

# Cummins Engine Company, Inc.

## Notes to Consolidated Financial Statements

### **Note 1. Accounting Policies:**

**Principles of Consolidation:** The consolidated financial statements include all significant majority-owned subsidiaries. Affiliated companies in which Cummins does not have a controlling interest, or for which control is expected to be temporary, are accounted for using the equity method. Use of estimates and assumptions, as determined by management, is required in the preparation of consolidated financial statements in conformity with generally accepted accounting principles. Actual results could differ from these estimates and assumptions.

### **Revenue Recognition:**

The Company recognizes revenues on the sale of its products, net of estimated costs of returns, allowances and sales incentives, when the products are shipped to customers. The Company generally sells its products on open account under credit terms customary to the region of distribution. The Company performs ongoing credit evaluations of its customers and generally does not require collateral to secure its customers' receivables.

### **Foreign Currency:**

Assets and liabilities of foreign entities, where the local currency is the functional currency, have been translated at year-end exchange rates, and income and expenses have been translated to US dollars at average-period rates. Adjustments resulting from translation have been recorded in shareholders' investment and are included in net earnings only upon sale or liquidation of the underlying foreign investment.

For foreign entities where the US dollar is the functional currency, including those operating in highly inflationary economies, inventory, property, plant and equipment balances and related income statement accounts have been translated using historical exchange rates. The resulting gains and losses have been credited or charged to net earnings and were net losses of \$14 million in 2000, \$2 million in 1999 and \$5 million in 1998.

### **Derivative Instruments:**

The Company makes use of derivative instruments in its foreign exchange, commodity price and interest rate hedging programs. Derivatives currently in use are commodity and interest rate swaps, as well as foreign currency forward contracts. These contracts are used strictly for hedging and not for speculative purposes. Refer to Note 10 for more information on derivative financial instruments.

The Company enters into commodity swaps to offset the Company's exposure to price volatility for certain raw materials used in the manufacturing process. As the Company has the discretion to settle these transactions either in cash or by taking physical delivery, these contracts are not considered financial instruments for accounting purposes. These commodity swaps are accounted for as hedges.

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133 on accounting for derivative instruments and hedging activities. The statement is effective for fiscal years beginning after June 15, 2000. The Company will adopt this statement at the beginning of fiscal 2001 and has evaluated and modified its hedging strategy as it applies to the new statement. The statement will not have a material effect on the Company's results of operations.

### **Other Costs:**

Estimated costs of commitments for product coverage programs are charged to earnings at the time the Company sells its products.

Research & development expenditures, net of contract reimbursements, are expensed when incurred and were \$224 million in 2000, \$218 million in 1999 and \$228 million in 1998.

Maintenance and repair costs are charged to earnings as incurred.

### **Cash Equivalents:**

Cash equivalents include all highly liquid investments with an original maturity of three months or less at the time of purchase.