Revenue Recognition

Generally, revenues from merchandise sales are recorded at the time the product is shipped to the customer. The Company reports its sales levels on a net sales basis, which is computed by deducting from gross sales the amount of actual returns received and an amount established for anticipated returns. As a percent of gross sales, returns were 5.2% in fiscal 2003 and 4.9% in each of fiscal 2002 and 2001.

Advertising and Promotion

Costs associated with advertising are expensed during the year as incurred. Global advertising expenses, which primarily include television, radio and print media, and promotional expenses, such as products used as sales incentives, were $1,425.6 million, $1,326.2 million and $1,255.3 million in fiscal 2003, 2002 and 2001, respectively. These amounts include expenses relating to purchase with purchase and gift with purchase promotions that are reflected in net sales and cost of sales. Advertising and promotional expenses included in operating expenses were $1,227.3 million, $1,122.0 million and $1,060.8 million in fiscal 2003, 2002 and 2001, respectively.

Research and Development

Research and development costs, which amounted to $60.8 million, $61.3 million and $57.3 million in fiscal 2003, 2002 and 2001, respectively, are expensed as incurred.

Related Party Royalties and Trademarks

Under agreements covering the Company's purchase of trademarks for a percentage of related sales, royalty payments totaling $20.3 million, $16.5 million and $16.0 million in fiscal 2003, 2002 and 2001, respectively, have been charged to expense. Such payments were made to Mrs. Estée Lauder. During fiscal 1996, the Company purchased a stockholder's rights to receive certain U.S. royalty payments for $88.5 million, which was fully amortized by November 2000. In fiscal 2001, $6.6 million was amortized as a charge to expense.

Stock Compensation

The Company observes the provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS No. 123") by continuing to apply the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25").

The Company applies the intrinsic value method as outlined in APB No. 25 and related interpretations in accounting for stock options and share units granted under these programs. Under the intrinsic value method, no compensation expense is recognized if the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant. Accordingly, no compensation cost has been recognized on options granted to employees. SFAS No. 123 requires that the Company provide pro forma information regarding net earnings and net earnings per common share as if compensation cost for the Company's stock option programs had been determined in accordance with the fair value method prescribed therein. The Company adopted the disclosure portion of SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure" requiring quarterly SFAS No. 123 pro forma disclosure. The following table illustrates the effect on net earnings and earnings per common share as if the fair value method had been applied to all outstanding awards in each period presented.

YEAR ENDED JUNE 30	**2003**	2002[(i)]	2001[(ii)]
(In millions, except per share data)			
Net earnings attributed to common stock, as reported	**$296.4**	$168.5	$281.8
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	**22.9**	2.7	24.4
Pro forma net earnings, attributable to common stock	**$273.5**	$165.8	$257.4
Earnings per common share:			
Net earnings per common share—Basic, as reported	**$ 1.27**	$ .71	$ 1.18
Net earnings per common share—Basic, pro forma	**$ 1.18**	$ .70	$ 1.08
Net earnings per common share—Diluted, as reported	**$ 1.26**	$ .70	$ 1.16
Net earnings per common share—Diluted, pro forma	**$ 1.16**	$ .68	$ 1.06

(i) Beginning in fiscal 2002, the pro forma charge for compensation cost related to stock options granted will be recognized over the service period. The service period represents the period of time between the date of grant and the date each option becomes exercisable without consideration of acceleration provisions (e.g. retirement, change of control, etc.).

(ii) In fiscal 2001, the Company determined the pro forma charge for compensation cost assuming all options were immediately vested upon the date of grant.