)%	(0.1)%	26.8%	(85.9)%	7.9%	6.0%
Pre-tax income margin	12.4%	12.1%	34.4%	0.7%	46.5%	17.0%
For the six months ended June 30, 2009:						
External revenue	$ 17,862	$ 8,736	$ 9,705	$ 7,083	$ 1,146	$ 44,533
Internal revenue	685	456	1,227	420	836	3,624
Total revenue	$ 18,547	$ 9,191	$ 10,933	$ 7,503	$ 1,982	$ 48,156
Pre-tax income	$ 2,509	$ 1,130	$ 3,186	$ 361	$ 825	$ 8,011
Pre-tax income margin	13.5%	12.3%	29.1%	4.8%	41.6%	16.6%

Reconciliations to IBM as Reported:

(Dollars in millions)	**Six Months Ended June 30, 2010**	**Six Months Ended June 30, 2009**
Revenue:		
Total reportable segments	$ 49,891	$ 48,156
Eliminations/other	(3,310)	(3,195)
Total IBM Consolidated	$ 46,581	$ 44,962
Pre-tax income:		
Total reportable segments	$ 8,496	$ 8,011
Eliminations/other	(406)	(627)*
Total IBM Consolidated	$ 8,090	$ 7,385

* Includes a provision for losses related to a joint venture investment.

26

Table of Contents

Notes to Consolidated Financial Statements (continued)

10. Equity Activity:

(Dollars in millions)	Common Stock and Additional Paid in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total IBM Stockholders Equity	Noncontrolling Interests	Total Equity
Equity January 1, 2010	$ 41,810	$ 80,900	$ (81,243)	$ (18,830)	$ 22,637	$ 118	$ 22,755
Net income		5,987			5,987		5,987
Other comprehensive income/(loss), net of tax (total)				320	320		320
Cash dividends declared common stock		(1,551)			(1,551)		(1,551)
Stock transactions related to employee plans net	1,712	(12)	200		1,899		1,899
Other treasury shares purchased not retired			(8,233)		(8,233)		(8,233)
Changes in noncontrolling interests						(1)	(1)
Equity June 30, 2010	$43,522	$ 85,323	$(89,276)	$ (18,510)	$ 21,059	$ 117	$ 21,176

(Dollars in millions)	Common Stock and Additional Paid in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total IBM Stockholders Equity	Noncontrolling Interests	Total Equity
Equity January 1, 2009	$39,129	$ 70,353	$ (74,171)	$ (21,845)	$ 13,465	$ 119	$ 13,584
Net income		5,398			5,398		5,398
Other comprehensive income/(loss), net of tax (total)				802	802		802
Cash dividends declared common stock		(1,407)			(1,407)		(1,407)
Stock transactions related to employee plans net	645	(16)	2		631		631
Other treasury shares purchased not retired			(3,510)		(3,510)		(3,510)
						(25)	(25)

Changes in noncontrolling interests							
Equity June 30, 2009	$39,774	$ 74,328	$(77,679)	$ (21,043)	$ 15,380	$ 94	$ 15,473

Table of Contents

Notes to Consolidated Financial Statements (continued)

The following table summarizes Net income plus other comprehensive income/(loss), a component of IBM stockholders equity in the Consolidated Statement of Financial Position:

(Dollars in millions)	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Net income	$ 3,386	$ 3,103	$ 5,987	$ 5,398
Other comprehensive income/(loss) net of tax:				
Foreign currency translation adjustments	(929)	1,150	(1,081)	766
Net change in retirement-related benefit plans	168	118	392	351
Net unrealized gains/(losses) on marketable securities	(47)	42	(6)	36
Net unrealized gains/(losses) on cash flow hedge derivatives	475	(704)	1,015	(351)
Total other comprehensive income/(loss)	(332)	605	320	802
Net income plus other comprehensive income/(loss)	$ 3,053	$ 3,709	$ 6,306	$ 6,200

11. 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 tables provide the total retirement-related benefit plans impact on income before income taxes:

For the three months ended June 30: (Dollars in millions)	2010	2009*	Yr. to Yr. Percent Change
Retirement-related plans cost			
Defined benefit and contribution pension plans	$ 234	$ 229	2.0%
Nonpension postretirement plans	86	88	(2.3)
Total	$ 319	$ 317	0.9%

* Reclassified to conform with 2010 presentation.

For the six months ended June 30: (Dollars in millions)	2010	2009*	Yr. to Yr. Percent Change
Retirement-related plans cost			
Defined benefit and contribution pension plans	$ 555	$ 580	(4.4)%
Nonpension postretirement plans	173	173	