

**Note 1 Significant Accounting Policies**

The significant accounting policies followed in the preparation of the accompanying consolidated financial statements are summarized below.

**Nature of Operations** — The Company is a leading worldwide producer of motion control products, including fluid power systems, electromechanical controls and related components. The Company evaluates performance based on segment operating income before Corporate general and administrative expenses, Interest expense and Income taxes.

The Company operates in two principal business segments: Industrial and Aerospace. The Industrial Segment is an aggregation of several business units which produce motion-control and fluid power system components for builders and users of various types of manufacturing, packaging, processing, transportation, agricultural, construction, and military machinery, vehicles and equipment. Industrial Segment products are marketed primarily through field sales employees and independent distributors. The North American Industrial business represents the largest portion of the Company's manufacturing plants and distribution networks and primarily services North America. The International Industrial operations bring Parker products and services to countries throughout Europe, Asia Pacific and Latin America.

The Aerospace Segment produces hydraulic, pneumatic and fuel systems and components which are utilized on virtually every domestic commercial, military and general aviation aircraft and also performs a vital role in naval vessels, land-based weapons systems, satellites and space vehicles. This Segment serves original equipment and maintenance, repair and overhaul customers worldwide. Aerospace Segment products are marketed by field sales employees and are sold directly to the manufacturer and to the end user.

The Company also reports an Other Segment consisting of several business units which produce motion-control and fluid power system components for use primarily in the transportation industry and a business unit which designs and manufactures custom-engineered buildings. The products in this segment are marketed primarily through field sales employees and independent distributors.

See the table of Business Segment Information "By Industry" and "By Geographic Area" on page 25 for further disclosure of business segment information.

There are no individual customers to whom sales are five percent or more of the Company's consolidated sales. Due to the diverse group of customers throughout the world the Company does not consider itself exposed to any concentration of credit risks. The Company manufactures and markets its products throughout the world. Although certain risks and uncertainties exist, the diversity and breadth of the Company's products and geographic operations mitigate significantly the risk that adverse changes would materially affect the Company's operating results.

**Use of Estimates** — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**Basis of Consolidation** — The consolidated financial statements include the accounts of all domestic and foreign subsidiaries. All material

intercompany transactions and profits have been eliminated in the consolidated financial statements. Within the Business Segment Information, intersegment and interarea sales are recorded at fair market value and are immaterial in amount.

**Revenue Recognition** — Revenue is recognized when the risks and rewards of ownership and title to the product has transferred to the customer. On December 3, 1999 the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," (SAB 101). SAB 101 reflects the basic principles of revenue recognition in accounting principles generally accepted in the United States of America. No significant changes to the Company's revenue recognition policies were necessary to comply with SAB 101.

In the fourth quarter of 2001 the Company adopted Emerging Issues Task Force (EITF) Issue 00-10, "Accounting for Shipping and Handling Fees and Costs," which requires amounts billed to customers for shipping and handling to be included as a component of sales. The Company restated its Net sales for the first three quarters of 2001 and total year Net sales for 2000 and 1999, resulting in an increase in both Net sales and Cost of sales of \$23,164, \$30,281 and \$27,896, respectively.

**Cash** — Cash equivalents consist of short-term highly liquid investments, with a three-month or less maturity, carried at cost plus accrued interest, which are readily convertible into cash.

**Inventories** — Inventories are stated at the lower of cost or market. The majority of domestic inventories are valued by the last-in, first-out method and the balance of the Company's inventories are valued by the first-in, first-out method.

**Long-term Contracts** — The Company enters into long-term contracts for the production of aerospace products and the manufacture of custom-engineered buildings. For financial statement purposes, sales are recorded as deliveries are made (units of delivery method of percentage-of-completion). Unbilled costs on these contracts are included in inventory. Progress payments are netted against the inventory balances. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined.

**Plant, Equipment and Depreciation** — Plant and equipment are recorded at cost and are depreciated principally using the straight-line method for financial reporting purposes. Depreciation rates are based on estimated useful lives of the assets, generally 40 years for buildings; 15 years for land improvements and building equipment; 10 years for machinery; and seven years for equipment. Improvements which extend the useful life of property are capitalized, and maintenance and repairs are expensed. When property is retired or otherwise disposed of, the cost and accumulated depreciation are removed from the appropriate accounts and any gain or loss is included in current income.

**Investments and Other Assets** — Investments in joint-venture companies in which ownership is 50% or less and in which the Company does not have operating control are stated at cost plus the Company's equity in undistributed earnings. These investments and the related earnings are not material to the consolidated financial statements.

**Excess Cost of Investments** — The excess cost of investments over net assets acquired is being amortized, on a straight-line basis, over periods ranging from 15 years to 40 years. Unamortized cost in excess of associated