SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended: December 31, 2002

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from: __________ to __________

1-4471 (Commission File Number)

XEROX CORPORATION

(Exact name of registrant as specified in its charter)

New York	**16-0468020**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

P.O. Box 1600, Stamford, Connecticut
(Address of principal executive offices)

06904
(Zip Code)

Registrant's telephone number, including area code: (203) 968-3000

Securities registered pursuant to Section 12(b) of the Act:

Title of each Class	Name of Each Exchange on Which Registered
Common Stock, $1 par value	New York Stock Exchange Chicago Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 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: ☒ No: ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by a check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2) Yes: ☒ No: ☐

The aggregate market value of the voting stock of the registrant held by non-affiliates as of June 28, 2002 was: $5,071,919,514.

Indicate the number of shares outstanding of each of the registrant’s classes of common stock, as of the latest practicable date:

Class	Outstanding at February 28, 2003
Common Stock, $1 par value	740,320,265 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are incorporated herein by reference:

Document	Part of Form 10-K in Which Incorporated
Xerox Corporation 2002 Annual Report to Shareholders	I & II
Xerox Corporation Notice of 2003 Annual Meeting of Shareholders and Proxy Statement (to be filed not later than 120 days after the close of the fiscal year covered by this report on Form 10-K)	III

Forward Looking Statements

From time to time we and our representatives, may provide information, whether orally or in writing, including certain statements in this Annual Report on Form 10-K, which are forward-looking. These forward-looking statements and other information are based on our beliefs as well as assumptions made by us using information currently available.

The words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “will,” and similar expressions, as they relate to us, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended. We do not intend to update these forward-looking statements.

We are making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors which could cause actual results to differ materially from those contained in the forward-looking statements. Such factors include, but are not limited to, the following:

Competition—We operate in an environment of significant competition, driven by rapid technological advances and the demands of customers to become more efficient. There are a number of companies worldwide with significant financial resources that compete with us to provide document processing products and services in each of the markets we serve, some of which operate on a global basis. Our success in future performance is largely dependent upon our ability to compete successfully in the markets we currently serve and to expand into additional market segments.

Transition to Digital—Presently, black and white light-lens copiers represent between 15-20% of our revenues. This segment of the market is mature with anticipated declining industry revenues as the market transitions to digital technology. Some of our new digital products replace or compete with our current light-lens equipment. Changes in the mix of products from light-lens to digital, and the pace of that change, as well as competitive developments, could cause actual results to vary from those expected.

Expansion of Color—Color printing and copying represents an important and growing segment of the market. Printing from computers has both facilitated and increased the demand for color. A significant part of our strategy and ultimate success in this changing market is our ability to develop and market technology that produces color prints and copies quickly, easily and at reduced cost. Our continuing success in this strategy depends on our ability to make the investments and commit the necessary resources in this highly competitive market, as well as the pace of color adoption by our existing and prospective customers.

Pricing—Our success depends on our ability to obtain adequate pricing for our products and services which provides a reasonable return to our shareholders. Depending on competitive market factors, future prices we obtain for our products and services may decline from historical levels. In addition, pricing actions to offset the effect of currency devaluations may not prove sufficient to offset further devaluations or may not hold in the face of customer resistance and/or competition.

Customer Financing Activities— Prior to 2002, we financed approximately 80 percent of our equipment sales. To fund these arrangements, we accessed the credit markets and used cash generated from operations. The long-term viability and profitability of our customer financing activities is dependent, in part, on our ability to borrow and the cost of borrowing in the credit markets. This ability and cost, in turn, is dependent on our credit ratings. We are currently funding our customer financing activity from an eight-year agreement we completed with General Electric in the U.S., other third-party financing arrangements, cash generated from operations, as well as from cash on hand, unregistered capital markets offerings and securitizations. There is no assurance that we will be able to continue to fund our customer financing activity at present levels. We continue to negotiate and implement third-party vendor financing programs and securitizations of portions of our existing finance receivable portfolios and we continue to actively pursue alternative forms of financing including securitizations and secured borrowings. These initiatives are expected to improve our liquidity going forward. Our ability to continue to offer customer financing and be successful in the placement of equipment with customers is largely dependent upon successful completion of our third party financing initiatives.

Productivity—Our ability to sustain and improve profit margins is largely dependent on our ability to continue to improve the cost efficiency of our operations. Productivity improvements through process re-engineering, design efficiency and supplier and manufacturing cost improvements are required to offset labor cost inflation, potential materials cost increases and competitive price pressures.

International Operations—We derive approximately 40 percent of our revenue from operations outside the United States. In addition, we manufacture or acquire many of our products and/or their components outside the United States. Our future revenues, costs and results from operations could be affected by a number of factors, including changes in foreign currency exchange rates, changes in economic conditions from country to country, changes in a country's political conditions, trade protection measures, licensing requirements and local tax issues. Our ability to enter into new foreign exchange contracts to manage foreign exchange risk is currently limited given our below investment grade credit ratings. Despite our current credit ratings, we have been able to restore a significant level of currency derivative capacity. Although we are still unable to hedge all of our currency exposures, we are utilizing our current capacity to hedge currency exposures primarily related to foreign currency denominated debt. We anticipate continued volatility in our results of operations due to market changes in interest rates and foreign currency rates which we are currently unable to hedge.

New Products/Research and Development—The process of developing new high technology products and solutions is inherently complex and uncertain. It requires accurate anticipation of customers' changing needs and emerging technological trends. We must make long-term investments and commit significant resources before knowing whether these investments will eventually result in products that achieve customer acceptance and generate the revenues required to provide desired returns from these investments.

Revenue Trends—Our ability to return to and maintain a consistent trend of revenue growth over the intermediate to longer term is largely dependent upon expansion of our worldwide equipment placements, as well as sales of services and supplies occurring after the initial equipment placement (post sale revenue) in the key growth markets of color and multifunction devices. We expect that revenue growth can be further enhanced through our consulting services in the areas of document, content and knowledge management. The ability to achieve growth in our equipment placements is subject to the successful implementation of our initiatives to provide advanced systems, industry-oriented global solutions and services for major customers, improved direct sales productivity and expansion of our indirect distribution channels in the face of global competition and pricing pressures. Our ability to increase post sale revenue is largely dependent on our ability to increase equipment placements, equipment utilization and color adoption. Equipment placements typically occur through leases with original terms of three to five years. Our leases generate contractual and contingent post sale revenue. Once equipment placements start to increase, there will be a lag before post sale revenues also start to increase. The ability to grow our customers' usage of our products may continue to be adversely impacted by the movement towards distributed printing and electronic substitutes and the impact of lower equipment placements in prior periods. If we are unable to return to and maintain a consistent trend of revenue growth, there could be a material adverse effect on our operating results.

Liquidity—The adequacy of our liquidity depends on our ability to successfully generate positive cash flow from an appropriate combination of operating improvements, financing from third parties, access to capital markets and additional asset sales, including sales or securitizations of our receivables portfolios. We believe our liquidity (including operating and other cash flows that we expect to generate) will be sufficient to meet operating cash flow requirements as they occur and to satisfy all scheduled debt maturities for at least the next twelve months; however, our ability to maintain positive liquidity going forward is highly dependent on achieving our expected operating results, including capturing the benefits from restructuring activities, and continuing to complete announced vendor financing and other initiatives that are discussed in this Annual Report on Form 10-K. There is no assurance that these initiatives will be successful. Failure to successfully complete these initiatives could have a material adverse effect on our liquidity and our operations, and could require us to consider further measures, including deferring planned capital expenditures, reducing discretionary spending, selling additional assets and if necessary, restructuring existing debt.

In June 2002, we entered into an Amended and Restated Credit Agreement (the "New Credit Facility") with a group of lenders, replacing our prior $7 billion facility (the "Old Revolver"). At that time, we permanently repaid $2.8 billion of the Old Revolver and subsequently paid $710 million on the New Credit Facility. At December 31, 2002, the New Credit Facility consisted of two tranches of term loans totaling $2.0 billion and a $1.5 billion revolving credit facility that includes a $200 million letter of credit subfacility. At December 31, 2002, $3.5 billion was outstanding under the New Credit Facility. At December 31, 2002 we had no additional borrowing capacity under the New Credit Facility since the entire revolving facility was outstanding, including a $10 million letter of credit under the subfacility. The New Credit Facility requires principal payments as well as prepayments in the case of certain events. A full discussion of these terms and the final maturity dates of the various loans is included in the Capital Resources and Liquidity section in our 2002 Annual Report which is incorporated by reference herein. The New Credit Facility contains affirmative and negative covenants including limitations on issuance of debt and preferred stock; certain fundamental changes, as defined; investments and acquisitions; mergers; certain transactions with affiliates; creation of liens; asset transfers; hedging transactions; payment of dividends; inter-company loans and certain restricted payments; and a requirement to transfer excess foreign cash, as defined, and excess cash of Xerox Credit Corporation to us in certain circumstances. It also contains additional financial covenants, including minimum EBITDA, as defined, maximum leverage (total adjusted debt divided by EBITDA), annual maximum capital expenditures limits and minimum consolidated net worth, as defined. We are, and expect to remain, in full compliance with the covenants and other provisions of the New Credit Facility for at least the next twelve months. Any failure to be in compliance with any material provision or covenant of the New Credit Facility could have a material adverse effect on our liquidity and operations.

Litigation — We are a defendant in numerous litigation and regulatory matters involving securities law, patent law, environmental law, employment law and the Employee Retirement Income Security Act (ERISA). Should these matters result in a change in our determination as to an unfavorable outcome, result in a final adverse judgment or be settled for significant amounts, they could have a material adverse effect on our results of operations, cash flows and financial position in the period or periods in which such determination, judgment or settlement occurs.

PART I

Item 1. Business

Overview

References herein to "we," "us" or "our" refer to Xerox Corporation and its subsidiaries unless the context specifically states or implies otherwise.

We are The Document Company, and a leader in the global document market, developing, manufacturing, marketing, servicing and financing a complete range of document equipment, software, solutions and services. We operate in over 130 countries worldwide, and distribute our products in the Western Hemisphere through divisions, wholly-owned subsidiaries and third-party distributors. In Europe, Africa, the Middle East, India and parts of Asia, we distribute our products through Xerox Limited and related companies (collectively "Xerox Limited"). We had approximately 67,800 employees at December 31, 2002.

The document industry is undergoing a fundamental transformation, including the continued transition from older light-lens devices to digital technology, the transition from black and white to color, the management of publishing and printing jobs over the internet, the use of variable data to create customized documents, increased reliance on outsourcing and the increase in mobile workers utilizing hand-held devices. Documents are increasingly created and stored in digital electronic form and the internet is increasing the amount of information that can be accessed in the form of electronic documents. We believe these trends play to the strengths of our product and service offerings and represent opportunities for future growth. Two important areas for our growth include color and services and solutions that tailor our product and service offerings to solve industry specific customer problems.

We develop document technologies, systems, solutions and services intended to improve our customers' work processes and business results. Our success rests on our ability to understand our customers' needs and provide innovative document management solutions and services that deliver value to them. We deliver value to customers by leveraging our core competencies in technology, document knowledge, global sales and service, brand reputation and value added solutions across our three core markets, high-end production environments, small to large networked offices and services.

We compete in both monochrome (i.e. black and white) and color markets by providing the industry's broadest range of document products, solutions and services. Our products include printing and publishing systems, digital multi-function devices (which can print, copy, scan and fax) and digital copiers, laser and solid ink printers, fax machines, document-management software, and supplies such as toner, paper and ink. We also provide software and solutions that can improve document access for mobile workers and help businesses easily print books or create personalized documents for their customers. In addition, we provide a range of comprehensive document management services, such as operating in-house production centers, developing online document repositories and analyzing how customers can most efficiently create and share documents in the office.

Segment Information

Our reportable segments are Production, Office, Developing Markets Operations ("DMO"), Small Office/Home Office ("SOHO") and Other. Operating segment financial information is found in Note 9 to the Consolidated Financial Statements, which is incorporated herein by reference. We have a very broad and diverse base of customers, both geographically and demographically, ranging from small and middle market businesses to graphic arts shops, governmental entities, educational institutions and large (Fortune 1000) corporate accounts. None of our business segments depends upon a single customer, or a few customers, the loss of which would have a material adverse effect on our business.

Production

We provide monochrome and color systems for three main customer environments: production publishing, transaction printing and enterprise-wide printing. We are the only manufacturer in the market that offers a complete family of production publishing systems from 65 to 180 impressions per minute. In addition, we continue to support analog devices currently installed at customer locations. We offer total document solutions and services that can scan, view, manage and produce documents, as well as a variety of pre-press and post-press options to fully meet customer demands.

Our goals in the Production segment in 2002 were to improve our market coverage, stabilize our sales force and to implement a program that we call the “New Business of Printing.” The “New Business of Printing” includes introducing innovative production systems and solutions to expand our leadership position and focus on the higher growth digital color opportunities. Based on our analysis of projected equipment installations data from International Data Corporation and InfoSource, production digital color revenues are expected to have a compound annual growth rate of more than 30 percent through 2006. This “New Business of Printing” responds to increasing customer requirements for fast turnaround times, precise quantities, personalization and customization and is built on the solid foundation of the digital production print on demand market, which we created in 1990 with the introduction of our first DocuTech Production Publisher. We provide content creation and management, production and fulfillment solutions and services to improve our customers’ work processes and business results. Our digital technology enables personalization and printing on demand that can eliminate inventory and warehousing costs.

Our results in 2002 include the addition of specialists with unique industry experience, an alliance with several partners to market products to commercial printers and increased tenure and expertise of our sales force. We introduced the following products in 2002:

- In October, we launched the DocuColor iGen3 Digital Production Press at a base list price of $500,000. The DocuColor iGen3 utilizes next generation color technology which we expect will expand the digital color print on demand market, as its speed, image quality, personalization and cost advantages enable the device to capture valuable pages from the color offset printing market. The DocuColor iGen3 consists of modular components that work together as a sophisticated print shop. Utilizing patented imaging technology which produces photographic quality output indistinguishable from offset printing, this breakthrough technology can produce over 100 pages per minute at an operating cost of about 5 cents per page. This product is the result of a multi-year R&D investment of approximately $1 billion. We expect to begin realizing material revenue contributions from this product in 2004 and 2005.
- In July, we launched the DocuColor 6060, which complements the successful DocuColor 2000 family by offering a more advanced set of features, productivity and capabilities.
- In June, we introduced the DocuColor 1632 (16 ppm color / 32 ppm black and white) and DocuColor 2240 (22 ppm color / 40 ppm black and white) midrange color printers/copiers. These printers/copiers deliver affordability and speed with a benchmark cost for color pages of less than 10 cents a page. These products are the first to utilize emulsion aggregation toner, which delivers superior quality and improved efficiency.
- In April, we launched the new common “DocuSP” controller technology which, for the first time, provides a consistent way to prepare and process print jobs in color and black-and-white from DocuTech to DocuColor high-end systems.
- In November, we introduced the Xerox 1010, our new 101 page per minute digital device and latest entry into the light production market.

Office

Our Office segment includes global, national and small to medium sized commercial customers as well as government, education and other public sector customers. Office systems and services encompass monochrome devices at speeds up to 90 pages per minute, including our family of Document Centre digital multi-function products; color laser, LED (light emitting diode), solid ink and monochrome laser desktop printers; digital copiers; light-lens copiers and facsimile products.

Our goals in the Office segment in 2002 were to improve the competitiveness of our cost structure, increase our market coverage through indirect channel expansion and capture growth opportunities in this market. Our strategy to capture growth in the Office remains centered around three key areas: color, digital multifunction devices and solutions. We will drive the market to color printing and copying by making color as easy, fast and affordable as traditional black and white. We continue to lead the transition from single-function machines to multi-function devices by ensuring that multi-function devices continue to be more cost-effective. We provide further value to our customers by offering a range of solutions including wireless document access for mobile workers and the Office Document Assessment (“ODA”) in which we analyze a business’ workflow, document needs and then identify the most efficient, productive mix of office equipment and software for that business, thereby helping to reduce the customer’s document related costs.

Our 2002 results include improving the Office operating margin by outsourcing substantially all our office product manufacturing to Flextronics, moving more of our sales from direct to lower cost indirect channels, thus improving efficiency and reducing costs and capturing the service productivity enabled by our digital offerings. In addition, we launched important new products and product platforms including the following:

- We launched the Document Centre 500 series in June 2002, which prints at speeds of 35, 45 and 55 pages per minute. This series of digital multifunction systems brings unparalleled productivity and features to small and mid-sized workgroups at significantly lower prices. We believe the network and fax options have compelling economics versus the alternative of purchasing single function printers and fax machines since the print engine, output mechanics and most of the software required are part of the base digital copier.
- We expanded our WorkCentre Pro family of products targeted at lower-volume cost conscious customers with the launch, in Europe and our Developing Markets, of the WorkCentre Pro 421, 423 and 428.
- We launched the Phaser 8200 solid ink color printer and the Phaser 6200 and 7300 laser color printers, all of which use single pass color technology and are among the fastest in their respective classes. These products are designed to accelerate customer migration to color by offering cost and print quality advantages that make it practical and cost-efficient to replace traditional black-and-white printers.

DMO

DMO includes marketing, direct sales, distributions programs and service operations for Xerox products, supplies and services in Latin America, the Middle East, India, Eurasia, Russia, and Africa. Over 120 countries are included in DMO, with Brazil representing approximately 40% of total DMO revenues in 2002. DMO operations are managed separately as a segment due to the political and economic volatility and unique nature of its markets. Our 2002 DMO goals included improving liquidity and reducing business risk, as well as profitable revenue generation while reducing costs to enable a return to profitability. Our results include a return to profitability in DMO due to accelerated cost reductions as well as our refocused efforts on limiting aggressively priced low margin contracts and only selling to customers at higher and more acceptable margins. In addition, our DMO operations have reduced debt reflecting improved operating cash generation and our transition to third party vendor financing or cash sales. See Note 2 to the Consolidated Financial Statements incorporated by reference, for a discussion of our restructuring efforts.

SOHO

In line with our strategy to focus on our core business, we announced the disengagement from our worldwide consumer/personal inkjet printer business in June 2001. We continue to sell consumables for the inkjet printers and personal copiers previously sold through indirect channels in North America and Europe. We expect that sales of these supplies will continue over the next few years, but will decline over time as the existing population of equipment is replaced.

Other

We sell cut-sheet paper to our customers for use in their document processing products. The market for cut-sheet paper is highly competitive and revenues are significantly affected by pricing. Our strategy is to charge a premium over mill wholesale prices, which is adequate to cover our costs and the value we add as a distributor. We also offer other document processing products, including devices designed to reproduce large engineering and architectural drawings up to three feet by four feet in size, which are developed and sold through Xerox Engineering Systems. Our consulting services revenue is also included in the Other segment.

Research and Development

Investment in research and development ("R&D") is critical to drive future growth, and we have directed our investments to the fastest growing segments of the market. Our goal is to continue to create innovative technologies that will expand current and future markets. Our R&D investments employ three key themes: 1) continue to reinvent our machines to deliver better quality, more functionality and improved productivity, 2) rethink how people work, including the use of variable information printing to customize documents and 3) redefine the document through new inventions such as "smart paper," a "paper-like" display media which enables retail signage to be instantly updated. Our research scientists regularly meet with customers and have dialogues with our business groups to ensure they understand customer requirements and develop products and solutions that can be commercialized.

In 2002, R&D expense was $917 million, compared with $997 million in 2001 and $1,064 million in 2000. 2002 R&D spending focused primarily on the development of high-end business applications and extending our color capabilities. The DocuColor iGen3, an advanced next-generation digital printing press launched in October 2002 that uses our patented imaging technology to produce photographic quality prints indistinguishable from offset, is an example of the type of breakthrough technologies we developed that we expect will drive our future growth.

Our R&D is strategically coordinated with that of Fuji Xerox, which invested $580 million in R&D in 2002 which, together with our investment resulted in a combined total of $1.5 billion. To maximize the synergies of our relationship, Xerox R&D expenditures are focused primarily on the Production segment while Fuji Xerox R&D expenditures are principally focused on the Office segment.

Patents, Trademarks and Licenses

We are a technology company. We were awarded over 700 U.S. patents in 2002, ranking us 19th on the list of companies that had been awarded the most U.S. patents during the year, rising in rank from 21st the year before. With our research partner, Fuji Xerox, we were awarded close to 900 U.S. patents in 2002. Our patent portfolio evolves as new patents are awarded to us and as older patents expire. As of December 31, 2002, we held approximately 7,700 U.S. patents. These patents expire at various dates up to 17 years from the date of award. While we believe that our portfolio of patents and applications has value, in general no single patent is essential to our business or any individual segment. In addition, any of our proprietary rights could be challenged, invalidated or circumvented, or may not provide significant competitive advantages.

In the U.S., we own approximately 800 trademarks (registered or applied for). These trademarks have a perpetual life, subject to renewal every ten years. We vigorously enforce and protect our trademarks. We hold a perpetual trademark license for "DocuColor."

In the U.S., we are party to approximately 150 agreements which involve U.S. patent licenses. We are the licensor in approximately 140 of those agreements. Most of the patent licenses expire concurrently with the expiration of the last patent identified in the license.

Competition

We encounter aggressive competition in all areas of our business. Our competitors range from large international companies to relatively small firms. We compete primarily on the basis of technology, performance, price, quality, reliability, brand, distribution and customer service and support. To remain competitive we must develop new products and services and periodically enhance our existing offerings.

We are the leader, or among the leaders, in each of our principal business segments. Our key competitors include Hewlett Packard, Canon, Ricoh, IKON and in certain areas of the business, Pitney Bowes, Heidelberger Druckmaschinen Aktiengesellschaft, Oce, Nexpress, Konica-Minolta and Lexmark.

We believe that our brand recognition, reputation for quality, innovative technology, breadth of product offerings and large customer base are important competitive advantages. We, and our competitors, continue to develop and market new and innovative products at competitive prices and, at any given time, we may set new market standards for quality, speed and function. In recent years, price pressure has continued. If this pressure is not mitigated by cost and expense reductions, our ability to profitably maintain or build market share could be adversely affected.

Marketing and Distribution

We manage our business and report our financial results based on the principal business segments described above. The marketing and selling of our products and solutions, however, are organized according to geography and channel types. Our products and solutions are principally sold directly to customers by our worldwide sales force totaling approximately 10,000 employees and through a network of independent agents, dealers, value-added resellers and systems integrators. We are expanding our use of cost-effective indirect distribution channels (such as “Teleweb,” a combination of telephone and internet selling) for basic product offerings, and increasingly utilizing our direct sales force to address our customers’ more advanced technology, solutions and services requirements.

We market our Phaser line of color and monochrome laser-class and solid ink printers through office information technology industry resellers, who typically access our products through distributors. In addition, new initiatives are being implemented to add channel capacity through direct-to-customer e-commerce and direct-to-customer selling using our direct sales force in select large accounts.

We are increasing our use of partners to improve our market coverage. In 2002, we announced an alliance with KPG and Premier Partners to market our DocuColor 2000 series to commercial printers. We also announced a strategic alliance with Electronic Data Systems (“EDS”) designed to integrate EDS’ information technology (“IT”) services with our document management systems and services to provide customers with full IT infrastructure support.

In 2002, we increased our advertising spending as we invested in a new advertising campaign designed to focus on our solutions for specific customers. Our brand is a valuable resource and continues to be recognized in the top ten percent of all brands worldwide.

Backlog

We believe that backlog, or the value of unfilled orders, is not a meaningful indicator of future business prospects due to the significant proportion of our revenue that follows equipment installation, the large volume of products delivered from shelf inventories and the shortening of product life cycles.

Seasonality

Our revenues are affected by such factors as the introduction of new products, the length of the sales cycles and the seasonality of technology purchases. As a result, our operating results are difficult to predict. These factors have historically resulted in lower revenue in the first quarter than in the immediately preceding fourth quarter.

Fuji Xerox

Fuji Xerox Co., Limited is an unconsolidated entity in which Xerox Limited currently owns 25 percent and which Fuji Photo Film Co., Ltd. ("FujiFilm") owns 75 percent. These ownership interests reflect the March 2001 sale of half our original ownership interest in Fuji Xerox to FujiFilm for $1.3 billion in cash. Fuji Xerox develops, manufactures and distributes document processing products in Japan, China, Hong Kong and other areas of the Pacific Rim, Australia and New Zealand. We retain significant rights as a minority shareholder. Our technology licensing agreements with Fuji Xerox ensure that the two companies retain uninterrupted access to each other's portfolio of patents, technology and products.

Service

As of December 31, 2002, we had a worldwide service force of over 17,000 employees and a network of independent service agents. We are expanding our use of cost-effective remote service technology for basic product offerings while utilizing our direct service force to address customers' more advanced technology requirements. We believe that our service force represents a significant competitive advantage in that the service force is continually trained on our products and their diagnostic equipment is state-of-the-art. Twenty-four-hours-a-day, seven-days-a-week service is available in major metropolitan areas around the world. As a result, we are able to guarantee a consistent and superior level of service worldwide.

Manufacturing Outsourcing

In the fourth quarter of 2001, we entered into purchase and supply agreements with Flextronics, a global electronics manufacturing services company. Under these agreements, Flextronics purchased related inventory, property and equipment. Pursuant to the purchase agreement, we sold our operations in Toronto, Canada; Aguascalientes, Mexico; Penang, Malaysia, Venray; The Netherlands and Resende, Brazil to Flextronics in a series of transactions, which were completed in 2002. Approximately 4,100 Xerox employees in certain of these operations transferred to Flextronics.

Under the supply agreement, Flextronics manufactures and supplies equipment and components, including electronic components, for the Office segment of our business. This represents approximately 50% of our overall worldwide manufacturing operations. The initial term of the Flextronics supply agreement is five years subject to our right to extend for two years. Thereafter, it will automatically be renewed for one-year periods, unless either party elects to terminate the agreement. We have agreed to purchase from Flextronics most of our requirements for certain products in specified product families. We also must purchase certain electronic components from Flextronics, so long as Flextronics meets certain pricing requirements. Flextronics must acquire inventory in anticipation of meeting our forecasted requirements and must maintain sufficient manufacturing capacity to satisfy such forecasted requirements. Under certain circumstances, we may become obligated to repurchase inventory that remains unused for more than 180 days, becomes obsolete or upon termination of the supply agreement. Our remaining manufacturing operations are primarily located in Rochester, NY for our high-end production products and consumables and Wilsonville, OR for consumable supplies and components for our Office segment products.

The foregoing summary of the supply agreement is not complete and is in all respects subject to the actual provisions of the supply agreement, which has been filed with the Securities and Exchange Commission.

International Operations

Our international operations represented approximately 40 percent of total revenues in 2002. Our largest interest outside the United States is Xerox Limited which operates predominately in Europe. Latin American operations are conducted through subsidiaries or distributors in over 39 countries. Fuji Xerox, an unconsolidated entity of which we own 25 percent, develops, manufactures and distributes document processing products in Japan, China, Hong Kong and other areas of the Pacific Rim, Australia and New Zealand.

Our financial results by geographical area for 2002, 2001 and 2000, which are included in Note 9 to the Consolidated Financial Statements in our 2002 Annual Report, are hereby incorporated by reference.

Other Information

Xerox is a New York corporation and our principal executive offices are located at 800 Long Ridge Road, P. O. Box 1600, Stamford, Connecticut 06904-1600. Our telephone number is (203) 968-3000.

Through the Investor Relations section of our Internet website, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all related amendments are available, free of charge, as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. Our Internet address is http://www.xerox.com.

Item 2. Properties

We own a total of nine principal manufacturing and engineering facilities and lease two additional facilities. The manufacturing and engineering facilities, located in California, New York, Oklahoma, Canada, UK, Ireland and The Netherlands, are used jointly by the Production and Office Segments, those in Oregon by the Office Segment, and those in Brazil and India by the DMO Segment. The research activities in our principal research centers benefit all our operating segments.

In 2001 and the first half of 2002, as part of our outsourcing initiatives, we sold and/or subleased to Flextronics certain of our manufacturing locations in Mexico, Malaysia, Canada, The Netherlands, and Brazil. Also, as we implemented the Turnaround Program (discussed in Note 2 to the Consolidated Financial Statements in our Annual Report, incorporated by reference), several properties became surplus. In 2002, the Turnaround Program resulted in an additional 23 domestic surplus properties and 15 international properties. The surplus properties are leases that we are obligated to maintain through required contractual periods. We have disposed or subleased certain of these properties and are aggressively pursuing the successful disposition and subleasing of all remaining surplus properties.

In addition, we have numerous facilities, which encompass general offices, sales offices, service locations and distribution centers. The principal owned facilities are located in the United States, France, Ireland, Brazil, India and Mexico. The principal leased facilities are located in the United States, Brazil, Canada, UK, Mexico, France, Germany and Italy. In 2002, we entered into a joint venture (Xerox Capital Services) with General Electric to manage our administrative billing, credit and collection function. Xerox Capital Services licenses several of our owned and leased facilities for their use. The three principal Xerox Capital Services administrative facilities are located in Florida, Illinois and Texas.

Our Connecticut based corporate headquarters facility is leased; however, we own the underlying land. We also lease a portion of a training facility, located in Virginia.

It is our opinion that our properties have been well maintained, are in sound operating condition and contain all the necessary equipment and facilities to perform our functions.

Item 3. Legal Proceedings

The information set forth under Note 15 to the Consolidated Financial Statements, “Litigation, Regulatory Matters and Other Contingencies,” of the Xerox Corporation 2002 Annual Report is hereby incorporated by reference.

Item 4. Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

Market Information, Holders and Dividends

The information set forth under the following captions of the Xerox Corporation 2002 Annual Report to Shareholders is hereby incorporated by reference:

Caption

Stock Listed and Traded
Xerox Common Stock Prices and Dividends
Five Years in Review — Common Shareholders of Record at Year-End

Recent Sales of Unregistered Securities

During the quarter ended December 31, 2002, Registrant issued the following securities in transactions that were not registered under the Securities Act of 1933, as amended (the Act):

1. Xerox Common Stock

(a) Securities Sold: On October 1, 2002, Registrant issued 17,909 shares of Common Stock, par value $1 per share.

(b) No underwriters participated. The shares were issued to each of the non-employee Directors of Registrant: A.A. Johnson, V.E. Jordan, Jr., Y. Kobayashi, H. Kopper, R.S. Larsen, G.J. Mitchell, N.J. Nicholas, Jr., J.E. Pepper, M.R. Seger and T.C. Theobald.

(c) The shares were issued at a deemed purchase price of $4.95 per share (aggregate price $88,625), based upon the market value on the date of issuance, in payment of the quarterly Directors' fees pursuant to Registrant's Restricted Stock Plan for Directors.

(d) Exemption from registration under the Act was claimed based upon Section 4(2) as a sale by an issuer not involving a public offering.

Item 6. *Selected Financial Data*

The following selected financial data for the five years ended December 31, 2002, as set forth and included under the caption "Five Years in Review," of the Xerox Corporation 2002 Annual Report to Shareholders, is incorporated by reference in this Form 10-K.

Revenues
Income (Loss) from continuing operations
Per-Share Data
  Earnings (Loss) from continuing operations – Basic and Diluted
  Common Dividends declared
Total assets
Long-term debt
Company-obligated, mandatorily redeemable preferred securities of subsidiary trusts holding solely subordinated debentures of the Company
Preferred stock

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information set forth under the caption "Management's Discussion and Analysis of Results of Operations and Financial Condition," of the Xerox Corporation 2002 Annual Report is hereby incorporated by reference.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The information set forth under the caption "Financial Risk Management," in the Xerox Corporation 2002 Annual Report is hereby incorporated by reference.

Item 8. Financial Statements and Supplementary Data

The consolidated financial statements, together with the reports thereon of PricewaterhouseCoopers LLP, included in the Xerox Corporation 2002 Annual Report, are incorporated by reference in this Form 10-K. With the exception of the aforementioned information and the information incorporated in Items 5, 6, 7, 7A and 8, the Xerox Corporation 2002 Annual Report is not to be deemed filed as part of this Form 10-K.

The quarterly financial data included under the caption "Quarterly Results of Operations (Unaudited)" of the Xerox Corporation 2002 Annual Report is incorporated by reference in this Annual Report on Form 10-K.

The financial statement schedule required herein is filed as referenced in Item 15 of this Form 10-K.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

On October 4, 2001, we ended the engagement of KPMG LLP and retained PricewaterhouseCoopers LLP as our independent auditors. At that time, we filed a Current Report on Form 8-K dated September 28, 2001. The text of the Form 8-K Report that we filed is as follows:

"On October 4, 2001, Xerox Corporation ("Company") determined to change the Company's independent accountants, and, accordingly, ended the engagement of KPMG LLP ("KPMG") in that role and retained PricewaterhouseCoopers LLP as its independent accountants for the fiscal year ending December 31, 2001. The Audit Committee of the Board of Directors (the "Audit Committee") and the Board of Directors of the Company approved the decision to change independent accountants.

The reports of KPMG on the financial statements of the Company for each of the fiscal years ended December 31, 2000 and December 31, 1999 contained no adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principles. Except to the extent discussed below, for the fiscal years ended December 31, 2000 and December 31, 1999 and through the date of this report, there were no disagreements with KPMG on any matter of accounting principles or practices, financial statement disclosure or audit scope or procedure which, if not resolved to the satisfaction of KPMG, would have caused it to make reference to the subject matter of such disagreement in its reports on the financial statements for such fiscal years. Nor, except to the extent discussed below, were there any reportable events within the meaning of Item 304(a)(1)(v) of Regulation S-K for the fiscal years ended December 31, 2000 and December 31, 1999 and through the date of this report. With respect to the matters discussed below, the Audit Committee discussed them with KPMG and authorized KPMG to respond fully to inquiries of PricewaterhouseCoopers LLP concerning them.

In March 2001, KPMG informed management and the Audit Committee that it wished to expand significantly the scope of its audit work in connection with the audit of the Company's 2000 financial statements. KPMG proposed that certain additional procedures be performed, including that the Audit Committee appoint Special Counsel to conduct an inquiry into certain issues, which procedures were performed in March, April and May 2001.

While the expanded procedures were being performed, KPMG informed the Audit Committee and management that KPMG was unwilling to rely on representations by two employees in one of the Company's geographic operating units. Management removed those employees from responsibility in connection with the Company's system of financial reporting.

As a result of observations during its 2000 audit, and other information discussed with the Audit Committee, KPMG reported certain material weaknesses in the Company's internal control systems and made recommendations concerning certain components of the Company's business:

- KPMG emphasized the importance for internal control of the tone set by the Company's top management. KPMG noted that, as a result of its audit and information reported by Special Counsel, it believed there was evidence that management was not successful in setting the appropriate tone with respect to financial reporting. It recommended that the Company take steps to remediate appropriately those issues. Certain personnel changes have been made based in part on KPMG views offered to the Audit Committee and management.
- Customer Business Operations ("CBO") in the Company's North American Solutions Group. KPMG noted issues with regard to CBO's ability to bill customers accurately for services, and noted that difficulties in that area had resulted in unfavorable billing adjustments during 2000. Although KPMG recognized that the Company had initiated several steps to address this issue, it concluded that it remained unclear when those changes would result in sustained improvement in reducing non-cash resolution adjustments of billing differences. It acknowledged that this weakness did not suggest that the net trade receivable account balance is unreasonably stated at December 31, 2000, but that proper reporting required extensive evaluation of billing adjustments during the fourth quarter. KPMG suggested various business and operational changes to address this issue.
- Communication of Accounting and Control Policies. KPMG noted that policy documents need to be updated, among other things to address issues identified by the Company's worldwide audit function. Special Counsel and KPMG, recommended that the Company also provide increased formal training to ensure that its personnel understand the accounting and control guidance in its policies.
- Consolidation and Corporate-Level Entries. KPMG observed that the Company's quarterly consolidation process is manually intensive, requiring numerous adjustments at corporate financial reporting levels. It recommended that the Company's Consolidated Financial Information System be augmented to enhance the monitoring and review of corporate-level and manual entries, and further that the Company ensure adequate segregation of duties in the preparation and approval of such entries.
- Appropriateness of the Concessionaire Business Model in Latin American Countries. KPMG noted that during 2000, analysis by the Company's worldwide audit function indicated that certain issues existed with respect to this business model, including that certain concessionaires may lack economic substance independent of the Company, and that certain business practices involving concessionaires resulted in allowances with respect to receivables in 2000. KPMG suggested periodic assessment of the financial position of prospective and existing concessionaires, and that the Company monitor its business relationship with them to ensure that they are substantive independent distributors of the Company's products.

In addition to those items, KPMG noted that organizational changes, including the Company's Turnaround Program and associated reductions in headcount, had and would continue to stress the Company's internal control structure. KPMG recommended that the Company take steps to ensure that issues likely to impact the control environment receive appropriate management attention. KPMG also recommended improved balance sheet account reconciliation and analysis on a global basis, in particular with respect to intercompany balances.

The foregoing matters were considered by KPMG in connection with their 2000 audit and did not result in any adverse opinion or disclaimer of opinion or any qualification or modification as to uncertainty, audit scope or accounting principles. KPMG's auditor's report dated May 30, 2001 contained a separate paragraph stating that the Company's 1999 and 1998 consolidated financial statements had been restated.

The Company commenced actions in fiscal 2000 and expanded actions in fiscal 2001 which, collectively, it believes have addressed the above-discussed matters.

The Company has provided KPMG a copy of this Report and requested KPMG to furnish it with a letter addressed to the Securities and Exchange Commission stating whether it agrees with the statements made herein. A copy of such letter, dated October 4, 2001, is filed as an Exhibit to the Company's Form 8-K."

PART III

Item 10. Directors and Executive Officers of the Registrant

The information regarding compliance with Section 16(a) of the Securities and Exchange Act of 1934 is incorporated herein by reference from the section entitled “Section 16(a) Beneficial Ownership Reporting Compliance” of our definitive Proxy Statement (the “Proxy Statement”) to be filed pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, for our Annual Meeting of Stockholders to be held on May 15, 2003. The Proxy Statement will be filed within 120 days after the end of our fiscal year ended December 31, 2002.

The information regarding directors is incorporated herein by reference from the section entitled “PROPOSAL #1: ELECTION OF DIRECTORS” in the Proxy Statement.

Executive Officers of Xerox

The following is a list of the executive officers of Xerox, their current ages, their present positions and the year appointed to their present positions. Anne M. Mulcahy, Chairman of the Board and CEO and Thomas J. Dolan, Senior Vice President, are sister and brother. There are no other family relationships between any of the executive officers named.

Each officer is elected to hold office until the meeting of the Board of Directors held on the day of the next annual meeting of shareholders, subject to the provisions of the By-Laws.

Name	Age	Present Position	Year Appointed to Present Position	Officer Since
Anne M. Mulcahy*	50	Chairman of the Board and Chief Executive Officer	2002	1992
Carlos Pascual	57	Executive Vice President President, Developing Markets Operations	2000	1994
Lawrence A. Zimmerman	60	Senior Vice President and Chief Financial Officer	2002	2002
Ursula M. Burns	44	Senior Vice President President, Business Group Operations	2002	1997
Thomas J. Dolan	58	Senior Vice President President, Xerox Global Services	2001	1997
James A. Firestone	48	Senior Vice President President, Corporate Operations Group	2001	1998
Hervé J. Gallaire	58	Senior Vice President President, Xerox Innovation Group and Chief Technology Officer	2001	1997
Gilbert J. Hatch	53	Senior Vice President President, Production Systems Group	2002	1997
Michael C. MacDonald	48	Senior Vice President President, North American Solutions Group	2000	1997

* Member of Xerox Board of Directors

Executive Officers of Xerox, Continued

Name	Age	Present Position	Year Appointed to Present Position	Officer Since
Hector J. Motroni	59	Senior Vice President and Chief Staff Officer and Chief Ethics Officer	2003	1994
Harry R. Beeth	58	Vice President and Controller	2002	2002
Christina E. Clayton	55	Vice President and General Counsel	2000	2000
Jean-Noel Machon	50	Vice President President, Xerox Europe Group	2000	2000
James J. Miller	51	Vice President President, Office Group	2002	2000
Leslie F. Varon	46	Vice President Investor Relations and Corporate Secretary	2001	2001
Gary R. Kabureck	49	Assistant Controller and Chief Accounting Officer	2001	2000

Each officer named above, with the exception of Lawrence A. Zimmerman, Harry R. Beeth and James A. Firestone, has been an officer or an executive of Xerox or its subsidiaries for at least the past five years.

Prior to joining Xerox in 2002, Mr. Zimmerman had been with System Software Associates, Inc. where he was Executive Vice President and Chief Financial Officer from 1998 – 1999. Prior to that, he retired from International Business Machines Corporation (IBM), where he was Senior Finance Executive for IBM's Server Division from 1996 – 1998, Vice President of Finance for Europe, Middle East and Africa Operations from 1994 – 1996 and IBM Corporate Controller from 1991 – 1994. He held various other positions at IBM from 1967 – 1991.

Prior to joining Xerox in 1998, Mr. Firestone had been with IBM where he was General Manager, Consumer Division from 1995 to 1998. He was President, Consumer Services at Ameritech Corporation from 1993 to 1995. Prior to that he was with American Express Company where he was President, Travelers Cheques in 1993, Executive Vice President, Small Business and Corporate Services from 1989 to 1993, President, Travel Related Services-Japan from 1984 to 1989, Vice President, Finance and Planning, Travel Related Services-Japan from 1982 to 1984 and he held various other positions at American Express in Japan and at their headquarters from 1978 to 1982.

Prior to joining Xerox in 2002, Mr. Beeth had retired from IBM where he was Vice President, Finance for the Server division from 1998 until his retirement in 2000; Vice President, Finance, Microelectronics division from 1996-1998; Assistant Controller from 1994-1996; Group Director of Finance and Planning Operations for the North American sales organization form 1991-1994; and Vice President, Finance and Planning for the National Services organization from 1988-1990. He held various positions at IBM from 1967-1988.

Item 11. Executive Compensation

Information regarding executive compensation is incorporated herein by reference from the section entitled "Executive Officer Compensation" in the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information regarding security ownership of certain beneficial owners and management and securities authorized for issuance under equity compensation plans is incorporated herein by reference from the sections entitled "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plan Information" in the Proxy Statement.

Item 13. Certain Relationships and Related Transactions

Information regarding certain relationships and related transactions is incorporated herein by reference from the section entitled "Certain Relationships and Related Transactions" in the Proxy Statement.

Item 14. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

Under the supervision, and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934, within 90 days of the filing date of this report (the “Evaluation Date”). Based on this evaluation, our principal executive officer and principal financial officer concluded that as of the Evaluation Date our disclosure controls and procedures were effective such that the material information required to be included in our Securities and Exchange Commission (“SEC”) reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms relating to Xerox Corporation, including our consolidated subsidiaries, and was made known to them by others within those entities, particularly during the period when this report was being prepared.

(b) Changes in Internal Controls.

Since the Evaluation Date, there have not been any significant changes in our internal controls or in other factors that could significantly affect such controls.

PART IV

Item 15. Exhibits, Financial Statement Schedule and Reports on Form 8-K

(a) (1) Index to Financial Statements and Financial Statement Schedule, filed as part of this report:

Report of Independent Accountants

Consolidated Statements of Income for each of the years in the three-year period ended December 31, 2002

Consolidated Balance Sheets as of December 31, 2002 and 2001

Consolidated Statements of Cash Flows for each of the years in the three-year period ended December 31, 2002

Consolidated Statements of Common Shareholders’ Equity for each of the years in the three-year period ended December 31, 2002

Notes to Consolidated Financial Statements

Financial Statement Schedule

I—Financial statements of Fuji Xerox Co., Limited to be filed by June 30, 2003 (financial statements required by Regulation S-X which are excluded from the annual report to shareholders by Rule 14a-3(b))

II—Valuation and qualifying accounts

All other schedules are omitted as they are not applicable, or the information required is included in the financial statements or notes thereto.

(2) Supplementary Data:

Quarterly Results of Operations (unaudited)

Five Years in Review

Commercial and Industrial (Article 5) Schedule

(3) The exhibits filed herewith or incorporated herein by reference are set forth in the Index of Exhibits included herein.

(b) Current Reports on Form 8-K dated September 26, 2002 (filed October 1, 2002), September 30, 2002 (filed October 3, 2002), October 21, 2002, November 19, 2002 and December 20, 2002 reporting Item 5 "Other Events" were filed during the last quarter of the period covered by this Report.

(c) The management contracts or compensatory plans or arrangements listed in the Index of Exhibits that are applicable to the executive officers named in the Summary Compensation Table which appears in Registrant's 2003 Proxy Statement are preceded by an asterisk (*).

(d) Financial statements required by Regulation S-X which are excluded from the annual report to shareholders by Rule 14a-3(b), including (1) separate financial statements of subsidiaries not consolidated and fifty-percent-or-less-owned persons and (2) schedules, are filed under Item 15(a) of this Report which is incorporated herein by reference.

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

XEROX CORPORATION

By: /s/ ANNE M. MULCAHY

Anne M. Mulcahy
Chairman of the Board and Chief Executive Officer

March 31, 2003

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

March 31, 2003

Signature	Title
Principal Executive Officer:	
/s/ ANNE M. MULCAHY **Anne M. Mulcahy**	Chairman of the Board, Chief Executive Officer and Director
Principal Financial Officer:	
/s/ LAWRENCE A. ZIMMERMAN **Lawrence A. Zimmerman**	Senior Vice President and Chief Financial Officer
Principal Accounting Officer:	
/s/ GARY R. KABURECK **Gary R. Kabureck**	Assistant Controller and Chief Accounting Officer

/s/ ANTONIA AX:SON JOHNSON **Antonia Ax:son Johnson**	Director
/s/ VERNON E. JORDAN, JR. **Vernon E. Jordan, Jr.**	Director
/s/ YOTARO KOBAYASHI **Yotaro Kobayashi**	Director
/s/ HILMAR KOPPER **Hilmar Kopper**	Director
/s/ RALPH S. LARSEN **Ralph S. Larsen**	Director
/s/ N. J. NICHOLAS, JR. **N. J. Nicholas, Jr.**	Director
/s/ JOHN E. PEPPER **John E. Pepper**	Director

CEO CERTIFICATIONS

I, Anne M. Mulcahy, Chairman of the Board and Chief Executive Officer, certify that:

1. I have reviewed this Annual Report on Form 10-K of Xerox Corporation;

2. Based on my knowledge, this Annual Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Annual Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Annual Report;

4. The registrant’s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Annual Report is being prepared;

b) Evaluated the effectiveness of the registrant’s disclosure controls and procedures as of a date within 90 days prior to the filing date of this Annual Report (the “Evaluation Date”); and

c) Presented in this Annual Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The registrant’s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant’s ability to record, process, summarize and report financial data and have identified for the registrant’s auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal controls;and

6. The registrant’s other certifying officers and I have indicated in this Annual Report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

March 31, 2003

/s/ ANNE M. MULCAHY

Anne M. Mulcahy
Principal Executive Officer

CFO CERTIFICATIONS

I, Lawrence A. Zimmerman, Senior Vice President and Chief Financial Officer, certify that:

1. I have reviewed this Annual Report on Form 10-K of Xerox Corporation;

2. Based on my knowledge, this Annual Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Annual Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Annual Report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Annual Report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this Annual Report (the "Evaluation Date"); and

c) Presented in this Annual Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this Annual Report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

March 31, 2003

/s/ LAWRENCE A. ZIMMERMAN

Lawrence A. Zimmerman
Principal Financial Officer

Report of Independent Accountants on Financial Statement Schedule

To the Board of Directors of Xerox Corporation

Our audits of the consolidated financial statements referred to in our report dated January 28, 2003, except for Note 15, which is as of March 27, 2003, appearing in the 2002 Annual Report to Shareholders of Xerox Corporation (which report and consolidated financial statements are incorporated by reference in this Annual Report on Form 10-K) also included an audit of the financial statement schedule listed in Item 15(a)(1) of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

As discussed in Note 1, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, “Goodwill and Other Intangible Assets” on January 1, 2002.

/s/ PRICEWATERHOUSECOOPERS LLP
PricewaterhouseCoopers LLP
Stamford, Connecticut
January 28, 2003

SCHEDULE II

Valuation and Qualifying Accounts
Year ended December 31, 2002, 2001 and 2000

(in millions)	Balance at Beginning of period	Additions charged to bad debt provision [1]	Additions charged to other income statement accounts[1]	Deductions and other, net of recoveries [2]	Balance at end of period
2002					
Allowance for Losses on:					
Accounts Receivable	$ 306	$ 187	$ (3)	$ (208)	$ 282
Finance Receivables	368	145	24	(213)	324
	$ 674	$ 332	$ 21	$ (421)	$ 606
2001					
Allowance for Losses on:					
Accounts Receivable	$ 289	$ 154	$ 30	$ (167)	$ 306
Finance Receivables	345	284	38	(299)	368
	$ 634	$ 438	$ 68	$ (466)	$ 674
2000					
Allowance for Losses on:					
Accounts Receivable	$ 148	$ 299	$ 58	$ (216)	$ 289
Finance Receivables	331	173	82	(241)	345
	$ 479	$ 472	$ 140	$ (457)	$ 634

(1) Bad debt provisions relate to estimated losses due to credit and similar uncollectibility issues. Other provisions relate to reserves necessary to reflect events of non-payment such as customer accommodations and contract terminations.

(2) Deductions and other, net of recoveries primarily relates to receivable write-offs, but also includes the impact of foreign currency translation adjustments and recoveries of previously written off receivables.

INDEX OF EXHIBITS

Document and Location

(3)(a)(1) Restated Certificate of Incorporation of Registrant filed with the Department of State of New York on October 29, 1996, as amended by Certificate of Amendment of the Certificate of Incorporation of Registrant filed with the Department of State of New York on May 21, 1999.

Incorporated by reference to Exhibit 3(a) to Amendment No. 5 to Registrant’s Form 8-A Registration Statement dated February 8, 2000.

(2) Certificate of Amendment of Certificate of Incorporation of Registrant filed with the Department of State of New York on September 9, 2002.

Incorporated by reference to Exhibit 3(a) to Registrant’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.

(b) By-Laws of Registrant, as amended through September 1, 2002.

Incorporated by reference to Exhibit 3(b) to Registrant’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.

(4)(a)(1) Indenture dated as of December 1, 1991, between Registrant and Citibank, N.A., as trustee, relating to unlimited amounts of debt securities which may be issued from time to time by Registrant when and as authorized by or pursuant to a resolution of Registrant’s Board of Directors (the “December 1991 Indenture”).

Incorporated by reference to Exhibit 4(a) to Registration Nos. 33-44597, 33-49177 and 33-54629.

(2) Instrument of Resignation, Appointment and Acceptance dated as of February 1, 2001, among Registrant, Citibank, N.A., as resigning trustee, and Wilmington Trust Company, as successor trustee, relating to the December 1991 Indenture.

Incorporated by reference to Exhibit 4 (a)(2) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.

(b)(1) Indenture dated as of September 20, 1996, between Registrant and Citibank, N.A., as trustee, relating to unlimited amounts of debt securities which may be issued from time to time by Registrant when and as authorized by or pursuant to a resolution of Registrant’s Board of Directors (the “September 1996 Indenture”).

Incorporated by reference to Exhibit 4(a) to Registration Statement No. 333-13179.

(2) Instrument of Resignation, Appointment and Acceptance dated as of February 1, 2001, among Registrant, Citibank, N.A., as resigning trustee, and Wilmington Trust Company, as successor trustee, relating to the September 1996 Indenture.

Incorporated by reference to Exhibit 4 (b)(2) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.

(c)(1) Indenture dated as of January 29, 1997, between Registrant and Bank One, National Association (as successor by merger with The First National Bank of Chicago) (“Bank One”), as trustee (the “January 1997 Indenture”), relating to Registrant’s Junior Subordinated Deferrable Interest Debentures (“Junior Subordinated Debentures”).

Incorporated by reference to Exhibit 4.1 to Registration Statement No. 333-24193.

(2) Form of Certificate of Exchange relating to Junior Subordinated Debentures.

Incorporated by reference to Exhibit A to Exhibit 4.1 to Registration Statement No. 333-24193.

(3) Certificate of Trust of Xerox Capital Trust I executed as of January 23, 1997.

Incorporated by reference to Exhibit 4.3 to Registration Statement No. 333-24193.

(4) Amended and Restated Declaration of Trust of Xerox Capital Trust I dated as of January 29, 1997.

Incorporated by reference to Exhibit 4.4 to Registration Statement No. 333-24193.

(5) Form of Exchange Capital Security Certificate for Xerox Capital Trust I.

Incorporated by reference to Exhibit A-1 to Exhibit 4.4 to Registration Statement No. 333-24193.

(6) Series A Capital Securities Guarantee Agreement of Registrant dated as of January 29, 1997, relating to Series A Capital Securities of Xerox Capital Trust I.

Incorporated by reference to Exhibit 4.6 to Registration Statement No. 333-24193.

(7) Registration Rights Agreement dated January 29, 1997, among Registrant, Xerox Capital Trust I and the initial purchasers named therein.

Incorporated by reference to Exhibit 4.7 to Registration Statement No. 333-24193.

(8) Instrument of Resignation, Appointment and Acceptance dated as of November 30, 2001, among Registrant, Bank One as resigning trustee, and Wells Fargo Bank Minnesota, National Association (“Wells Fargo”), as successor Trustee, relating to the January 1997 Indenture.

Incorporated by reference to Exhibit (c)(8) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended.

(d)(1) Indenture dated as of October 1, 1997, among Registrant, Xerox Overseas Holding Limited (formerly Xerox Overseas Holding PLC), Xerox Capital (Europe) plc (formerly Rank Xerox Capital (Europe) plc) and Citibank, N.A., as trustee, relating to unlimited amounts of debt securities which may be issued from time to time by Registrant and unlimited amounts of guaranteed debt securities which may be issued from time to time by the other issuers when and as authorized by or pursuant to a resolution or resolutions of the Board of Directors of Registrant or the other issuers, as applicable (the “October 1997 Indenture”).

Incorporated by reference to Exhibit 4(b) to Registration Statement Nos. 333-34333, 333-34333-01 and 333-34333-02.

(2) Instrument of Resignation, Appointment and Acceptance dated as of February 1, 2001, among Registrant, the other issuers under the October 1997 Indenture, Citibank, N.A., as resigning trustee, and Wilmington Trust Company, as successor trustee, relating to the October 1997 Indenture.

Incorporated by reference to Exhibit 4 (d)(2) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.

(e)(1) Indenture dated as of April 21, 1998, between Registrant and Bank One, as trustee, relating to $1,012,198,000 principal amount at maturity of Registrant’s Convertible Subordinated Debentures due 2018 (the “April 1998 Indenture”).

Incorporated by reference to Exhibit 4(b) to Registration Statement No. 333-59355.

(2) Instrument of Resignation, Appointment and Acceptance dated as of July 26, 2001, among Registrant, Bank One as resigning trustee, and Wells Fargo, as successor Trustee, relating to the April 1998 Indenture (the "April 1998 Indenture Trustee Assignment").

Incorporated by reference to Exhibit 4 (e)(2) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(3) Amendment to Instrument of Resignation, Appointment and Acceptance dated as of October 22, 2001, among Registrant, Bank One as resigning trustee, and Wells Fargo, as successor Trustee, relating to the April 1998 Indenture Trustee Assignment.

Incorporated by reference to Exhibit 4(e)(3) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(f) Indenture, dated as of July 1, 2001, between Xerox Equipment Lease Owner Trust 2001-1 ("Trust") and U.S. Bank National Association, as trustee, relating to $513,000,000 Floating Rate Asset Backed Notes issued by the Trust .

Incorporated by reference to Exhibit 4(f) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(g)(1) Indenture, dated as of November 27, 2001, between Registrant and Wells Fargo, as trustee, relating to Registrant's 7-1/2% Convertible Junior Subordinated Debentures Due 2021.

Incorporated by reference to Exhibit 4(g)(1) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(2) Indenture, dated as of November 27, 2001, between Xerox Funding LLC II and Wells Fargo, as trustee, relating to Xerox Funding LLC II's 7-1/2% Convertible Junior Subordinated Debentures Due 2021.

Incorporated by reference to Exhibit 4(g)(2) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(3) Amended and Restated Declaration of Trust of Xerox Capital Trust II, dated as of November 27, 2001, by Registrant, as sponsor, Wells Fargo, as property trustee, Wilmington Trust Company, as Delaware trustee, and the administrative trustees named therein, relating to Xerox Capital Trust II's 7-1/2% Convertible Trust Preferred Securities and 7-1/2% Convertible Common Securities.

Incorporated by reference to Exhibit 4(g)(3) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(4) Pledge Agreement, made as of November 27, 2001, by Xerox Funding LLC II in favor of Wells Fargo, as trustee and for the holders of Xerox Funding LLC II's 7-1/2% Convertible Junior Subordinated Debentures Due 2021.

Incorporated by reference to Exhibit 4(g)(4) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(h)(1) Indenture, dated as of January 17, 2002, between Registrant and Wells Fargo, as trustee, relating to Registrant's 9-3/4% Senior Notes due 2009 (Denominated in U.S. Dollars) (the "January 17, 2002 U.S. Dollar Indenture").

Incorporated by reference to Exhibit 4(h)(1) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(2) Indenture, dated as of January 17, 2002, between Registrant and Wells Fargo, as trustee, relating to Registrant's 9-3/4% Senior Notes due 2009 (Denominated in Euros) (the "January 17, 2002 Euro Indenture").

Incorporated by reference to Exhibit 4(h)(2) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(3) Registration Rights Agreement, dated as of January 17, 2002, among Registrant and the initial purchasers named therein, relating to Registrant's $600,000,000 9-3/4% Senior Notes due 2009.

Incorporated by reference to Exhibit 4(h)(3) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(4) Registration Rights Agreement, dated as of January 17, 2002, among Registrant and the initial purchasers named therein, relating to Registrant's (euro)225,000,000 9-3/4% Senior Notes due 2009.

Incorporated by reference to Exhibit 4(h)(4) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.

(5) First Supplemental Indenture dated as of June 21, 2002 between Registrant and Wells Fargo, as trustee, to the January 17, 2002 U.S. Dollar Indenture.

Incorporated by reference to Exhibit (4)(h)(5) to Registrant's Current Report on Form 8-K dated June 21, 2002.

(6) First Supplemental Indenture dated as of June 21, 2002 between Registrant and Wells Fargo, as trustee, to the January 17, 2002 Euro Indenture.

Incorporated by reference to Exhibit (4)(h)(6) to Registrant's Current Report on Form 8-K dated June 21, 2002.

(i) Indenture dated as of October 2, 1995, between Xerox Credit Corporation ("XCC") and State Street Bank and Trust Company ("State Street"), as trustee, relating to unlimited amounts of debt securities which may be issued from time to time by XCC when and as authorized by XCC's Board of Directors or Executive Committee of the Board of Directors.

Incorporated by reference to Exhibit 4(a) to XCC's Registration Statement Nos. 33-61481 and 333-29677.

(j) Rights Agreement dated as of April 7, 1997 between Registrant and The First National Bank of Boston, as Rights Agent.

Incorporated by reference to Exhibit 4.10 to Registrant's Current Report on Form 8-K dated April 7, 1997.

(k) $7,000,000,000 Revolving Credit Agreement, dated October 22, 1997, among Registrant, XCC and certain Overseas Borrowers, as Borrowers, various lenders and Morgan Guaranty Trust Company of New York, The Chase Manhattan Bank, Citibank, N.A. and Bank One, as Agents.

Incorporated by reference to Exhibit 4(h) to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000.

(l)(1) Amended and Restated Credit Agreement, dated as of June 21, 2002, among Registrant and Overseas Borrowers, as Borrowers, various Lenders and Bank One, N.A., JPMorgan Chase Bank, and Citibank, N.A. as Agents (the "Amended Credit Agreement").

Incorporated by reference to Exhibit 4(l)(1) to Registrant's Current Report on Form 8-K dated June 21, 2002.

(2) Guarantee and Security Agreement dated as of June 21, 2002 among Registrant, the Subsidiary Guarantors and Bank One, N.A., as Agent, relating to the Amended Credit Agreement.

Incorporated by reference to Exhibit 4 (l) (2) to Registrant's Current Report on Form 8-K dated June 21, 2002.

(3) Canadian Guarantee and Security Agreement dated as of June 21, 2002 among Xerox Canada Capital Ltd., the Guarantors and Bank One, N.A., Canada Branch, as Agent, relating to the Amended Credit Agreement.

Incorporated by reference to Exhibit 4 (l) (3) to Registrant's Current Report on Form 8-K dated June 21, 2002.

(4) Deed of Guarantee and Indemnity Made June 21, 2002 between Bank One, N.A., as Agent, and Xerox Overseas Holdings Limited and Xerox UK Holdings Limited, as Guarantors, relating to Obligations of Xerox Capital (Europe) plc and the Amended Credit Agreement.

Incorporated by reference to Exhibit 4 (l) (4) to Registrant's Current Report on Form 8-K dated June 21, 2002.

(5) Debenture dated June 21, 2002 between Xerox Capital (Europe) plc and Bank One, N.A., as Agent, relating to the Amended Credit Agreement.

Incorporated by reference to Exhibit 4 (l) (5) to Registrant's Current Report on Form 8-K dated June 21, 2002.

(6) Mortgage, Assignment of Leases and Rents, Security Agreement, Financing Statement and Fixture Filing dated as of June 21, 2002 by Xerox Corporation, as Mortgagor, to Bank One, N.A., as Agent for the Lenders, the Mortgagee, relating to property in the County of Monroe, State of New York and the Amended Credit Agreement.

Incorporated by reference to Exhibit 4 (l) (6) to Registrant's Current Report on Form 8-K dated June 21, 2002.

(7) Covenant Reset Schedule Relating to the Amended Credit Agreement.

Incorporated by reference to Exhibit 99.6 to Registrant's Current Report on Form 8-K dated September 26, 2002.

(m) Master Demand Note dated November 20, 2001 between Registrant and Xerox Credit Corporation.

Incorporated by reference to Exhibit 4(m) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended.

(n) Instruments with respect to long-term debt where the total amount of securities authorized thereunder does not exceed 10% of the total assets of Registrant and its subsidiaries on a consolidated basis have not been filed. Registrant agrees to furnish to the Commission a copy of each such instrument upon request.

(10) The management contracts or compensatory plans or arrangements listed below that are applicable to the executive officers named in the Summary Compensation Table which appears in Registrant's 2003 Proxy Statement are preceded by an asterisk (*).

*(a) Registrant's Form of Salary Continuance Agreement.

Incorporated by reference to Exhibit 10 (a) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended.

*(b) Registrant's 1991 Long-Term Incentive Plan, as amended through October 9, 2000.

Incorporated by reference to Exhibit 10 (b) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.

(c) Registrant's 1996 Non-Employee Director Stock Option Plan, as amended through May 20, 1999.

Incorporated by reference to Registrant's Notice of the 1999 Annual Meeting of Shareholders and Proxy Statement pursuant to Regulation 14A.

*(d) Description of Registrant's Annual Performance Incentive Plan.

*(e) 1997 Restatement of Registrant's Unfunded Retirement Income Guarantee Plan, as amended through October 9, 2000.

Incorporated by reference to Exhibit 10 (e) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.

*(f) 1997 Restatement of Registrant's Unfunded Supplemental Retirement Plan, as amended through October 9, 2000

Incorporated by reference to Exhibit 10 (f) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.

*(g) Executive Performance Incentive Plan.

Incorporated by reference to Exhibit 10 (g) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended.

(h) 1996 Amendment and Restatement of Registrant's Restricted Stock Plan for Directors.

Incorporated by reference to Exhibit 10 (h) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended.

*(i) Form of severance agreement entered into with various executive officers, effective October 15, 2000

Incorporated by reference to Exhibit 10 (i)(2) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.

*(j) Registrant's Contributory Life Insurance Program, as amended as of January 1, 1999.

Incorporated by reference to Exhibit 10 (j) to Registrant's Annual Report on Form 10-K for the year ended December 31, 1999.

(k) Registrant's Deferred Compensation Plan for Directors, 1997 Amendment and Restatement, as amended through October 9, 2000.

	Incorporated by reference to Exhibit 10 (k) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.
*(l)	Registrant’s Deferred Compensation Plan for Executives, 1997 Amendment and Restatement, as amended through October 9, 2000.
	Incorporated by reference to Exhibit 10 (l) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.
*(m)	Letter Agreement dated June 4, 1997 between Registrant and G. Richard Thoman, former President and Chief Executive Officer of Registrant.
	Incorporated by reference to Exhibit 10 (n) to Registrant’s Quarterly Report on Form 10-Q for the Quarter Ended June 30, 1997.
*(n)	Registrant’s 1998 Employee Stock Option Plan, as amended through October 9, 2000.
	Incorporated by reference to Exhibit 10 (n) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.
*(o)	Registrant’s CEO Challenge Bonus Program.
	Incorporated by reference to Exhibit 10 (o) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.
(p)	Separation Agreement dated May 11, 2000 between Registrant and G. Richard Thoman, former President and Chief Executive Officer of Registrant.
	Incorporated by reference to Exhibit 10 (p) to Registrant’s Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2000.
(q)	Letter Agreement dated December 4, 2000 between Registrant and William F. Buehler, Vice Chairman of Registrant.
	Incorporated by reference to Exhibit 10 (p) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2000 filed on June 7, 2001.
(r)	(1) Separation Agreement dated October 3, 2001 between Registrant and Barry D. Romeril, Vice Chairman and Chief Financial Officer of Registrant.
	Incorporated by reference to Exhibit 10 (r)(1) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.
(2)	Form of Release between Registrant and Barry D. Romeril, Vice Chairman and Chief Financial Officer of Registrant.
	Incorporated by reference to Exhibit 10 (r)(2)) to Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended July 1, 2002.
*(s)	Letter Agreement dated July 23, 2002 between Registrant and Carlos Pascual, Executive Vice President of Registrant.
	Incorporated by reference to Exhibit 10 (s) to Registrant’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2002, as amended.

(t)	Master Supply Agreement, dated as of November 30, 2001, between Registrant and Flextronics International Ltd. **	
	Incorporated by reference to Exhibit 10 (t)(1) to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, as amended.	
*(u)	Letter Agreement dated May 20, 2002 between Registrant and Lawrence A. Zimmerman, Senior Vice President and Chief Financial Officer of Registrant	
	Incorporated by reference to Exhibit 10 (u) to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002.	
(v)	Amended and Restated Loan Agreement dated as of October 21, 2002 between Xerox Lease Funding LLC and General Electric Capital Corporation	

(12) Computation of Ratio of Earnings to Fixed charges.

(13) Registrant's 2002 Annual Report to Shareholders.

(21) Subsidiaries of Registrant.

(23) Consent of PricewaterhouseCoopers LLP.

(99.1) Certification of CEO and CFO pursuant to 18 U.S.C. §1350 as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002.

(99.2) Order under Section 36 of the Securities Exchange Act of 1934 Granting Exemptions from Certain Provisions of the Act and Rules Thereunder, dated April 11, 2002 (Release No. 45730).

Incorporated by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K dated April 11, 2002.

** Pursuant to the Freedom of Information Act, the confidential portion of this material has been omitted and filed separately with the Securities and Exchange Commission.

EXHIBIT 10(d)

Annual Performance Incentive Plan (APIP)

Under APIP, executive officers of the Company are eligible to receive performance-related cash payments if approved by the Compensation Committee (the Committee). Payments are, in general, only made if Committee-established annual performance objectives are met.

Early in 2002, the Committee approved an annual incentive target and maximum opportunity, expressed as a percentage of base salary, for each participating officer. The Committee also established overall threshold, target and maximum measures of performance for the 2002 APIP. The performance measures and weightings for 2002 were cash management (40%), performance profit (40%), and revenue (20%). Additional goals were also established for each officer that included business-unit specific and/or individual performance goals and objectives, including new product launches, and executing business turnarounds. The weights associated with each business-unit specific or individual performance goal and objective used vary.

In June 2002, the Company restated and adjusted its 1997 - 2001 financial results. Following the restatement, the Committee approved mid-year payments of one-half the target amounts and approved revised performance goals for 2002 on a post-restatement basis. The mid-year payment was credited toward the full-year APIP.

For 2002, the performance against the post-restatement goals was as follows: cash management was below targeted levels, revenue generation was slightly below plan and performance profit was significantly better than plan. The Company successfully launched 17 new products and made significant progress in improving its Developing Markets Organization. Accordingly, the Committee approved the balance of the APIP awards to participating officers which when aggregated with the mid-year payment ranged in total from 100% target levels to approximately 171% of target based on their individual and unit performance.

Exhibit 10 (v)

EXECUTION COPY

AMENDED AND RESTATED LOAN AGREEMENT

Dated as of October 21, 2002

between

XEROX LEASE FUNDING LLC

as Borrower,

and

GENERAL ELECTRIC CAPITAL CORPORATION,

as Lender

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AMENDED AND RESTATED LOAN AGREEMENT (this "Agreement"), dated as of October 21, 2002, between XEROX LEASE FUNDING LLC, a Delaware limited liability company ("Borrower"), and GENERAL ELECTRIC CAPITAL CORPORATION, a Delaware corporation, as lender ("Lender").

RECITALS

These Recitals shall be construed as part of this Agreement.

A. Borrower and Lender are parties to a Loan Agreement dated as of November 20, 2001 (as amended to the date hereof, the "Existing Loan Agreement").

B. Pursuant to the terms of the Existing Loan Agreement, Lender has made the Existing Term Loans (as defined below) to Borrower.

C. Pursuant to the Framework Agreement (as defined below), Borrower has agreed to provide Lender the first opportunity to make loans against certain Financing Contracts (as defined below) on the terms and conditions set forth in the Program Agreement (as defined below) and Lender has agreed, on the terms and conditions set forth herein, to make such loans.

D. Borrower has requested that Lender amend and restate the Existing Loan Agreement on the terms and conditions set forth herein (i) to amend the terms and conditions of the Existing Term Loans and (ii) in order to effect the agreements referred to in Recital C above, to make Additional Incremental Term Loans (as defined below) to Borrower, in an aggregate principal amount not exceeding for all such Additional Incremental Term Loans at any time outstanding, the Maximum Amount (as defined below).

E. Borrower and Lender do not intend that this Agreement constitute a novation of the Existing Term Loans or any of the Obligations (as defined below) under the Existing Loan Agreement or evidence any repayment of such Existing Term Loans or Obligations, but that this Agreement only amend and restate in its entirety the Existing Loan Agreement and provide for Additional Incremental Terms Loans as set forth herein.

F. Capitalized terms used in this Agreement shall have the meanings ascribed to them in Annex A, and, for purposes of this Agreement, the rules of construction set forth in Annex A shall govern. All Appendices hereto, or expressly identified to this Agreement, are incorporated herein by reference, and taken together with this Agreement, shall constitute but a single agreement.

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter contained, and for other good and valuable consideration, the parties hereto agree as follows:

ARTICLE I
AMOUNT AND TERMS OF CREDIT

1.1. Credit Facilities.

(a) Existing Term Loan Facility. Schedule 1.1(a)(i) sets forth the original principal amount of the Term Loans heretofore made by Lender to Borrower under the Existing Loan Agreement (each, an "Existing Term Loan" and collectively the "Existing Term Loans"), each of which is evidenced by the corresponding promissory note in the form of Exhibit 1.1(a)(ii) or 1.1(a)(iii) of the Existing Loan Agreement (each an "Existing Term Note" and collectively, the "Existing Term Notes"). From and after the Effective Date, the Existing Term Loans shall be governed by the terms of this Agreement.

(b) Additional Incremental Term Loan Facility. Lender agrees, on the terms and conditions set forth herein, to make loans (each an "Additional Incremental Term Loan") to Borrower, on each Incremental Closing Date during the period from the Effective Date until a Termination Event shall have occurred, in a principal amount equal to the Funding Amount for such Additional Incremental Term Loan; provided, in no event shall Lender be obligated to make any Additional Incremental Term Loan hereunder if the then aggregate outstanding principal amount of all Additional Incremental Term Loans, together with the principal amount of the proposed Additional Incremental Term Loan, would exceed the Maximum Amount. All Additional Incremental Term Loans shall be evidenced by one promissory note in the form of Exhibit 1.1(b) (the "Additional Term Note" and collectively with the Existing Term Notes, the "Notes").

(c) Borrowing Procedures for Additional Incremental Term Loans.

(i) Additional Incremental Term Loans shall be made only on an Incremental Closing Date unless otherwise agreed by Lender.

(ii) Not later than the fifth (5th) Business Day of each calendar month, Borrower shall deliver (or cause Portfolio Servicer to deliver) to Lender a Data Certification for a proposed Additional Incremental Term Loan.

(iii) Upon Lender's receipt of a Data Certification, Lender shall have five (5) Business Days in which to review such Data Certification and deliver to Borrower an Exception Notice or Acceptance Notice. If Lender determines that (a) any of the components or calculations contained in or delivered in connection with such Data Certification are erroneous, inaccurate or incomplete or (b) in Lender's reasonable judgment any of the components or calculations contained in or delivered in connection with such Data Certification would cause any of the conditions precedent set forth in Section 2.4 and 2.5 not to be satisfied, then in either such case Lender shall give the Borrower and the Portfolio Servicer notice thereof (which may, at Lender's option, be telephonic or written, an "Exception Notice"), specifying in reasonable detail, to the extent known to Lender and practicable, the nature of such errors, inaccuracies, omissions and/or other matters with a view to assisting Borrower in identifying the actions, if any, required to cure the same. If Lender does not have a basis to deliver an Exception Notice, then Lender shall deliver to Borrower written notice of its acceptance thereof (an "Acceptance Notice"); provided that if Lender has not completed its determination as to whether it has a basis to deliver an Exception Notice, then prior to issuing an Acceptance Notice Lender shall be entitled to request (either telephonically or in writing) a five (5) Business Day extension of the time frame in which Lender must deliver either an Exception Notice or Acceptance Notice, and Borrower agrees not to unreasonably withhold its consent (which may be oral or written) to any such extension requested by Lender. If Lender fails to deliver either an Exception Notice or Acceptance Notice on or prior to the fifth Business Day (or if such time period is extended pursuant to the foregoing sentence, tenth Business Day) after Lender's receipt of a Data Certification, then such Data

Certification shall be deemed rejected by Lender. Nothing in this Section 1.1(c)(iii) shall limit Borrower's right to submit a subsequent Data Certification with respect to Financing Contracts covered by a Data Certification deemed rejected pursuant to the preceding sentence. Except as required to be disclosed in an Exception Notice, Lender's failure to identify any (or each and every) error, inaccuracy or omission in an Exception Notice, or in connection with Lender's acceptance of a Data Certification, shall not constitute a waiver of Lender's rights or remedies under this Agreement or any other Related Transaction Document.

(iv) If Lender gives Borrower an Exception Notice, Borrower shall (or shall cause Portfolio Servicer to) correct the previously delivered Data Certification with respect to the matters identified in such Exception Notice and submit a modified Data Certification to Lender as soon as practicable, but in any event no later than five (5) Business Days after Borrower's receipt of such Exception Notice, whereupon the process set forth in subsections (ii) and (iii) and this subsection (iv) shall be repeated until Lender accepts the Data Certification pursuant to an Acceptance Notice. Such corrections shall include, without limitation, (x) deleting Financing Contracts from such Data Certification, but only if any matters identified with respect to such Financing Contracts cannot be cured after Borrower's (or Xerox's) use of commercially reasonable efforts to cure such matters without deleting such Financing Contracts and (y) in the case of correcting any potential failure to satisfy the conditions precedent set forth in clauses (d), (e) or (v) of Section 2.4, as applicable, deleting Financing Contracts from such Data Certification such that after giving effect to such deletions the conditions precedent set forth in clauses (d), (e) or (v) of Section 2.4, as applicable, will be satisfied. In connection with the correction of any Data Certification, Borrower shall use its commercially reasonable efforts to maximize the principal amount of the proposed Additional Incremental Term Loan to which such Data Certification relates.

(v) Within two (2) Business Days after Lender has accepted a particular Data Certification Borrower shall, subject to Section 1.1(d), deliver to Lender a Borrowing Request (each such date of delivery, a "Borrowing Request Delivery Date"), based on such accepted Data Certification specifying an Incremental Closing Date which is three (3) Business Days after the date of delivery of such Borrowing Request.

(vi) If Borrower determines that any condition precedent set forth in (A) Section 2.4 will not be satisfied as of the relevant Borrowing Request Delivery Date or (B) Section 2.5 will not be satisfied as of the relevant Incremental Closing Date, then, in either case, concurrently with Borrower's delivery of a Borrowing Request pursuant to Section 1.1(c)(v), Borrower shall deliver to Lender a written request for a waiver of such condition(s) precedent specifying in reasonable detail the event(s) or circumstance(s) giving rise to the non-satisfaction of such condition(s) precedent (a "Waiver Request").

(vii) If Borrower delivers a Waiver Request to Lender in accordance with the terms set forth above, then Borrower shall not be liable for any charges and assessments referred to in Section 1.1(c)(ix) in respect of the related Borrowing Request. If Lender grants the relief set forth in the Waiver Request (or such other relief as may be agreed to in writing by Borrower and Lender) then (A) the Incremental Closing Date specified in such Borrowing Request shall be automatically extended to the third Business Day after Lender grants such relief; (B) the Borrowing Request Delivery Date (including, without limitation, for purposes of Section 2.4) shall be deemed to be the date Lender grants such relief; and (C) all representations, warranties and certifications in the related Borrowing Request shall be deemed made as of such new Borrowing Request Delivery Date. If Lender does not grant the waivers set forth in the Waiver Request (or other relief as may be agreed to in writing by Borrower and Lender) on or prior to the proposed Incremental Closing Date set forth in the related Borrowing Request, then such Borrowing Request shall be deemed terminated as of such proposed Incremental Closing Date; provided that, except as otherwise expressly provided in the Program Agreement, (x) Lender shall not be deemed to forfeit its rights under the Program Agreement with respect to the Candidate Financing Contracts covered by such Borrowing Request, (y) Lender shall not be released of its obligations to make Term Loans relating to such Candidate Financing Contracts if included in subsequent Data Certifications in accordance with the terms and conditions of this Agreement (including Sections 2.4 and 2.5) and (z) Borrower shall be entitled and obligated to include such Candidate Financing Contracts in any subsequent Incremental Data Certification and related Borrowing Request submitted by Borrower under this Section 1.1.

(viii) Upon satisfaction of all of the conditions set forth above and in Sections 2.4 and 2.5, as applicable, Lender shall make the Additional Incremental Term Loan specified in such Borrowing Request in a principal amount equal to the Funding Amount for such Additional Incremental Term Loan.

(ix) Except as set forth in Section 1.1(c)(vii), once executed and delivered a Borrowing Request shall be irrevocable by Borrower. In addition to all amounts required to be paid by Borrower pursuant to Section 1.4, Borrower shall compensate Lender for any and all charges or assessments imposed by Lender on its Vendor Financial Services operating business as a result of the failure of a proposed Term Loan to be funded on the date specified therefor in an irrevocable Borrowing Request related thereto for any reason (other than as a result of a wrongful refusal by Lender, in violation of the terms of this Agreement, to make the Term Loan in accordance with the terms hereof); provided that Borrower's liability for such charges or assessments shall not exceed the amount of interest that would have accrued on the principal amount of such proposed Additional Incremental Term Loan specified in the Borrowing Request relating thereto (with such interest to be calculated at the proposed Discount Rate specified in the Borrowing Request relating to such proposed Additional Incremental Term Loan) during the period from and including the date of the proposed Incremental Closing Date for such proposed Additional Incremental Term Loan as specified in the related Borrowing Request to but excluding the next Business Day occurring after such proposed Incremental Closing Date. Furthermore, Borrower shall not be liable for any such charges or assessments unless Lender makes a demand therefor within ten (10) Business Days after the proposed Incremental Closing Date that describes the calculation and amount of such assessments.

(d) Minimum Funding Amounts. Notwithstanding anything to the contrary contained in this Agreement, (i) Borrower shall not be obligated to submit any Borrowing Request with respect to any Incremental Data Certification unless the principal amount of the proposed Additional Incremental Term Loan is at least $10,000,000; and (ii) Lender shall not be obligated to make any Additional Incremental Term Loan unless the principal amount thereof is at least $2,500,000. If Borrower or Lender exercise their rights under this Section 1.1(d), Borrower shall not be excused from its obligation to deliver the related Data Certification as provided in Section 1.1(c)(ii) and all Financing Contracts covered by such Data Certification must be included in the next Data Certification required to be submitted by Borrower pursuant to Section 1.1(c)(ii).

(e) Excluded Financing Contracts. If Lender waives one or more elements of the definition of Excluded Financing Contract with respect to any Candidate Financing Contract, Lender shall be deemed to have also waived any breach of the representations, warranties and covenants as to such Candidate Financing Contract made in any Related Transaction Document, to the extent (and solely to the extent) such breach is based on the existence of the element so waived. A waiver of any such element, representation, warranty or covenant as to any particular Candidate Financing Contract shall not be deemed a waiver of any other element or a waiver with respect to any other Candidate Financing Contract.

(f) Reliance on Certifications and Requests. Lender shall be entitled to rely upon, and shall be fully protected in relying upon, any Borrowing Request or Data Certification purporting to be executed by an Authorized Officer of Borrower and believed by Lender to be genuine. Lender may assume that each Person purporting to be an Authorized Officer of Borrower executing and delivering such a request was duly authorized, unless the responsible individual acting thereon for Lender has actual knowledge to the contrary.

1.2. Use of Proceeds.

(a) Borrower shall utilize the proceeds of the Existing Term Loans (net of the proceeds otherwise required to be applied pursuant to Sections 1.3(b) and 1.4(b)) solely to finance the payments required to be made by Borrower to Xerox pursuant to Section 2.01 of the Sale and Contribution Agreement in respect of the Tier I Transfers made on the applicable Closing Date.

(b) Borrower shall use the proceeds of each Additional Incremental Term Loan solely to make the payments required to be made by Borrower to Xerox pursuant to Section 2.01 of the Sale and Contribution Agreement in respect of the Tier I Transfers made on the Closing Date of such Additional Incremental Term Loan.

1.3. Cash Management System

(a) Establishment and Maintenance of Accounts.

(i) Payment Account and Related Accounts. On or before the Initial Closing Date, each of the Lockboxes, Lockbox Deposit Accounts, Lockbox Concentration Account and the Payment Account shall have been established in accordance with the terms of the Lockbox Account Agreement (as in effect on the Initial Closing Date) and Payment Account Agreement (as in effect on the Initial Closing Date), as applicable, and the Collateral Agent shall have legal title to each of the Lockboxes, Lockbox Deposit Accounts, Lockbox Concentration Account and the Payment Account for the benefit of the Beneficial Owners (as of the Initial Closing Date), and each such agreement shall be in full force and effect.

(ii) GE Capital Control Account. On or before the Initial Closing Date, Borrower shall have established an account with Citibank, N.A. in the name of Borrower (the "GE Capital Control Account") under account number 795253 and with respect to which Lender has sole dominion and control and a perfected, first priority security interest therein and the funds on deposit therein pursuant to the Deposit Account Control Agreement (as in effect on the Initial Closing Date).

(iii) Other Monetization Accounts. On or before the Initial Closing Date, each of the Monetization Accounts and the Controlled Accounts (other than the GE Capital Control Account) shall have been established in accordance with the terms of the Allocation Agreement.

(b) Funding of the Holdback Account. (1) On the Initial Closing Date, pursuant to the letter of direction delivered by Borrower pursuant to Section 2.1(l) of the Existing Loan Agreement, Lender caused $75 million of the proceeds of the Initial Term Loan to be deposited in the Holdback Account.

(ii) On the first Incremental Closing Date, pursuant to the letter of direction delivered by Borrower pursuant to Section 2.3(i) of the Existing Loan Agreement, Lender caused $40 million of the proceeds of such Incremental Term Loan to be deposited in the Holdback Account.

(iii) On the second Incremental Closing Date, pursuant to the letter of direction delivered by Borrower pursuant to Section 2.3(i) of the Existing Loan Agreement, Lender caused $35 million of the proceeds of such Incremental Term Loan to be deposited in the Holdback Account.

(c) Return of Funds in the Controlled Accounts. On the Termination Date, Lender shall cause all funds then on deposit in the Controlled Accounts (other than any funds necessary to pay third party service and supply providers through the Termination Date, or, if later, through the earlier to occur of (X) the date at which Lender may terminate the contract(s) with such third party service or supply providers without penalty and (Y) the date which is one (1) year following the Termination Date) to be transferred to the MPE 1 Account.

1.4. Interest, Fees and Principal

(a) Interest Rate. Interest shall accrue on each outstanding Term Loan at a rate per annum equal to the Discount Rate specified in the Initial Borrowing Request or Incremental Borrowing Request, as applicable, related thereto.

(b) Fees. (i) Borrower has paid to Lender on the Initial Closing Date a non-refundable origination fee equal to 0.65% of the amount of the Initial Term Loan made by Lender.

(ii) Borrower has paid to Lender on each Incremental Closing Date occurring prior to the Effective Date, a non-refundable origination fee equal to (a) 0.65% of the amount of the Term Loan made by Lender on such Closing Date minus (b) the sum of the Fee Credit Amounts (calculated as of the Tagging Date relating to the relevant Replacement Financing Contracts) for all Replacement Financing Contracts listed on the Statement of Cash Flows for such Incremental Closing Date and which were acquired by Borrower from Xerox on such Incremental Closing Date.

(c) Application of Monthly Aggregate Payment Amount. With respect to each outstanding Term Loan, on each Actual Application Date, Lender shall cause the Monthly Aggregate Payment Amount to be applied or distributed from the GE Capital Control Account as follows:

(i) if, as of such Actual Application Date, no Turbo Event shall have occurred and be continuing:

first, to all accrued and unpaid interest on such Term Loan for the Applicable Interest Period (and any prior Applicable Interest Period(s));

second, to the outstanding principal balance of such Term Loan to the extent necessary to reduce the outstanding principal balance thereof to the corresponding Targeted Principal Balance for such Term Loan as of the immediately preceding Determination Date (after giving effect to any adjustment to such Targeted Principal Balance based on the information contained in the related Settlement Report);

third, to all accrued and unpaid interest on each other Term Loan;

fourth, to the outstanding principal balance of each other Term Loan to the extent necessary to reduce the outstanding principal balance thereof to the corresponding Targeted Principal Balance for such Term Loan as of the immediately preceding Determination Date (after giving effect to any adjustment to such Targeted Principal Balance based on the information contained in the related Settlement Report); and

fifth, to the MPE 1 Account;

provided, however, if sufficient funds are not available to fund all payments to be made in respect of any category of Obligation described in the third or fourth clauses above, the available funds being applied to such Obligations shall be allocated to the payment of such Obligations on a Term Loan-by-Term Loan basis, beginning with the oldest outstanding Term Loan and continuing thereafter in chronological order of the outstanding Term Loans, based on the date on which each Term Loan was advanced.

(ii) if, as of such Actual Application Date, a Turbo Event shall have occurred and be continuing, then first as set forth in clauses first through fourth of subclause (i) above, and thereafter:

first, to the remaining outstanding principal balance of all outstanding Term Loans until each such Term Loan has been paid in full;

second, to any other Obligations then due and owing; and

third, to the MPE 1 Account;

provided, however, if sufficient funds are not available to fund all payments to be made in respect of any category of Obligation described in the first clause above, the available funds being applied to any such Obligations shall be allocated to the payment of such Obligations on a Term Loan-by-Term Loan basis, beginning with the oldest outstanding Term Loan and continuing thereafter in chronological order of the outstanding Term Loans, based on the date on which each Term Loan was advanced; and provided further if Lender affirmatively waives in writing the failure of Borrower to have satisfied any condition precedent set forth in Sections 2.4 or 2.5 which failure also constitutes a Turbo Event, such Turbo Event shall be deemed, for purposes of this Section 1.4(c), to cease to be continuing.

(d) Computation of Interest. All computations of interest shall be made by Lender on the basis of a 365/366-day year, as applicable, in each case for the actual number of days occurring in the Applicable Interest Period for which such interest is payable. For purposes of computing interest on the Obligations as of any date, no deposits to the GE Capital Control Account shall be deemed received by Lender until applied in accordance with Section 1.4(c).

(e) Acceptance of Settlement Report. The acceptance by Lender of the Settlement Report after the Settlement Date to which it relates shall not be deemed to be a waiver by Lender of any failure by Borrower to perform any provision of this Agreement or any Default or Event of Default arising from such failure or otherwise related to the delivery of such Settlement Report.

(f) Maximum Lawful Rate. Notwithstanding anything to the contrary set forth in this Section 1.4, if a court of competent jurisdiction determines in a final order that the rate of interest payable hereunder exceeds the highest rate of interest permissible under law (the "maximum lawful rate"), then so long as the maximum lawful rate would be so exceeded, the rate of interest payable hereunder shall be equal to the maximum lawful rate; provided, however, that if at any time thereafter the rate of interest payable hereunder is less than the maximum lawful rate, Borrower shall continue to pay interest hereunder at the maximum lawful rate until such time as the total interest received by Lender is equal to the total interest that would have been received had the interest rate payable hereunder been (but for the operation of this paragraph) the interest rate payable since the applicable Closing Date as otherwise provided in this Agreement. Thereafter, interest hereunder shall be paid at the rate(s) of interest and in the manner provided in Sections 1.4(a) through (e), unless and until the rate of interest again exceeds the maximum lawful rate, and at that time this paragraph shall again apply. In no event shall the total interest received by Lender pursuant to the terms hereof exceed the amount that Lender could lawfully have received had the interest due hereunder been calculated for the full term hereof at the maximum lawful rate. If the maximum lawful rate is calculated pursuant to this paragraph, such interest shall be calculated at a daily rate equal to the maximum lawful rate divided by the number of days in the year in which such calculation is made. If, notwithstanding the provisions of this Section 1.4(f), a court of competent jurisdiction shall finally determine that Lender has received interest hereunder in excess of the maximum lawful rate, Lender shall, to the extent permitted by applicable law, promptly apply such excess in the order specified in Section 1.4(c) and thereafter shall refund any excess to Borrower or as a court of competent jurisdiction may otherwise order.

1.5. Loan Account and Accounting.

Lender shall maintain a loan account (the "loan account") on its books to record the borrowing of the Initial Term Loan and any borrowing of an Incremental Term Loan, all payments made by or on behalf of Borrower and all other debits and credits as provided in this Agreement with respect to the Term Loans or any other Obligations. All entries in the loan account shall be made in accordance with Lender's customary accounting practices as in effect from time to time. The balance in the loan account, as recorded on Lender's most recent printout or other written statement, shall, absent manifest error and subject to each of Borrower's and Lender's rights under the Allocation Agreement to receive Misapplied Proceeds and/or Misdirected Contract Payments which may affect the balance reflected in the loan account, be presumptive evidence of the amounts due and owing by Borrower under this Agreement; provided, that any failure to so record or any error in so recording shall not limit or otherwise affect Borrower's duty to pay the Obligations.

1.6. Indemnity.

(a) Borrower's Indemnification. Borrower shall indemnify and hold harmless each Indemnified Person from and against any and all Damages which may be suffered or incurred by any such Indemnified Person resulting from, arising out of, based on or relating to (i) credit having been extended, suspended or terminated under this Agreement (including by reason of Borrower's failure to satisfy any condition to lending set forth in Article II hereof) and the other Loan Documents, the administration of such credit and/or the enforcement of Lender's rights and remedies under the Related Transaction Documents (except that Borrower shall not be liable for any indemnification to an Indemnified Person to the extent that any indemnified liabilities result from that Indemnified Person's gross negligence, willful misconduct or violation of law) and (ii) any representations, warranties, covenants and/or obligations set forth in any Related Transaction Document (other than those made by Lender) which have been breached or are otherwise unfulfilled, incorrect, untrue, misleading or inaccurate (as applicable).

(b) Lender's Indemnification. Lender shall indemnify and hold harmless each Indemnified Person from and against any and all Damages which may be suffered or incurred by such Indemnified Person resulting from, arising out of, based on or relating to, any breach of Lender's warranties set forth in Section 3A.1 or Lender's breach of contract arising from (i) any failure by Lender to perform its contractual obligations hereunder (except that Lender shall not be liable for any indemnification to any Indemnified Person to the extent that any indemnified liabilities result from that Indemnified Person's gross negligence, willful misconduct or violation of law) and (ii) any representations, warranties, covenants and/or obligations set forth in any Related Transaction Document (other than those made by any Transaction Party) which have been breached or are otherwise unfulfilled, incorrect, untrue misleading or inaccurate (as applicable).

(c) GENERAL LIMITATION. NO INDEMNIFIED PERSON SHALL BE RESPONSIBLE OR LIABLE TO ANY OTHER PARTY TO ANY LOAN DOCUMENT, ANY SUCCESSOR, ASSIGNEE OR THIRD PARTY BENEFICIARY OF SUCH PERSON OR ANY OTHER PERSON ASSERTING CLAIMS DERIVATIVELY THROUGH SUCH PARTY, FOR INDIRECT, PUNITIVE, EXEMPLARY OR CONSEQUENTIAL DAMAGES.

1.7 Taxes.

(a) Tax Forms. Lender shall provide Borrower with a completed IRS Form W-9 (or other applicable IRS forms) and all required renewals thereof (or any successor forms).

(b) Gross-Up. Any and all payments made or deemed made by

Borrower hereunder or under the Notes shall be made, in accordance with this Section 1.7, free and clear of and without deduction for any and all present or future Taxes. If Borrower shall be required by law to deduct any Taxes from or in respect of any sum payable hereunder or under the Notes, (i) the sum payable shall be increased as much as shall be necessary so that after making all required deductions (including deductions applicable to additional sums payable under this Section 1.7) Lender receives an amount equal to the sum it would have received had no such deductions been made, (ii) Borrower shall make such deductions, and (iii) Borrower shall pay the full amount deducted to the relevant Governmental Authority in accordance with applicable law.

(c) Other Taxes. Borrower shall be obligated to pay any stamp or documentary Taxes or any other excise Taxes arising from any payment made hereunder or under the Notes or from the execution, delivery or enforcement of, or otherwise with respect to, this Agreement, the Term Loans or Borrower's obligations hereunder.

(d) Borrower Indemnity. Borrower shall indemnify and, within ten (10) days of demand therefor, pay Lender for the full amount of Taxes paid by Lender on or with respect to this Agreement or the Notes, or with respect to any payment hereunder or under the Notes, and any liability (excluding penalties and additions to Taxes imposed solely as a result of Lender's willful misconduct, negligence or violation of law) arising therefrom or with respect thereto, whether or not such Taxes were correctly or legally asserted. If Lender receives a refund of all or any part of indemnified Taxes paid by Borrower, Lender shall promptly pay Borrower the amount of such refund.

(e) Withholding Tax Liability. In the event that Lender assigns all or any portion of the Term Loans or grants a participation therein, Lender shall be the paying agent and "withholding agent" (within the meaning of section 1.1441-7 of the Treasury regulations) with respect to any such assignment or participation (and, in addition, shall be responsible for any related federal information reporting). Lender shall indemnify and, within ten (10) days of demand therefor, pay Borrower for the full amount of any and all federal withholding taxes (including interest, penalties and additions to taxes) for which Borrower is liable as the "withholding agent" (within the meaning of section 1.1441-7 of the Treasury regulations) with respect to payments made on (i) any participation in the Term Loans granted by Lender or (ii) Term Loans that have been assigned by Lender.

(f) Tax Receipts. As soon as reasonably practicable after the payment of any indemnified Taxes by Borrower to a Governmental Authority, Borrower shall deliver to Lender the original or a certified copy of a receipt issued by such Governmental Authority evidencing such payment, a copy of the return reporting such payment or other evidence of such payment reasonably available to Borrower and satisfactory to Lender.

(g) After-Tax Basis. All payments under Section 1.7(d) or (e) shall be made on an "after-tax" basis, by increasing the amount of any payment as necessary so that after payment of all Taxes imposed on such payment the recipient receives an amount equal to the same it would have received had no Taxes been payable thereon.

(h) Assignees and Participants. The provisions and indemnity of this Section 1.7 do not apply to any Taxes, or any liability with respect thereto, which may be incurred by any successor, assignee (including without limitation any foreign branch, division or Affiliate of Lender) or participant of Lender to the extent the indemnity payable hereunder is greater than the amount that would have resulted if such successor, assignee or participant were GE Capital, a U.S. corporation.

(i) Notice/Contest. If Lender receives notice of a claim for Taxes the liability for which is imposed on Borrower pursuant to this Section 1.7, Lender shall provide prompt notice of such claim and shall contest, upon the request of and at the sole expense of Borrower, such claim for Taxes (but only if such contest may be made in good faith). Lender will not settle the subject claim without the prior written consent of Borrower, which consent shall not be unreasonably withheld or delayed, unless and to the extent Lender waives its right to payment of the amount owing by Borrower under this Section 1.7.

(j) Tax Treatment. Borrower and Lender agree, for federal and state income tax purposes, to treat the Term Loans as debt of Borrower and not to treat Lender as the owner of any Collateral or Equipment which is subject to a lease agreement (and not as entitled to any depreciation thereon). Neither Borrower nor Lender shall take any position for federal or state income tax purposes contrary to the foregoing (whether on its tax returns or otherwise) unless required to do so by a taxing authority.

1.8. Single Loan.

All Term Loans to Borrower and all of the other Obligations of Borrower arising under this Agreement and the other Loan Documents shall constitute one general obligation of Borrower secured, until the Termination Date, by all of the Collateral.

1.9. Earnings on Funds in Controlled Accounts.

The funds on deposit in each Controlled Account shall be invested in one or more Specified Investments; provided, that Lender shall not be liable for any loss of principal or income on such funds due to the choice of Specified Investments or any conversion of invested funds into cash when such funds are required to be released or applied to any obligation under a Related Transaction Document. No interest or other amounts earned on funds on deposit shall constitute Collateral. All interest or other amounts earned on funds in the Controlled Accounts shall be payable to Borrower and reported as such for income tax purposes. On each Actual Application Date, prior to the application of funds in the GE Capital Control Account in accordance with Section 1.4(c), Lender shall cause all interest income (net of losses) actually earned on the funds on deposit in each Controlled Account (as determined by Portfolio Servicer and specified on the related Settlement Report) to be distributed to the MPE 1 Account.

1.10. Service Provider Preparation of Certain Documents.

Borrower hereby agrees that notwithstanding the fact that after the JV Operational Date, the JV will initially prepare the Incremental Data File and Statement of Cash Flows for Term Loans made after such date, Borrower is and continues to be responsible for the accuracy of each Incremental Data File, Statement of Cash Flows and the Incremental Data Certification and calculations, analyses, any notices or certifications related to any and all Term Loans (and each other component thereof) and any representation or warranty contained herein or in any other Loan Document relating thereto. Borrower hereby waives as a defense to any inaccuracy of any portion of any such Incremental Data File, Statement of Cash Flows, the Incremental Data Certification related thereto and calculations, analyses, any notices or certifications, or any representation or warranty contained herein or any other Loan Document with respect thereto, that such information was initially prepared by the JV. Nothing in this Section 1.10 shall be deemed to constitute a waiver of Borrower's rights or remedies against the JV under or pursuant to any Related Transaction Document.

ARTICLE II

CONDITIONS PRECEDENT

2.1. Conditions to the Initial Term Loan.

Lender shall not be obligated to make the Initial Term Loan on the Initial Closing Date, or to take, fulfill, or perform any other action or obligation hereunder, until the conditions set forth in Sections 2.1 and 2.2 of the Existing Loan Agreement have been satisfied or provided for in a manner satisfactory to Lender, in Lender's sole discretion, or waived in writing by Lender.

2.2. Conditions to the Existing Incremental Term Loans.

Lender shall not be obligated to make any Existing Incremental Term Loan until the conditions set forth in Sections 2.2 and 2.3 of the Existing Loan Agreement have been satisfied or provided for in a manner satisfactory to Lender, in Lender's sole discretion, or waived in writing by Lender.

2.3. Conditions to Effective Date.

This Agreement shall not be effective, and Lender shall not be obligated to take, fulfill or perform any action or obligation hereunder, until the conditions set forth in this Section 2.3 have been satisfied or provided for in a manner satisfactory to Lender, in Lender's reasonable judgment, or waived by Lender in writing.

(a) Certain Documents. Lender shall have received, in each case, in form and substance reasonably satisfactory to it (i) this Agreement duly executed by Borrower and delivered to Lender; (ii) the Security Agreement duly executed by Borrower, together with all instruments, documents and agreements executed pursuant thereto; (iii) the Collateral Assignment duly executed by each Transaction Party which is a party thereto; (iv) the Lockbox Account Agreement duly executed by Borrower, MPE 2, the Collateral Agent and the Lockbox Bank; (v) the Payment Account Agreement duly executed by the Collateral Agent and all other Persons party thereto; (vi) the Allocation Agreement duly executed by Borrower, Lender and each other Transaction Party which is a party thereto; (vii) the Program Agreement duly executed by Xerox, Borrower and MPE 2; (viii) the Deposit Account Control Agreement duly executed by Borrower and the Depository Bank; and (ix) any other agreement referenced in the definition of Related Transaction Documents which has been amended and/or restated in connection with the transactions contemplated by this Agreement, in each case duly executed by each party thereto;

(b) Charter and Good Standing Certificate. For each Transaction Party (other than XCC and the JV), such Person's (i) charter (or other equivalent organizational documentation) and all amendments thereto, (ii) good standing certificates (including verification of good standing as to franchise taxes other than with respect to Xerox) in its state of organization or formation, as applicable, each certified as of the Effective Date by such Person's corporate secretary or an assistant secretary as being in full force and effect without any modification or amendment;

(c) Bylaws and Resolutions. For each Transaction Party (other than XCC and the JV), (i) such Person's bylaws, operating agreement or limited partnership agreement, as applicable, together with all amendments thereto and (ii) resolutions of such Person's Board of Directors (or equivalent managers) and Stockholders, if required, approving and authorizing the execution, delivery and performance of the Loan Documents and the other Related Transaction Documents to which such Person is a party and the transactions to be consummated in connection therewith, each certified as of the Effective Date by such Person's corporate secretary or an assistant secretary as being in full force and effect without any modification or amendment;

(d) Incumbency Certificates. For each Transaction Party (other than XCC), signature and incumbency certificates of the officers of each such Person executing any of the Loan Documents or the other Related Transaction Documents, certified as of the Effective Date by such Person's corporate secretary or an assistant secretary as being true, accurate, correct and complete;

(e) Opinions of Nixon Peabody. Lender shall have received duly executed originals of opinions of Nixon Peabody LLP, counsel for the Transaction Parties, each in the forms set forth as Exhibits 2.3(e)(i) through (iii) hereto, respectively;

(f) Opinion of Xerox General Counsel. Lender shall have received duly executed originals of an opinion, in the form set forth as Exhibit 2.3(f) hereto, of the General Counsel or an Associate General Counsel of Xerox addressed to Lender;

(g) Opinion of Skadden Arps. Lender shall have received duly executed originals of opinions of Skadden, Arps, Slate, Meagher & Flom LLP, special counsel for the Transaction Parties, in the form set forth as Exhibit 2.3(g) hereto;

(h) Opinions of Lender's Counsel. Lender shall have received duly executed originals of opinions of Weil, Gotshal & Manges LLP, counsel for Lender, each in the forms set forth as Exhibits 2.3(h)(i) through (iii) hereto, respectively; provided that neither Xerox nor any other Person (other than Lender) shall be entitled to rely on the opinions in the forms of Exhibits 2.3(h)(i) and (ii);

(i) Opinion of GE Capital Operations Counsel. Lender shall have received duly executed originals of an opinion, in the form set forth as Exhibit 2.3(i) hereto, of an Operations Counsel of GE Capital addressed to MPE 1 and Xerox;

(j) Security Interests and Code Filings. Lender shall have received evidence satisfactory to Lender that Lender has a valid and perfected first priority security interest in the Collateral, including (i) such documents duly executed by each Transaction Party (including financing statements under the Code and other applicable documents under the laws of any jurisdiction with respect to the perfection of Liens) as Lender may request in order to perfect its security interests in the Collateral and (ii) copies of Code search reports listing all effective financing statements that name any Transaction Party as debtor, together with copies of such financing statements, none of which shall cover the Collateral, except for those relating to the Tier I Transfers and Equipment and Tax Payment Transfers;

(k) Borrower's Certificate. Lender shall have received a certificate in form and substance reasonably satisfactory to Lender, from an Authorized Person of Borrower, certifying that as of the date hereof:

(i) No Down-Grade of Index Debt. (i) All Index Debt of Xerox is rated at least "B+" by S&P and at least "B1" by Moody's, and (ii) Xerox has Index Debt rated by both S&P and Moody's,

(ii) No Litigation. No Litigation has been commenced against Xerox which would require Xerox, in accordance with GAAP as in effect as of September 11, 2001, to recognize a liability or post a reserve in respect thereof, in either case, in excess of $500 million,

(iii) No Default. No Default or Event of Default under (and as defined in) the Existing Loan Agreement has occurred and is continuing, and

(iv) Approvals. Borrower and the other Transaction Parties have obtained all required consents and approvals of all Persons (including, without limitation, all requisite Governmental Authorities) to the execution, delivery and performance of this Agreement, the other Loan Documents and the other Related Transaction Documents;

(l) Required Lenders Confirmation. Lender shall have received a confirmation in the form attached hereto as Exhibit 2.3(l) pertaining to the Existing Revolving Credit Agreement and executed by the Required Lenders (as defined therein); and

(m) Other Documents. Lender shall have received such other certificates, documents and agreements respecting any Transaction Party as Lender may, in its reasonable discretion, request.

The execution and delivery by Borrower of this Agreement shall be deemed to constitute, as of the date of such execution and delivery, (X) a representation and warranty by Borrower that the statements set forth in clauses (i) through (iv) of subsection 2.3(k) are true and correct as of the date hereof and (Y) a reaffirmation by Borrower of the granting and continuance of Lender's Liens pursuant to the Collateral Documents.

2.4. Conditions to Each Additional Incremental Loan.

Lender shall not be obligated to make any Additional Incremental Term Loan (including without limitation, the initial Additional Incremental Term Loan) on any Closing Date if, either before or after giving pro forma effect to such Additional Incremental Term Loan, one or more of the conditions set forth in Section 2.5 and in this Section 2.4 shall not, as of the related Borrowing Request Delivery Date, have been satisfied or provided for in a manner satisfactory to Lender, in Lender's reasonable judgment, or waived in writing by Lender.

(a) Sale and Contribution Agreement. All of the representations and warranties set forth in subclauses (a)(iv) (as to the valid transfer of the Transferred Assets), (a)(xii), (a)(xiii) and (b) through (e) of Section 4.01 of the Sale and Contribution Agreement in respect of the Candidate Financing Contracts and related Transferred Assets to be acquired on such Incremental Closing Date by Borrower from Xerox pursuant to the Sale and Contribution Agreement shall be true and correct in all respects;

(b) Compliance with Credit Policy. Each of the Candidate Financing Contracts included in the relevant Data Certification shall have been approved by the Portfolio Servicer in compliance with the Credit Policy unless otherwise specifically approved in writing by Lender.

(c) Additional Related Transaction Documents. Lender shall have received, prior the making of the initial Additional Incremental Term Loan, the duly executed original of the Additional Term Note dated as of the Effective Date. Lender shall have received duly executed copies of each Related Transaction Document which was not executed and delivered to Lender as part of any prior Tier I Transfer or prior Equipment and Tax Payment Transfer and which relates to the Tier I Transfer or Equipment and Tax Payment Transfer to occur on the relevant Incremental Closing Date.

(d) Service Coverage Test. The Service Coverage Test in respect of the Candidate Financing Contracts (taken as a whole) has been satisfied in accordance with Section 4.01(c)(xxii) of the Sale and Contribution Agreement.

(e) Supply Coverage Test. The Supply Coverage Test in respect of the Candidate Financing Contracts (taken as a whole) has been satisfied in accordance with Section 4.01(c)(xxii) of the Sale and Contribution Agreement.

(f) Compliance with Section 1.1(c). Borrower shall have complied with its obligations under Section 1.1(c).

(g) Loss Rate Adjustments. The Portfolio Servicer shall have delivered to Lender and Borrower the information required to permit the Loss Rates to be adjusted in accordance with Section 6.20 and such Loss Rates applicable to such Candidate Financing Contracts shall have been adjusted in compliance with Section 6.20 (including as a result of any automatic adjustment mechanism contained in Annex B).

(h) Accuracy of Certain Representations and Warranties.

(i) Except for the representations and warranties expressly referred to in subsection (ii) below and Section 2.5(d) all of the representations and warranties of Borrower contained in this Agreement shall be true and correct (except to the extent that such representation or warranty expressly relates to an earlier date (in which case such representation or warranty shall be true and correct as of such earlier date)).

(ii) All of the representations and warranties contained in the following provisions shall be true and correct except to the extent that such representation or warranty expressly relates to an earlier date (in which case such representation or warranty shall be true and correct as of such earlier date) and except to the extent that the failure of any such representation or warranty to be true and correct would not give rise, individually or in the aggregate, to either a Prospective Collateral Defect or a Separateness/True Sale Concern: (A) clause (d) of Section 3.1, the last sentence of Section 3.4, the third sentence of Section 3.21, the second sentence of Section 3.22 and Section 3.24 and (B) to the extent applicable to Financing Contracts then comprising the Portfolio (and not the Candidate Financing Contracts) the second sentence of Section 3.4 and Sections 3.25 and 3.26.

(i) Related Transaction Document Representations and Warranties. Except as set forth in clauses (a) and (h) above and clause (o) below, all of the representations and warranties of any Transaction Party contained in the Related Transaction Documents (other than this Agreement) shall be true and correct in all material respects.

(j) Performance of Certain Loan Agreement Covenants. Borrower shall have performed, kept and observed all of the provisions of Section 1.2, Article IV (other than Section 4.01(e) thereof), clauses (a) and (b) of Section 5.1, Sections 5.3, 6.1, 6.3, 6.4, 6.5, 6.6, Section 6.8 through Section 6.17, clauses (a) and (b) of Section 6.18 and Section 6.19 and Borrower's charter shall not have been revoked or otherwise terminated by its state of organization.

(k) Compliance with Section 4.01(e). Borrower shall have performed, kept and observed all of the provisions of Section 4.01(e) if, in Lender's reasonable determination, the information requested thereunder by Lender which has not been timely delivered is necessary for Lender to determine whether any other condition precedent set forth in this Section 2.4 or Section 2.5 has been or will be satisfied as of the required date for satisfaction of such condition precedent.

(l) Compliance with Section 6.2. Borrower shall have performed, kept and observed all of the provisions of Section 6.2 unless any noncompliance therewith either (i) would not give rise to Prospective Collateral Defect or a Separateness/True Sale Concern or (ii) involves investments, loans, advances or acquisitions exceeding, in the aggregate, $1 million.

(m) Compliance with Sections 6.7 and 6.18. Borrower shall not have created, or suffered a Lien to be created, in contravention of Section 6.7 or clause (c) of Section 6.18 unless (i) any such Lien was not created by or assented to by Borrower, (ii) the Person asserting or creating such Lien is not the PBGC, (iii) the Person asserting or creating such Lien has not taken any action to enforce such Lien, (iv) Borrower has created a reserve on its books for such Lien and (v) either (A) Borrower has, within thirty (30) days from the date such Lien was initially asserted or created, contested such Lien and diligently prosecuted such contest so that such Lien and any claim relating thereto has been released no later than the sixtieth (60th) day following the initial assertion or creation of such Lien or (B) if such Lien relates only to Financing Contracts then comprising the Portfolio (and not to Candidate Financing Contracts) such Lien would not, either individually or in the aggregate with all other Liens, give rise to a Prospective Collateral Defect or a Separateness/True Sale Concern.

(n) Compliance with Certain Affirmative Covenants. Borrower shall have performed, kept and observed all of the provisions of clauses (c) and (d) of Section 5.1, and Sections 5.2 and 5.4 unless either (i) such noncompliance would not give rise to a Prospective Collateral Defect or a Separateness/True Sale Concern or (ii) Borrower shall have failed to cure such noncompliance within thirty (30) days from the earlier to occur of (A) the knowledge of any Responsible Person of Borrower (or the knowledge of any Responsible Person of any other Transaction Party other than the JV) of such failure or neglect and (B) the date on which Lender provided notice of such failure or neglect to Borrower.

(o) Other Covenants in the Loan Agreement and Warranties in the Related Transaction Documents. Borrower shall have performed, kept and observed all other material provisions of this Agreement or of any of the other Loan Documents (other than provisions covered by any other subsection of this Section 2.4 or Section 2.5) except to the extent such noncompliance would not give rise to a Prospective Collateral Defect or a Separateness/True Sale Concern.

(p) Certain Sale and Contribution Agreement Representations and Warranties. All of the representations and warranties made by Xerox in any of subsections (a)(iv) (as to the valid transfer of the Transferred Assets), (a)(xii), (a)(xiii), (b), (c), (d) and (e) of Section 4.01 of the Sale and Contribution Agreement shall be true and correct with respect to the Financing Contracts and Transferred Assets then comprising the Portfolio as of the date when made or deemed made except to the extent either (i) Xerox shall have repurchased from Borrower the Financing Contract to which such representation or warranty relates on the date on which any such repurchase may be required by the terms of the Sale and Contribution Agreement or (ii) Xerox shall have made the payments (if any) required by Article V or Section 6.04 of the Sale and Contribution Agreement on or before the date such payment is required by the Sale and Contribution Agreement.

(q) Judgments. There are no final judgments or judgments for the payment of money outstanding against Borrower which have not, within thirty (30) days after the entry thereof, been discharged or the execution thereof stayed or bonded pending appeal (unless such judgments have been discharged prior to the expiration of any such stay).

(r) Valid and Binding Agreements. Each material provision of each Loan Document and other Related Transaction Documents shall be valid, binding and enforceable in accordance with its terms (and no Transaction Party other than the JV (when acting at the direction or with the concurrence of GE Capital) shall have challenged the enforceability of any Loan Document or other Related Transaction Document or shall have asserted in writing, or engaged in any action or inaction based on any such assertion, that any provision of any of the Loan Documents or other Related Transaction Documents has ceased to be or otherwise is not valid, binding and enforceable in accordance with its terms) unless such failure, challenge or assertion would not give rise to a Prospective Collateral Defect or a Separateness/True Sale Concern.

(s) Undertaking and Replacement Agreement. Xerox shall have performed, kept and observed the provisions of Section 6.01 of the Undertaking and Replacement Agreement within ten (10) Business Days after the date specified in such Section 6.01 for compliance therewith.

(t) Compliance with Other Related Transactions Documents. Except as otherwise specified in this Section 2.4, each Transaction Party other than Borrower or the JV shall have performed, kept and observed each of the provisions of the Loan Documents and other Related Transaction Documents (other than subsections (f) and (j) of Section 6.01 of the Sale and Contribution Agreement) except to the extent any noncompliance therewith would not give rise to a Prospective Collateral Defect or a Separateness/True Sale Concern.

(u) Compliance with Section 6.01(k) of the Sale and Contribution Agreement. Xerox shall have performed, kept and observed the provisions of Section 6.01(k) of the Sale and Contribution Agreement.

(v) Concentration Percentage; Obligor Exposure. Either (i) the Concentration Percentage with respect to any Obligor under any Candidate Financing Contract does not exceed one percent (1%) or (ii) the Obligor Exposure for such Obligor does not exceed the dollar amount specified for such Obligor, if any, on Schedule 2.4(v) (as such Schedule may be modified from time to time by Lender in its sole discretion, by giving notice of such modification to Borrower).

The request and acceptance by Borrower of the proceeds of any Additional Incremental Term Loan shall be deemed to constitute, as of the date thereof, (i) a representation and warranty by Borrower that except to the extent described in a Waiver Request, the conditions in this Section 2.4 have been satisfied, (ii) a representation and warranty that any conditions imposed by Lender to the effectiveness of any waiver granted by Lender of a condition precedent described in a Waiver Request have been satisfied and (iii) a reaffirmation by Borrower of the granting and continuance of Lender's Liens pursuant to the Collateral Documents.

2.5. Closing Date Conditions to Each Additional Incremental Term Loan.

Lender shall not be obligated to make any Additional Incremental Term Loan on any Incremental Closing Date unless the conditions set forth in this Section 2.5 shall have been, as of such Incremental Closing Date, satisfied or provided for in a manner satisfactory to Lender, in Lender's reasonable judgment, or waived in writing by Lender.

(a) Defaults, Events of Default. No Default or Event of Default shall have occurred and be continuing.

(b) GE Termination Event. No GE Termination Event shall have occurred and be continuing.

(c) Title, Liens. Borrower shall have good and marketable title to each of the Candidate Financing Contracts free and clear of all Liens except Liens in favor of Lender and Permitted Liens and Lender shall have a valid, enforceable and first priority Lien thereon.

(d) Certain Representations. The representations and warranties set forth in Sections 3.1(a) and (c) and in Section 3.3 (other than clauses (e) and (g)) and Section 3.7 shall be true and correct in all respects.

(e) Material Agreements and Consents. The representations and warranties contained in clauses (e) and (g) of Section 3.3 shall be true and correct with respect to all periods prior to the instant Incremental Closing Date with respect to (A) all agreements referred to in such clause (e) that are material and (B) all consents or approvals required from any Person which is not also a Governmental Authority in respect of any material agreements referred to in clause (A) above, respectively.

(f) Certain Covenants. Borrower shall be in compliance with Sections 5.16, 6.1 and 6.14 of this Agreement.

(g) Tagging Date Current. No Candidate Financing Contract has a Tagging Date that precedes the related Incremental Closing Date by more than thirty (30) days.

(h) Delinquent Payments. Neither Xerox nor Borrower shall have failed to make any payment to Borrower or Lender due under any of the Related Transaction Documents within five (5) Business Days after written demand therefor from Lender, unless (i) Xerox or Borrower, as the case may be, is in good faith disputing its obligation to make such payments and gives Lender written notice thereof within five (5) Business Days of its receipt of such written demand and (ii) if the aggregate amount of all such disputed payments exceeds $250,000, Xerox or Borrower, as applicable, shall, within two (2) Business Days after written request therefor from Lender, have deposited cash in an amount equal to the aggregate amounts so disputed into an escrow account (with documentation governing such account in form and substance reasonably satisfactory to Lender, the "Escrowed Funds"). Any and all of Borrower's rights in and to the Escrowed Funds shall constitute additional Collateral for the payment of the Obligations. Upon the resolution of the dispute pertaining to a particular amount of Escrowed Funds, such Escrowed Funds shall be released to the party legally entitled thereto (and if such party is Borrower or Lender, such funds shall be deposited directly from such escrow account into the Payment Account and allocated and distributed in accordance with the Allocation Agreement and Payment Account Agreement).

The request and acceptance by Borrower of the proceeds of any Additional Incremental Term Loan shall be deemed to constitute, as of the date thereof, (i) a representation and warranty by Borrower that the conditions in this Section 2.5 have been satisfied and (ii) a reaffirmation by Borrower of the granting and continuance of Lender's Liens pursuant to the Collateral Documents.

2.6. Cure.

If, at any date of determination, Borrower fails to satisfy a condition precedent set forth in Section 2.4 or 2.5, such condition precedent shall (solely for purposes of Sections 2.4 and 2.5, and without limiting Lender's rights under Section 5.14 or under any other Related Transaction Document, be deemed cured if and when the event or circumstance which is the basis for such failure shall cease to exist and the adverse consequences to Borrower and Lender arising therefrom shall have been reversed or remedied if necessary to the extent that, after giving effect to such reversal or remedy, such condition precedent would, on a pro forma basis after giving effect to such remediation, have been satisfied.

ARTICLE III
REPRESENTATIONS AND WARRANTIES BY BORROWER

To induce Lender to make the Term Loans, Borrower makes the following representations and warranties to Lender and its successors and permitted assigns, each and all of which shall survive the execution and delivery of this Agreement.

3.1. Limited Liability Company Existence; Compliance with Law.

Borrower (a) is a limited liability company duly formed, validly existing and in good standing under the laws of the State of Delaware; (b) is duly qualified to conduct business and is in good standing in each other jurisdiction where its ownership or lease of property or the conduct of its business requires such qualification; (c) has the requisite power and authority and the legal right to own, pledge, mortgage or otherwise encumber and operate its properties, to lease the property it operates under lease and to conduct its business as now, and proposed to be, conducted; (d) has all necessary and material licenses, permits, consents or approvals from or by, and has made all material filings with, and has given all material notices to, all Governmental Authorities having jurisdiction, to the extent required for such ownership, operation and conduct; (e) is in compliance with its certificate of formation and operating agreement (and any other constituent documents); and (f) is in compliance in all material respects with all material applicable Requirements of Law.

3.2. Chief Executive Office; State of Organization; FEIN

As of each Closing Date, the current location of Borrower's chief executive office, state of organization and charter number are set forth in Disclosure Schedule (3.2). In addition, Disclosure Schedule (3.2) lists the federal employer identification number of Borrower and any trade names used or proposed to be used by Borrower.

3.3. Power, Authorization, Enforceable Obligations

The execution, delivery and performance by Borrower of the Related Transaction Documents to which it is a party, the creation of all Liens provided for therein and the consummation by Borrower of the transactions contemplated thereby: (a) are within Borrower's power; (b) have been duly authorized by all necessary or proper limited liability company action; (c) do not contravene any provision of Borrower's certificate of formation and operating agreement (or any other constituent documents); (d) do not violate any applicable Requirements of Law, or any order or decree of any court or Governmental Authority applicable to Borrower; (e) do not conflict with or result in the breach or termination of, constitute a default under or accelerate or permit the acceleration of any performance required by, any indenture, mortgage, deed of trust, lease, agreement, commitment or other instrument to which Borrower is a party or by which Borrower or any of its property is bound; (f) do not result in the creation or imposition of any Lien upon any of the property of such Person other than those in favor of Lender pursuant to the Loan Documents; and (g) do not require the consent or approval of, or the giving of notice to, the registration with, or the taking of any action in respect of, any Governmental Authority or any other Person, except those referred to in Section 2.3(k), all of which will have been duly obtained, made or complied with prior to and be effective as of each Closing Date. Each of the Related Transaction Documents to which Borrower is a party has been duly executed and delivered by Borrower and each such Related Transaction Document constitutes a legal, valid and binding obligation of Borrower enforceable against it in accordance with its terms.

3.4. Ownership of Property Liens.

Borrower does not own, lease or sublease any real property other than as permitted in the Separateness Agreement. Borrower has good and marketable title to all of its personal property and assets. As of each Closing Date, none of the properties and assets of Borrower are subject to any Liens other than Permitted Encumbrances, and there are no facts, circumstances or conditions known to Borrower that may result in any Liens other than Permitted Encumbrances. Borrower has received all deeds, assignments, waivers, consents, nondisturbance and attornment or similar agreements, bills of sale and other documents, and has duly effected all recordings, filings and other actions necessary to establish, protect and perfect its right, title and interest in and to all of its assets.

3.5. Labor Matters.

Borrower does not have any paid employees or paid officers.

3.6. Outstanding Stock; Investments.

All of the issued and outstanding Stock of Borrower is directly owned legally and beneficially by Xerox, and such Stock is validly issued, fully paid and nonassessable and is not subject to any Lien. There are no outstanding rights to purchase, options, warrants or similar rights or agreements pursuant to which Borrower may be required to issue, sell, repurchase or redeem any of its Stock or other equity securities. All of the issued and outstanding Stock of MPE 2 is directly owned legally and beneficially by Borrower and such stock is validly issued, fully paid and nonassessable and is not subject to any Lien. Borrower does not have any Subsidiaries other than MPE 2. Borrower has no investments other than Specified Investments and the Stock of MPE 2.

3.7. Government Regulation.

Borrower is not an "investment company" or an "affiliated person" of, or "promoter" or "principal underwriter" for, an "investment company," as such terms are defined in the Investment Company Act of 1940. Borrower is not subject to regulation under the Public Utility Holding Company Act of 1935, the Federal Power Act, or any other federal or state statute that restricts or limits its ability to incur Indebtedness or to perform its obligations hereunder. The making of the Term Loans by Lender to Borrower, the application of the proceeds thereof and repayment thereof and the consummation of the Related Transactions do not violate any provision of any such statute or any rule, regulation or order issued by the Securities and Exchange Commission.

3.8. Margin Regulations.

Borrower is not engaged principally, or as one of its important activities, in the business of extending credit for the purpose of "purchasing" or "carrying" any "margin stock" as such terms are defined in Regulation U of the Federal Reserve Board as now and from time to time hereafter in effect (such securities being referred to herein as "Margin Stock"). Borrower does not own any Margin Stock, and none of the proceeds of the Term Loans or other extensions of credit under this Agreement have been used, directly or indirectly, for the purpose of purchasing or carrying any Margin Stock, for the purpose of reducing or retiring any Indebtedness that was originally incurred to purchase or carry any Margin Stock or for any other purpose that might cause any of the Term Loans or other extensions of credit under this Agreement to be considered a "purpose credit" within the meaning of Regulations T, U or X of the Federal Reserve Board.

3.9. Charges.

All tax returns, reports and statements, including information returns, required by any Governmental Authority to be filed by Borrower have been filed with the appropriate Governmental Authority and all Charges have been paid prior to the date on which any fine, penalty, interest or late charge may be added thereto for nonpayment thereof (or any such fine, penalty, interest, late charge or loss has been paid), excluding Charges or other amounts being contested in accordance with Section 5.2(b). If any Tax return filed by Borrower has been or is currently being audited by any applicable Governmental Authority, there are no material assessments currently outstanding or threatened material assessments in connection with such audited Tax returns. Borrower has not executed or filed with any Governmental Authority any agreement or other document extending, or having the effect of extending, the period for assessment or collection of any Charges. Borrower is not liable for any Charges: (a) under any agreement (including any tax sharing agreements) or (b) to its knowledge, as a transferee.

3.10. ERISA.

(a) Borrower does not sponsor or contribute to any "employee benefit plan" as such term is defined in Section 3(3) of ERISA. To Borrower's knowledge, neither Xerox nor any ERISA Affiliate has failed to make any contribution or pay any amount due as required by either Section 412 of the IRC or Section 302 of ERISA or the terms of any Title IV Plan except to the extent the failure to make such contribution or pay such amount would not (i) subject Xerox or any ERISA Affiliate (other than Borrower) to any liability, in excess of $1,000,000, singly or in the aggregate or (ii) subject Borrower to a lien described in Section 412(n) of the IRC. To Borrower's knowledge, neither Xerox nor any ERISA Affiliate has engaged in a "prohibited transaction", as defined in Section 406 of ERISA and Section 4975 of the IRC, in connection with any Plan of such ERISA Affiliate, that could subject Borrower or such ERISA Affiliate to a material tax on prohibited transactions imposed by Section 502(i) of ERISA or Section 4975 of the IRC.

(b) Except as set forth in Disclosure Schedule (3.10) or where the failure of any of the following to be true would not give rise to (A) a funding obligation required by Section 412 of the IRC or Section 302 of ERISA that Xerox or any of its ERISA Affiliates (other than Borrower) fails to timely pay, or a termination liability under Title IV of ERISA that Xerox or any of its ERISA Affiliates (other than Borrower) fails to timely pay, in either case, in excess of $1,000,000, singly or in the aggregate, or (B) a lien described in Section 412(n) of the IRC against Borrower's assets: (i) no Title IV Plan has any Unfunded Pension Liability; (ii) no ERISA Event or event described in Section 4062(e) of ERISA with respect to any Title IV Plan has occurred or is reasonably expected to occur; (iii) neither Xerox nor any ERISA Affiliate has incurred or reasonably expects to incur any liability as a result of a complete or partial withdrawal from a Multiemployer Plan maintained by Xerox or any ERISA Affiliate; (iv) within the last five (5) years no Title IV Plan of Xerox or any ERISA Affiliate has been terminated, whether or not in a "standard termination" as that term is used in Section 4041(b)(1) of ERISA, nor has any Title IV Plan of Xerox or any ERISA Affiliate (determined at any time within the last five (5) years) with Unfunded Pension Liabilities been transferred outside of the "controlled group" (within the meaning of Section 4001(a)(14) of ERISA) of Xerox or any

ERISA Affiliate (determined at such time); and (v) except in the case of any ESOP, Stock of Xerox and all ERISA Affiliates makes up, in the aggregate, no more than ten percent (10%) of the fair market value of the assets of any Title IV Plan maintained by Xerox or any ERISA Affiliate measured on the basis of fair market value as of the latest valuation date of any such Plan.

3.11. No Litigation; Agent for Service of Process.

No Litigation is now pending or, to the knowledge of Borrower, threatened against any Transaction Party (a) that challenges any Transaction Party's right or power to enter into or perform any of its obligations under the Related Transaction Documents to which it is a party, or the validity or enforceability of any Related Transaction Document or any action taken thereunder, (b) that seeks to prevent the consummation of the Related Transactions on an Incremental Closing Date or (c) that relates to or affects any of the Candidate Financing Contracts or related Transferred Assets. As of the Initial Closing Date there was, and as of the Effective Date there is, no Litigation pending or, to Borrower's knowledge, threatened against Borrower. CSC Corporation is Borrower's agent for service of process in the State of New York.

3.12. Brokers.

Except for Merrill Lynch, which was retained by Xerox in connection with transactions relating to Related Transactions occurring prior to the Effective Date only, no broker or finder brought about the obtaining, making or closing of the Related Transactions, and neither Borrower nor any Affiliate thereof (other than Xerox) has any obligation to any Person, including Merrill Lynch, in respect of any finder's or brokerage fees in connection therewith.

3.13. Full Disclosure.

To the knowledge of an Authorized Officer of Borrower, after due inquiry, no material information contained in this Agreement, any of the other Loan Documents, or any of the other Related Transaction Documents, or any collateral reports or other written reports from time to time delivered hereunder or any written statement furnished by or on behalf of Borrower to Lender pursuant to the terms of this Agreement contains or will contain any material misstatement of a material fact or omits or will omit to state a material fact necessary to make the statements contained herein or therein not misleading in any material respect in light of the circumstances under which they were made.

3.14. Solvency.

Both before and after giving effect to (a) the Term Loans to be made on the Initial Closing Date and each Incremental Closing Date, (b) the disbursement of the proceeds of such Term Loans pursuant to the instructions of Borrower, (c) the consummation of the other Related Transactions, (d) the payment by Borrower of any dividends as permitted herein and (e) the payment and accrual of all transaction costs in connection with the foregoing, Borrower is and will be Solvent.

3.15. Liabilities.

Other than (a) the liabilities, commitments or obligations (whether absolute, accrued, contingent or otherwise) arising under or in respect of the Related Transaction Documents, (b) immaterial amounts due and payable in the ordinary course of business of a special-purpose company, (c) liabilities owing by Borrower to any Obligor for which Borrower is entitled to indemnification from the Portfolio Servicer and (d) liabilities not exceeding in the aggregate $7.5 million for which Borrower is entitled to indemnification from Xerox, Borrower does not have any liabilities, commitments or obligations (whether absolute, accrued, contingent or otherwise), whether due or to become due.

3.16. Controlled Accounts.

Each of the Controlled Accounts is free and clear of any Lien (other than the Lien in favor of Lender).

3.17. Bulk Sales.

The execution, delivery and performance of the Related Transaction Documents do not require compliance with any "bulk sales" law by Borrower or any other Transaction Party.

3.18. Business.

Since its formation, Borrower has conducted no business other than (i) the acquisition of Transferred Assets from Xerox under the Sale and Contribution Agreement, (ii) the contribution of the Equipment, Sales Tax Payments and Uplift Payments to MPE 2 under the Contribution Agreement, (iii) the execution and delivery of the Related Transaction Documents to which it is a party and the consummation of the transactions contemplated thereby (including the borrowing of the Term Loans) and (iv) such other activities as are incidental to each of the foregoing.

3.19. Consideration for Transferred Assets.

(a) Borrower shall have given reasonably equivalent value to Xerox in consideration for each Tier I Transfer and no such transfer shall have been made for or on account of an antecedent debt owed by Borrower to Xerox. The purchases by and contributions to Borrower constitute valid and true sales and transfers for consideration (and not merely a pledge of the Transferred Assets for security purposes), and shall be effective protection against any claim by a creditor of Xerox to the Transferred Assets and no such Transferred Assets shall constitute property of Xerox.

(b) MPE 2 shall have given reasonably equivalent value to Borrower in consideration for the transfers made to it pursuant to the Contribution Agreement and no such transfer shall have been for or on account of an antecedent debt owed by MPE 2 to Borrower. The contributions to MPE 2 constitute valid and true sales and transfers for consideration (and not merely a pledge of the assets subject to each Equipment and Tax Payment Transfer for security purposes), and shall be effective protection against any claim by a creditor of Borrower to such assets and no such assets shall constitute property of Borrower.

3.20. Separate Existence.

Borrower is operated as an entity with assets and liabilities distinct from those of Xerox and MPE 2, and Borrower acknowledges that Lender is entering into the Loan Documents in reliance upon Borrower's identity as a separate legal entity from each of Xerox and MPE 2. From and after the date of its formation, Borrower has been and will be operated in such a manner as to comply with (a) the provisions of its constituent documents and (b) the Separateness Agreement.

3.21. Tier I Transfer.

The Sale and Contribution Agreement is the only agreement pursuant to which Borrower purchases or acquires Transferred Assets or any other assets. Borrower has furnished to Lender true, correct and complete copies of each Related Transaction Document to which Borrower is a party, each of which is in full force and effect. Neither Borrower nor any other Transaction Party is in default of any of its obligations under the Related Transaction Documents. Upon the purchase by or contribution to Borrower of each Financing Contract under the Sale and Contribution Agreement and prior to giving effect to any Equipment and Tax Payment Transfer, Borrower shall be the lawful owner of, and have good title to, the Transferred Assets, free and clear of any Liens (except for Permitted Encumbrances). All Transferred Assets are purchased without recourse to Xerox except as described in the Sale and Contribution Agreement.

3.22. Equipment and Tax Payment Transfer.

The Contribution Agreement is the only agreement pursuant to which Borrower transfers the Equipment, Sales Tax Payments and Uplift Payments or any other assets to MPE 2. Upon the contribution to MPE 2 of the Equipment, Sales Tax Payments and Uplift Payments under the Contribution Agreement, MPE 2 shall be the lawful owner of, and have good title to, the Equipment, Sales Tax Payments and Uplift Payments, free and clear of any Liens (except for Permitted Encumbrances). All Equipment, Sales Tax Payments and Uplift Payments are transferred without recourse to Borrower except as described in the Contribution Agreement.

3.23. Borrower's Tax Election.

Borrower has not made any election to be treated as a corporation and, consequently, it will be treated as a disregarded entity for United States federal income tax purposes.

3.24. No Violation of Law.

(a) Borrower owns and operates, and at all times since its acquisition thereof has owned and operated, each of the Transferred Assets (other than the Equipment, Sales Tax Payments and Uplift Payments transferred to MPE 2) in compliance with all Requirements of Law applicable to it, including but not limited to laws pertaining to usury, installment or conditional sales and sales financing, (b) neither the billing and collection nor enforcement of any Financing Contract or Credit Enhancement in accordance with the terms thereof has resulted or will result in the violation of any Requirement of Law applicable to it, (c) Borrower has not received any written notice of violation of any Requirement of Law from any Governmental Authority relating to the acquisition, collection, administration or enforcement of any Financing Contract or Credit Enhancement and (d) Borrower is not subject to any judgment, writ, decree, injunction or order of any Governmental Authority relating to the foreclosure, acquisition or disposition of any Transferred Asset or, in each case, any transactions or activities incidental thereto.

3.25. Data Files; Statement of Cash Flows; Borrowing Request.

(a) The Data File delivered as a part of any Initial Data Certification or Incremental Data Certification, as applicable, is and on the relevant Closing Date will be, true, complete and correct in all respects as of the Tagging Date for the Financing Contracts included in such Data File.

(b) The Statement of Cash Flows delivered as a part of any Initial Data Certification or Incremental Data Certification, as applicable, is and on the relevant Closing Date will be true, complete and correct in all respects as of the Tagging Date for the Financing Contracts included in such Statement of Cash Flows.

(c) The calculations contained in any Data Certification and Borrowing Request delivered in connection with any Term Loan have been calculated in accordance with the terms of this Agreement.

3.26. Lien Priority.

The Liens granted to Lender pursuant to this Agreement and the other Collateral Documents are and will at all times be fully perfected first priority Liens in and to the Collateral described herein and therein.

ARTICLE III-A

REPRESENTATIONS AND WARRANTIES BY LENDER

3A.1 To induce Borrower to enter into this Agreement, Lender makes the following representations and warranties to Borrower, each and all of which shall survive the execution and delivery of this Agreement:

(a) Power, Authorization, etc. The execution, delivery and performance by Lender of the Related Transaction Documents to which it is a party and the consummation by Lender of the transactions contemplated thereby: (i) are within Lender's power; (ii) have been duly authorized by all necessary or proper corporate action; (iii) do not contravene any provision of Lender's charter or by-laws (or any other constituent documents); (d) do not violate any applicable Requirements of Law, or any order or decree of any court or Governmental Authority applicable to Lender; (iv) do not conflict with or result in the breach or termination of, constitute a default under or accelerate or permit the acceleration of any performance required by, any indenture, mortgage, deed of trust, lease, agreement, commitment or other instrument to which Lender is a party or by which Lender or any of its property is bound; and (v) do not require the consent or approval of, or the giving of notice to, the registration with, or the taking of any action in respect of, any Governmental Authority or any other Person (other than the filing of any UCC-1 financing statements against Borrower).

(b) Enforceable Obligations. Each of the Related Transaction Documents to which Lender is a party has been duly executed and delivered by Lender and each such Related Transaction Document constitutes a legal, valid and binding obligation of Lender enforceable against it in accordance with its terms.

ARTICLE IV

NOTICE REQUIREMENTS

4.1. Notices .

(a) Borrower hereby agrees that from and after the Initial Closing Date and until the Termination Date, it shall deliver to Lender the following:

(b) Default Notices. As soon as practicable, and in any event within five (5) Business Days after an officer or manager of Borrower has actual knowledge of the existence of any Default or any Event of Default, telephonic or telecopied notice specifying the nature of such Default or Event of Default, including the anticipated effect thereof, which notice, if given telephonically, shall be promptly confirmed in writing on the next Business Day.

(c) Litigation. Promptly upon learning thereof, written notice of any Litigation commenced or threatened against Borrower or any allegation of criminal misconduct by Borrower.

(d) Revocations, Etc. Promptly upon learning thereof, copies of any notice that (i) any license, permits, charter registration or approval necessary for the conduct of Borrower's business has been or may be revoked, terminated, limited or modified in any adverse way or (ii) Borrower is to cease and desist any practice, procedure or policy employed by it in the conduct of its business.

(e) Adverse Claim. Immediately upon learning thereof, notice of any Adverse Claim made or asserted against any of the Financing Contracts then owned by Borrower.

(f) Other Documents. Within five (5) Business Days after receipt thereof, such other financial and other information respecting Borrower's business or financial condition as Lender shall, from time to time, reasonably request.

ARTICLE V

AFFIRMATIVE COVENANTS

Borrower agrees that from and after the Initial Closing Date and until the Termination Date:

5.1. Maintenance of Existence and Conduct of Business.

Borrower shall: (a) do or cause to be done all things necessary to preserve and keep in full force and effect its existence as a limited liability company and its rights, licenses, franchises and privileges under the laws of each jurisdiction where the ownership of its properties and the conduct of its business require such qualification; (b) continue to conduct its business substantially as now conducted or as otherwise permitted hereunder; (c) at all times maintain, preserve and protect all of its assets and properties used or useful in the conduct of its business, and keep the same in good repair, working order and condition in all material respects (taking into consideration ordinary wear and tear) and from time to time make, or cause to be made, all necessary or appropriate repairs, replacements and improvements thereto consistent with industry practices; and (d) transact business only in such corporate and trade names as are set forth in

Disclosure Schedule (3.2).

5.2. Payment of Charges.

Subject to Section 5.2(b), Borrower shall pay and discharge or cause to be paid and discharged promptly all Charges payable by it, including (i) Charges imposed upon it, its income and profits, or any of its property (real, personal or mixed), (ii) lawful claims for labor, materials, supplies and services or otherwise, and (iii) all storage or rental charges payable to warehousemen or bailees, in each case, before any thereof shall become past due.

(a) Borrower may in good faith contest, by appropriate proceedings, the validity or amount of any Charges described in Section 5.2(a); provided, (i) adequate reserves with respect to such contest are maintained on the books of Borrower, in accordance with GAAP; (ii) no Lien shall be imposed to secure payment of such Charges (other than payments to warehousemen and bailees) that is superior to any of the Liens securing the Obligations and such contest is maintained and prosecuted continuously and with diligence and operates to suspend collection or enforcement of such Charges; (iii) none of the Collateral becomes subject to forfeiture or loss as a result of such contest; (iv) Borrower shall promptly pay or discharge such contested Charges and all additional charges, interest, penalties and expenses, if any, and shall deliver to Lender evidence reasonably acceptable to Lender of such compliance, payment or discharge, if such contest is terminated or discontinued adversely to Borrower or the conditions set forth in this Section 5.2(b) are no longer met; and (v) Lender has not advised Borrower in writing that Lender reasonably believes that nonpayment or nondischarge thereof could have or result in a Material Adverse Effect.

5.3. Books and Records; Access.

(a) Borrower shall keep, at its principal place of business, adequate books and records with respect to its business activities, separate from those of Xerox or any of its Affiliates, in which full, true and correct entries, reflecting all financial transactions, are made in accordance with GAAP and Requirements of Law.

(b) Borrower shall, during normal business hours, from time to time upon five (5) Business Days' prior notice, at Lender's sole expense, and as frequently as Lender determines to be appropriate, but not more than once during any three-month period if no Default or Event of Default then exists: (i) provide Lender and any of its officers, employees and agents (collectively, its "representatives") access to its properties, facilities, advisors and employees (including officers) of Borrower and to the Collateral, (ii) permit Lender, and any of its representatives, to inspect, audit and make extracts from Borrower's books and records and (iii) permit Lender, and its representatives, to inspect, review, evaluate and make test verifications and counts of the Collateral of Borrower. If a Default or Event of Default has occurred and is continuing, or if access is necessary to preserve or protect the Collateral as determined by Lender, Borrower shall provide such access during normal business hours and without advance notice. Borrower shall make available to Lender and its representatives, as quickly as is possible under the circumstances, originals or copies of all books and records that Lender or such representative may reasonably request; provided that if no Default or Event of Default then exists, Lender shall not make more than one such request in any three-month period. Borrower shall deliver any document or instrument necessary for Lender and its representatives, as Lender may from time to time reasonably request, to obtain Records from any service bureau or other Person that maintains Records for Borrower, and shall maintain duplicate Records or supporting documentation on media, including computer tapes and discs owned by Borrower; provided that if no Default or Event of Default then exists, Lender shall not make more than one such request in any three-month period. Notwithstanding the foregoing, in no event shall the provisions of this Section 5.3(b) abrogate or otherwise limit any rights of Lender to have access to any Transaction Party (including Borrower) and/or otherwise audit any Transaction Party (including Borrower) pursuant to the express terms of any other Related Transaction Document to which Lender is a party.

5.4. Compliance with Laws.

(a) Borrower shall comply in all material respects with all Requirements of Law applicable to it and to the Transferred Assets.

(b) Borrower shall cause the Portfolio Servicer to perform its obligations with respect to, and otherwise comply in all material respects with, the applicable Policies in regard to the Transferred Assets.

5.5. Intellectual Property.

Borrower will conduct its business and affairs without infringement of or interference with any intellectual property of any other Person in any material respect.

5.6. Further Assurances.

Borrower agrees that it shall, at its expense and upon request of Lender, duly execute and deliver, or cause to be duly executed and delivered, to Lender such further instruments and do and cause to be done such further acts as may be necessary or proper in the reasonable opinion of Lender to carry out more effectively the provisions and purposes of this Agreement or any other Loan Document.

5.7. Defense of Collateral.

Borrower shall defend the right, title, claim of possession and interest of Lender in, to and under the Collateral, whether now existing or hereafter created, against all claims of third parties claiming through or under Borrower, MPE 2 or Xerox. Borrower will duly fulfill all material obligations on its part to be fulfilled under or in connection with each item of Collateral and will do nothing to impair its rights or the rights of Lender in such Collateral. Borrower shall pay any property, excise, transfer or similar Taxes arising with respect to the Collateral or on account of the transactions contemplated by the Related Transaction Documents.

5.8. Purchase of Financing Contracts.

Borrower shall purchase Financing Contracts solely pursuant to the Sale and Contribution Agreement.

5.9. Collateral Records.

Borrower shall maintain and implement, or cause the Portfolio

Servicer to maintain and implement, administrative and operating procedures (including, without limitation, an ability to recreate Records in the event of the destruction of the originals thereof consistent with the disaster recovery procedures of Xerox delivered to Lender prior to the Initial Closing Date), and keep and maintain, or cause to be kept and maintained, all Records and other information reasonably necessary or advisable for the collection of the Contract Payments and administration of the Transferred Assets.

5.10. Related Transaction Documents.

Borrower shall comply with the terms of, employ the procedures outlined in, and enforce the obligations of Xerox and MPE 2 under all of the Related Transaction Documents to which Borrower is a party.

5.11. Financing Contract Matters; Delivery of Settlement Report.

Borrower shall promptly remit to the Portfolio Servicer all notices, financial statements and other deliveries and information received by it from any Obligor under the Financing Contracts. Borrower shall deliver copies of all documents required by Xerox's credit or investment approval with respect to each Financing Contract to the Portfolio Servicer. Borrower shall cause the Portfolio Servicer to deliver, on each Settlement Date, the Settlement Report for the immediately preceding Settlement Period.

5.12. Redirection Notices.

With respect to any Obligor to whom Xerox shall not have delivered an Initial Monetization Invoice prior to the applicable Closing Date, Borrower shall, pursuant to the Initial Monetization Invoice issued to such Obligor, direct such Obligor (by means of including the correct address for a Lockbox on the face of such invoice), to remit all Contract Payments and/or payments with respect to IM/Pooling Contracts invoiced to such Obligor on or after the date of such Initial Monetization Invoice (other than the Excluded Payments) in respect of such Obligor's Financing Contract to a Lockbox; provided that the fact that an Obligor has been given an option to remit its Contract Payment by means of (a) electronic funds transfer to either the EFT Lockbox Account or the EBPP Lockbox Account or (b) credit card to the Credit Card Lockbox Account shall not cause Borrower to be in violation of this Section 5.12 (except to the extent otherwise provided in the Program Agreement or the Sale and Contribution Agreement).

5.13. Deficiency Payments.

If Xerox shall not have deposited into the Payment Account the amount required to be paid by it pursuant to any of Section 2.17(b), Article V or Section 6.04 or Section 6.05 of the Sale and Contribution Agreement in respect of any Financing Contract, then Borrower shall, within one (1) Business Day after such payment was required to be paid into the Payment Account pursuant to the Sale and Contribution Agreement, deposit into the Payment Account an amount equal to the excess of the aggregate amount which would have been distributed to any of the Controlled Accounts in accordance with the terms of the Allocation Agreement and Payment Account Agreement if Xerox had made the required deposit over the amount, if any, deposited by Xerox into the Payment Account.

5.14. Indemnity for Gap Period.

Borrower shall indemnify and hold harmless each Indemnified Person from and against any and all Damages which may be suffered or incurred by such Indemnified Person resulting from, arising out of, based on or relating to, the failure by Borrower to satisfy, as of any Incremental Closing Date, any of the conditions precedent set forth in subsections (a) through (v) of Section 2.4, notwithstanding that, for purposes of Section 2.4, satisfaction of such conditions precedent are measured as of the Borrowing Request Delivery Date. The obligations of the Borrower under this Section 5.14 shall not be modified, affected or impaired in any way by, and Borrower hereby irrevocably waives as an excuse for performance of such obligations and as a defense to the indemnification provided herein, any knowledge (whether actual or constructive) of Lender that any such condition has not been satisfied as of any such Incremental Closing Date or the relevant Borrowing Request Delivery Date , unless affirmatively waived in writing by an authorized representative of Lender as of such date.

5.15. Separateness Opinion.

Upon the breach of any representation, warranty, or covenant in this Agreement that is the basis of a condition precedent set forth in Section 2.4 which is qualified by "Separateness/True Sale Concern," Borrower shall, if requested by Lender, engage Nixon Peabody LLP (or another law firm reasonably acceptable to Borrower and Lender) to review the relevant events, actions, circumstances, omissions or other items and to issue (or conclude that it cannot, consistent with its professional standards, issue) an opinion on which Lender may rely, in substantially the form of Exhibit 3.27 hereto. The issuance or failure to issue such an opinion shall not be conclusive as to whether a "Separateness/True Sale Concern" exists, but shall serve only to assist Lender in determining whether the relevant condition precedent has been satisfied.

5.16. Payment of Liabilities.

Borrower shall, within sixty (60) days after a liability becomes (a) a nondisputed liquidated sum or (b) a liquidated sum reduced to a judgment which is not then stayed, pay all liabilities described in clause (c) of Section 3.15.

ARTICLE VI

NEGATIVE COVENANTS

Borrower agrees that from and after the Initial Closing Date until the Termination Date:

6.1. Mergers, Subsidiaries, Etc.

Borrower shall not directly or indirectly, by operation of law or otherwise, (a) form or acquire any Subsidiary (other than MPE 2) or (b) merge with, consolidate with, acquire all or substantially all of the assets or Stock of, or otherwise combine with or acquire, any Person.

6.2. Investments; Loans and Advances.

Except as otherwise expressly permitted by this Section 6, Borrower shall not make or permit to exist any investment in or to any Person except that Borrower may (a) own Credit Enhancements, so long as such Credit Enhancements are subject to a first priority perfected security interest in favor of Lender and (b) hold or cause funds on deposit in any account referred to herein to be invested in Specified Investments. Except pursuant to Section 3.03(a) of the Transition Proceeds Agreement, under no circumstances shall Borrower make or permit to exist any loan or advance to any Person or acquire, by operation of law or otherwise, any Stock in any partnership or other entity or association in which any investor therein or holder of Stock thereof does not have limited liability.

6.3. Indebtedness.

Borrower shall not create, incur, assume or permit to exist any Indebtedness, except Indebtedness to Lender under this Agreement and the other Loan Documents.

6.4. Affiliate Transactions. Borrower shall not enter into or be a party to any transaction with any Affiliate of Borrower except:

(a) the transactions expressly contemplated by or in furtherance of the Related Transaction Documents; and

(b) to the extent not otherwise prohibited under this Agreement, other transactions in the nature of directors' fees upon fair and reasonable terms that are no less favorable to Borrower than would be obtained in a comparable arm's length transaction with a Person not an Affiliate of Borrower.

6.5 Capital Structure and Business.

Borrower shall not (a) engage at any time in any business or business activity or own any assets other than (i) the acquisition and ownership of Transferred Assets pursuant to the Sale and Contribution Agreement, the disposition of Equipment, Sales Tax Payments and Uplift Payments pursuant to the Contribution Agreement, (ii) the transactions contemplated by this Agreement, including the borrowing of the Term Loans and (iii) any activity incidental to the foregoing and necessary or convenient to accomplish the foregoing, or enter into or be a party to any agreement or instrument other than in connection with the foregoing, except those agreements or instruments permitted under Section 6.13, (b) make any change in its capital structure as described in Section 3.6, including the issuance or sale of any shares of Stock, warrants or other securities convertible into Stock or any revision of the terms of its outstanding Stock, (c) amend its certificate of formation or operating agreement (or any other constituent document) or (d) hire or contract for the services of any person as a paid employee or officer of Borrower.

6.6. Guaranteed Indebtedness.

Borrower shall not create, incur, assume or permit to exist any obligation guaranteeing, providing comfort or otherwise supporting any indebtedness, lease, dividend, or other obligation ("primary obligation") of any other Person (the "primary obligor") in any manner, including any obligation or arrangement of such Person to (a) purchase or repurchase any such primary obligation, (b) advance or supply funds (i) for the purchase or payment of any such primary obligation or (ii) to maintain working capital or equity capital of the primary obligor or otherwise to maintain the net worth or solvency or any balance sheet condition of the primary obligor, (c) purchase property, securities or services primarily for the purpose of assuring the owner of any such primary obligation of the ability of the primary obligor to make payment of such primary obligation, (d) protect the beneficiary from loss (other than product warranties given in the ordinary course of business) or (e) indemnify the owner of such primary obligation against loss in respect thereof except (A) by endorsement of instruments or items of payment for deposit to the general account of Borrower, (B) reimbursement and indemnification obligations in favor of Lender as provided for in this Agreement and the other Loan Documents, (C) reimbursement and indemnification obligations in favor of any other Transaction Party as provided for in the Related Transaction Documents, (D) the limited indemnification obligations of Borrower in its certificate of formation and operating agreement and (E) the obligations of Borrower to purchase Financing Contracts pursuant to the Sale and Contribution Agreement.

6.7. Liens.

Borrower shall not grant, create, incur, assume or permit to exist any Lien on or with respect to any of its revenues, properties or assets (whether now owned or hereafter acquired) except for Permitted Encumbrances. Sale of Assets.

6.8. Sale of Assets

Borrower shall not sell, transfer, convey, assign or otherwise dispose of all or any part of its property or assets (including the Financing Contracts or Borrower's right to receive income in respect thereof), other than the assignments and transfers expressly contemplated by the Related Transaction Documents or distributions to Xerox that do not violate any of the terms of this Agreement or the other Related Transaction Documents.

6.9. Cancellation of Indebtedness.

Except as expressly permitted pursuant to Sections 2.14, 2.15, 6.01(c) and (g) of the Sale and Contribution Agreement and/or Section 2(f) of the Portfolio Service Contract, Borrower shall not, nor shall it permit any Transaction Party to, cancel or modify any claim or debt owing to Borrower.

6.10. Restricted Payments.

Borrower shall not make or declare any dividend to Xerox unless (a) any such dividend which is declared or made by Borrower shall comply with all limited liability company formalities required for the payment of distributions to Xerox, including that Borrower is, and after making such dividend shall continue to be, Solvent, (b) Borrower shall have made all accruals and reserves required in accordance with GAAP, together with a reserve for the amount by which any anticipated obligations and liabilities of Borrower during the period from the Initial Closing Date through the Termination Date exceed the anticipated cash flow to be received by Borrower during such period and (c) Borrower shall have paid to Lender all payment obligations then due and owing to Lender by Borrower under Sections 1.6, 1.7, 5.13, 5.14 and 9.3 hereunder.

6.11. Change of Corporate Name, Etc.

Borrower shall not change its corporate name or any trade name, or without at least thirty (30) days' prior written notice to Lender and after Lender's written acknowledgment that any reasonable action requested by

Lender in connection therewith, including to continue the perfection of any Liens in favor of Lender in any Collateral, has been completed or taken. Without limiting the foregoing, Borrower shall not change its name, identity or corporate structure (including its state of organization) in any manner that might make any financing or continuation statement filed in connection herewith seriously misleading within the meaning of Section 9-506 of the Code or any other then applicable provision of the Code except upon prior written notice to Lender and after Lender's written acknowledgment that any reasonable action requested by Lender in connection therewith, including to continue the perfection of any Liens in favor of Lender in any Collateral, has been completed or taken.

6.12. Leases; Real Estate Purchase.

Except as required by the Separateness Agreement, Borrower shall not enter into any operating lease (as lessee or sublessee) for personal property or Real Estate. Borrower shall not purchase a fee simple ownership interest in real estate.

6.13. Agreements.

Borrower shall not (a) become a party to, or permit any of its properties to be bound by, any indenture, mortgage, instrument, contract, agreement, lease, commitment or other undertaking, except the Related Transaction Documents, and any lease of office space required by the Separateness Agreement, (b) issue any power of attorney (except to Lender or the Portfolio Servicer or except for the purpose of permitting any Person to perform any ministerial functions on behalf of Borrower that are not prohibited by or inconsistent with the terms of the Related Transaction Documents), or (c) amend, supplement, modify or waive any of the provisions of any Related Transaction Document or request, consent or agree to or suffer to exist or permit any such amendment, supplement, modification or waiver or exercise any consent rights granted to it thereunder, in each case, without the prior written consent of Lender.

6.14. Tax Treatment.

Borrower shall not elect to be classified as an association taxable as a corporation for United States federal or state income tax purposes.

6.15. Actions Affecting Rights.

Borrower shall not (a) take any action, or fail to take any action if such action or failure to take action would reasonably be expected to interfere with Lender's enforcement of any rights hereunder or under the other Related Transaction Documents, including rights with respect to the Financing Contracts or (b) fail to pay or cause to be paid any Charges or other obligations of Borrower or its Affiliates with respect to the Transferred Assets, or fail to defend any action, if such failure to pay or defend may adversely affect the priority or enforceability of the Lender's Lien on the Collateral.

6.16. Direction of Contract Payments.

Borrower shall not, directly or indirectly, instruct any Obligor to make any Contract Payment and/or payments with respect to IM/Pooling

Contracts (other than the Excluded Payments) to any account or to any address other than the Lockbox; provided that the fact that an Obligor has been given an option to remit its Contract Payment by means of (a) electronic funds transfer to either the EFT Lockbox Account or the EBPP Lockbox Account or (b) credit card to the Credit Card Lockbox Account shall not cause Borrower to be in violation of this Section 5.12 (except to the extent otherwise provided in the Program Agreement or the Sale and Contribution Agreement).

6.17. Margin Stock.

Borrower will not take or permit to be taken any action which Lender reasonably expects would cause any Loan Document or Borrower's use of the proceeds of any Term Loan to violate any regulation of the Federal Reserve Board.

6.18. Changes to Transferred Assets.

Borrower shall not, nor shall it permit the Portfolio Servicer or any other Transaction Party to, (a) except as expressly permitted pursuant to Sections 2.14, 2.15, 6.01(c) and (g) of the Sale and Contribution Agreement and/or Section 2(f) of the Portfolio Service Contract, waive or commit to waive any rights with respect to any Transferred Asset, (b) except as expressly permitted pursuant to the Sale and Contribution Agreement and/or the Portfolio Service Contract (other than with respect to Borrower's rights or remedies against Xerox under the Sale and Contribution Agreement), directly or indirectly in any way amend, modify, extend or otherwise restructure the payment schedule, payment terms or any other material term or condition of any Transferred Asset, or make any advance, extension, novation, modification or other accommodation to any Obligor thereunder or (c) permit any Lien on any of the Transferred Assets (other than Permitted Encumbrances), in each case, without the prior written consent of Lender. Notwithstanding the foregoing, in no event shall Borrower take any action, or permit any other Transaction Party to take any action, under this Section 6.18, which would violate Section 6.13(c).

6.19. Bring-down of Legal Opinion.

On each anniversary of the Effective Date, Borrower shall cause Nixon Peabody LLP to confirm, as of such date, the continued accuracy of the legal opinions delivered pursuant to Section 2.3(e)(iv) pursuant to a bring-down opinion in form and substance satisfactory to Lender.

6.20. Adjustments to Loss Rates; Amendment to Annex B.

The Loss Rates shall be adjusted in accordance with the procedures set forth in Sections III and IV of Annex B attached hereto.

ARTICLE VII
EVENTS OF DEFAULT; RIGHTS AND REMEDIES

7.1. Events of Default.

The occurrence of any one or more of the following events (regardless of the reason therefor) shall constitute an "Event of Default" hereunder:

(a) A Termination Event.

(b) A case or proceeding is commenced against Borrower seeking a decree or order in respect of Borrower (i) under the Bankruptcy Code, as now constituted or hereafter amended or any other applicable federal, state or foreign bankruptcy or other similar law, (ii) appointing a custodian, receiver, liquidator, assignee, trustee or sequestrator (or similar official) for Borrower or for any substantial part of any Borrower's assets, or (iii) ordering the winding-up or liquidation of the affairs of Borrower, and such case or proceeding shall remain undismissed or unstayed for sixty (60) days or more or a decree or order granting the relief sought in such case or proceeding is entered by a court of competent jurisdiction.

(c) Borrower (i) files a petition seeking relief under the Bankruptcy Code, or any other applicable federal, state or foreign bankruptcy or other similar law, (ii) consents to or fails to contest in a timely and appropriate manner the institution of proceedings thereunder or the filing of any such petition or the appointment of or taking possession by a custodian, receiver, liquidator, assignee, trustee or sequestrator (or similar official) for Borrower or for any substantial part of its assets, (iii) makes an assignment for the benefit of creditors, (iv) takes any action in furtherance of any of the foregoing, or (v) admits in writing its inability to, or is generally unable to, pay its debts as such debts become due.

(d) Borrower shall become an "investment company" within the meaning of the Investment Company Act of 1940, as amended.

7.2. Remedies.

(a) If any Event of Default has occurred and is continuing, Lender may, without notice, take any or all of the following actions: (i) declare all or any portion of the Obligations, including all or any portion of any Term Loan to be forthwith due and payable, all without presentment, demand, protest or further notice of any kind, all of which are expressly waived by Borrower; provided that Lender may not take any such action in respect of an Event of Default described in clause (a) of Section 7.1; (ii) terminate its commitment to make Additional Incremental Term Loans; or (iii) exercise any rights and remedies provided to Lender under the Loan Documents or at law or equity, including all remedies provided under the Code; provided, however, that upon the occurrence of an Event of Default specified in Sections 7.1(b) or (c), all of the Obligations shall become immediately due and payable without declaration, notice or demand by any Person.

(b) Subject to clause (c) below, the rights and remedies of Borrower and Lender under this Agreement shall be cumulative and nonexclusive of any other rights and remedies that Borrower or Lender (as the case may be) may have under any other agreement, including the other Loan Documents, by operation of law or otherwise. Without impairing any Lien granted to Lender, in the event of Borrower's failure to pay when due any principal of, or accrued and unpaid interest on, any Term Loan, Lender's recourse for such failure shall be solely against the Collateral and Lender shall not seek any personal money judgment (including for any deficiency arising out of a failure to realize sufficient proceeds from the Collateral) against Borrower. The provisions of the preceding sentence shall not apply to any Obligations other than the principal of, and accrued and unpaid interest on, the Term Loans.

(c) The limitations on Lender's ability to seek recourse or a deficiency against the Borrower set forth in clause (b) above shall not apply to the extent, and only to the extent, that the validity, priority or enforceability of Lender's Lien in any of the Financing Contracts constituting part of the Portfolio or proceeds thereof either (i) is being challenged in a proceeding by any Person (other than the JV, the Lender or an Affiliate of Lender or (ii) has been found to be invalid, junior, unenforceable or is otherwise terminated, modified, limited or impaired by a nonappealable order of a court of competent jurisdiction (other than by reason of acts or omissions of Lender, including, without limitation, the failure to file any required continuation statement); provided that to the extent that (A) the limitation in clause (b) above is not applicable for a period of time pursuant to subclause (i) of this clause (c), (B) the challenge providing the basis for such inapplicability is ultimately unsuccessful and (C) during such period the Lender has received and applied to the Term Loans payments from Obligors to which Lender would not have been entitled but for this clause (c), then Lender shall refund to Borrower within five (5) Business Days after the date such challenge is defeated and becomes nonappealable or is otherwise formally and permanently abandoned an amount equal to the excess of (X) the payments so received and applied over (Y) the aggregate amount of Lease Payments and Installment Payments paid by Obligors during such period which have not and will not be received by Lender; provided Lender shall have no obligation to bring any action against any third party to enforce its rights to receive such Lease Payments or Installment Payments.

7.3. Waivers by Borrower.

Except as otherwise provided for in this Agreement or by applicable law, Borrower waives: (a) presentment, demand and protest and notice of presentment, dishonor, notice of intent to accelerate, notice of acceleration, protest, default, nonpayment, maturity, release, compromise, settlement, extension or renewal of any or all commercial paper, accounts, contract rights, documents, instruments, chattel paper and guaranties at any time held by Lender on which Borrower may in any way be liable, and hereby ratifies and confirms whatever Lender may do in this regard, (b) all rights to notice and a hearing prior to Lender's taking possession or control of, or to Lender's attachment or levy upon, the Collateral or any bond or security that might be required by any court prior to allowing Lender to exercise any of its remedies, and (c) the benefit of all valuation, appraisal and exemption laws.

ARTICLE VIII

SUCCESSORS AND ASSIGNS

8.1. Successors and Assigns.

(a) Binding on Successors and Assigns. This Agreement and the other Loan Documents shall be binding on and shall inure to the benefit of Borrower, Lender and their respective successors and assigns (including, in the case of Borrower, a debtor-in-possession on behalf of Borrower), except as otherwise provided herein or therein.

(b) No Assignment by Borrower. Borrower may not assign, transfer, hypothecate or otherwise convey its rights, benefits, obligations or duties hereunder or under any of the other Loan Documents without the prior express written consent of Lender. Any such purported assignment, transfer, hypothecation or other conveyance by Borrower without the prior express written consent of Lender shall be void.

(c) Assignment of Existing Term Loans. Lender may assign or participate all or any part of its rights and obligations under this Agreement and the other Loan Documents with respect to any Existing Term Loan (or any interest therein) to any other Person without Borrower's consent; provided that Lender shall not assign or participate any of its rights and obligations under this Agreement with respect to Existing Term Loans to any Person (other than an Affiliate of Lender) that directly engages in competition with Xerox in respect of the marketing or selling (other than retail marketing or selling) of document processing and imaging goods (and products ancillary thereto as part of a document solutions system).

(d) Assignment of Additional Incremental Term Loans. Lender may assign or participate all or any part of its rights and obligations under this Agreement and the other Loan Documents with respect to any outstanding Additional Incremental Term Loan (or any interest therein) to any other Person; provided that, so long as no GE Capital Termination Event based in whole or in part on the breach of Section 8.02(a)(iv) of the Program Agreement has occurred, Lender shall not assign or participate any such rights or obligations to any Person that directly engages in competition with Xerox in respect of the marketing or selling (other than retail marketing or selling) of document processing and imaging goods (and products ancillary thereto as part of a document solutions system); provided further that Lender shall not assign any of its rights and obligations (or any interest therein) with respect to outstanding Additional Incremental Term Loans to any Person (other than an Affiliate of Lender) unless Lender first complies with the provisions of this Section 8.1(d).

(i) Lender shall first offer to assign or participate such Additional Incremental Term Loans (or an interest therein) to Xerox by delivery to Xerox of a written offer to sell such Additional Incremental Term Loans setting forth the price and other terms that Lender then intends to offer to third parties.

(ii) If (A) within ten (10) Business Days of delivery of such notice Xerox does not agree to purchase all of the Additional Incremental Term Loans (or interest) specified in such notice at the price and on the terms set forth therein or (B) within 10 (ten) Business Days after Xerox does so agree, such purchase is not consummated, then Lender may offer such Additional Incremental Term Loans (or interest) to third parties at the price and on the terms specified in the notice.

(iii) If all such Additional Incremental Terms Loans (or interests therein) are not assigned or participated at the price and on the terms specified in the notice, then Lender shall be entitled to offer such Additional Incremental Term Loans (or interest therein) to third parties, and Xerox shall be entitled to bid for such Additional Incremental Term Loans (or interest therein) on the same basis as such third parties, and Lender shall be entitled to negotiate with respect to, and ultimately dispose of, such Additional Incremental Term Loans (or interest therein) on such terms and such price (which may be higher or lower than the price and terms initially offered to Xerox) as Lender may in its sole discretion determine is in its interest so long as Lender does not act arbitrarily or capriciously in making such determination.

(iv) Xerox is a third party beneficiary of this Section

8.1(d).

(e) General Electric Capital Corporation to be Agent for Assignees. In the event General Electric Capital Corporation assigns any of its rights and obligations under this Agreement, Borrower shall only be required to deal solely and directly with General Electric Capital Corporation or an Affiliate thereof, as agent for such assignee(s), and, under such circumstances, Borrower hereby agrees that it shall deliver its signature page to an amendment to this Agreement which adds agency provisions (including provisions with respect to the paying agent and withholding agent duties referred to in Section 1.7(e)) reasonably acceptable to GE Capital and Borrower within five (5) Business Days after its receipt thereof.

(f) No Third Party Beneficiaries. The terms and provisions of this Agreement are for the purpose of defining the relative rights and obligations of Borrower and Lender with respect to the transactions contemplated hereby and, except as expressly provided in Section 8.1(d), no Person shall be a third party beneficiary of any of the terms and provisions of this Agreement or any of the other Loan Documents.

ARTICLE IX

MISCELLANEOUS

9.1. Complete Agreement; Modification of Agreement.

This Agreement and the other Related Transaction Documents constitute the complete agreement between the parties with respect to the subject matter thereof and may not be modified, altered or amended except as set forth in Section 9.2 below. The Monetization Agreement dated as of September 11, 2001, the Framework Agreement and any other document or agreement between Borrower and Lender or any of their respective Affiliates predating this Agreement and relating to a financing of substantially similar form, purpose or effect shall, except as provided in Section 9.19 below, be superseded by this Agreement and the other Related Transaction Documents.

9.2. Amendments and Waivers.

No amendment, modification, termination or waiver of any provision of this Agreement (other than Annex B in accordance with Section 6.20) or any of the Notes, or any consent to any departure by Borrower therefrom, shall in any event be effective unless the same shall be in writing and signed by Lender and Borrower.

Upon payment in full in cash and performance of all of the Obligations (other than indemnification Obligations), termination of Lender's obligation to lend hereunder and a release of all claims against Lender, and so long as no suits, actions, proceedings, or claims are pending or threatened against any Indemnified Person asserting any damages, losses or liabilities that are liabilities described in Section 1.6, Lender shall deliver to Borrower termination statements, Lien releases and other documents necessary or appropriate to evidence the termination of the Liens securing payment of the Obligations.

9.3. Fees and Expenses.

Borrower shall reimburse Lender for all out-of-pocket fees, costs and expenses (including the reasonable fees and expenses of all of its counsel, advisors, consultants and auditors) incurred in connection with:

(a) any amendments, modifications or waivers of, or consents with respect to, or terminations of, the Existing Loan Agreement or any of the Loan Documents or other Related Transaction Documents requested by any of Xerox, Borrower or MPE 2 (or any of their respective Affiliates) occurring prior to the Effective Date (and excluding this amendment and restatement and any other amendments and/or restatements of other Loan Documents or Related Transaction Documents entered into in connection therewith) or advice in connection with its rights thereunder;

(b) any Litigation (whether instituted by Lender, Borrower or any other Person) in any way relating to the Collateral, any of the Loan Documents, any other Related Transaction Document or any other agreement to be executed or delivered in connection herewith or therewith, and whether as a party, witness or otherwise) including any Litigation and any appeal or review thereof, in connection with a case commenced by or against Borrower or any other Person that may be obligated to Lender by virtue of the Loan Documents; including any such Litigation arising in connection with any work- out or restructuring of the Term Loans during the pendency of one or more Events of Default; provided that no Person shall be entitled to reimbursement under this clause (b) in respect of any Litigation to the extent any of the foregoing relates to the Loan Documents and results from such Person's gross negligence, willful misconduct, violation of law, breach of warranty under a Loan Document or such Person's failure to perform its contractual obligations under a Loan Document;

(c) any attempt to enforce any remedies of Lender against any or all of the Transaction Parties or any other Person that may be obligated to Lender by virtue of any of the Loan Documents or other Related Transaction Documents, including any such attempt to enforce any such remedies in the course of any work-out or restructuring of the Term Loans during the pendency of one or more Events of Default; and

(d) any workout or restructuring of the Term Loans during the pendency of one or more Events of Default, including, as to each of clauses (a) through (d) above, all reasonable attorneys' and other professional and service providers' fees arising from such services and other advice, assistance or representation, including those in connection with any appellate proceedings; and all expenses, costs, charges and other fees incurred by such counsel and others in any way or respect arising in connection with or relating to any of the events or actions described in this Section 9.3, all of which shall be payable, on demand, by Borrower to Lender. Without limiting the generality of the foregoing, such expenses, costs, charges and fees may include: fees, costs and expenses of accountants, environmental advisors, appraisers, investment bankers, management and other consultants and paralegals, court costs and expenses, photocopying and duplication expenses, court reporter fees, costs and expenses, long distance telephone charges, air express charges, telegram or telecopy charges, secretarial overtime charges, and expenses for travel, lodging and food paid or incurred in connection with the performance of such legal or other advisory services.

9.4. No Waiver.

Lender's failure, at any time or times, to require strict performance by Borrower of any provision of this Agreement or any other Loan Documents shall not waive, affect or diminish any right of Lender thereafter to demand strict compliance and performance herewith or therewith. Any suspension or waiver of an Event of Default shall not suspend, waive or affect any other Event of Default whether the same is prior or subsequent thereto and whether the same or of a different type. None of the undertakings, agreements, warranties, covenants and representations of Borrower contained in this Agreement or any of the other Loan Documents and no Default or Event of Default by Borrower shall be deemed to have been suspended or waived by Lender, unless such waiver or suspension is by an instrument in writing signed by an officer of or other authorized employee of Lender and directed to Borrower specifying such suspension or waiver.

9.5. Severability.

Wherever possible, each provision of this Agreement and the other Loan Documents shall be interpreted in such a manner as to be effective and valid under applicable law, but if any provision of this Agreement or any other Loan Document shall be prohibited by or invalid under applicable law, such provision shall be ineffective to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Agreement or such other Loan Document.

9.6. Conflict of Terms.

Except as otherwise provided in this Agreement or any of the other Loan Documents by specific reference to the applicable provisions of this Agreement, if any provision contained in this Agreement conflicts with any provision in any of the other Loan Documents, the provision contained in this Agreement shall govern and control.

9.7. Confidentiality.

Lender agrees that all Confidential Information will be kept confidential by Lender and its Representatives and will not be (a) disclosed by Lender or its Representatives to any Person whomsoever or (b) used by Lender or its Representatives, in each case, except with the prior written consent of Borrower or except as expressly otherwise permitted by the terms of this Section 9.7, Article 18 of the JV Agreement, Section 2(b) of the Retained Business Servicing Agreement or Section 2(d)(vi) of the Portfolio Service Agreement. Neither Lender nor its Representatives will use the Confidential Information for any reason or purpose other than in connection with (i) the performance, monitoring or administration of this Agreement, (ii) the enforcement of Lender's rights and remedies hereunder or under the other Related Transaction Documents and (iii) participations or assignments of the Term Loans as provided in Section 8.1; provided, prior to any disclosure of Confidential Information to any potential assignee or participant, such assignee or participant shall agree (in a manner that is enforceable by Borrower) that it will use any Confidential Information delivered to it solely to evaluate its potential purchase of an assignment or participation and shall agree that it shall not (i) disclose or make available, without the prior written consent of Borrower, any Confidential Information (including information relating to any Obligor under any Financing Contract (including information relating to the pricing of or the provisions of any such Financing Contract) or (ii) use any Confidential Information to identify and directly or indirectly solicit any type of business with any Obligor. Lender also agrees to be responsible for enforcing the terms of this Section 9.7 as to its Representatives and the maintenance of the confidentiality of the Confidential Information by Lender and its Representatives and to take such action, legal or otherwise, to the extent necessary to cause such Representatives to comply with the terms and conditions of this Section 9.7 and thereby prevent any improper disclosure or misuse of the Confidential Information by any of Lender's Representatives (including all actions that Lender would take to protect its own confidential information).

9.8. GOVERNING LAW.

EXCEPT AS OTHERWISE EXPRESSLY PROVIDED IN ANY OF THE LOAN DOCUMENTS, IN ALL RESPECTS, INCLUDING ALL MATTERS OF CONSTRUCTION, VALIDITY AND PERFORMANCE, THE LOAN DOCUMENTS AND THE OBLIGATIONS SHALL BE GOVERNED BY, AND CONSTRUED AND ENFORCED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF NEW YORK APPLICABLE TO CONTRACTS MADE AND PERFORMED IN THAT STATE AND ANY APPLICABLE LAWS OF THE UNITED STATES OF AMERICA. BORROWER HEREBY CONSENTS AND AGREES THAT THE STATE OR FEDERAL COURTS LOCATED IN NEW YORK COUNTY, CITY OF NEW YORK, NEW YORK SHALL HAVE EXCLUSIVE JURISDICTION TO HEAR AND DETERMINE ANY CLAIMS OR DISPUTES BETWEEN BORROWER AND LENDER PERTAINING TO THIS AGREEMENT OR ANY OF THE OTHER LOAN DOCUMENTS OR TO ANY MATTER ARISING OUT OF OR RELATING TO THIS AGREEMENT OR ANY OF THE OTHER LOAN DOCUMENTS, PROVIDED, THAT LENDER AND BORROWER ACKNOWLEDGE THAT ANY APPEALS FROM THOSE COURTS MAY HAVE TO BE HEARD BY A COURT LOCATED OUTSIDE OF NEW YORK COUNTY, AND, PROVIDED, FURTHER NOTHING IN THIS AGREEMENT SHALL BE DEEMED OR OPERATE TO PRECLUDE LENDER FROM BRINGING SUIT OR TAKING OTHER LEGAL ACTION IN ANY OTHER JURISDICTION TO REALIZE ON THE COLLATERAL OR ANY OTHER SECURITY FOR THE OBLIGATIONS, OR TO ENFORCE A JUDGMENT OR OTHER COURT ORDER IN FAVOR OF LENDER. BORROWER EXPRESSLY SUBMITS AND CONSENTS IN ADVANCE TO SUCH JURISDICTION IN ANY ACTION OR SUIT COMMENCED IN ANY SUCH COURT, AND BORROWER HEREBY WAIVES ANY OBJECTION THAT BORROWER MAY HAVE BASED UPON LACK OF PERSONAL JURISDICTION, IMPROPER VENUE OR FORUM NON CONVENIENS AND HEREBY CONSENTS TO THE GRANTING OF SUCH LEGAL OR EQUITABLE RELIEF AS IS DEEMED APPROPRIATE BY SUCH COURT. BORROWER HEREBY WAIVES PERSONAL SERVICE OF THE SUMMONS, COMPLAINT AND OTHER PROCESS ISSUED IN ANY SUCH ACTION OR SUIT AND AGREES THAT SERVICE OF SUCH SUMMONS, COMPLAINTS AND OTHER PROCESS MAY BE MADE BY REGISTERED OR CERTIFIED MAIL ADDRESSED TO BORROWER AT THE ADDRESS SET FORTH IN SECTION 9.9 OF THIS AGREEMENT AND THAT SERVICE SO MADE SHALL BE DEEMED COMPLETED UPON THE EARLIER OF BORROWER'S ACTUAL RECEIPT THEREOF OR FIVE (5) BUSINESS DAYS AFTER DEPOSIT IN THE UNITED STATES MAILS, PROPER POSTAGE PREPAID.

9.9. Notices.

Except as otherwise provided herein, whenever it is provided herein that any notice, demand, request, consent, approval, declaration or other communication shall or may be given to or served upon any of the parties by any other parties, or whenever any of the parties desires to give or serve upon any other parties any communication with respect to this Agreement, each such notice, demand, request, consent, approval, declaration or other communication shall be in writing and shall be deemed to have been validly served, given or delivered (a) upon the earlier of actual receipt and five (5) Business Days after deposit in the United States Mail, registered or certified mail, return receipt requested, with proper postage prepaid, (b) two (2) Business Days after deposit with a reputable overnight courier with all charges prepaid or (c) when delivered, if hand-delivered by messenger, all of which shall be addressed to the party to be notified and sent to the address set forth below or to such other address as may be substituted by notice given as herein provided:

(A) If to Lender:

General Electric Capital Corporation
10 Riverview Drive
Danbury, Connecticut 06810
Attention: Xerox Program Manager
Telephone No.: (203) 749-6000

- and -

General Electric Capital Corporation
10 Riverview Drive
Danbury, Connecticut 06810
Attention: Business General Counsel
Telephone No.: (203) 749-6000

with copies to:

Weil, Gotshal & Manges LLP
767 Fifth Avenue
New York, New York
Attention: William M. Gutowitz, Esq.
Telephone No.: (212) 310-8000

(B) If to Borrower:

Xerox Lease Funding LLC
800 Long Ridge Road
Mail Stop 2-4-B8
Stamford, Connecticut 06904
Attention: Treasurer
Telephone No.: (203) 968-3000

with copies to:

Xerox Corporation
800 Long Ridge Road
P.O. Box 1600 (except for courier) Stamford, Connecticut 06904
Attention: Office of General Counsel Telephone No.: (203) 968-3000

- and -

Xerox Corporation
100 Clinton Avenue South
Xerox Square - MS 21
Rochester, New York 14644
Attention: Director of Contract Management Office
Telephone No.: (585) 423-5090

- and -

Nixon Peabody LLP

1300 Clinton Square
Rochester, New York 14604-1792
Attention: Lori B. Green, Esq.
Telephone No.: (585) 263-1000

The giving of any notice required hereunder may be waived in writing by the party entitled to receive such notice. Failure or delay in delivering copies of any notice, demand, request, consent, approval, declaration or other communication to any Person (other than Borrower or Lender) designated above to receive copies shall in no way adversely affect the effectiveness of such notice, demand, request, consent, approval, declaration or other communication.

9.10. Section Titles.

The Section titles and Table of Contents contained in this Agreement are and shall be without substantive meaning or content of any kind whatsoever and are not a part of the agreement between the parties hereto.

9.11. Counterparts.

This Agreement may be executed in any number of separate counterparts, each of which shall collectively and separately constitute one agreement.

9.12. WAIVER OF JURY TRIAL.

BECAUSE DISPUTES ARISING IN CONNECTION WITH COMPLEX FINANCIAL TRANSACTIONS ARE MOST QUICKLY AND ECONOMICALLY RESOLVED BY AN EXPERIENCED AND EXPERT PERSON AND THE PARTIES WISH APPLICABLE STATE AND FEDERAL LAWS TO APPLY (RATHER THAN ARBITRATION RULES), THE PARTIES DESIRE THAT THEIR DISPUTES BE RESOLVED BY A JUDGE APPLYING SUCH APPLICABLE LAWS. THEREFORE, TO ACHIEVE THE BEST COMBINATION OF THE BENEFITS OF THE JUDICIAL SYSTEM AND OF ARBITRATION, THE PARTIES HERETO WAIVE ALL RIGHT TO TRIAL BY JURY IN ANY ACTION, SUIT, OR PROCEEDING BROUGHT TO RESOLVE ANY DISPUTE, WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE, BETWEEN LENDER AND BORROWER ARISING OUT OF, CONNECTED WITH, RELATED TO, OR INCIDENTAL TO THE RELATIONSHIP ESTABLISHED AMONG THEM IN CONNECTION WITH, THIS AGREEMENT OR ANY OF THE OTHER LOAN DOCUMENTS OR THE TRANSACTIONS RELATED THERETO.

9.13. Press Releases and Related Matters.

Borrower agrees that neither it nor its Affiliates will in the future issue any press releases or other public disclosure using the name of Lender or its Affiliates or referring to this Agreement, the other Loan Documents or the other Related Transactions Documents without at least two (2) Business Days' prior notice to Lender and without the prior written consent of Lender unless (and only to the extent that) such Borrower or Affiliate thereof is required to do so under law and then, in any event, such Borrower or Affiliate thereof will consult with Lender before issuing such press release or other public disclosure. Borrower consents to the publication by Lender of a tombstone or similar advertising material relating to the financing transactions contemplated by this Agreement. Lender shall provide a draft of such tombstone or similar advertising material to Borrower for review and comment prior to the publication thereof. Lender reserves the right to provide to industry trade organizations information necessary and customary for inclusion in league table measurements.

9.14. Reinstatement.

This Agreement shall remain in full force and effect and continue to be effective should any petition be filed by or against Borrower for liquidation or reorganization, should Borrower become insolvent or make an assignment for the benefit of any creditor or creditors or should a receiver or trustee be appointed for all or any significant part of Borrower's assets, and shall continue to be effective or to be reinstated, as the case may be, if at any time payment and performance of the Obligations, or any part thereof, is, pursuant to applicable law, rescinded or reduced in amount, or must otherwise be restored or returned by any obligee of the Obligations, whether as a "voidable preference," "fraudulent conveyance," or otherwise, all as though such payment or performance had not been made. In the event that any payment, or any part thereof, is rescinded, reduced, restored or returned (whether pursuant to the conditions or circumstances described above or as a result of Lender's being required pursuant to the Allocation Agreement to return any amounts applied to the Obligations as a result of such amounts constituting Misdirected Xerox Proceeds or Misapplied Proceeds), the Obligations shall be reinstated and deemed reduced only by such amount paid and not so rescinded, reduced, restored or returned.

9.15. Advice of Counsel

Each of the parties represents to each other party hereto that it has discussed this Agreement and, specifically, the provisions of Sections 9.8 and 9.12, with its counsel.

9.16. No Strict Construction.

The parties hereto have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by the parties hereto and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any provisions of this Agreement.

9.17. Survival of Obligations Upon Termination of Financing Arrangements.

Except as otherwise expressly provided for in the Loan Documents, no termination or cancellation (regardless of cause or procedure) of any financing arrangement under this Agreement shall in any way affect or impair the obligations, duties and liabilities of Borrower or the rights of Lender relating to any unpaid portion of the Term Loans or any other Obligations, due or not due, liquidated, contingent or unliquidated or any transaction or event occurring prior to such termination, or any transaction or event, the performance of which is required after the Termination Date. Except as otherwise expressly provided herein or in any other Loan Document, all undertakings, agreements, covenants, warranties and representations of or binding upon Borrower, and all rights of Lender, all as contained in the Loan Documents, shall not terminate or expire, but rather shall survive any such termination or cancellation and shall continue in full force and effect until the Termination Date; provided, that the provisions of Article IX, the payment obligations under Section 1.7, and the indemnities contained in the Loan Documents shall survive the Termination Date.

9.18. Non-Business Days.

If the payment of any Obligation becomes due and payable, or the performance of any covenant, undertaking or agreement is to be performed, on a day other than a Business Day, the date for payment or performance thereof will be extended to the next succeeding Business Day and, with respect to payments of Obligations, interest thereon shall be payable at the applicable Discount Rate.

9.19. Effect of Amendment and Restatement.

(a) On the Effective Date, the Existing Loan Agreement shall be amended and restated in its entirety by this Agreement and the Existing Loan Agreement shall thereafter be of no further force and effect except to evidence (i) the incurrence by Borrower of the "Obligations" under and as defined in the Existing Loan Agreement (whether or not such "Obligations" are contingent as of the Effective Date), (ii) the representations and warranties made by Borrower prior to the Effective Date and (iii) any action or omission performed or required to be performed pursuant to such Existing Loan Agreement prior to the Effective Date (including any failure, prior to the Effective Date, to comply with the covenants contained in such Existing Loan Agreement). The amendments and restatements set forth herein shall not cure any breach of the Existing Loan Agreement existing prior to the Effective Date. This Agreement is not in any way intended to constitute a novation of the obligations and liabilities existing under the Existing Loan Agreement or evidence payment of all or any portion of such obligations and liabilities.

(b) The terms and conditions of this Agreement and Lender's rights and remedies under this Agreement and the other Loan Documents shall apply to all of the Obligations incurred under the Existing Loan Agreement and the promissory notes issued thereunder.

(c) Borrower reaffirms the Liens granted pursuant to the Loan Documents to the Collateral Agent for the benefit of the Lender, which Liens shall continue in full force and effect during the term of this Agreement and any renewals thereof and shall continue to secure the Obligations.

(d) On and after the Effective Date, (i) all references to the Existing Loan Agreement (or to any amendment or any amendment and restatement thereof) in the Loan Documents (other than this Agreement) shall be deemed to refer to the Existing Loan Agreement as amended and restated hereby, (ii) all references to any section (or subsection) of the Existing Loan Agreement or in any Loan Document (but not herein) shall be amended to become, mutatis mutandis, references to the corresponding provisions of this Agreement and (iii) except as the context otherwise provides, on or after the Effective Date, all references to this Agreement herein (including for purposes of indemnification) shall be deemed to be references to the Existing Loan Agreement as amended and restated hereby.

(e) This amendment and restatement is limited as written and except as set forth in clause (f) below is not a consent to any other amendment, restatement or waiver, whether or not similar and, except as expressly provided herein or in any other Loan Document, all terms and conditions of the Loan Documents remain in full force and effect unless otherwise specifically amended hereby or any other Loan Document.

(f) Lender hereby consents to the amendment and restatement, as of the Effective Date, of each of the documents listed on Schedule 9.19(f) hereto each in the form and substance executed by (or in the case of any such documents to which Lender is not a party, a fully executed copy thereof was delivered to) Lender on the Effective Date.

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IN WITNESS WHEREOF, this Agreement has been duly executed as of the date first written above.

XEROX LEASE FUNDING LLC,
as Borrower

By:_______________________________
Title:____________________________

GENERAL ELECTRIC CAPITAL
CORPORATION, as Lender

By:_______________________________
Title:____________________________

ANNEX A

to

LOAN AGREEMENT

DEFINITIONS

Capitalized terms used in this Agreement shall have (unless otherwise provided elsewhere in this Agreement) the following respective meanings and all references to Articles, Sections, Exhibits, Schedules or Annexes in the following definitions shall refer to Articles, Sections, Exhibits, Schedules or Annexes of or to this Agreement:

"Acceptance Notice" has the meaning set forth in Section 1.1(c)(iii).

"Activation Date" means, with respect to any Financing Contract, the date upon which the XEEP System initiates a receivable reflecting the Obligor's obligation under such Financing Contract, thereby permitting the commencement of billing, all based upon Xerox's provision of all Equipment and initial related services and/or installation services, as applicable, to an Obligor under such Financing Contract.

"Active Financing Contract" means, as of any Determination Date, a Financing Contract other than a Financing Contract (a) which has been terminated or otherwise prepaid in full by the Obligor thereunder on or prior to such Determination Date, (b) which is a Deemed Write-Off or an Actual Write-Off as of such Determination Date, (c) for which the final contractually scheduled Lease Payment or Installment Payment, as applicable, thereunder has become due and payable on or prior to such Determination Date or (d) with respect to which payments were made or required to be made by Xerox to Borrower on or prior to such Determination Date pursuant to Section 2.16, Section 2.17, Article V, Section 6.04 or Section 6.05 of the Sale and Contribution Agreement or Section 6.01 of the Undertaking and Replacement Agreement.

"Actual Application Date" means the Business Day immediately following the date upon which a Settlement Report is actually received by Lender.

"Actual Write-Off" means, when used in respect of any Financing Contract, a Financing Contract which, as of the date of determination, has been or was otherwise required to be written off, in whole or in part, in accordance with the Write-Off Policy.

"Additional Incremental Term Loan" has the meaning ascribed to it in Section 1.1(b).

"Additional Incremental Term Loan TPB" means, with respect to any Additional Incremental Term Loan as of any Determination Date, an amount derived as follows: (a) first, for each Active Financing Contract, as of such Determination Date, the purchase price for which was paid by Borrower with the proceeds of such Additional Incremental Term Loan, determine the net present values (as of such Determination Date) of each Lease Payment or Installment Payment, as applicable, to first become due thereunder after such Determination Date (to the extent not prepaid on or prior to such Determination Date), such net present values to be derived using a discount rate equal to the Discount Rate applicable to such Additional Incremental Term Loan, (b) next, aggregate each of the amounts derived pursuant to clause (a), and (c) finally, multiply the sum derived in clause (b) by the Term Loan Advance Rate applicable to such Additional Incremental Term Loan.

"Additional Term Note" has the meaning ascribed to it in Section 1.1(b).

"Adverse Claim" means any claim of ownership or any Lien other than any ownership interest or Lien created under the Sale and Contribution Agreement or the Loan Documents.

"Affiliate" means, with respect to any Person, (a) each Person that, directly or indirectly, owns or controls, whether beneficially, or as a trustee, guardian or other fiduciary, 10% or more of the Stock having ordinary voting power in the election of directors of such Person, (b) each Person that controls, is controlled by or is under common control with such Person and (c) each of such Person's officers, directors, joint venturers and partners, provided, however, that the term "Affiliate," when used in respect of Borrower, shall specifically exclude the JV (but only to the extent that Lender or a Subsidiary of Lender has an equity interest in the JV) and

Lender. For the purposes of this Agreement, "control" of a Person shall mean the possession, directly or indirectly, of the power to direct or cause the direction of its management or policies, whether through the ownership of voting securities, by contract or otherwise.

"Agreement" means this Amended and Restated Loan Agreement between Borrower and Lender, as the same may be amended, supplemented, restated or otherwise modified from time to time.

"Allocation Agreement" means that certain Allocation and Distribution Agreement dated as of the Initial Closing Date by and among Xerox, MPE 2, Borrower, Lender, the Portfolio Servicer and the Collateral Agent, as amended and restated as of the Effective Date.

"Appendices" means all collective references to all Annexes, Disclosure Schedules, Exhibits and other attachments to this Agreement.

"Applicable Interest Period" means:

(a) with respect to all Existing Loans:

(i) the interest periods specified in Section 1.4(d) of the Existing Loan Agreement for all such periods ending prior to the last Actual Application Date that occurs prior to the Effective Date; and

(ii) if the Effective Date occurs on or prior to the Actual Application Date in the calendar month in which the Effective Date occurs, the Applicable Interest Periods shall be: (A) as at such Actual Application Date, an interest period from (and including) the Actual Application Date in the month preceding the Effective Date to (and excluding) the first day of the Settlement Period in which the Effective Date occurs, and (B) as at the Actual Application Date in the calendar month succeeding the month in which the Effective Date occurs, an interest period from (and including) the first day of the Settlement Period in which the Effective Date occurs to (and excluding) the earlier of the Termination Date (if any) or the first day of the first full Settlement Period commencing on or after the Effective Date; and

(iii) if the Effective Date occurs after the Actual Application Date in the calendar month in which the Effective Date occurs, the Applicable Interest Period shall be as at the Actual Application Date in the next calendar month from (and including) the Actual Application Date in the calendar month in which the Effective Date occurs to (and excluding) the earlier of the Termination Date (if any) or the first day of the first full Settlement Period commencing on or after the Effective Date; and

(b) with respect to an Additional Incremental Term Loan having a Closing Date within the calendar month in which the Effective Date occurs, the Applicable Interest Period shall be as at the Actual Application Date in the next calendar month from (and including) the Closing Date for such Term Loan to (and excluding) the earlier of the Termination Date (if any) or the first day of the first full Settlement Period commencing on or after the Effective Date; and

(c) with respect to all Term Loans, the Applicable Interest Period shall be as at the Actual Application Dates related to each Settlement Date in months after the calendar month following the month in which the Effective

Date occurred from (and including) the later of (A) the first day of the immediately preceding Settlement Period and (B) the Closing Date for such Term Loan to (and excluding) the earlier of the Termination Date (if any) or the first day of the current Settlement Period.

"Authorized Officer" means in respect of Borrower its President and any Vice President.

"Bankruptcy Code" means the provisions of Title 11 of the United States Code, 11 U.S.C. Sections 101 et seq.

"Bankruptcy Event" means, with respect to any Obligor, (i) the commencement by such Obligor of a voluntary case under, or the consent by such Obligor to the entry of an order for relief in an involuntary case under, any federal or state bankruptcy, insolvency, fraudulent conveyance, reorganization, moratorium or other similar law now or hereafter in effect, or (ii) the consent by such Obligor to the appointment of, or taking possession by, a receiver, custodian, liquidator, assignee, trustee or sequestrator (or other similar official) of such Obligor or of any substantial part of its property, or (iii) the making of a general assignment by such Obligor generally to pay its debts as they benefit creditors, or (iv) the admission in writing of such Obligor of its inability to pay its debts as they become due in the ordinary course of business, or (v) the adoption of a resolution by its directors or shareholders (or analogous managers or equity owners) in furtherance of any of the foregoing, or (vi) the entry by a court of competent jurisdiction of an order for relief in respect of such Obligor in an involuntary case under any bankruptcy, insolvency, fraudulent conveyance, reorganization, moratorium or other similar law now or hereafter in effect, or the appointment of a receiver, custodian, liquidator, assignee, trustee or sequestrator (or other similar official) of such Person or of any substantial part of its Property, or the ordering of the winding up or liquidation of its affairs.

"Beneficial Owners" means each of MPE 2, Borrower, and GE Capital.

"Borrower" has the meaning ascribed to it in the preamble to this Agreement.

"Borrowing Request" means an Initial Borrowing Request or Incremental Borrowing Request, as applicable.

"Borrowing Request Delivery Date" has the meaning ascribed to it in Section 1.1(c)(v).

"Business Day" means any day that is not a Saturday, a Sunday or a day on which banks are required or permitted to be closed in the State of New York.

"Candidate Financing Contract" means, with respect to each Additional Incremental Term Loan, each Financing Contract conveyed or proposed to be conveyed by Xerox to Borrower pursuant to the Sale and Contribution Agreement in connection with such Additional Incremental Term Loan.

"Charges" means all federal, state, county, city, municipal, local, foreign or other governmental taxes (including taxes owed to the PBGC at the time due and payable), levies, assessments, charges, liens, claims or encumbrances upon or relating to (a) the Collateral, (b) the Obligations, (c) the income or gross receipts of Borrower, (d) Borrower's ownership or use of any properties or other assets or (e) any other aspect of Borrower's business.

"Closing Date" means any of the Initial Closing Date and each Incremental Closing Date.

"Code" means the Uniform Commercial Code as the same may, from time to time, be enacted and in effect in the State of New York; provided that in the event that, by reason of mandatory provisions of law, any or all of the attachment, perfection or priority of, or remedies with respect to, Lender's Lien on any Collateral is governed by the Uniform Commercial Code as enacted and in effect in a jurisdiction other than the State of New York, the term "Code" shall mean the Uniform Commercial Code as enacted and in effect in such other jurisdiction solely for purposes of the provisions hereof relating to such attachment, perfection, priority or remedies and for purposes of definitions related to such provisions.

"Collateral" means the property referred to in the Security Agreement together with the property covered by the other Collateral Documents, and any other property, real or personal, tangible or intangible, now existing or hereafter acquired, that may at any time be or become subject to a security interest or Lien in favor of Lender to secure the Obligations. "Collateral Agent" has the meaning ascribed to it in the Payment Account Agreement.

"Collateral Assignment" means that certain Collateral Assignment of Rights dated as of the Initial Closing Date by and between Borrower and Lender, and acknowledged and agreed to by the other Transaction Parties named therein, as amended and restated as of the Effective Date.

"Collateral Documents" means the Security Agreement, the Deposit Account Control Agreement, the Collateral Assignment and all similar agreements entered into after the Initial Closing Date guaranteeing payment of, or granting a Lien upon property as security for payment of, the Obligations.

"Concentration Percentage" means, with respect to each Obligor, a fraction (expressed as a percentage) (i) the numerator of which is the Obligor Exposure for such Obligor and (ii) the denominator of which is the sum of the outstanding principal amount of (x) the proposed Term Loan in connection with which the Concentration Percentage is then being determined plus (y) all other then-outstanding Term Loans.

"Confidential Information" means all information relating to Xerox or any of Xerox's customers, the Borrower or MPE 2, that has been or may hereafter be provided or shown to Lender by such disclosing party or its Representatives or is otherwise obtained from review of disclosing party's documents or property or discussions with any such disclosing party's Representatives, irrespective of the form of the communication, and also includes all notes, analyses, compilations, studies, summaries or other material prepared by such disclosing party or Representatives containing or based, in whole or in part, on any information included in the foregoing; provided that Confidential Information shall not include any information which (i) is or becomes available to the public other than as a result of a disclosure by Lender or any of Lender's Representatives; (ii) becomes available to Lender on a non-confidential basis and not in contravention of applicable Law from a source other than any such disclosing party or any of its Representatives which is not known to Lender or any of its Representatives to be bound by a confidential relationship with or obligation of confidentiality to the disclosing party or by a confidentiality or other similar agreement; (iii) was known to Lender or any of its Representatives on a non-confidential basis and not in contravention of applicable Law or a confidentiality or other similar agreement prior to its disclosure to such recipient by any such disclosing party or its Representatives; or (iv) is acquired or developed by Lender or any of its Representatives without violating any obligation under Section 9.7.

"Contract Payments" has the meaning ascribed to it in the Allocation Agreement.

"Contracts" means any one or more leases, installment sales contracts, agreements giving rise to trade receivables and other similar agreements to which Xerox or any of its Subsidiaries is, or may from time to time be, a party.

"Contractually Scheduled Term" has the meaning ascribed to it in the Sale and Contribution Agreement.

"Contribution Agreement" means that certain Contribution Agreement dated as of the Initial Closing Date between MPE 2 and Borrower, as amended and restated as of the Effective Date.

"Controlled Accounts" means a collective reference to the GE Capital Control Account, the Equipment Servicing Collateral Account, the Equipment Supply Collateral Account, and the Holdback Account.

"Credit Card Lockbox Account" has the meaning ascribed to it in the Sale and Contribution Agreement.

"Credit Classification" means the code representing the credit classification of an Obligor, as of the date a Financing Contract was originated, determined in accordance with the Credit Policy relating to such Obligor's Financing Contract.

"Credit Enhancement" has the meaning ascribed to it in the Allocation Agreement.

"Credit Policy" means (a) with respect to any Financing Contract in existence as of the Initial Closing Date, the credit policy of Xerox in effect at the time of the creation of such Financing Contract, (b) with respect to any Financing Contract created after the Initial Closing Date but prior to the Effective Date, the credit policy attached hereto as Annex D-1 and (c) with respect to any Financing Contract created on or after the Effective Date, the credit policy attached hereto as Annex D-2, as the same is in effect on the Effective Date and as subsequently modified or amended with the written approval of the Management Committee of the Portfolio Servicer, Lender and Borrower; provided, that for purposes of this definition, the Credit Policy referred to in clause (c) above shall be such Credit Policy without giving effect to any delegation pursuant to the third sentence of such Credit Policy of the authority of the Chief Risk Officer (as defined in such Credit Policy) to act in his or her "Reasonable Discretion" (as defined in such Credit Policy) or any provisions of such Credit Policy that allow exceptions, modifications or waivers thereof with the approval or consent of any Person (including, without limitation, Xerox, its Office of General Counsel, a "Xerox Approval Authority" or other designation) unless, in each such case, Lender shall have also given its written consent to such delegation, exception, modification or waiver; provided further, however, that (i) for purposes of approving extensions of credit with respect to any Obligor, an exception, modification or waiver recommended by the Chief Risk Officer and approved by a "Xerox Approval Authority" within the parameters of such recommendation allowing the Chief Risk Officer to increase, in general, or exceed, on a case-by-case basis, the applicable limits set forth in Article II of such Credit Policy for such Obligor shall be given effect and (ii) an exception, modification or waiver of the first sentence of the third and fourth "bulleted" paragraphs of Section IV of such Credit Policy and the sixth "bulleted" paragraph of Section IV of such Credit Policy shall not be deemed to be inconsistent with such Credit Policy, in each case with respect to clauses (i) and (ii) whether or not Lender shall have given its written consent to such exception, modification or waiver.

"Damages" shall mean, with respect to any Indemnified Person, (a) any and all losses (including, but not limited to, liquidated damages), claims, damages, liabilities, obligations, judgments, equitable relief granted, settlements, awards (including back pay awards), demands, offsets, defenses, counterclaims, actions or proceedings, reasonable out-of-pocket costs, expenses and attorneys' fees (including any such reasonable costs, expenses and attorneys' fees incurred in enforcing any right of indemnification held by such Person or with respect to any appeal), interest and penalties, if any, and (b) shall be deemed to include any and all losses resulting from the failure of any Indemnified Person to receive any amounts payable with respect to any Financing Contract.

"Data Certification" means the Initial Data Certification or any Incremental Data Certification, as applicable.

"Data File" means the Initial Data File or any Incremental Data File, as applicable.

"Deemed Write-Off" means, when used in respect of any Financing Contract, a Financing Contract that, as of the date of determination, does not constitute a Qualifying Financing Contract.

"Default" means any event that, with the passage of time or notice or both, would, unless cured or waived, become an Event of Default.

"Deposit Account Control Agreement" means that certain letter agreement dated as of the Initial Closing Date by and among Borrower, Lender and the Depository Bank, as amended and restated as of the Effective Date.

"Depository Bank" shall have the meaning ascribed to it in the Allocation Agreement.

"Determination Date" means, with respect to any Term Loan, the last day of a Settlement Period relating to such Term Loan.

"Discount Rate" shall mean: (i) with respect to each Existing Loan, the per annum rate indicated for such Existing Loan on Schedule 1.1(a) hereto and (ii) with respect of each Additional Incremental Term Loan, a rate per annum equal to the "Discount Rate" determined in accordance with Annex E to this Agreement.

"Dollars" or "$" means lawful currency of the United States of America.

"EBPP Lockbox Account" shall have the meaning ascribed to it in the Sale and Contribution Agreement.

"Effective Date" means October 21, 2002.

"EFT Lockbox Account" shall have the meaning ascribed to it in the Sale and Contribution Agreement.

"Equipment" means, with respect to any Financing Contract, all equipment and other property subject to such Financing Contract.

"Equipment and Tax Payment Transfer" means the transfer by Borrower to MPE 2 pursuant to the Contribution Agreement of all of Borrower's right, title and interest in and to the Transferred Equipment (as defined in the Sale and Contribution Agreement) and the Sales Tax Payments and the Uplift Payments payable in respect of the Financing Contracts related thereto.

"Equipment Servicing Collateral Account" has the meaning ascribed to it in the Allocation Agreement.

"Equipment Supply Collateral Account" has the meaning ascribed to it in the Allocation Agreement.

"ERISA" means the Employee Retirement Income Security Act of 1974 (or any successor legislation thereto), as amended from time to time, and any regulations promulgated thereunder.

"ERISA Affiliate" means, with respect to Xerox or Borrower, any trade or business (whether or not incorporated) that, together with Xerox or Borrower, are treated as a single employer within the meaning of Sections 414(b), (c), (m) or (o) of the IRC.

"ERISA Event" means, with respect to Xerox, Borrower or any ERISA Affiliate, (a) any event described in Section 4043(c) of ERISA with respect to a Title IV Plan; (b) the withdrawal of Xerox, Borrower or any ERISA Affiliate from a Title IV Plan subject to Section 4063 of ERISA during a plan year in which it was a substantial employer, as defined in Section 4001(a)(2) of ERISA; (c) the complete or partial withdrawal of Xerox, Borrower or any ERISA Affiliate from any Multiemployer Plan; (d) the filing of a notice of intent to terminate a Title IV Plan or the treatment of a plan amendment as a termination under Section 4041 of ERISA; (e) the institution of proceedings to terminate a Title IV Plan or Multiemployer Plan by the PBGC; (f) the failure by Xerox, Borrower or any ERISA Affiliate to make when due required contributions to a Multiemployer Plan or Title IV Plan unless such failure is cured within 30 days; (g) any other event or condition which might reasonably be expected to constitute grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any Title IV Plan or Multiemployer Plan or for the imposition of liability under Section 4069 or 4212(c) of ERISA; (h) the termination of a Multiemployer Plan under Section 4041A of ERISA or the reorganization or insolvency of a Multiemployer Plan under Section 4241 or 4245 of ERISA; (i) the loss of a Qualified Plan's qualification or tax exempt status; or (j) the termination of a Plan described in Section 4064 of ERISA.

"Escrow Agent" means Citibank, N.A., or any other financial institution acceptable to Borrower and Lender.

"Escrow Agreement" means that certain Escrow Agreement dated as of the Initial Closing Date, as amended and restated as of the Effective Date, by and among Xerox, Lender and Escrow Agent relating to the deposit by Xerox with the escrow agent of a list of spare parts, consumables and other supplies for the Equipment and names of employees of Xerox engaged in servicing the Equipment.

"Escrowed Funds" has the meaning ascribed to it in Section 2.5(h).

"ESOP" means a Plan that is intended to satisfy the requirements of Section 4975(e)(7) of the IRC.

"Event of Default" has the meaning ascribed to it in Section 7.1.

"Evergreen Payments" has the meaning ascribed to it in the Allocation Agreement.

"Exception Notice" has the meaning set forth in Section 1.1(c)(iii).

"Exchange Act" means the Securities Exchange Act of 1934, as amended.

"Excluded Financing Contract" means any Financing Contract as to which any one of the following circumstances or conditions is applicable as of the Tagging Date relating thereto:

(a) Intentionally Omitted;

(b) unless otherwise waived in writing by Lender, a Bankruptcy Event has occurred and is continuing with respect to any Obligor thereunder;

(c) Intentionally Omitted;

(d) such Financing Contract either (i) includes among the obligations of Xerox thereunder, the provision of facilities management or similar services or (ii) is recorded by Xerox on its books and records maintained consistent with past practice as an "XBS" (DMA) agreement or otherwise constitutes an XBS Agreement (as defined in the Program Agreement);

(e) unless otherwise waived in writing by Lender, the XEEP System identifies Xerox or any Affiliate of Xerox as the "obligor" or "lessee" thereunder or the Person to which invoices are to be sent in respect of such Financing Contract;

(f) unless otherwise waived in writing by Lender, the XEEP System shows a status code other than "active" in respect of such Financing Contract;

(g) either (i) the first two digits of the XMC Code with respect to such Financing Contract as reflected on the XEEP System are "88" or (ii) any of the Equipment subject thereto is used by an Obligor thereunder for personal, family or household use, or an Obligor thereunder is a consumer;

(h) any Obligor under such Financing Contract is (i) the United States federal government or any agency, department or instrumentality thereof or (ii) a U.S. Virgin Islands Governmental Authority;

(i) such Financing Contract constitutes a tax exempt municipal lease;

(j) unless otherwise waived in writing by Lender, any portion of any Contract Payment for such Financing Contract is or will be included on an invoice to an Obligor, which invoice also includes Other Obligations, unless such invoice is issued solely with respect to (i) IM/Pooling Contracts or (ii) Simon Financing Contracts;

(k) Xerox shall have suspended or waived, whether permanently or for a period of time, the obligation of an Obligor to make Contract Payments that would otherwise then be due and payable thereunder, and such suspension or waiver is then in effect;

(l) unless otherwise waived in writing by Lender, the final contractually scheduled payment thereunder (i.e., exclusive of "evergreen payments") shall have been due on or prior to such Tagging Date;

(m) unless otherwise waived in writing by Lender, the Activation Date of such Financing Contract, or the date of installation of the Equipment related thereto, shall have occurred prior to January 1, 1996;

(n) the Minimum Lease Payment or Periodic Installment Sale Payment, as applicable, thereunder is less than or equal to $10.00 per month;

(o) the Equipment related thereto is not located at an Obligor location within any State of the United States of America, Washington, D.C. or the U.S. Virgin Islands;

(p) unless otherwise waived in writing by Lender, the "Lease Payment" with respect to such Financing Contract as identified in the cost per copy billing system does not equal the "Lease Payment" with respect to such Financing Contract as identified in the XEEP System;

(q) unless otherwise waived in writing by Lender, the number of due but uncollected payments in respect thereof exceeds seven (7), without giving effect to any right of set-off or other rights and/or defenses of an Obligor thereunder;

(r) unless otherwise waived in writing by Lender, the contractually scheduled payments to be made thereunder are due other than on a monthly basis;

(s) either there is no Credit Classification applicable to such Financing Contract or there is no corresponding Loss Rate set forth on Exhibit B for such Credit Classification;

(t) unless otherwise waived in writing by Lender, following the occurrence of a Credit Card Failure Event (as defined in the Sale and Contribution Agreement) such Financing Contract would, if transferred to Borrower, constitute a Mandatory Credit Card Contract (as defined in the Sale and Contribution Agreement);

(u) unless otherwise waived in writing by Lender, (i) such Financing Contract shall constitute a Bundled Service Financing Contract (as defined in the Sale and Contribution Agreement) that is in the form of an installment sale agreement and (ii) the Tagging Date with respect to such Financing Contract shall be both on or after June 30, 2003 and prior to the date (if any) on which both (A) the Necessary Installment Sale EBS Changes (as defined in the Sale and Contribution Agreement) shall have been effected and (B) Lender and Borrower shall have agreed in writing upon mutually satisfactory adjustments to the Service Coverage Test to take into account Bundled Service Financing Contracts that are in the form of an installment sale agreement;

(v) unless otherwise waived in writing by Lender, a Lockbox Transfer Termination Event shall have occurred and the Obligor under such Financing Contract shall be legally entitled to effect payments thereunder by means of credit card, EBPP (as defined in the Sale and Contribution Agreement) or electronic funds transfer;

(w) such Financing Contract is a QRT Financing Contract and the transfer of such QRT Financing Contract (together with all other QRT Financing Contracts concurrently transferred) pursuant to the Sale and Contribution Agreement (i) is subject to the provisions of Section 6.04(a)(ix) of the Existing Revolving Credit Agreement (or a substantially identical test under any amendment, modification, supplement, refinancing or replacement of the Existing Revolving Credit Agreement) and (ii) results in an Investment (as defined in the Existing Revolving Credit Agreement or a substantially identical term under any amendment, modification, supplement, refinancing or replacement of the Existing Revolving Credit Agreement) by Xerox in Borrower that exceeds the amount received by Borrower as cash proceeds of the Term Loan or proposed Term Loan relating to such QRT Financing Contracts and paid to Xerox, such result to be determined by Xerox in compliance with the provisions of the Existing Revolving Credit Agreement, as amended, modified, supplemented, refinanced or replaced, interpreted in accordance with the confirmation attached hereto as Exhibit 2.3(l) or any such amendment, modification, supplement, refinancing or replacement of the Existing Revolving Credit Agreement; or

(x) unless otherwise waived in writing by Lender, following the occurrence of a Simon Failure Event (as defined in the Sale and Contribution Agreement) such Financing Contract would, if transferred to Borrower, constitute a Simon Financing Contract.

Any waiver by Lender contemplated above in this definition of Excluded Financing Contract may, at the sole discretion of Lender, apply to a single Financing Contract or to one or more Financing Contracts, as expressly set forth in such waiver.

"Excluded Payments" shall have the meaning ascribed to it in the Sale and Contribution Agreement.

"Existing Incremental Term Loans" means any and all of the Existing Term Loans as of the Effective Date other than the Initial Term Loan as described in items 2, 3, 4, 5 and 6 on Schedule 1.1(a) hereto.

"Existing Loan Agreement" has the meaning ascribed to it in Recital A of this Agreement.

"Existing Revolving Credit Agreement" means that certain Amended and Restated Credit Agreement dated as of June 21, 2002 by and among Xerox, the overseas borrowers party thereto, the lenders from time to time party thereto, Bank One, NA, as administrative agent, collateral agent and LC issuing bank and the other agents from time to time party thereto, as the same is in effect on the Effective Date.

"Existing Term Loans" has the meaning ascribed to it in Section 1.1(a).

"Existing Term Loan TPB" means, with respect to any Term Loan as of any Determination Date, an amount equal to (a) the amount shown as the Targeted Principal Balance as of such Determination Date on the Targeted Principal Balance Schedule for such Term Loan, minus (b) with respect to each Financing Contract relating to such Term Loan which was terminated or otherwise prepaid in full by an Obligor thereunder on or prior to such Determination Date, an amount equal to the Reduction Amount for such Financing Contract determined as of the date of such termination or prepayment, minus (c) with respect to any Financing Contract for which payments were made or required to be made by Xerox to Borrower pursuant to Section 2.16, Section 2.17, Article V, Section 6.04 or Section 6.05 of the Sale and Contribution Agreement or Section 6.01 of the Undertaking and Replacement Agreement on or prior to such Determination Date, an amount equal to the Reduction Amount for such Financing Contract determined as of the date such amount was paid or required to be paid pursuant to the Sale and Contribution Agreement, minus (d) with respect to each Financing Contract which constituted a Deemed Write-Off or, to the extent such Financing Contract did not previously constitute a Deemed Write-Off, an Actual Write- Off, in each case, on or prior to such Determination Date, an amount equal to the Reduction Amount for such Financing Contract determined as of the date such Financing Contract became a Deemed Write-Off or Actual Write-Off, as applicable, plus (e) with respect to each Financing Contract which, as of such date, no longer constitutes a Deemed Write-Off but which is not an Actual Write-Off, the Reduction Amount for such Financing Contract as of the date such Financing Contract became a Deemed Write-Off.

"Existing Term Notes" has the meaning ascribed to it in Section 1.1(a).

"Federal Reserve Board" means the Board of Governors of the Federal Reserve System.

"Fee Credit Amount" means, with respect to each Replacement Financing Contract to be purchased by Borrower from Xerox on a Closing Date prior to the Effective Date an amount determined as follows: if and only if the NPV Amount (as determined in accordance with Annex E to this Agreement as of the relevant Tagging Date) for such Replacement Financing Contract is equal to or greater than the Future Payment Amount of the related Replaced Financing Contract (as determined on the date such Replaced Financing Contract is terminated), an amount equal to 0.65% of the Future Payment Amount of the related Replaced Financing Contract, otherwise, the "Fee Credit Amount" shall equal zero.

"Financing Contract" means any contract relating to Equipment and related services (including any schedule thereto and any amendment, assignment, assumption, renewal or novation thereof and any ancillary agreements thereto) that is in the form of either a lease agreement or an installment sale contract between an Obligor, on one hand, and Xerox, on the other hand, and which has been or is proposed to be transferred to Borrower pursuant to the Sale and Contribution Agreement.

"Financing Contract Advance Rate" has the meaning ascribed thereto in Annex E to this Agreement.

"Financing Contract Information" means, with respect to any Financing Contract, the following information with respect to such Financing Contract and the related Obligor(s) thereunder and under any related Credit Enhancement, in each case (unless otherwise noted) as of the relevant Tagging Date: (a) the customer number or contract number assigned thereto by Xerox, (b) the Market Segment applicable thereto as of the date such Financing Contract was originated, (c) the legal name of such Obligor, (d) the XMC Code applicable thereto, (e) the form of such agreement (e.g., fair market value lease, fixed purchase option lease, installment sale contract, etc.), (f) the total amount financed by Xerox under such agreement (in dollars), (g) the annual percentage rate applicable to such agreement (expressed as a percentage), (h) the Minimum Lease Payment or Periodic Installment Sale Payment, as applicable, and the allocation thereof pursuant to and in accordance with the Allocation Agreement (in dollars), (i) the current status of such agreement (e.g., active, extend, default, final and write-off), (j) the principal balance remaining thereunder (in dollars), (k) the number of due, but uncollected, Minimum Lease Payments or Periodic Installment Sale Payments, as applicable, (l) such Obligor's Credit Classification under the Credit Policy applicable thereto at the time such Financing Contract was originated, (m) the Index Month (as defined in the Sale and Contribution Agreement) in respect of such Financing Contract and the Base Equipment Servicing Payment in respect of such month and (n) the Tagging Date with respect to such Financing Contract.

"Framework Agreement" means that certain Framework Agreement dated as of September 11, 2001, as amended to the Effective Date, by and between Xerox and GE Capital.

"Funding Amount" means the original principal amount of each Term Loan computed in accordance with Annex E hereto.

"Future Payment Amount" means, with respect to any Financing Contract, the amount specified in clause (ii) of the definition of Loan Payment Amount for such Financing Contract and determined as of the date (a) such Financing Contract was terminated or prepaid in full by an Obligor thereunder, (b) on which a payment was made or required to be made pursuant to any of Section 2.16, Section 2.17, Article V, or Section 6.05 of the Sale and Contribution Agreement or Section 5.01 of the Undertaking and Replacement Agreement or (c) solely for the purposes of the definition of Reduction Amount, such Financing Contract became an Actual Write-Off or Deemed Write- Off, as applicable. Notwithstanding the foregoing, as to any Financing Contract for which a payment was required to be made under Section 6.04 of the Sale and Contribution Agreement, the "Future Payment Amount" with respect to such Financing Contract shall be an amount determined by Lender in good faith to be fairly allocable to payments that would otherwise have become due under such Financing Contract after the date of such required payment.

"GAAP" means generally accepted accounting principles in the United States of America as in effect from time to time, consistently applied.

"GE Capital Control Account" has the meaning ascribed to it in Section 1.3(a)(ii) of this Agreement.

"GE Capital Termination Event" has the meaning ascribed to it in the Program Agreement.

"Governmental Authority" means any nation or government, any state or other political subdivision thereof, and any agency, department or other entity exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government.

"Historical Loss Data" means the historical loss data tape in the form set forth as Annex C to this Agreement.

"Holdback Account" has the meaning ascribed to it in the Allocation Agreement.

"IM/Pooling Contracts" means Financing Contracts and agreements and instruments evidencing Other Obligations for which (i) amounts due from the Obligor thereunder are summarized and billed to such Obligor under a single, summary invoice on a monthly basis with detail pursuant to the IM System, (ii) amounts due from the Obligor thereunder are summarized and billed to such Obligor under a single, summary invoice on a monthly basis without detail pursuant to the IM System or (iii) amounts due from the Obligor thereunder are aggregated and billed to such Obligor on a monthly basis under a single, aggregate invoice pursuant to the Pooling System.

"IM System" means that certain management billing system referred to by Xerox as the "Invoice Management" or "IM" system and employed by the JV to administer certain Contracts in a manner such that amounts due from Obligors under one or more Contracts are summarized and billed to the Obligor under a single, summary invoice on a monthly basis (with or without detail).

"Incremental Borrowing Request" means, with respect to any proposed Incremental Term Loan, a written notice substantially in the form of Exhibit 1.1(c)(v) to this Agreement, containing (in each case, as determined in accordance with Annex E to this Agreement) (i) the original principal amount of the relevant Incremental Term Loan and (ii) the Discount Rate applicable thereto.

"Incremental Closing Date" means the date upon which Lender makes an Incremental Term Loan to Borrower;

"Incremental Data Certification" means, with respect to any proposed Incremental Term Loan, a written certification of Borrower, in the form of Exhibit 1.1(c)(ii) to this Agreement, containing (i) the Term Loan Advance Rate applicable to such Incremental Term Loan, (ii) a Statement of Cash Flows for the Candidate Financing Contracts, (iii) the Incremental Data File with respect to such Candidate Financing Contracts, (iv) the Tagging Date with respect to the Candidate Financing Contracts, (v) the Base Service Percentage and Base Supply Percentage applicable to the Candidate Financing Contracts , (vi) a certification that, except to the extent waived by Lender in writing or through the application of Section 1.1(e), (A) none of the Candidate Financing Contracts constitute Excluded Financing Contracts, (B) the inclusion of such Candidate Financing Contracts in the Data File would not result in any of the representations and warranties set forth in subclauses (a)(iv) (as to the valid transfer of the Candidate Financing Contracts and the related Transferred Assets), (a)(xii), (a)(xiii) and (b) through (e) of Section 4.01 of the Sale and Contribution Agreement being untrue or incorrect and (C) either the Concentration Percentage with respect to each Obligor under a Candidate Financing Contract does not exceed one percent (1%) or the Obligor Exposure with respect to such Obligor does not exceed the amount permitted for such Obligor by Section 2.4(v) of the Agreement.

"Incremental Data File" means, with respect to any Financing Contracts to be acquired by Borrower on a Closing Date after the Initial Closing Date pursuant to the Sale and Contribution Agreement, a computer disk, computer tape or other computer generated format setting forth the Financing Contract Information for such Financing Contracts.

"Incremental Financing Contract" means a Financing Contract to be acquired by Borrower from Xerox on a particular Incremental Closing Date pursuant to the Sale and Contribution Agreement and against which a related Incremental Term Loan is actually advanced.

"Incremental Term Loans" means a collective reference to the Existing Incremental Term Loans and the Additional Incremental Term Loans.

"Indebtedness" means, with respect to any Person, without duplication, (a) all indebtedness of such Person for borrowed money or for the deferred purchase price of property payment for which is deferred ninety (90) days or more, but excluding obligations to trade creditors incurred in the ordinary course of business unsecured and that are not overdue by more than ninety (90) days unless being contested in good faith, (b) all reimbursement and other obligations with respect to letters of credit, bankers' acceptances and surety bonds, whether or not matured, (c) all obligations evidenced by notes, bonds, debentures or similar instruments, (d) all indebtedness created or arising under any conditional sale or other title retention agreement with respect to property acquired by such Person (even though the rights and remedies of the seller or lender under such agreement in the event of default are limited to repossession or sale of such property), (e) all capital lease obligations (defined as, with respect to any lease to which such Person is a party, the amount of the obligation of such Person that, in accordance with GAAP, would appear on a balance sheet of such Person in respect of such lease) and the present value of future rental payments under synthetic leases, (f) all obligations of such Person under commodity purchase or option agreements or other commodity price hedging arrangements, in each case whether contingent or matured, (g) all obligations of such Person under any foreign exchange contract, currency swap agreement, interest rate swap, cap or collar agreement or other similar agreement or arrangement designed to alter the risks of that Person arising from fluctuations in currency values or interest rates, in each case whether contingent or matured, (h) all Indebtedness referred to above secured by (or for which the holder of such Indebtedness has an existing right, contingent or otherwise, to be secured by) any Lien upon or in property or other assets (including accounts and contract rights) owned by such Person, even though such Person has not assumed or become liable for the payment of such Indebtedness, and (i) the Obligations.

"Indemnification Agreement" means that certain Indemnification Agreement dated as of the Initial Closing Date by and among Xerox, Borrower and MPE 2.

"Indemnified Person" means, (i) with respect to Lender, Lender and its Affiliates, and each of Lender's and its Affiliates' respective officers, directors, employees, attorneys, agents and representatives and (ii) with respect to Borrower, Borrower and its Affiliates, and each of Borrower's and its Affiliates' respective officers, directors, employees, attorneys, agents and representatives.

"Index Debt" means, with respect to any Person, any long-term, senior unsecured Indebtedness of such Person (without any third party credit enhancement).

"Initial Borrowing Request" means a written notice substantially in the form of Exhibit 2.1(b) to the Existing Loan Agreement containing (in each case, as determined in accordance with Annex E to the Existing Loan Agreement) (i) the original principal amount of the Initial Term Loan, (ii) the Discount Rate applicable thereto and (iii) the Targeted Principal Balance Schedule related thereto.

"Initial Closing Date" means November 20, 2001.

"Initial Data Certification" means a written certification, in the form of Exhibit 2.1(a) to the Existing Loan Agreement, containing (i) the proposed Initial Closing Date, (ii) the Term Loan Advance Rate applicable to the Initial Term Loan, (iii) the Historical Loss Data, (iv) a Statement of Cash Flows for the Initial Financing Contracts and (v) the Initial Data File.

"Initial Data File" means the computer disk, computer tape or other computer generated format setting forth the Financing Contract Information as to the Initial Financing Contracts.

"Initial Financing Contracts" means the Financing Contracts to be acquired by Borrower from Xerox on the Initial Closing Date pursuant to the Sale and Contribution Agreement.

"Initial Monetization Invoice" has the meaning ascribed to such term in the Sale and Contribution Agreement.

"Initial Term Loan" means the Existing Term Loan made by Lender to Borrower on the Initial Closing Date and described in item 1 on Schedule 1.1(a) hereto.

"Installment Payment" has the meaning ascribed to it in the Allocation Agreement.

"IRC" means the Internal Revenue Code of 1986, as amended, and any successor thereto.

"IRS" means the Internal Revenue Service, or any successor thereto.

"JV" means Xerox Capital Services, LLC, a Delaware limited liability company.

"JV Agreement" has the meaning ascribed to such term in the Program Agreement.

"JV Operational Date" means May 1, 2002.

"Lease Payment" has the meaning ascribed to it in the Allocation Agreement.

"Lender" means General Electric Capital Corporation and its permitted successors and assigns.

"Lien" means any mortgage or deed of trust, pledge, hypothecation, assignment, deposit arrangement, lien, charge, claim, security interest, easement or encumbrance, or preference, priority or other security agreement or preferential arrangement of any kind or nature whatsoever (including any lease or title retention agreement, any financing lease having substantially the same economic effect as any of the foregoing, and the filing of, or agreement to give, any financing statement perfecting a security interest under the Code or comparable law of any jurisdiction).

"Litigation" means any action, claim, lawsuit, demand, investigation or proceeding before or by any Governmental Authority or before any arbitrator or panel of arbitrators.

"Loan Documents" means this Agreement, the Notes, the Collateral Documents, the Lockbox Account Agreement, the Payment Account Agreement and all other agreements, instruments, documents and certificates executed and delivered to, or in favor of, Lender and including all other pledges, powers of attorney, consents, assignments, contracts, notices, and all other written matter whether heretofore, now or hereafter executed by or on behalf of Borrower or any other Person, or any employee of any of them, and delivered to Lender in connection with this Agreement or the transactions contemplated thereby. Any reference in this Agreement or any other Loan Document to a Loan Document shall include all annexes, appendices, exhibits, schedules or other attachments thereto, and all permitted amendments, restatements, supplements or other modifications thereto, and shall refer to this Agreement or such Loan Document as the same may be in effect at any and all times such reference becomes operative.

"Loan Payment Amount" has the meaning ascribed to it in the Sale and Contribution Agreement.

"Lockbox" has the meaning ascribed to it in the Lockbox Account Agreement.

"Lockbox Account Agreement" means that certain Lockbox Account Agreement by and between PNC Bank, National Association and the Collateral Agent dated as of the Initial Closing Date and acknowledged and agreed to by the Beneficial Owners and, solely for purposes of Section 1 thereof, Xerox, as amended and restated as of the Effective Date.

"Lockbox Concentration Account" has the meaning ascribed to it in the Lockbox Account Agreement.

"Lockbox Deposit Account" has the meaning ascribed to it in the Lockbox Account Agreement.

"Loss Component" has the meaning ascribed thereto on Annex E to this Agreement.

"Loss Rates" has the meaning ascribed thereto on Annex E to this

Agreement, as the same may be adjusted from time to time in accordance with Section 6.20 of this Agreement.

"Margin Stock" has the meaning ascribed to it in Section 3.8.

"Market Segment" means, with respect to any Financing Contract, the classification by Xerox (in accordance with its past practices) of the Obligor thereunder into one of the following categories: "general markets", "government" or "major account/named account".

"Material Adverse Effect" means a material adverse effect on (a) Borrower's ability to enforce its rights under the Related Transaction Documents (other than the Loan Documents), (b) Lender's ability to enforce Borrower's rights under such Related Transaction Documents, (c) the Collateral, Lender's Liens on the Collateral or the priority of such Liens or (d) Lender's rights and remedies under this Agreement and the other Loan Documents.

"Maximum Amount" means Five Billion Dollars ($5,000,000,000).

"Minimum Lease Payment" means, with respect to any Financing Contract that is in the form of a lease agreement, the periodic minimum lease payment due thereunder.

"Misapplied Proceeds" shall have the meaning ascribed to it in the Allocation Agreement.

"Misdirected Contract Payments" shall have the meaning ascribed to it in the Allocation Agreement.

"Misdirected Xerox Proceeds" shall have the meaning ascribed to it in the Allocation Agreement.

"Monetization Accounts" means a collective reference to the MPE 1 Account, the MPE 2 Account and the Sales Tax Account.

"Monthly Aggregate Payment Amount" means, with respect to any Term Loan and for each Settlement Period, all amounts deposited into the GE Capital Control Account in respect of such Term Loan during such Settlement Period minus (b) the amounts paid under Section 6(b) of the Allocation Agreement in respect of such Settlement Period.

"Moody's" means Moody's Investors Services, Inc.

"MPE 1 Account" has the meaning ascribed to it in the Allocation Agreement.

"MPE 2" means Xerox Lease Equipment LLC, a Delaware limited liability company.

"MPE 2 Account" has the meaning ascribed to it in the Allocation Agreement.

"Multiemployer Plan" means a "multiemployer plan" as defined in Section 4001(a)(3) of ERISA, and to which Xerox, Borrower or any ERISA Affiliate is making, is obligated to make or has made or been obligated to make, contributions on behalf of participants who are or were employed by any of them.

"Notes" has the meaning ascribed to it in Section 1.1(b).

"Obligations" means all loans, advances, debts, liabilities and obligations, for the performance of covenants, tasks or duties or for payment of monetary amounts (whether or not such performance is then required or contingent, or such amounts are liquidated or determinable) owing by Borrower to Lender, and all covenants and duties regarding such amounts, of any kind or nature, present or future, whether or not evidenced by any note, agreement or other instrument, arising under this Agreement or any of the other Loan Documents. This term includes all principal, interest (including all interest that accrues after the commencement of any case or proceeding in bankruptcy by or against Borrower, whether or not allowed in such case or proceeding), fees, Charges, expenses, attorneys' fees and any other sum chargeable to Borrower under this Agreement or any of the other Loan Documents.

"Obligor" means, with respect to any Financing Contract, the party obligated to make payments with respect to such Financing Contract, including any obligor in respect of any Credit Enhancement.

"Obligor Exposure" means with respect to any Obligor, as of any date of determination, the sum of the net present value amounts as calculated by and reflected on the XEEP System as of the Tagging Date relating to a proposed Term Loan for (a) all Financing Contracts to be acquired by Borrower from Xerox pursuant to the Sale and Contribution Agreement on such date to which such Obligor or any Related Person (as defined in the Sale and Contribution Agreement) is a party or provides a Credit Enhancement plus (b) all Financing Contracts theretofore transferred by Xerox to Borrower pursuant to the Sale and Contribution Agreement and continued to be owned by Borrower as of such date to which such Obligor or any Related Person is a party or provides a Credit Enhancement, plus, from and after July 1, 2003, to the extent not reflected in the net present value amounts as calculated by and reflected on the XEEP System, all due but uncollected Lease Payments or Installment Payments, as applicable, relating to Financing Contracts referred to in clause (b).

"Obligor's Rights" means a collective reference to the Obligor's rights under a Financing Contract (including, without limitation, the Obligor's rights to quiet enjoyment of the Equipment and to any Equipment purchase rights provided for in a Financing Contract).

"Other Obligations" means, in respect of each Obligor, any and all charges, debts, liabilities or obligations of such Obligor pursuant to a Serviced Asset other than those owing by such Obligor pursuant to and under Transferred Assets.

"Payment Account" has the meaning ascribed to it in the Payment Account Agreement.

"Payment Account Agreement" means that certain Payment Account Agreement dated as of the Initial Closing Date by and among the Beneficial Owners, Xerox, the JV and the Collateral Agent, as amended and restated as of the Effective Date.

"Payment Amount" has the meaning ascribed to it in the Sale and

Contribution Agreement.

"PBGC" means the Pension Benefit Guaranty Corporation or any successor thereto.

"Periodic Installment Sale Payment" means, with respect to any Financing Contract which is in the form of an installment sale agreement, the periodic minimum installment sale payment thereunder.

"Permitted Delinquency" means, with respect to any Financing Contract, that the aggregate of (a) the number of due and uncollected payments, without giving effect to any right of set-off or any other rights and/or defenses of an Obligor thereunder, plus (b) the number of payments which shall have been suspended or waived plus (c) the number of months that have passed since the expiration of the Contractually Scheduled Term, is not greater than seven (7).

"Permitted Encumbrances" means the following encumbrances: (a) with respect to any Transferred Assets which do not constitute Credit Enhancements, Liens for Taxes not yet due and payable or which are being contested in accordance with Section 5.2(b), (b) presently existing or hereafter created Liens in favor of Lender and (c) Liens expressly permitted and contemplated by the Related Transaction Documents (other than the Loan Documents) as in effect on the Initial Closing Date.

"Person" means any individual, sole proprietorship, partnership, joint venture, trust, unincorporated organization, association, corporation, limited liability company, institution, public benefit corporation, other entity or government (whether federal, state, county, city, municipal, local, foreign, or otherwise, including any instrumentality, division, agency, body or department thereof).

"Plan" means, at any time, an employee benefit plan, as defined in Section 3(3) of ERISA, that Xerox, Borrower or any ERISA Affiliate maintains, contributes to or has an obligation to contribute to or has maintained, contributed to or had an obligation to contribute to at any time within the past seven (7) years on behalf of participants who are or were employed by Xerox, Borrower or any ERISA Affiliate.

"Policies" means the collection and servicing procedures referred to in the Portfolio Service Contract and which are in effect on the Initial Closing Date, as the same may from time to time be amended, restated, supplemented or otherwise modified with the written consent of Lender.

"Pooling System" means that certain management billing system referred to by Xerox as the "Pooling System" and employed by the JV to administer certain Contracts in a manner such that the amounts due from Obligors under one or more Contracts are aggregated in respect of the copy volumes of a specific pool of machines and billed at a common meter rate to the Obligor on a monthly basis under a single, aggregate invoice.

"Portfolio" means a collective reference to the Financing Contracts acquired by Borrower from Xerox pursuant to the Sale and Contribution Agreement and against which the Term Loans were advanced by Lender.

"Portfolio Service Contract" means (i) for all periods prior to May 1, 2002 that certain Portfolio Service Contract dated as of the Initial

Closing Date by and among Xerox, Borrower, MPE 2 and Lender pursuant to which Xerox shall be obligated to bill and collect the Financing Contracts on behalf of Borrower and (ii) for all periods from and after May 1, 2002, that certain Monetization Portfolio Service Contract dated as of May 1, 2002 by and among Borrower, MPE 2, Xerox, the JV and Lender, as amended and restated as of the Effective Date, as the same may be further amended, amended and restated, supplemented or modified from time to time.

"Portfolio Servicer" means (i) for the period commencing on November 20, 2001 through but excluding the JV Operational Date, Xerox as "Portfolio Servicer" under the Portfolio Service Contract and (ii) from and after the JV Operational Date, the JV (or any successor servicer of the Portfolio pursuant to the Portfolio Service Contract).

"Program Agreement" means that certain Program Agreement dated as of the Effective Date by and among Lender, Xerox, Borrower and MPE 2.

"Prospective Collateral Defect", with respect to any (i) Candidate Financing Contract, any event or circumstance that would, or that Lender reasonably expects would, give rise to any meaningful adverse effect on (a) such Candidate Financing Contract and the related Purchased Assets, (b) the collectibility of such Candidate Financing Contract, (c) the availability or efficacy of any of the Lender's rights and remedies under this Agreement or any of the other Related Transaction Documents (including, without limitation, Lender's Liens on such Candidate Financing Contracts) or (d) Borrower's title to such Candidate Financing Contract and the related Purchased Assets, and (ii) Financing Contracts comprising a part of the Portfolio, any event or circumstance that would, or that Lender reasonably expects would, give rise to any meaningful adverse effect (in relation to the Financing Contracts then comprising the Portfolio, taken as a whole) on (a) the Financing Contracts then comprising the Portfolio, (b) the collectibility of the Financing Contracts then comprising the Portfolio, (c) the availability or efficacy of any of Lender's rights and remedies under this Agreement or any of the other Related Transaction Documents (including, without limitation, Lender's Liens on such Candidate Financing Contracts) or (d) Borrower's title to the Financing Contracts then comprising the Portfolio.

"QRT Financing Contract" means any Financing Contract that (i) has an Activation Date (A) in the case of a Financing Contract that is an XBS Agreement (or a component of an arrangement that historically would be treated by Xerox as XBS Agreement), prior to September 30, 2002 or (B) in the case of a Financing Contract other than a Financing Contract covered by clause (A), prior to April 1, 2002, (ii) is an IM/Pooling Contract described in clause (i) of the definition thereof or (iii) is a Simon Financing Contract.

"Qualified Plan" means a Plan that is intended to be tax-qualified under Section 401(a) of the IRC.

"Qualifying Financing Contract" means, as of any date of determination, any Financing Contract which satisfies each of the following conditions:

(i) there are no payment defaults, delinquencies or suspensions of any Obligor's payment obligations thereunder, in each case, other than a Permitted Delinquency with respect to such Financing Contract; and

(ii) no Bankruptcy Event shall have occurred and be continuing with respect to any Obligor under such Financing Contract.

"Rated Investment Grade" means that Xerox's Index Debt shall be rated both at least "Baa3" by Moody's and at least "BBB-" by S&P.

"Records" shall mean all Financing Contracts, Credit Enhancements and other documents, books, records and other information (including computer programs, tapes, disks, data processing software and related property and rights) prepared and/or maintained by Xerox, the Portfolio Servicer, MPE 2 or Borrower specifically with respect to the Transferred Assets and the Obligors.

"Reduction Amount" means, with respect to any Financing Contract as at any date of determination, the product of (A) the Future Payment Amount relating to such Financing Contract as at such date multiplied by (B) the Financing Contract Advance Rate applicable to such Financing Contract.

"Related Transaction Documents" means the Loan Documents, the XCC Transfer Agreement, the Sale and Contribution Agreement, the Contribution Agreement, the Escrow Agreement, the Transition Proceeds Agreement, the Undertaking and Replacement Agreement, the Portfolio Service Contract, the Separateness Agreement, the Indemnification Agreement, the Allocation Agreement, the Tax Administration Agreement, the Program Agreement, the Retained Business Servicing Agreement and all other agreements or instruments executed in connection with the Related Transactions pursuant to the Related Transaction Documents, in each case, as the same may be amended, amended and restated, waived, supplemented or otherwise modified from time to time in accordance with the terms thereof.

"Related Transactions" means the borrowing of the Initial Term Loan on the Initial Closing Date, the borrowing of any other Term Loan on any Closing Date, any Tier I Transfer, any XCC Transfer, any Equipment and Tax Payment Transfer, the payment of all fees, costs and expenses associated with all of the foregoing and the execution and delivery of all of the Related Transaction Documents.

"Replaced Financing Contract" means, as of any date of determination, any Financing Contract (a) which was previously included in the Portfolio, (b) which was terminated by Xerox pursuant to Article V of the Sale and Contribution Agreement contemporaneously with the execution and delivery by Xerox of a Replacement Financing Contract with the same Obligor (or any Affiliate thereof) and (c) for which the Loan Payment Amount with respect thereto was received in the Payment Account as provided in Article V of the Sale and Contribution Agreement.

"Replacement Financing Contract" means a Financing Contract entered into by Xerox contemporaneously with the termination by Xerox (pursuant to Article 6.01(c) or (g) of the Sale and Contribution Agreement) of a Financing Contract then constituting a part of the Portfolio.

"Representatives" means with respect to any Person, any such Person's employees, officers, directors, agents, attorneys, consultants, accountants, advisors and other representatives.

"Requirements of Law" shall mean, as to any Person, any law, treaty, statute, rule, regulation, common law or determination of an arbitrator or a court or other Governmental Authority and all official directives, consents, approvals, authorizations, guidelines, restrictions and policies of any Governmental Authority, in each case applicable to or binding upon such Person or any of its property or to which such Person or any of its property is subject, including any environmental law.

"Responsible Person" means, with respect to any Person, any one of the following: an officer, senior manager or senior executive of such Person.

"Retained Business Servicing Agreement" has the meaning ascribed to it in the Program Agreement.

"S&P" means Standard and Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc.

"Sale and Contribution Agreement" means that certain Sale and Contribution Agreement dated as of the Initial Closing Date between Xerox and Borrower, as amended and restated as of the Effective Date.

"Sales Tax Account" has the meaning ascribed to it in the Allocation Agreement.

"Sales Tax Payments" has the meaning ascribed to it in the Allocation Agreement.

"Security Agreement" means that certain Security Agreement dated as of the Initial Closing Date by and between Borrower and Lender, as amended and restated as of the Effective Date.

"Separateness Agreement" means that certain Separateness Agreement dated as of the Initial Closing Date by and among Xerox, MPE 2 and Borrower, as amended and restated as of the Effective Date.

"Separateness/True Sale Concern" means any event or circumstance that would, or may reasonably be expected to, give rise (either alone or together with other then-existing facts or circumstances) to (a) a materially greater risk as to the substantive consolidation of Borrower or MPE 2 with Xerox, (b) the incurrence of liabilities (fixed or contingent) of Borrower other than liabilities permitted by Section 3.15 or (c) a materially greater risk as to Borrower's acquisition of any Financing Contract being treated as anything other than a true sale and absolute transfer of such Financing Contract under the Bankruptcy Code.

"Service Coverage Test" has the meaning ascribed to it in the Sale and Contribution Agreement.

"Serviced Asset" has the meaning ascribed to it under each of (i) the Retained Business Servicing Agreement and (ii) the Portfolio Service Contract.

"Settlement Date" means, for each Term Loan and each Settlement Period related to such Term Loan, the sixteenth (16th) day after the end of such Settlement Period; provided that if such day is not a Business Day, then the Settlement Date shall be the next succeeding Business Day.

"Settlement Period" means with respect to any Term Loan, (a) initially, the period from the Tagging Date of such Term Loan to and including the last day of the calendar month in which such Closing Date occurred and (b) thereafter, each successive period commencing on the first day of each calendar month through and including the last day of such calendar month or, if earlier, the Termination Date.

"Settlement Report" means a report delivered by Portfolio Servicer to Lender pursuant to the Portfolio Service Contract one Business Day prior to any Settlement Date and setting forth, with respect to the Settlement Period ending immediately prior to such Settlement Date, the following information:

(a) the amount of interest income (net of losses) actually earned on funds on deposit in each of the respective Controlled Accounts during such Settlement Period;

(b) with respect to any Financing Contract for which payments were made or required to be made pursuant to any of Section 2.16, Section 2.17, Article V, Section 6.04 or Section 6.05 of the Sale and Contribution Agreement or Section 6.01 of the Undertaking and Replacement Agreement during such Settlement Period, (i) the date on which such payment was made or otherwise became due, (ii) the amount of such payment which was made or required to be made with respect to such Financing Contract, (iii) the amount of such payment with respect to such Financing Contract which was actually deposited in the GE Capital Control Account, (iv) other than with respect to payments required to be made under Section 6.04 of the Sale and Contribution Agreement, the Future Payment Amount with respect to such Financing Contract, (v) the Financing Contract Advance Rate applicable to such Financing Contract and (vi) the Term Loan to which such Financing Contract relates;

(c) the amount of all payments received in respect of a Financing Contract (other than payments referred to in clause (b) above or clause (i) below) deposited into the GE Capital Control Account during such Settlement Period and the Term Loan to which such Financing Contract relates;

(d) as to any Financing Contracts which became a Deemed Write-Off during such Settlement Period, (i) the Future Payment Amount with respect to such Financing Contract (determined as of the related Determination Date such Financing Contract became a Deemed Write-Off), (ii) the Financing Contract Advance Rate applicable to such Financing Contract and (iii) the Term Loan to which such Financing Contract relates;

(e) as to any Financing Contract which ceased to be a Deemed Write-Off during such Settlement Period, the amount by which the Targeted Principal Balance was previously reduced in respect of such Financing Contract and the Term Loan to which such Financing Contract relates;

(f) as to any Financing Contracts which became an Actual Write-Off during such Settlement Period, (i) the date upon which such Financing Contract became an Actual Write-Off, (ii) the Future Payment Amount with respect to such Financing Contract (determined as of the date such Financing Contract became an Actual Write-Off), (iii) the Financing Contract Advance Rate applicable to such Financing Contract and (iv) the Term Loan to which such Financing Contract relates;

(g) the Accrued Portfolio Servicing Amount for such Settlement

Period;

(h) the amount of funds deposited by Borrower into the GE Capital Control Account pursuant to Section 5.13 of the Loan Agreement and (i) the Financing Contract to which such payment relates and (ii) the Term Loan to which such Financing Contract relates;

(i) with respect to any Financing Contract which was terminated or otherwise prepaid in full by an Obligor thereunder during such Settlement Period, (i) the date on which such Financing Contract was terminated or prepaid in full, (ii) the Loan Payment Amount with respect to such Financing Contract which was deposited into the Payment Account, (ii) the Future Payment Amount with respect to such Financing Contract, (iii) the Financing Contract Advance Rate applicable to such Financing Contract and (iv) the Term Loan to which such Financing Contract relates; and

(j) with respect to each Term Loan: (a) the Targeted Principal Balance of such Term Loan as of the immediately preceding Determination Date after taking into account the information set forth in subclauses (a) through (i) above, (b) the accrued but unpaid interest with respect to such Term Loan as of the immediately preceding Determination Date, (c) the amount of the Monthly Aggregate Payment Amount to be applied to the accrued and unpaid interest on such Term Loan, (d) the amount of the Monthly Aggregate Payment Amount to be applied to such Term Loan in order to reduce the outstanding principal balance thereof to the Targeted Principal Balance (as adjusted pursuant to clause (a) above) as of the immediately preceding Determination Date, (e) the amount of the Monthly Aggregate Payment Amount, if any, which is required to be applied to any other Term Loan in order to reduce the outstanding principal balance thereof to the Targeted Principal Balance applicable thereto (as adjusted pursuant to clause (a) above) as of the immediately preceding Determination Date and (f) the amount, if any, which should be distributed to the MPE 1 Account.

"Simon Financing Contract" has the meaning ascribed to it in the Sale and Contribution Agreement.

"Solvent" means, with respect to any Person on a particular date, that on such date (a) the fair value of the property of such Person is greater than the total amount of liabilities, including contingent liabilities, of such Person, (b) the present fair saleable value of the assets of such Person is not less than the amount that will be required to pay the probable liability of such Person on its debts as they become absolute and matured, (c) such Person does not intend to, and does not believe that it will, incur debts or liabilities beyond such Person's ability to pay as such debts and liabilities mature and (d) such Person is not engaged in a business or transaction, and is not about to engage in a business or transaction, for which such Person's property would constitute an unreasonably small capital. The amount of contingent liabilities (such as Litigation, guaranties and pension plan liabilities) at any time shall be computed as the amount that, in light of all the facts and circumstances existing at the time, represents the amount that can reasonably be expected to become an actual or matured liability.

"Specified Investments" means book entry securities, negotiable instruments or securities represented by instruments in bearer or registered form which evidence any of the following:

(i) marketable direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, the United States (or by any agency thereof to the extent such obligations are backed by the full faith and credit of the such government), in each case maturing within one (1) year from the date of acquisition thereof;

(ii) marketable direct obligations issued by any state of the United States of America or any political subdivision of any such state or any public instrumentality thereof maturing within one (1) year from the date of acquisition thereof and having, at such date, one of the two highest ratings obtainable from either S&P or Moody's;

(iii) commercial paper maturing within one (1) year from the date of acquisition thereof and having, at such date of acquisition, at least the second highest credit rating obtainable from S&P or Moody's;

(iv) certificates of deposit, banker's acceptances and time deposits maturing within one (1) year from the date of acquisition thereof issued or guaranteed by or placed with, and money market deposit accounts issued or offered by, any bank organized under the laws of the United States or any state thereof or the District of Columbia or any country in the European Union (as it exists on the Effective Date) or Switzerland or any U.S. branch of a foreign bank which has at the date of acquisition thereof a combined capital and surplus of at least $100,000,000;

(v) repurchase agreements with a term of not more than seven (7) days for securities described in clause (i) above and entered into with a financial institution satisfying the criteria described in clause (iv) above; and

(vi) Investments in money market funds that invest substantially all of their assets in securities of the types described in clauses (i)-(v) above.

"Statement of Cash Flows means, with respect to the Financing Contracts to be acquired by Borrower from Xerox pursuant to the Sale and Contribution Agreement on a particular Closing Date, a spreadsheet prepared in Microsoft Excel, and containing the following information (with each Financing Contract being presented on a separate "Row") as of the respective Tagging Dates for such Financing Contracts: (a) Column 1 -for each Row, the contract number or customer number assigned by Xerox with respect to such Financing Contract, (b) Column 2 - for each Row, the sum of all Lease Payments or Installment Payments, as applicable, (expressed in dollars) with respect to such Financing Contract, due and uncollected, including Lease Payments or Installment Payments, as applicable, for which invoices have been issued prior to such Tagging Date and (c) Columns 3 through end-for each Row, commencing with the first Lease Payment or Installment Payment, as applicable, (expressed in dollars) with respect to such Financing Contract for which an invoice has been or will be issued on or after such Tagging Date, the Lease Payment or Installment Payment, as applicable, due in the month in which such Tagging Date occurs and each month thereafter (inserting $0 when no Lease Payment or Installment Payment, as applicable, is due in a particular month).

"Stock" means all shares, options, warrants, general or limited partnership interests, membership interests, or other equivalents (regardless of how designated) of or in a corporation, partnership, limited liability company or equivalent entity whether voting or nonvoting, including common stock, preferred stock or any other "equity security" (as such term is defined in Rule 3a11-1 of the General Rules and Regulations promulgated by the Securities and Exchange Commission under the Exchange Act).

"Stockholder" means, with respect to any Person, each holder of Stock of such Person.

"Subsidiary" means, with respect to any Person, (a) any corporation of which an aggregate of more than 50% of the outstanding Stock having ordinary voting power to elect a majority of the board of directors of such corporation (irrespective of whether, at the time, Stock of any other class or classes of such corporation shall have or might have voting power by reason of the happening of any contingency) is at the time, directly or indirectly, owned legally or beneficially by such Person and/or one or more Subsidiaries of such Person, or with respect to which any such Person has the right to vote or designate the vote of 50% or more of such Stock whether by proxy, agreement, operation of law or otherwise, and (b) any partnership or limited liability company in which such Person and/or one or more Subsidiaries of such Person shall have an interest (whether in the form of voting or participation in profits or capital contribution) of more than 50% or of which any such Person is a general partner or may exercise the powers of a general partner.

"Supply Coverage Test" has the meaning ascribed to it in the Sale and Contribution Agreement.

"Supporting Obligations" has the meaning ascribed thereto in the Code.

"Tagging Date" means (a) with respect to an Initial Financing Contract, October 2, 2001 and (b) with respect to any other Financing Contract, the date specified in the relevant Incremental Data Certification delivered under this Agreement.

"Targeted Principal Balance" means (i) with respect to any Existing Term Loan, the Existing Term Loan TPB for such Existing Term Loan and (ii) with respect to any Additional Incremental Term Loan, the Additional Incremental Term Loan TPB for such Additional Incremental Term Loan.

"Targeted Principal Balance Schedule" means, with respect to any Existing Term Loan, a schedule indicating the monthly Targeted Principal Balances of such Existing Term Loan prepared in accordance with Annex E of the Existing Loan Agreement and set forth in the Initial Borrowing Request or relevant Incremental Borrowing Request, as applicable (as each such Targeted Principal Balance may be reduced or increased from time to time in accordance with the definition thereof).

"Tax Administration Agreement" means that certain Tax Administration Agreement dated as of the Initial Closing Date by and between Xerox, Borrower and MPE 2, as amended and restated as of the Effective Date.

"Taxes" means any and all current or future taxes, levies, imposts, deductions, duty, charges or withholdings, assessment or other charge of whatever nature imposed by any governmental authority, but excluding therefrom (i) United States federal income taxes (whether imposed by withholding or otherwise) and taxes imposed on or measured by the net income of Lender by the jurisdictions under the laws of which Lender is organized or conducts business or any political subdivision thereof, (ii) any tax (x) based upon receipts, franchise, capital, doing business or net worth, (y) in the nature of an intangible or similar tax upon or with respect to the value or principal amount of the interest of Lender in the Term Loans evidenced by this Agreement or (z) under the Michigan Single Business Tax, in each case in this clause (ii) to which Lender is subject (to the extent of the tax rate then in effect) on the date this Agreement is executed (iii) any tax resulting solely from the negligence or willful misconduct of Lender, (iv) any tax imposed as a result of the failure to provide to Borrower any form needed to obtain an exemption from or reduced rate of tax (the delivery of which by Lender is authorized by law), provided that Borrower has timely provided the form to Lender and requested in writing that Lender deliver the completed form to Borrower and (v) any tax imposed on or with respect to the transfer, assignment, participation or syndication by Lender of its interest, in whole or in part, in the Term Loans evidenced by this Agreement.

"Term Loan Advance Rate" has the meaning ascribed thereto on Annex E to this Agreement.

"Term Loans" means, collectively, the Incremental Term Loans and the Initial Term Loan.

"Termination Date" means the date on which all of the Term Loans have been indefeasibly repaid in full and all other Obligations under this Agreement and the other Loan Documents have been completely discharged, and Borrower shall not have any further right to borrow any monies under this Agreement.

"Termination Event" means the earliest to occur of any of the following: (a) the expiration of the Term (as defined in the Program Agreement and as the same may be extended from time to time in accordance therewith), (b) a GE Capital Termination Event shall have occurred, Lender shall have delivered to Xerox a written notice stating that Lender has elected to terminate the Program Agreement and the Termination Notice Period shall have expired, (c) a Xerox Termination Event (as defined in the Program Agreement) shall have occurred, Xerox shall have delivered a written notice to Lender stating that Xerox has terminated the Program Agreement and the Termination Notice Period shall have expired; (d) the date which is twelve (12) months following Lender's receipt of notice of a Xerox Termination for Convenience (as defined, and delivered in accordance with the terms of, the Program Agreement) or (e) a Management Committee Termination (as defined in the Program Agreement) shall have occurred.

"Tier I Transfer" means any transfer by Xerox to Borrower of the Purchased Assets and the Transferred Equipment (as each is defined in the Sale and Contribution Agreement), in each case, in accordance with the terms of the Sale and Contribution Agreement.

"Title IV Plan" means a Pension Plan (other than a Multiemployer Plan) that is covered by Title IV of ERISA.

"Transferred Assets" means those assets acquired by Borrower pursuant to the Tier I Transfers, together with all of Borrower's rights against Xerox under the Sale and Contribution Agreement.

"Transaction Parties" means a collective reference to XCC, Xerox, MPE 2, the Portfolio Servicer and Borrower.

"Transition Proceeds Agreement" means that certain Transition Proceeds Agreement dated as of the Initial Closing Date by and among Borrower and Lender, as amended and restated as of the Effective Date.

"Turbo Event" means any of the following events or circumstances:

(i) a Default under Section 7.1(b) or Event of Default has occurred and is continuing;

(ii) a GE Capital Termination Event has occurred and is continuing;

(iii) any of the representations or warranties contained in the following subsections shall not be true and correct in all respects as of any Settlement Date or Actual Application Date: Sections 3.1(a), 3.1(c), 3.3 (other than clauses (e) and (g) thereof) and Section 3.7;

(iv) any of the representation or warranties contained in clauses (e) or (g) of Section 3.3 shall not be true and correct with respect to all periods prior to any Incremental Closing Date with respect to (A) all agreements referred to in clause (e) that are material or (B) all consents or approvals required from any Person which is not also a Governmental Authority in respect of any material contract referred to in clause (A) above.

(v) the Borrower shall not be in compliance with any of the following covenants: Sections 5.16, 6.1 and 6.14;

(vi) Borrower shall not have good and marketable title to all of the Financing Contracts comprising the Portfolio free and clear of all Liens (except Liens in favor of Lender and Permitted Liens) and such failure has, or would reasonably be expected to, give rise to a Prospective Collateral Defect or a Separateness/True Sale Concern;

(vii) Lender shall not have a valid enforceable and first priority Lien on all of the Financing Contracts comprising the Portfolio and such failure has, or would reasonably be expected to give rise to, a Prospective Collateral Defect or a Separateness/True Sale Concern; or

(viii) Xerox or Borrower shall have failed to make any payment to Borrower or Lender due under any of the Related Transaction Documents within five (5) Business Days after written demand therefor from Lender unless (i) Xerox or Borrower, as the case may be, is in good faith disputing its obligation to make such payments and gives Lender written notice thereof and (ii) if the aggregate amount of all such disputed payments exceeds $250,000, Xerox or Borrower, as applicable, within two (2) Business Days after written request therefor from Lender, shall have deposited cash in an amount equal to the aggregate amounts so disputed into an escrow account (with documentation governing such account in form and substance reasonably satisfactory to Lender). Upon the request of Lender, any and all of Borrower's rights in and to the Escrowed Funds shall constitute additional Collateral for the payment of the Obligations. Upon the resolution of the dispute pertaining to a particular amount of Escrowed Funds, such Escrowed Funds shall be released to the party legally entitled thereto (and if such party is Borrower or Lender, such funds shall be deposited directly from such escrow account into the Payment Account and allocated and distributed in accordance with the Allocation Agreement and Payment Account Agreement).

"Undertaking and Replacement Agreement" means that certain Undertaking and Replacement Agreement dated as of the Initial Closing Date by and between Xerox and Lender, as amended and restated as of the Effective Date.

"Unfunded Pension Liability" means, at any time, the aggregate amount, if any, of the sum of (a) the amount by which the present value of all accrued benefits under each Title IV Plan exceeds the fair market value of all assets of such Title IV Plan allocable to such benefits in accordance with Title IV of ERISA, all determined as of the most recent valuation date for each such Title IV Plan using the actuarial assumptions for funding purposes in effect under such Title IV Plan, and (b) for a period of five (5) years following a transaction which might reasonably be expected to be covered by Section 4069 of ERISA, the liabilities (whether or not accrued) that could be avoided by Xerox, Borrower or any ERISA Affiliate as a result of such transaction.

"Uplift Payments" has the meaning ascribed to it in the Allocation Agreement.

"Waiver Request" has the meaning set forth in Section 1.1(c)(vi).

"Write-Off Policy" means the Xerox historical write off policy delivered to Lender pursuant to Section 2.3(q) of the Existing Loan Agreement and applied in a manner consistent with Xerox's past practices.

"XCC" means Xerox Credit Corporation, a Delaware corporation.

"XCC Transfer" means the transfer by XCC to Xerox of certain Financing Contracts previously sold by Xerox to XCC, which such Financing Contracts shall be repurchased by Xerox from XCC pursuant to that certain XCC Transfer Agreement, free and clear of Liens prior to the transfer thereof by Xerox to Borrower.

"XCC Transfer Agreement" means that certain Asset Purchase Agreement dated as of the Initial Closing Date between Xerox and XCC.

"XEEP System" means that certain management information system as used by the JV to monitor and account for the Financing Contracts.

"Xerox" means Xerox Corporation, a New York corporation.

"XMC Code" means, with respect to any Financing Contract, the Xerox Marketing Code assigned to such Financing Contract on the date of its origination, which such Xerox Marketing Code is based upon the Standard Industrial Classification Code.

Unless otherwise specified, reference in this Agreement or any of the Appendices to an Article, Section, subsection or clause refer to such Article, Section, subsection or clause as contained in this Agreement. The words "herein," "hereof" and "hereunder" and other words of similar import refer to this Agreement as a whole, including all Annexes, Exhibits and Disclosure Schedules, as the same may from time to time be amended, restated, modified or supplemented in accordance with their terms, and not to any particular section, subsection or clause contained in this Agreement or any such Annex, Exhibit or Schedule.

WHEREVER FROM THE CONTEXT IT APPEARS APPROPRIATE, EACH TERM STATED IN EITHER THE SINGULAR OR PLURAL SHALL INCLUDE THE SINGULAR AND THE PLURAL, AND PRONOUNS STATED IN THE MASCULINE, FEMININE OR NEUTER GENDER SHALL INCLUDE THE MASCULINE, FEMININE AND NEUTER GENDERS. THE WORDS "INCLUDING", "INCLUDES" AND "INCLUDE" SHALL BE DEEMED TO BE FOLLOWED BY THE WORDS "WITHOUT LIMITATION"; THE WORD "OR" IS NOT EXCLUSIVE; REFERENCES TO PERSONS INCLUDE THEIR RESPECTIVE SUCCESSORS AND ASSIGNS (TO THE EXTENT AND ONLY TO THE EXTENT PERMITTED BY THE LOAN DOCUMENTS) OR, IN THE CASE OF GOVERNMENTAL PERSONS, PERSONS SUCCEEDING TO THE RELEVANT FUNCTIONS OF SUCH PERSONS; AND ALL REFERENCES TO STATUTES AND RELATED REGULATIONS SHALL INCLUDE ANY AMENDMENTS OF THE SAME AND ANY SUCCESSOR STATUTES AND REGULATIONS. A FINANCING CONTRACT SHALL RELATE TO A PARTICULAR TERM LOAN IF THE PROCEEDS OF SUCH TERM LOAN WILL BE OR WERE USED BY BORROWER TO PAY XEROX THE PURCHASE PRICE OF SUCH FINANCING CONTRACT. WHENEVER ANY PROVISION IN THE LOAN AGREEMENT REFERS TO THE KNOWLEDGE (OR AN ANALOGOUS PHRASE) OF BORROWER OR ANY OTHER TRANSACTION PARTY, SUCH WORDS ARE INTENDED TO SIGNIFY THAT BORROWER OR SUCH OTHER TRANSACTION PARTY HAS ACTUAL KNOWLEDGE OR AWARENESS OF A PARTICULAR FACT OR CIRCUMSTANCE OR THAT BORROWER OR SUCH OTHER TRANSACTION PARTY, IF IT HAD EXERCISED REASONABLE DILIGENCE, WOULD HAVE KNOWN OR BEEN AWARE OF SUCH FACT OR CIRCUMSTANCE.

Annex E

to

Amended and Restated Loan Agreement

dated October 21, 2002

Calculation of Advance Rates, Discount Rate and Targeted Principal Balance

I Defined Terms:

Unless defined herein, capitalized terms used in this Annex shall have the meanings ascribed to them in Annex A to the Loan Agreement.

"Financing Contract Advance Rate" means, with respect to any Financing Contract, an amount equal to one (1) minus the Loss Component (expressed as a decimal) attributable to such Financing Contract.

"Term Loan Advance Rate" means, with respect to any Term Loan, an amount equal to one (1) minus the Term Loan Loss Ratio applicable to such Term Loan. The "Term Loan Loss Ratio" with respect to a Term Loan shall be calculated as follows: (i) first, for each Financing Contract related to such Term Loan, calculate the net present value (derived using a discount rate of 6%) of all Lease Payments or Installment Payments, as applicable, which became due or are to become due on or after the relevant Tagging Date for such Financing Contract (as determined by taking the amount set forth for such Financing Contract in Columns C through the end of the Statement of Cash Flows delivered in connection with the Term Loan related thereto) (the "NPV Amount"), (ii) second, calculate the sum of the NPV Amounts for all Financing Contracts related to such Term Loan, (iii) third, for each Financing Contract related to such Term Loan, calculate the product of (a) the Loss Component attributable to such Financing Contract multiplied by (b) the NPV Amount for such Financing Contract (the "FC Loss Amount"), (iv) fourth, calculate the sum of the FC Loss Amounts for all Financing Contracts related to such Term

Loan, and (v) fifth, divide the amount derived from clause (iv) by the number derived from clause (ii).

"Loss Component" means, with respect to any Financing Contract, an amount, determined as of the relevant Tagging Date, equal to:

(a) if such Financing Contract is currently paid or has four (4) or fewer Minimum Lease Payments or Periodic Installment Sale Payments, as applicable, due but uncollected, three (3) multiplied by the Loss Rate applicable to such Financing Contract;

(b) if such Financing Contract has five (5) Minimum Lease Payments or Periodic Installment Sale Payments, as applicable, due but uncollected, three and one-half (3.5) multiplied by the Loss Rate applicable to such Financing Contract;

(c) if such Financing Contract has six (6) Minimum Lease Payments or Periodic Installment Sale Payments, as applicable, due but uncollected, four (4) multiplied by the Loss Rate applicable to such Financing Contract; or

(d) if such Financing Contract has seven (7) minimum Lease Payments or Periodic Installment Sale Payments, as applicable, due but uncollected, four and one-half (4.5) multiplied by the Loss Rate applicable to such Financing Contract.

"Loss Rate" means, with respect to each Financing Contract, the loss rate set forth on Annex B to the Agreement, as determined by reference to the Credit Classification and Market Segment of such Financing Contract (as determined as of the date such Financing Contract was credit approved).

II Data Input:

Using the password protected Microsoft Excel model created by GE Capital, a copy of which is attached (by disk or CD) as Attachment I hereto, for each Term Loan, input the data as follows (Note: references herein to worksheet and cell shall mean those worksheets and cell locations in the Microsoft Excel model):

1) In cell F4 of the Assumptions worksheet, input the interest rate for the one (1) month US Dollar LIBOR rate determined by the British Bankers' Association as of the Borrowing Request Delivery Date.

2) In cell F5 of the Assumptions worksheet, input the interest rate for the two (2) month US Dollar LIBOR rate determined by the British Bankers' Association as of the Borrowing Request Delivery Date.

3) In cell F6 of the Assumptions worksheet, input the interest rate for the three (3) month US Dollar LIBOR rate determined by the British Bankers' Association as of the Borrowing Request Delivery Date.

4) In cell F7 of the Assumptions worksheet, input the interest rate for the six (6) month US Dollar LIBOR rate determined by the British Bankers' Association as of the Borrowing Request Delivery Date.

5) In cell F8 of the Assumptions worksheet, input the U.S. Dollar interest rate for one (1) year interest swaps determined by the International

Swaps and Derivatives Association (ISDA) mid-market par swap rates. Rates are for a fixed rate payer in return for receiving three month LIBOR, and are based on rates collected at 11:00 a.m. (local time in New York) by Garban Intercapital plc and published on Reuters page ISDAFIX1 as of the Borrowing Request Delivery Date.

6) In cell F9 of the Assumptions worksheet, input the U.S. Dollar interest rate for two (2) year interest rate swaps determined by the International Swaps and Derivatives Association (ISDA) mid-market par swap rates. Rates are based on rates collected at 11:00 a.m. (local time in New York) by Garban Intercapital plc and published on Reuters page ISDAFIX1 as of the Borrowing Request Delivery Date.

7) In cell FlO of the Assumptions worksheet, input the U.S. Dollar interest rate for three (3) year interest rate swaps determined by the International Swaps and Derivatives Association (ISDA) mid-market par swap rates. Rates are for a fixed rate payer in return for receiving three month LIBOR, and are based on rates collected at 11:00 a.m. (local time in New York) by Garban Intercapital plc and published on Reuters page ISDAFIX1 as of the Borrowing Request Delivery Date.

8) In cell Fl 1 of the Assumptions worksheet, input the U.S. Dollar interest rate for four (4) year interest rate swaps determined by the International Swaps and Derivatives Association (ISDA) mid-market par swap rates. Rates are based on rates collected at 11:00 a.m. (local time in New York) by Garban Intercapital plc and published on Reuters page ISDAFIX1 as of the Borrowing Request Delivery Date.

9) In cell F12 of the Assumptions worksheet, input the U.S. Dollar interest rate for five (5) year interest rate swaps determined by the International Swaps and Derivatives Association (ISDA) mid-market par swap rates. Rates are based on rates collected at 11:00 a.m. (local time in New York) by Garban Intercapital plc and published on Reuters page ISDAFIX1 as of the Borrowing Request Delivery Date.

10) In cell F13 of the Assumptions worksheet, input the U.S. Dollar interest rate for seven (7) year interest rate swaps determined by the International Swaps and Derivatives Association (ISDA) mid-market par swap rates, Rates are based on rates collected at 11:00 a.m. (local time in New York) by Garban Intercapital plc and published on Reuters page ISDAFIX1 as of the Borrowing Request Delivery Date.

11) In cell Fl7 of the Assumptions worksheet, input the applicable Term Loan Advance Rate.

12) In cell C23 of the Assumptions worksheet, input the first monthly cash flow from Column C of the Statement of Cash Flows (representing the contractual Lease Payment or Installment Payment due in the month following the Tagging Date).

13) In cell C24 of the Assumptions worksheet, input the second monthly cash flow from the Statement of Cash Flows (representing the contractual Lease Payment or

Installment Payment due in the month following the month in which Closing Date occurs). Continue to enter each monthly cash flow from the Statement of Cash Flows downward in cells C25 through C111.

14) In cell F15 of the Assumptions Worksheet, input the GE Capital Combined Tax Rate as of such date (as such term is defined in the Program Agreement).

From time to time Borrower may propose to Lender, for its consideration, an amendment to that portion of the Statement of Cash Flows data inputs referred to in items 12 and 13 of this Section II as Borrower may consider appropriate to reflect assumptions for prepayment, buyout, delinquency and write-off performance of the Portfolio as compared with the contractual repayment requirements and the mix inherent in such assumptions. Such amendment shall only be effective if Lender shall consent thereto in writing, in its sole discretion, in which case such amendment shall only be effective with respect to Additional Incremental Term Loans funded by Lender after the effective date of such amendment.

III Location of Model Output:

After input of the initial data, the Microsoft Excel model will calculate the following, which may be found in the model as follows (Note: references herein to worksheet and cell shall mean those worksheets and cell locations in the Microsoft Excel model):

1) The Discount Rate with respect to (a) the third through fifth Incremental Term Loans shall be the Blended for Term Rate found in cell M53 of the Blended for Term Worksheet (as such worksheet existed prior to the Amendment Effective Date) and (b) all Additional Incremental Term Loans shall be the Blended for Term Rate found in cell M106 of the Blended for Term worksheet. (Note: Computation of interest earned on the applicable Term Loan shall use a Discount Rate expressed to an accuracy of six decimal places, or four decimal places if expressed as a percentage.)

2) The principal amount of the applicable Term Loan (e.g., the Term Loan Amount) can be found in cell El21 of the Blended for Term worksheet. (Note: Computation of the principal amount of the applicable Term Loan shall use a Discount Rate expressed to an accuracy of six decimal places, or four decimal places if expressed as a percentage.)

Schedule 1.1

to

Loan Agreement

Existing Term Loans

1. Initial Term Loan:

(a) Original Principal Balance as of 10/14/02: $835,076,177
(b) Discount Rate: 5.2661%

2. First Incremental Term Loan:

(a) Original Principal Balance as of 10/14/02: $340,371,789
(b) Discount Rate: 5.5998%

3. Second Incremental Term Loan:

   (a) Original Principal Balance as of 10/14/02: $266,058,005
   (b) Discount Rate: 5.8877%

4. Third Incremental Term Loan:

   (a) Original Principal Balance as of 10/14/02: $499,015,108
   (b) Discount Rate: 5.5502%

5. Fourth Incremental Term Loan:

   (a) Original Principal Balance as of 10/14/02: $208,076,370
   (b) Discount Rate: 4.6984%

6. Fifth Incremental Term Loan:

   (a) Original Principal Balance as of 10/14/02: $314,536,914
   (b) Discount Rate: 4.5959%

Exhibit 12

Xerox Corporation
Computation of Ratio of Earnings to Fixed Charges

The ratio of earnings to fixed charges, the ratio of combined earnings to fixed charges and preferred stock dividends, as well as any deficiency of earnings are determined using the following applicable factors:

Earnings available for fixed charges are calculated first, by determining the sum of: (a) income (loss) from continuing operations before income taxes, adjustment for minorities' interests and equity income or loss, (b) fixed charges, as defined below, (c) amortization of capitalized interest and (d) distributed equity income. From this total, we subtract (a) capitalized interest and (b) preferred security dividend requirements of our consolidated subsidiaries and any accretion in the carrying value of the redeemable preferred securities of our consolidated subsidiaries.

Fixed charges are calculated as the sum of (a) interest costs (both expensed and capitalized), (b) amortization of debt expense and discount or premium relating to any indebtedness, (c) that portion of rental expense that is representative of the interest factor and (d) the amount of pre- tax earnings required to cover preferred security dividends and any accretion in the carrying value in the redeemable preferred securities of our consolidated subsidiaries. Note, in our calculation, all of the dividends and related carrying value accretion of the preferred securities of our consolidated subsidiaries are tax deductible, which are those referenced in Note 16 to the consolidated financial statements included in our 2002 Annual Report under the caption, "Company-Obligated, Mandatorily Redeemable Preferred Securities of Subsidiary Trusts Holding Solely Subordinated Debentures of the Company." Therefore, the amount of pre-tax earnings required to cover the dividend requirements and accretion, are equal to the amount of such dividends and accretion.

Preferred stock dividends used in the ratio of earnings to combined fixed charges and preferred stock dividends consist of the dividends paid on our Series B Convertible Preferred Stock. These dividends are tax deductible.

	Year Ended December 31,				
	2002	2001	2000	1999	1998
(In millions)					
Fixed charges:					
Interest expense	$ 751	$ 937	$ 1,090	$ 842	$ 763
Portion of rental expense which represents interest factor	82	111	115	132	145
Total fixed charges before capitalized interest and preferred security dividends of consolidated subsidiaries	833	1,048	1,205	974	908
Capitalized interest	—	—	3	8	—
Preferred security dividends of consolidated subsidiaries	145	60	56	55	55
Total fixed charges	$ 978	$ 1,108	$ 1,264	$ 1,037	$ 963
Earnings available for fixed charges:					
Earnings(1)	$ 306	$ 447	$ (301)	$ 1,336	61
Less: Undistributed equity in income of affiliated companies	(23)	(20)	(25)	(10)	(28)
Add: Fixed charges before capitalized interest and preferred security dividends of consolidated subsidiaries	833	1,048	1,205	974	908
Total earnings available for fixed charges	$ 1,116	$ 1,475	$ 879	$ 2,300	$ 941
Ratio of earnings to fixed charges	1.14	1.33	*	2.22	*

* Earnings for the years ended December 31, 2000 and 1998 were inadequate to cover fixed charges. The coverage deficiency was $385 and $22 million, respectively.

(1) Earnings is derived from our consolidated statements of income, included in our consolidated financial statements, as the sum of: (a) Income (Loss) before Income Taxes (Benefits), Equity Income, Minorities' Interest and Cumulative Effect of Change in Accounting Principle and (b) Equity in net income of unconsolidated affiliates.

Exhibit 12

Xerox Corporation
Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends

(In millions)	Year Ended December 31, 2002	2001	2000	1999	1998
Fixed charges:					
Interest expense	$ 751	$ 937	$ 1,090	$ 842	$ 763
Portion of rental expense which represents interest factor	82	111	115	132	145
Total fixed charges before capitalized interest, preferred security dividends of consolidated subsidiaries and preferred stock dividends	833	1,048	1,205	974	908
Capitalized interest	—	—	3	8	—
Preferred security dividends of consolidated subsidiaries	145	60	56	55	55
Preferred stock dividends	78	13	53	54	56
Total combined fixed charges and preferred stock dividends	$ 1,056	$ 1,121	$ 1,317	$ 1,091	$ 1,019
Earnings available for fixed charges:					
Earnings(1)	$ 306	$ 447	$ (301)	$ 1,336	$ 61
Less: Undistributed equity in income of affiliated companies	(23)	(20)	(25)	(10)	(28)
Add: fixed charges before capitalized interest, preferred security dividends of consolidated subsidiaries and preferred stock dividends	833	1,048	1,205	974	908
Total earnings available for fixed charges	$ 1,116	$ 1,475	$ 879	$ 2,300	$ 941
Ratio of earnings to combined fixed charges and preferred stock dividends	1.06	1.32	*	2.11	*

* Earnings for the years ended December 31, 2000 and 1998 were inadequate to cover combined fixed charges and preferred stock dividends. The coverage deficiency was $438 and $78 million, respectively.

(1) Same as above.

Exhibit 13

INDEX TO ANNUAL REPORT

REPORT OF MANAGEMENT

Our management is responsible for the integrity and objectivity of all information presented in this annual report. The consolidated financial statements were prepared in conformity with generally accepted accounting principles in the United States of America and include amounts based on management's best estimates and judgments.

We maintain an internal control structure designed to provide reasonable assurance that assets are safeguarded against loss or unauthorized use and that financial records are adequate and can be relied upon to produce financial statements in accordance with generally accepted accounting principles. This structure includes the hiring and training of qualified people, written accounting and control policies and procedures, clearly drawn lines of accountability and delegations of authority. In a business ethics policy that is communicated annually to all employees, we have established our intent to adhere to the highest standards of ethical conduct in all of our business activities.

We monitor our internal control structure with direct management reviews and a comprehensive program of internal audits. In addition, PricewaterhouseCoopers LLP, independent accountants, have audited the 2002, 2001 and 2000 consolidated financial statements and have considered the internal controls over financial reporting to the extent they considered necessary, in order to determine their audit procedures for the purpose of expressing an opinion on our consolidated financial statements.

The Audit Committee of the Board of Directors, which is composed solely of outside directors, meets regularly with the independent accountants, the internal auditors and representatives of management to review audits, financial reporting and internal control matters, as well as the nature and extent of the audit effort. The Audit Committee also recommends the engagement of the independent accountants. The independent accountants and internal auditors have free access to the Audit Committee.

/s/ Anne M. Mulcahy	/s/ Lawrence A. Zimmerman	/s/ Gary R. Kabureck
Anne M. Mulcahy Chairman and Chief Executive Officer	Lawrence A. Zimmerman Senior Vice President and Chief Financial Officer	Gary R. Kabureck Assistant Controller and Chief Accounting Officer

Management's Discussion and Analysis of Results of Operations and Financial Condition

Throughout this document, references to "we," "our" or "us" refer to Xerox Corporation and its subsidiaries.

Introduction:

This Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A") describes the matters that we consider to be important to understanding the results of our operations for each of the three years in the period ended December 31, 2002 and our capital resources and liquidity as of December 31, 2002 and 2001. Our discussion begins with an overview of our financial performance for the last three years and is followed by a review of the critical accounting judgments and estimates that we have made which we believe are most important to an understanding of our MD&A and our consolidated financial statements. These are the critical accounting policies that affect the recognition and measurement of our transactions and the balances in our consolidated financial statements. We then analyze the results of our operations for the last three years, including the trends in the overall business and our operating segments, followed by brief reference to where you can find more information on recent accounting pronouncements which we adopted during the year, as well as those not yet adopted that are expected to have an impact on our financial accounting practices. We conclude our MD&A with a discussion of our cash flows and liquidity, capital markets events and transactions, credit ratings, our new credit facility, derivatives, contractual commitments and related issues and important forward-looking cautionary statements.

Financial Overview:

In 2002, we returned to profitability, significantly strengthened our balance sheet and launched 17 new products, making the year one of our strongest ever for new products. Our results demonstrate effective execution to-date of our Turnaround Program, which we announced in October 2000. Our Turnaround Program has focused on improving liquidity, stabilizing our operations and significantly reducing our cost base in order to improve our competitiveness. By the end of 2002, we had sold assets totaling approximately $2.7 billion, implemented actions to reduce our annualized costs by approximately $1.7 billion and returned each of our core business segments to profitability. During this period we also transitioned a portion of our equipment financing to third parties in some geographies and implemented a strategy to securitize our finance receivables.

Throughout 2002, the worldwide economic environment and information technology spending remained weak, however our equipment sales and revenue declines moderated, reflecting the success of our new products launched during the year. Improved gross margins and reduced selling, administrative and general expenses, reflect benefits from our cost base reductions, our focus on more profitable revenue and our exit from certain businesses. While we reduced our overall cost base, we continued to invest in research and development, prioritizing our investments in the faster growing areas of our market. We strengthened our balance sheet and liquidity by generating operating cash flows of $1.9 billion, repaying debt of $3.2 billion, negotiating a new credit facility and securitizing almost half our finance receivables by the end of 2002.

Net income for 2002 of $91 million, or 2 cents per diluted share, included after-tax asset impairment and restructuring charges of $471 million ($670 million pre-tax), primarily associated with our Fourth Quarter 2002 Restructuring Program, a pre-tax and after-tax charge of $63 million for impaired goodwill and an after-tax charge of $72 million ($106 million pre-tax) for permanently impaired internal-use capitalized software, partially offset by $105 million of tax benefits arising from the favorable resolution of a foreign tax audit and tax law changes, as well as a favorable adjustment to compensation expense $31 million ($33 million pre-tax), that was previously accrued in 2001, associated with the reinstatement of dividends for our Employee Stock Ownership Plan ("ESOP").

The 2001 net loss of $94 million, or 15 cents per diluted share, included $507 million of after-tax charges ($715 million pre-tax) for restructuring and asset impairments associated with our Turnaround Program including our disengagement from our worldwide Small Office/Home Office ("SOHO") business. 2001 results also included a $304 million after-tax gain ($773 million pre-tax) from the sale of half of our interest in Fuji Xerox, a $38 million after-tax gain ($63 million pre-tax) related to the early retirement of debt, $21 million of after-tax gains ($29 million pre-tax) associated with unhedged foreign currency partially offset by $31 million ($33 million pre-tax) of increased compensation expense associated with the suspension of dividends for our ESOP and after-tax goodwill amortization of $59 million ($63 million pre-tax).

The $273 million net loss in 2000, or 48 cents per diluted share, was largely attributable to $339 million of after-tax charges ($475 million pre-tax) for restructuring and asset impairments and our $37 million share of a Fuji Xerox restructuring charge, partially offset by after-tax gains of $119 million ($200 million pre-tax) from the sale of our China operations and $69 million of after-tax gains ($103 million pre-tax) from unhedged foreign currency.

Application of Critical Accounting Policies:

In preparing our consolidated financial statements and accounting for the underlying transactions and balances, we apply accounting policies that are described in the Notes to the Consolidated Financial Statements. We consider the policies discussed below as critical to understanding our consolidated financial statements, as their application places the most significant demands on our management's judgment, since financial reporting results rely on estimates of the effects of matters that are inherently uncertain. Specific risks associated with these critical accounting policies are described in the following paragraphs. The impacts and significant risks associated with these policies on our business operations are discussed throughout this MD&A where such policies affect our reported and expected financial results. For a detailed discussion of the application of these and other accounting policies, see Note 1 to the Consolidated Financial Statements. Senior management has discussed the development and selection of the critical accounting policies, estimates and related disclosures, included herein, with the Audit Committee of the Board of Directors. Preparation of this annual report requires that we make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities as of the date of our financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Changes in assumptions and estimates are reflected in the period in which they occur. The impact of such changes could be material to the results of operations in any future period.

Revenue Recognition Under Bundled Arrangements: We sell most of our products and services under bundled contract arrangements, which contain multiple deliverable elements. These contractual lease arrangements typically include equipment, service, supplies and financing components for which the customer pays a single negotiated price for all elements. These arrangements typically also include a variable component for page volumes in excess of contractual minimums, which are often expressed in terms of price per page, which we refer to as the "cost per copy." In a typical bundled arrangement, our customer is quoted a fixed minimum monthly payment for 1) the equipment, 2) the associated services and other executory costs and 3) the financing element. The fixed minimum monthly payments are multiplied by the number of months in the contract term to arrive at the total fixed minimum payments that the customer is obligated to make ("fixed payments") over the lease term. The payments associated with page volumes in excess of the minimums are contingent on whether or not such minimums are exceeded ("contingent payments"). The minimum contractual committed copy volumes are typically negotiated to equal the customer's estimated copy volume at lease inception. In applying our lease accounting methodology, we consider the fixed payments for purposes of allocating to the fair value elements of the contract. We do not consider the contingent payments for purposes of allocating to the elements of the contract or recognizing revenue on the sale of the equipment, given the inherent uncertainties as to whether such amounts will ever be received. Contingent payments are recognized as revenue in the period when the customer exceeds the minimum copy volumes specified in the contract.

When separate prices are listed in multiple element customer contracts, such prices may not be representative of the fair values of those elements, because the prices of the different components of the arrangement may be modified through customer negotiations, although the aggregate consideration may remain the same. Therefore, revenues under these arrangements are allocated based upon estimated fair values of each element. Our revenue allocation methodology first begins by determining the fair value of the service component, as well as other executory costs and any profit thereon and second, by determining the fair value of the equipment based on comparison of the equipment values in our accounting systems to a range of cash selling prices or, if applicable, other verifiable objective evidence of fair value. We perform extensive analyses of available verifiable objective evidence of equipment fair value based on cash selling prices during the applicable period. The cash selling prices are compared to the range of values included in our lease accounting systems. The range of cash selling prices must support the reasonableness of the lease selling prices, taking into account residual values that accrue to our benefit, in order for us to determine that such lease prices are indicative of fair value. Our interest rates are developed based upon a variety of factors including local prevailing rates in the marketplace and the customer's credit history, industry and credit class. These rates are recorded within our pricing systems. The resultant implicit interest rate, which is the same as our pricing interest rate, unless adjustment to equipment values is required, is then compared to fair market value rates to assess the reasonableness of the fair value allocations to the multiple elements.

Revenue Recognition for Leases: Our accounting for leases involves specific determinations under Statement of Financial Accounting Standards No. 13 "Accounting for Leases" ("SFAS No. 13") which often involve complex provisions and significant judgments. The two primary criteria of SFAS No. 13 which we use to classify transactions as sales-type or operating leases are (1) a review of the lease term to determine if it is equal to or greater than 75 percent of the economic life of the equipment and (2) a review of the minimum lease payments to determine if they are equal to or greater than 90 percent of the fair market value of the equipment. Under our current product portfolio and business strategies, a non-cancelable lease of 45 months or more generally qualifies as a sale. Certain of our lease contracts are customized for larger customers, which results in complex terms and conditions and requires significant judgment in applying the above criteria. In addition to these, there are also other important criteria that are required to be assessed, including whether collectibility of the lease payments is reasonably predictable and whether there are important uncertainties related to costs that we have yet to incur with respect to the lease. In our opinion, our sales-type lease portfolios contain only normal credit and collection risks and have no important uncertainties with respect to future costs. Our leases in our Latin America operations have historically been recorded as operating leases since a majority of these leases are terminated significantly prior to the expiration of the contractual lease term. Specifically, because we generally do not collect the receivable from the initial transaction upon termination or during any subsequent lease term, the recoverability of the lease investment is deemed not to be predictable at lease inception. We continue to evaluate economic, business and political conditions in the Latin American region to determine if certain leases will qualify as sales type leases in future periods.

The critical estimates and judgments that we consider with respect to our lease accounting, are the determination of the economic life and the fair value of equipment, including the residual value. Those estimates are based upon historical experience with all our products. For purposes of estimating the economic life, we consider the most objective measure of historical experience to be the original contract term, since most equipment is returned by lessees at or near the end of the contracted term. The estimated economic life of most of our products is five years since this represents the most frequent contractual lease term for our principal products and only a small percentage of our leases are for original terms longer than five years. We believe that this is representative of the period during which the equipment is expected to be economically usable, with normal service, for the purpose for which it is intended. We continually evaluate the economic life of both existing and newly introduced products for purposes of this determination. Residual values are established at lease inception using estimates of fair value at the end of the lease term. Our residual values are established with due consideration to forecasted supply and demand for our various products, product retirement and future product launch plans, end of lease customer behavior, remanufacturing strategies, used equipment markets if any, competition and technological changes.

The vast majority of our leases that qualify as sales-type are non-cancelable and include cancellation penalties approximately equal to the full value of the leased equipment. Certain of our governmental contracts may have cancellation provisions or renewal clauses that are required by law, such as 1) those dependant on fiscal funding outside of a governmental unit's control, 2) those that can be cancelled if deemed in the taxpayer's best interest or 3) those that must be renewed each fiscal year, given limitations that may exist on entering multi-year contracts that are imposed by statute. In these circumstances and in accordance with the relevant accounting literature, we carefully evaluate these contracts to assess whether cancellation is remote or the renewal option is reasonably assured of exercise because of the existence of substantive economic penalties for the customer's failure to renew. Certain of our commercial contracts for multiple units of equipment may include clauses that allow for a return of a limited portion of such equipment (up to 10% of the value of equipment). These return clauses are only available in very limited circumstances as negotiated at lease inception. We account for our estimate of equipment to be returned under these contracts as operating leases.

Aside from the initial lease of equipment to our customers, we may enter subsequent transactions with the same customer whereby we extend the term. We evaluate the classification of lease extensions of sales-type leases using the originally determined economic life for each product. There may be instances where we have lease extensions for periods that are within the original economic life of the equipment. These are accounted for as sales-type leases only when the extensions occur in the last three months of the lease term and they otherwise meet the appropriate criteria of SFAS 13. All other lease extensions of this type are accounted for as direct financing leases. We generally account for lease extensions that go beyond the economic life as operating leases because of important uncertainties as to the amount of servicing and repair costs that we may incur.

Accounts and Finance Receivables Allowance for Doubtful Accounts and Credit Losses: We perform ongoing credit evaluations of our customers and adjust credit limits based upon customer payment history and current creditworthiness. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience credit loss rates similar to those we have experienced in the past. Measurement of such losses requires consideration of historical loss experience, including the need to adjust for current conditions, and judgments about the probable effects of relevant observable data, including present economic conditions such as delinquency rates and financial health of specific customers. We recorded $353 million, $506 million and $613 million in the Consolidated Statements of Income for provisions for doubtful accounts for both our accounts and finance receivables for the years ended December 31, 2002, 2001 and 2000, respectively, of which $332 million, $438 million and $472 million were included in selling, administrative and general expenses for such years, respectively. The declining trend in our provision for doubtful accounts was primarily due to improved customer administration, collection practices and credit approval policies, as well as our revenue declines.

Historically, about half of the provision for doubtful accounts relates to our finance receivables portfolio. This provision is inherently more difficult to estimate than the provision for trade accounts receivable because the underlying lease portfolio has an average maturity, at any time, of approximately two to three years and contains past due billed amounts, as well as unbilled amounts. Estimated credit quality of any given customer and class of customer or geographic location can significantly change during the life of the portfolio. We consider all available information in our quarterly assessments of the adequacy of the provision for doubtful accounts.

Provisions for Excess and Obsolete Inventory Losses and Residual Value Losses: We value our inventories at the lower of average cost or net realizable value. We regularly review inventory quantities, including equipment to be leased to customers, which is included as part of finished goods inventory, and record a provision for excess and/or obsolete inventory based primarily on our estimated forecast of product demand and production requirements. Several factors may influence the realizability of our inventories, including our decision to exit a product line, technological changes and new product development. These factors could result in an increase in the amount of excess or obsolete inventory quantities. Additionally, our estimates of future product demand may prove to be inaccurate, in which case we may have understated or overstated the provision required for excess and obsolete inventories. In the future, if we determine that our inventories have been overvalued, we would be required to recognize such incremental costs in cost of sales at the time of such determination. Likewise, if we determine that our inventories are undervalued, we may have overstated cost of sales in previous periods and would be required to recognize such additional operating income at the time of sale. Although we make every effort to ensure the accuracy of our forecasts of future product demand including the impact of future product launches and changes in remanufacturing strategies, significant unanticipated changes in demand or technological developments could significantly impact the value of our inventory and our reported operating results if our estimates prove to be inaccurate. We recorded $115 million, $242 million and $235 million in inventory write-down charges for the three years ended December 31, 2002, 2001 and 2000, respectively. The decline in inventory write-down charges was primarily due to the absence of business exiting activities, stabilization of our product lines, Flextronics related improvements and a lower level of inventories. At this time, management does not believe that anticipated product launches will have a material effect on the recovery of our existing inventory balance.

We have a similar accounting policy relating to unguaranteed residual values associated with equipment on-lease, which were $272 million and $414 million in our Consolidated Balance Sheets at December 31, 2002 and 2001, respectively. We review residual values regularly and, when appropriate, adjust them based on estimates of expected market conditions at the end of the lease, including the impacts of future product launches, changes in remanufacturing strategies and the expected lessee behavior at the end of the lease term. Impairment charges are recorded when available information indicates that the decline in recorded value is other than temporary and we would therefore not be able to fully recover the recorded values. We recorded $26 million, $14 million and $17 million in residual value impairment charges for the years ended December 31, 2002, 2001 and 2000, respectively.

Asset Valuations and Review for Potential Impairments: Our long-lived assets, excluding goodwill, are assessed for impairment by comparison of the total amount of undiscounted cash flows expected to be generated by such assets to their carrying value. During 2002, due to our decision to abandon the use of certain software applications, we recorded an impairment charge of $106 million in Selling, administrative and general expenses in the accompanying Consolidated Statement of Income.

We periodically review our long-lived assets, whereby we make assumptions regarding the valuation and the changes in circumstances that would affect the carrying value of these assets. If such analysis indicates that a possible impairment may exist, we are then required to estimate the fair value of the asset and, as deemed appropriate, expense all or a portion of the asset, based on a comparison to the book value of such asset or group of such assets. The determination of fair value includes numerous uncertainties, such as the impact of competition on future value. We believe that we have made reasonable estimates and judgments in determining whether our long-lived assets have been impaired; however, if there is a material change in the assumptions used in our determination of fair values or if there is a material change in economic conditions or circumstances influencing fair value, we could be required to recognize certain impairment charges in the future.

Goodwill and Other Acquired Intangible Assets: We have made acquisitions in the past that included the recognition of a significant amount of goodwill and other intangible assets. Under generally accepted accounting principles in effect through December 31, 2001, these assets were amortized over their estimated useful lives and were tested periodically, in order to determine if they were recoverable from estimated future pre-tax cash flows on an undiscounted basis over their useful lives. Effective January 1, 2002, we adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), whereby goodwill is no longer amortized but instead is assessed for impairment, at least annually and as triggering events occur that indicate a decline in fair value below that of its carrying value. In making these assessments, we rely on a number of factors including operating results, business plans, economic projections, anticipated future cash flows and market data. There are inherent uncertainties related to these factors and our judgment in applying them to the analysis of goodwill impairment, including risk that the carrying value of our goodwill may be overstated or understated. We have determined that the impact of adopting this new standard, under the transition provisions of SFAS No. 142, was an impairment charge of $63 million which was recorded as a cumulative effect of a change in accounting principle in the accompanying Consolidated Statement of Income for 2002.

Estimates Used Relating to Restructuring: In June 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS No. 146"), which addresses financial and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" ("EITF No. 94-3"). The principal difference between SFAS No. 146 and EITF No. 94-3 relates to the requirements for recognition of a liability for a cost associated with an exit or disposal activity. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, while EITF No. 94-3 requires that the liability be recognized at the date of an entity's commitment to an exit plan. We adopted SFAS No. 146 in the fourth quarter of 2002, which is required to be applied prospectively. All restructuring actions that were committed to prior to the adoption of SFAS No. 146 continue to be accounted for in accordance with EITF No. 94-3.

We have engaged in a number of restructuring actions over the last several years, which required our management to utilize significant estimates related to realizable values of assets that were made redundant or obsolete and expenses for severance and other employee separation costs, lease cancellation and other exit costs. Given the significance of, and the timing of the execution of such actions, this process is complex and involves periodic reassessments of estimates made at the time the original decisions were made. We continue to evaluate the adequacy of the remaining liabilities under these restructuring initiatives. As we continue to evaluate the business, there may be changes in estimates to amounts previously recorded as actions progress and are completed.

Pension and Post-retirement Benefit Plan Assumptions: We sponsor pension plans in various forms and in various countries covering substantially all employees who meet certain eligibility requirements. Post-retirement benefit plans cover primarily U.S. employees for retirement medical costs. As required by existing accounting rules, we employ a delayed recognition feature in measuring the costs and obligations of pension and post-retirement benefit plans. This allows for changes in the benefit obligations and changes in the value of assets set aside to meet those obligations, to be recognized, not as they occur, but systematically and gradually over subsequent periods. All changes are ultimately recognized, except to the extent they may be offset by subsequent changes. At any point, changes that have been identified and quantified await subsequent accounting recognition as net cost components and as liabilities or assets.

Several statistical and other factors that attempt to anticipate future events are used in calculating the expense, liability and asset values related to our pension and post-retirement benefit plans. These factors include assumptions we make about the discount rate, expected return on plan assets, rate of increase in healthcare costs, the rate of future compensation increases, and mortality, among others. Actual returns on plan assets are not immediately recognized in our income statement, due to the aforementioned delayed recognition feature that we follow in accounting for pensions. In calculating the expected return on the plan asset component of our net periodic pension cost, we apply our estimate of the long term rate of return to the plan assets that support our pension obligations, after deducting assets that are specifically allocated to Transitional Retirement Accounts (which are accounted for based on specific plan terms).

For purposes of determining the expected return on plan assets, we utilize a calculated value approach in determining the value of the pension plan assets, as opposed to a fair market value approach. The primary difference between the two methods relates to a systematic recognition of changes in fair value over time (generally two years) versus immediate recognition of changes in fair value. Our expected rate of return on plan assets is then applied to the calculated asset value to determine the amount of the expected return on plan assets to be used in the determination of the net periodic pension cost. The calculated value approach reduces the volatility in net periodic pension cost that results from using the fair market value approach.

The difference between the actual return on plan assets and the expected return on plan assets is added to, or subtracted from, any cumulative differences that arose in prior years. This amount is a component of the unrecognized net actuarial (gain) loss and is subject to amortization to net periodic pension cost over the remaining service lives of the employees participating in the pension plan.

As a result of actual asset returns being lower than expected asset returns over the previous two years, 2003 net periodic pension cost will increase. The total unrecognized actuarial loss as of December 31, 2002 is $1.8 billion. This amount will be amortized in the future, subject to offsetting gains or losses that will change the future amortization amount.

We have historically utilized a weighted average expected rate of return on plan assets of approximately 8.8 percent, on a worldwide basis, in determining our net periodic pension cost. In estimating this rate, we considered the historical returns earned by the plan assets, the rates of return expected in the future, and our investment strategy and asset mix with respect to the plans' funds. In response to market conditions during the prior three years, a re-evaluation of our domestic asset investment strategy with our external asset managers, and our overall expectation of lower long-term rates of return, we have reduced our weighted average expected rate of return for our major worldwide pension plans. The weighted average rate we will utilize to calculate our 2003 expense will be approximately 8.3 percent.

An additional significant assumption affecting our pension and post-retirement benefit obligations and the net periodic pension and other post-retirement benefit cost is the rate that we use to discount our future anticipated benefit obligations. In estimating this rate, we consider rates of return on high quality fixed-income investments currently available, and expected to be available, during the period to maturity of the pension benefits. The weighted average rate we will utilize to calculate our 2003 expense will be approximately 6.2 percent, which is a decrease from 6.8 percent in 2002. On a consolidated basis, we recognized net periodic pension cost of $168 million, $99 million and $44 million for the years ended December 31, 2002, 2001 and 2000, respectively. Pension cost is included as a component of cost of sales, cost of service, outsourcing and rentals, research and development expenses and selling, administrative and general expenses in our Consolidated Statements of Income. Pension cost is allocated to these income statement components based on the related employee costs.

The weighted average assumptions used in the computation of our projected net periodic pension cost for 2003, and our actual net periodic pension cost for 2002, 2001 and 2000, were as follows:

	2003 Projected	2002	2001	2000
Discount rate	6.2%	6.8%	7.0%	7.4%
Expected rate of return on plan assets	8.3%	8.8%	8.9%	8.9%
Rate of future compensation increases	4.0%	3.9%	3.8%	4.2%

As a result of the reduction in the expected rate of return on plan assets, the reduction in the discount rate, the slight increase in the rate of future compensation increases, the lower actual return on plan assets during the prior three years and certain other factors, our 2003 net periodic pension cost is expected to be $150 million higher than 2002.

The estimated impacts on net periodic pension cost of changes in the expected rate of return on plan assets assumption are as follows ($ in millions):

Assuming a Discount Rate of 6.2 percent	Increase/(Decrease) in 2003 Projected Net Periodic Pension Cost
0.25% increase in expected rate of return on plan assets	$ (11)
0.25% decrease in expected rate of return on plan assets	11

Our expected rate of return on plan assets has historically had, and will likely continue to have, a material impact on net periodic pension cost.

The estimated impacts on net periodic pension cost of changes in the discount rate assumption are as follows ($ in millions):

Assuming an Expected Rate of Return on Plan Assets of 8.3 percent	Increase/(Decrease) in 2003 Projected Net Periodic Pension Cost
0.25% increase in discount rate	$(26)
0.25% decrease in discount rate	31

The market performance over the past two years has decreased the value of the assets held by our worldwide pension plans and has correspondingly increased the amount by which our worldwide pension funds are under-funded. As a result of the reduction in the value of our pension plan assets and a decline in interest rates, which increased the present value of our benefit obligations for our major worldwide pension plans, we recorded during the fourth quarter of 2002 an incremental additional minimum pension liability. This incremental liability was recorded through a non-cash charge to Shareholders' Equity as required by SFAS No. 87 "Employers' Accounting for Pensions." The increase in the additional minimum pension liability of $413 million, resulted in an incremental after-tax charge to Shareholders' Equity of $231 million. These amounts will increase or decrease in the future based on the value of our pension obligations in relation to the value of the assets held by our pension plans to settle such obligations.

Income Taxes and Tax Valuation Allowances: We record the estimated future tax effects of temporary differences between the tax bases of assets and liabilities and amounts reported in our Consolidated Balance Sheets, as well as operating loss and tax credit carryforwards. We follow very specific and detailed guidelines in each tax jurisdiction regarding the recoverability of any tax assets recorded in our Consolidated Balance Sheets and provide necessary valuation allowances as required. We regularly review our deferred tax assets for recoverability based on projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. If we continue to operate at a loss in certain jurisdictions or are unable to generate sufficient future taxable income, or if there is a material change in the actual effective tax rates or time period within which the underlying temporary differences become taxable or deductible, we could be required to increase the valuation allowance against all or a significant portion of our deferred tax assets resulting in a substantial increase in our effective tax rate and a material adverse impact on our operating results. Conversely, if and when such jurisdictions were to become sufficiently profitable to recover previously reserved deferred tax assets, we would reduce all or a portion of the applicable valuation allowance in the period when such determination is made. This would result in an increase to reported earnings in such period. Increases to our valuation allowance, through charges to expense, were $15 million, $247 million, and $12 million for the years ended December 31, 2002, 2001 and 2000, respectively.

We are subject to ongoing tax examinations and assessments in various jurisdictions. Accordingly, we provide for additional tax expense based upon the probable outcomes of such matters. In addition, when applicable, we adjust the previously recorded tax expense to reflect examination results. Our ongoing assessments of the probable outcomes of the examinations and related tax positions require judgment and can materially increase or decrease our effective tax rate as well as impact our operating results.

Legal Contingencies: We are a defendant in numerous litigation and regulatory matters including those involving securities law, patent law, environmental law, employment law and ERISA, as discussed in Note 15 to the Consolidated Financial Statements. As required by Statement of Financial Accounting Standards No. 5 "Accounting for Contingencies," we determine whether an estimated loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. We analyze our litigation and regulatory matters based on available information to assess potential liability. We develop our views on estimated losses in consultation with outside counsel handling our defense in these matters, which involves an analysis of potential results, assuming a combination of litigation and settlement strategies. Should our views on estimated losses reflect the need to recognize a material accrual, or should these matters result in an adverse judgment or be settled for significant amounts, they could have a material adverse effect on our results of operations, cash flows and financial position in the period or periods in which such change in estimate, judgment or settlement occurs.

Other Accounting Policies: Other accounting policies, not involving the same level of significance, as those discussed above, are nevertheless important to an understanding of the financial statements. See Note 1 to the Consolidated Financial Statements, Summary of Significant Accounting Policies, which discusses other significant accounting policies.

Other accounts affected by management estimates: The following table summarizes other significant areas which require management estimates ($ in millions):

	Year Ended December 31,		
	2002	2001	2000
Amortization and impairment of goodwill and intangible assets	$ 99	$ 94	$ 86
Depreciation and obsolescence of equipment on operating leases	408	657	626
Depreciation of buildings and equipment	341	402	417
Amortization and impairment of capitalized software	249	179	115
Pension benefits - net periodic benefit cost	168	99	44
Other benefits - net periodic benefit cost	120	130	109

Summary of Total Company Results:

The following is a summary of our results ($ in millions, except share amounts):

	Year Ended December 31,		
	2002	2001	2000
Revenue	$ 15,849	$ 17,008	$ 18,751
Net income (loss)	91	(94)	(273)
Diluted Earnings (Loss) per share	$ 0.02	$ (0.15)	$ (0.48)

Revenues: A substantial portion of our consolidated revenues is derived from operations outside of the United States where the U.S. dollar is not the functional currency. We generally do not hedge the translation effect of revenues denominated in currencies where the local currency is the functional currency. When compared with the average of the major European and Canadian currencies on a revenue-weighted basis, the U.S. dollar was approximately 4 percent weaker in 2002 than in 2001 and three percent stronger in 2001 than in 2000. As a result, foreign currency translation favorably impacted total revenue growth by approximately one percentage point in 2002 and unfavorably impacted revenue growth by about one percentage point in 2001. Additionally, in 2002, currency devaluations in Brazil continued to impact our results, as the Brazilian Real devalued 19 percent against the U.S. dollar. The devaluation was 22 percent and 2 percent in 2001 and 2000, respectively.

Total revenues of $15.8 billion in 2002 declined 7 percent from 2001. Economic weakness and competitive pressures persisted throughout the year, however year over year revenue declines moderated during the year, reflecting the success of numerous recent product launches in our color and monochrome digital multifunction target markets. Approximately one quarter of the decline was due to our prioritization of more profitable revenue which resulted in reduced revenue in our Developing Markets Operations segment ("DMO"), reflecting a reduction in the number of printers and copiers at customer locations, primarily in Brazil and Argentina. In addition, approximately 15 percent of the decline was due to the discontinuation of equipment sales and declining supplies sales due to our SOHO exit in the second half of 2001. Approximately 10 percent of the decline reflects lower financing income revenue, resulting from lower equipment installations and our exit from the financing business in certain European countries. The remainder of the decline was due to a mix of economic weakness, continued competitive pressures and market transition from light-lens to digital technology. This resulted in continued declines in older light-lens products, as customers continue to transition to new digital technology, only modestly offset by growth in production color, monochrome digital multifunction, and color printers, reflecting the success of our new products in these key areas.

Total revenues of $17.0 billion in 2001 declined 9 percent from 2000, primarily reflecting the adverse impact of marketplace competition, further weakening of the worldwide economy and our reduced participation in aggressively priced bids and tenders as we focused on improving our profitability. In addition, approximately one quarter of the decline reflected the absence of revenues due to our exit from the SOHO business in the second half of 2001 and the sale of our China operations in 2000. Approximately 20 percent of the decline reflects lower revenue in DMO, also due to our decision to prioritize more profitable revenue.

Revenues by Type: Revenues and year-over-year changes by type of revenues were as follows ($ in millions):

	Revenues				
	Year Ended December 31,			Percent Change	
	2002	2001	2000	2002	2001
Equipment sales	$ 3,901	$ 4,329	$ 5,264	(10)%	(18)%
Post sale and other revenue	10,948	11,550	12,325	(5)%	(6)%
Finance income	1,000	1,129	1,162	(11)%	(3)%
Total Revenues	$ 15,849	$ 17,008	$ 18,751	(7)%	(9)%

A reconciliation of the above presentation of revenues to the revenue classifications included in our Consolidated Statements of Income is as follows ($ in millions):

	Year Ended December 31,		
	2002	2001	2000
Sales	$ 6,752	$ 7,443	$ 8,839
Less: Supplies, paper and other sales	(2,851)	(3,114)	(3,575)
Equipment Sales	$3,901	$ 4,329	$ 5,264
Service, outsourcing and rentals	$ 8,097	$ 8,436	$ 8,750
Add: Supplies, paper and other sales	2,851	3,114	3,575
Post sale and other revenue	$ 10,948	$ 11,550	$ 12,325

2002 Equipment sales of $3.9 billion declined 10 percent from $4.3 billion in 2001 and included a benefit of one-percentage point from currency. Year over year equipment sales declines moderated throughout 2002, reflecting the success of our 2002 product launches in the key areas of monochrome digital multifunction, as well as in Production and Office color. Approximately 35 percent of the decline was due to a decrease in light lens equipment sales due to customers that transitioned to digital technology. Less than 5 percent of our 2002 Equipment sales were for light lens devices and we expect this declining trend to continue. Approximately 30 percent of the Equipment sales decline was due to our exit from the SOHO segment in 2001 and the remainder of the decline was caused by a combination of the weak economy, marketplace competition and price pressures which approximated 5 to 10 percent and our decision to reduce participation in aggressively priced bids and tenders in Europe, as we reoriented our focus from market share to profitable revenue.

2001 Equipment sales of $4.3 billion declined 18 percent from $5.3 billion in 2000 and included an unfavorable currency impact of one percentage point. Over one-third of the decline was due to our exit from the SOHO segment in 2001 and the sale of our China operations in 2000. Approximately one quarter of the decline was due to customers that transitioned from light lens to digital technology. The balance of the decline reflected a combination of economic weakness, competitive price pressures which approximated 5 to 10 percent, and our decision to reduce participation in aggressively priced bids and tenders in Europe, as we reoriented our focus from market share to profitable revenue.

Post sale and other revenue consists of service, supplies, paper, rental, facilities management and other revenues derived from the equipment installed at customer locations and the volume of prints and copies that our customers make on that equipment, as well as associated services. 2002 Post sale and other revenue of $10.9 billion, declined 5 percent from $11.5 billion in 2001, including a favorable impact of one-percentage point from currency. Over half of the total decline in 2002 Post sale and other revenue was due to a reduction in the amount of equipment installations at certain DMO customer locations, as a result of reduced placements in recent periods and our exit from the SOHO segment in the second half of 2001. The balance of the decline included lower page print volumes and customers that transitioned from light lens to digital technology, reflecting weak monochrome equipment installations in the Production and Office segments which have not yet been offset by growth in color. Within post sale and other revenue, 2002 supplies, paper and other sales of $2.9 billion declined 8 percent from 2001 predominantly due to supplies declines reflecting our second half 2001 SOHO exit, lower DMO equipment installations and production and office light lens declines. Service, outsourcing and rental revenue of $8.1 billion declined 4 percent from 2001 predominantly due to lower rental revenues a the result of a reduction in the level of equipment installations at certain DMO customers in both current and prior periods.

2001 Post sale and other revenue of $11.5 billion, declined 6 percent from $12.3 billion in 2000 and included the adverse impact from currency translation of one-percentage point. Approximately 40 percent of the decline occurred in our DMO segment as a result of reduced equipment installations in that segment and 15 percent was due to the sale of our China operations in 2000. The remainder of the decline resulted from decreases in Production monochrome and Office light lens, and our decision to prioritize more profitable revenue, which were only partially offset by strong double-digit growth in color and monochrome digital multifunction. Within post sale and other revenue, 2001 supplies, paper and other sales of $3.1 billion declined 13 percent from 2000 due to lower paper sales reflecting reduced volumes and reduced Production, Office and DMO supplies revenues reflecting the declines discussed above. Service, outsourcing and rental revenue of $8.4 billion were 4 percent lower than 2000 as lower service and rental revenues were only partially offset by document outsourcing growth.

2002 Finance income revenue declined 11 percent from 2001, reflecting lower 2002 equipment sales, our full exit from the financing business in the Nordic countries and in Italy, as well as our partial exit of this business in The Netherlands and Germany. 2001 Finance income revenue declined 3 percent from 2000, reflecting lower equipment sales and the initial effects of our transition to a third party finance provider in the Nordic countries.

Finance income is primarily impacted by equipment lease originations and interest rates. The most significant factor is the level of equipment lease originations; accordingly, we expect that Finance income will decline in 2003, reflecting lower equipment lease originations in recent years. In addition, Finance income will be reduced to the extent we sell portions of our financing businesses, similar to the Nordic countries and Italy, or enter into agreements with third parties to provide financing directly to our customers. Since the vast majority of our third-party financing arrangements have been structured as secured borrowings, the lease receivables remain on our balance sheet and are expected to continue generating Finance income. As a result of the above factors, we expect the trend of the decreasing Finance income to stabilize, although periodic fluctuations will occur as a result of the level of equipment sales and interest rates.

We expect equipment sales to grow modestly in 2003, as our 2002 and planned 2003 product launches should enable us to strengthen our market position. Our ability to increase post sale revenue is dependent on our success increasing the amount of our equipment at customer locations and the volume of pages generated on that equipment. In 2003, we expect post sale and other revenue declines will continue to moderate as equipment sales increase and our services and solutions increase utilization of the equipment. Accordingly, we expect a modest total revenue decline in 2003.

Employee Stock Ownership Plan: As more fully discussed in Note 16 to the Consolidated Financial Statements, our Board of Directors reinstated the dividend on our Employee Stock Ownership Plan ("ESOP") in 2002, which resulted in a reversal of compensation expense previously recorded. The reversal of compensation expense corresponded to the line item in the Consolidated Statement of Income for 2002 where the charge was originally recorded and included $28 in both Cost of Sales and Selling, administrative and general expenses and $11 in Research and Development expenses. Of the total compensation expense originally recorded, $34 million and $33 million was recognized in 2002 and 2001, respectively. As such, 2002 benefited by $33 million of excess compensation expense reversal that was recorded in 2001. There is no corresponding earnings per share improvement in 2002, since the EPS calculation requires deduction of dividends declared from reported net income in arriving at net income available to common shareholders. In the fourth quarter 2002, an additional $11 million of dividends were declared.

Gross Margin: Gross margin by revenue classification was as follows:

	Year Ended December 31,		
	2002	2001	2000
Total gross margin	42.4%	38.2%	37.4%
Sales	37.8%	30.5%	31.2%
Service, outsourcing and rentals	44.0%	42.2%	41.1%
Finance income	59.9%	59.5%	57.1%

The 2002 gross margin of 42.4 percent improved 4.2 percentage points from 2001. 1.4 percentage points of the increase reflects our second half 2001 SOHO exit. Improved manufacturing and service productivity, which was more than offset by lower prices accounted for approximately one percentage point of improvement and higher margins in our DMO operating segment also contributed about 0.5 percentage points of the improvement. The balance of the increase includes the favorable ESOP compensation expense adjustment, favorable transaction currency, lower inventory charges associated with restructuring actions and improved document outsourcing margins associated with our focus on profitable revenue.

2002 Sales gross margin improved by 7.3 percentage points from 2001. Approximately 2.6 percentage points of the improvement was due to our SOHO exit, about 1.3 percentage points of the improvement was due to increases in DMO, 0.6 percentage points was due to lower inventory charges associated with restructuring actions and the balance was largely due to manufacturing productivity, which was more than offset by competitive price pressures. 2002 Service, outsourcing and rentals margins improved by 1.8 percentage points from 2001 reflecting the benefits of expense productivity actions and more profitable document outsourcing contracts.

The 2001 gross margin of 38.2 percent increased 0.8 percentage points from 2000, as improved manufacturing and service productivity more than offset unfavorable mix and competitive price pressures, particularly in the production monochrome area. 2001 Sales gross margin declined by 0.7 percentage points due to higher manufacturing expenses resulting from lower volume and plant utilization as well as a lower level of high margin licensing and software revenues. These improvements were partially offset by increased margins in our printer business. 2001 Service, outsourcing and rentals margin improved by 1.1 percentage points due primarily to service expense reductions and facilities maintenance gross margin improvements, partially offset by declines in DMO.

Finance income margins of approximately 60 percent reflect interest expense related to our financing operations. Equipment financing interest rates are determined based on a combination of actual interest expense incurred on financing debt, as well as our estimated cost of funds, applied against the estimated level of debt required to support our financed receivables. The estimate is based on an assumed ratio of debt as compared to our finance receivables. This ratio ranges from 80-90% of our average finance receivables. This methodology has been consistently applied for all periods presented. We expect our 2003 Finance income gross margin to be in line with 2002.

Research and Development: 2002 research and development ("R&D") spending of $917 million, was $80 million lower than 2001. Approximately 40 percent of the decline was due to our SOHO exit, another 40 percent of the decline reflects both benefits from cost restructuring actions and the receipt of external funding and the balance reflects the previously discussed favorable ESOP compensation expense adjustment. R&D spending represented our continued investment in technological development, particularly color, to maintain our position in the rapidly changing document processing market. We believe our R&D remains technologically competitive. Our R&D is strategically coordinated with that of Fuji Xerox, which invested $580 million in R&D in 2002, which together with our R&D spending resulted in a combined total of $1.5 billion. To maximize the synergies of our relationship, our R&D expenditures are focused on the Production segment while Fuji Xerox R&D expenditures are focused on the Office segment. In 2002, we were awarded over 700 U.S. patents ranking us 19th on the list of companies that had been awarded the most U.S. patents during the year. Together with Fuji Xerox, we were awarded close to 900 U.S. patents in 2002. Our patent portfolio evolves as new patents are awarded to us and as older patents expire. As of December 31, 2002, we held approximately 7,700 U.S. patents. These patents expire at various dates up to 17 years from the date of award. While we believe that our portfolio of patents and applications has value, in general no single patent is essential to our business or the individual segments. In addition, any of our proprietary rights could be challenged, invalidated or circumvented, or may not provide significant competitive advantages.

2001 R&D spending of $997 million declined by $67 million from 2000. Over half the reduction reflects the second half 2001 SOHO disengagement, with the balance due to cost reduction initiatives in 2000 and 2001.

Selling, Administrative and General Expenses: Selling, administrative and general ("SAG") expense information was as follows ($ in millions):

	Year Ended December 31,		
	2002	2001	2000
Total Selling, administrative and general expenses	$ 4,437	$ 4,728	$5,518
SAG as a percentage of revenue	28.0%	27.8%	29.1%

2002 SAG expense of $4,437 million declined by $291 million from 2001. The reduction includes lower bad debt expenses of $106 million, lower SOHO spending of $84 million and a $34 million favorable property tax adjustment in North America. These decreases were partially offset by $106 million of internal-use software impairment charges, $65 million of higher advertising and marketing communications spending, $18 million of increased professional fees and $26 million of losses associated with the exit from certain leased facilities. The balance of the reduction primarily reflects employment reductions associated with our cost base restructuring which has resulted in lower labor, benefit and related expenses.

2001 SAG expense of $4,728 million declined $790 million from 2000 reflecting significantly lower labor costs and other benefits derived from our cost reduction initiatives, temporarily lower advertising and marketing communications spending of $88 million and reduced SOHO spending of $62 million, partially offset by increased professional costs related to litigation, regulatory issues and related matters of $52 million.

We expect 2003 total SAG expense reductions in line with the 2002 decline.

Bad debt expense included in SAG, was $332 million, $438 million and $472 million in 2002, 2001 and 2000, respectively. Lower expense in 2002 is due to improved customer administration, collection practices and credit approval policies, as well as our revenue declines. 2001 provisions were lower than 2000 due to lower equipment sales, partially offset by reserve increases due to the weakened worldwide economy. Bad debt expenses as a percent of total revenue were 2.1 percent, 2.6 percent, and 2.5 percent for 2002, 2001 and 2000, respectively.

As with Finance income, the bad debt provision will be impacted to the extent we sell portions of our financing businesses, including existing receivables, or enter into agreements with third parties to provide financing directly to our customers. Any provision for customer credit would accordingly be factored in the proceeds we receive from the counterparty and the resultant revenue or gain recognized on the sale of equipment or receivables. However, as noted above, since most of our transactions with third parties involve secured borrowing structures, the associated finance receivables will remain in our Consolidated Balance Sheets. Accordingly, in these cases the provision for bad debts will continue to be recorded as usual and therefore no impact to our Consolidated Statements of Income is expected.

Restructuring Programs: Starting in late 2000, as a part of the Turnaround Program, we implemented work force resizing and cost reduction actions that reduced SAG expenses and improved gross margins by approximately $800 million in annualized savings during 2001 and an additional $300 million, for a total of $1.1 billion in annualized savings during 2002. These savings resulted from reducing layers of management, consolidating operations, reducing administrative and general spending, capturing service productivity savings from our digital products and tightly managing discretionary spending. We reduced our costs in our Office operating segment by moving to lower cost indirect sales and service channels and by outsourcing our office products manufacturing. In 2002, we implemented additional restructuring initiatives under the Turnaround Program related to additional worldwide employee severance actions, reflecting continued streamlining of existing operations, the elimination of redundant resources and the consolidation of activities into other existing operations and the Fourth Quarter 2002 Restructuring Program. These initiatives resulted in an additional $200 million of cost savings in 2002. Prospectively, we expect the annualized savings to be approximately $1.7 billion in 2003 as compared to 2000 spending levels from these programs.

In addition to the work force resizing and cost reduction actions, we also sold $2.7 billion of assets as part of the Turnaround Program. These sales were primarily focused on improving our liquidity, as well as transitioning a portion of our equipment financing to third parties in some geographies, a portion of our manufacturing activities to Flextronics and exiting certain non-core businesses.

The most significant of the sales included the sale of half of our 50 percent ownership interest in Fuji Xerox in 2001 to Fuji Photo Film Co., Ltd. ("Fuji Film") and our China operations in 2000 to Fuji Xerox,, in order to improve our liquidity. In connection with the sale of Fuji Xerox, we received $1.3 billion in cash and recorded a pre-tax gain of $773 million. Under the agreement Fuji Film's ownership interest in Fuji Xerox increased from 50 percent to 75 percent. Our ownership interest decreased to 25 percent and we retain significant rights as a minority shareholder. We account for our investment in Fuji Xerox under the equity method, both before and after the sale of the additional 25 percent. Subsequent to the sale, we have maintained our product distribution and technology agreements that ensure that both parties have access to each other's portfolio of patents, technology and products. Fuji Xerox continues to sell products to us as well as collaborate with us on R&D. In 2000, we recognized approximately $73 million of equity income from Fuji Xerox in our Consolidated Statement of Income. Our equity income from Fuji Xerox in 2002 and 2001 was approximately $45 million for both years.

The sale of our China operations to Fuji Xerox generated cash of $550 million and a pre-tax gain of $200 million. In connection with the sale, Fuji Xerox also assumed $118 million of indebtedness. Our China operations had $262 million of revenue in 2000, which is included in the accompanying Consolidated Statement of Income. While Fuji Xerox is our affiliate, we believe the negotiations for this transaction were similar to those that would have been entered into with an unaffiliated third party, both in terms of price and conditions. Both parties were represented by separate legal counsel. The sale of our China operations had no operational impact, other than the permanent reduction in sales. Given the sale to Fuji Xerox, however, we retained our equity share of the China operations' net income.

We sold our leasing business in four Nordic countries in 2001 and our leasing business in Italy in 2002 to a company now owned by GE. These sales were aligned with our strategy of transitioning portions of our equipment financing to third parties. We received $352 million in cash and retained interests in certain finance receivables for the sale of the Nordic leasing business and $200 million in cash, plus the assumption of $20 million in debt for the sale of our leasing business in Italy. The sale of the Nordic leasing business approximated book value. We recognized a pre-tax loss from the sale in Italy of approximately $27 million primarily related to the recognition of cumulative translation adjustment losses and final sale contingency settlements. The impact of both of these transactions was to eliminate finance receivables from our balance sheet approximating the proceeds received from the sales, thereby improving our liquidity. GE will be providing the ongoing financing for these customers in these countries. Removing the finance receivable portfolios and essentially outsourcing the financing to GE, will result in future reductions in finance income and financing interest expense, as well as general and administrative costs.

In addition to these sales, we also entered into a purchase and supply agreement with Flextronics, a global electronics manufacturing services company. Pursuant to the purchase agreement, we sold our operations in Toronto, Canada; Aguascalientes, Mexico; Penang, Malaysia; Venray, The Netherlands and Resende, Brazil to Flextronics for $167 million. In addition, Flextronics purchased the related inventory, property and equipment. We expect these sales, to a company that specializes in manufacturing as their core competency, will help us reduce manufacturing costs and help effectively manage our inventory levels. In total, approximately 4,100 employees in these operations transferred to Flextronics. For further discussion, refer to Note 4 to our Consolidated Financial Statements.

We also exited certain non-core businesses in 2001 and 2002. These sales included the sale of Katun Corporation in 2002, a supplier of after market copier/printer parts and supplies, for net proceeds of $67 million and the sale of Delphax in 2001, a manufacturer of high-speed electron beam imaging digital printing systems and related parts, supplies and services, for net proceeds of $16 million. These sales were essentially break-even. The sale of these businesses did not have a material effect on our financial position, results of operations or cash flows.

At this time, we have substantially completed our restructuring initiatives, although we expect 2003 restructuring charges of approximately $115 million as further described in Note 2 to our Consolidated Financial Statements.

Worldwide employment declined by approximately 11,100 in 2002, to approximately 67,800, largely as a result of our restructuring programs, and the transfer of employees to Flextronics, as part of our office manufacturing outsourcing. Worldwide employment was approximately 78,900 and 91,500 at December 31, 2001 and 2000, respectively.

Other Expenses, Net: Other expenses, net for the three years ended December 31, 2002 consisted of the following ($ in millions):

	Year Ended December 31,		
	2002	2001	2000
Non-financing interest expense	$ 350	$ 480	$ 592
Currency losses (gains), net	77	(29)	(103)
Legal and regulatory matters	37	--	--
Amortization of goodwill (2001 and 2000) and intangibles	36	94	86
Interest income	(77)	(101)	(77)
Gain on early extinguishment of debt	(1)	(63)	--
Business divestiture and asset sale (gains) losses	(1)	10	(67)
Purchased in-process research and development	--	--	27
All other, net	24	53	93
	$ 445	$ 444	$ 551

2002 non-financing interest expense was $130 million lower than 2001 reflecting lower debt levels throughout 2002 and lower borrowing costs in the first half of the year, partially offset by higher interest rates and borrowing costs in the second half of the year associated with the terms of the New Credit Facility. Lower borrowing costs reflect the continued decline in interest rates throughout 2002, coupled with our higher proportion of variable rate debt in 2002 as compared to 2001. Our current credit ratings are below investment grade and effectively constrain our ability to fully use derivative contracts to manage interest rate risk. Accordingly, although we benefited from lower interest rates in 2002, we have greater exposure to volatility in our results of operations. 2002 non-financing interest expense included net gains of $12 million from the mark-to-market valuation of our interest rate swaps. Differences between the contract terms of our interest rate swaps and the underlying related debt restricts hedge accounting treatment in accordance with Statement of Financial Accounting Standards No. 133 "Accounting for Derivative and Hedging Activities" ("SFAS No. 133"), which required us to record the mark-to-market valuation of these derivatives directly to earnings. 2001 non-financing interest expense was $112 million lower than 2000, reflecting lower interest rates and lower debt levels. Non-financing interest expense in 2001 included net losses of $2 million from the mark-to-market of our interest rate swaps. Due to the inherent volatility in the interest rate markets, we are unable to predict the amount of the above noted mark-to-market gains or losses in future periods. Such gains or losses could be material to the financial statements in any future reporting period.

Net currency losses (gains) result from the re-measurement of unhedged foreign currency-denominated assets and liabilities, the spot/forward premiums on foreign exchange forward contracts in those markets where we have been able to restore economic hedging capability and economic hedges of anticipated transactions for which we do not qualify for cash flow hedge accounting treatment under SFAS No. 133. In the first half of 2002, we incurred $57 million of exchange losses, primarily in Brazil and Argentina due to the devaluation of the underlying currencies. In the latter half of 2002, we have been able to restore hedging capability in the majority of our key markets. Therefore, the $20 million of currency losses in the second half of 2002 primarily represents the spot/forward premiums on foreign exchange forward contracts and unfavorable currency movements on economic hedges of anticipated transactions not qualifying for hedge accounting treatment. In 2001, exchange gains on yen debt of $107 million more than offset losses on Euro loans of $36 million, a $17 million exchange loss resulting from the peso devaluation in Argentina and other currency exchange losses of $25 million. In 2000, large gains on both the yen and Euro loans contributed to the $103 million gain. The 2001 and 2000 currency gains and losses were the result of net unhedged positions largely caused by our restricted access to the derivatives markets beginning in the fourth quarter 2000. Despite restoration of hedging capability in our key markets in the latter half of 2002, we are unable to predict the amount of the re-measurement gains or losses in future periods resulting from our remaining unhedged positions, due to the inherent volatility in the foreign currency markets. Such gains or losses could be material to the financial statements in any future reporting period.

Legal and regulatory matters includes $27 million of expenses related to certain litigation, indemnifications and associated claims, as well as the $10 million penalty incurred in connection with our settlement with the SEC. See Note 15 to the Consolidated Financial Statements for additional information.

Prior to 2002, goodwill and other intangible asset amortization related primarily to our acquisitions of the remaining minority interest in Xerox Limited in 1995 and 1997, XL Connect in 1998 and Color Printing and Imaging Division of Tektronix, Inc.

("CPID") in 2000. Effective January 1, 2002 and in connection with the adoption of SFAS No. 142, we no longer record amortization of goodwill. Intangible assets continue to be amortized over their useful lives. Further discussion is provided in Note 1 to the Consolidated Financial Statements.

Interest income is derived primarily from our significant invested cash balances since the latter part of 2000. 2002 interest income was lower than 2001 due to lower invested cash balances in the second half of 2002, resulting from the pay-down of the Old Revolver, as well as lower interest rates. 2001 interest income was $24 million higher than 2000 due to higher interest income resulting from a full year of invested cash balances in 2001, partially offset by lower interest from tax audit refunds. We expect 2003 interest income to be lower than 2002 based on projected lower average cash balances.

In 2002, we retired $52 million of long-term debt through the exchange of 6.4 million shares of common stock valued at $51 million. In 2001, we retired $374 million of long-term debt through the exchange of 41 million shares of common stock valued at $311 million. The shares were valued using the daily volume weighted average price of our common stock over a specified number of days prior to the exchange, based on contractual terms. These transactions resulted in gains of $1 million and $63 million in 2002 and 2001, respectively.

(Gains) losses on business divestitures and asset sales include the sales of our leasing business in Italy, our investment in Prudential Insurance Company common stock and our equity investment in Katun Corporation all in 2002, the sale of our Nordic leasing business in 2001 and the sale of our North American paper product line and a 25 percent interest in ContentGuard in 2000, as well as miscellaneous land, buildings and equipment in all years. Further discussion of our divestitures follows and is also contained in Note 4 to the Consolidated Financial Statements.

Purchased in-process research and development related to a 2000 acquisition. The charge represented the fair value of acquired research and development projects that were determined not to have reached technological feasibility as of the date of the acquisition.

Gain on Affiliate's Sale of Stock: In 2001 and 2000, gain on affiliate's sale of stock of $4 million and $21 million, respectively, reflects our proportionate share of the increase in equity of ScanSoft Inc., resulting from issuance of their stock in connection with one of their acquisitions. The 2000 gain was partially offset by a $5 million charge reflecting our share of in-process research and development associated with one of their acquisitions, which is included in equity in net income of unconsolidated affiliates. ScanSoft, an equity affiliate, is a developer of digital imaging software that enables users to leverage the power of their scanners, digital cameras and other electronic devices.

Income Taxes: The following table summarizes our consolidated income tax (benefits) and the related effective tax rate for each respective period:

	Year Ended December 31,		
	2002	2001	2000
Pre-tax income (loss)	$252	$394	$ (367)
Income taxes (benefits)	60	497	(70)
Effective tax rate	23.8%	126.1%	19.1%

The difference between the 2002 consolidated effective tax rate of 23.8 percent and the U.S. federal statutory income tax rate of 35 percent relates primarily to the recognition of tax benefits resulting from the favorable resolution of a foreign tax audit of approximately $79 million, tax law changes of approximately $26 million, as well as the impact of ESOP dividends. Such benefits were offset, in part, by tax expense recorded for the on-going examination in India, the sale of our interest in Katun Corporation, as well as recurring losses in certain jurisdictions where we are not providing tax benefits.

The difference between the 2001 effective tax rate and the U.S. federal statutory income tax rate, relates primarily to the recognition of deferred tax asset valuation allowances of $247 million from our recoverability assessments, the taxes incurred in connection with the sale of our partial interest in Fuji Xerox and recurring losses in low tax jurisdictions. The gain for tax purposes on the sale of Fuji Xerox was disproportionate to the gain for book purposes as a result of a lower tax basis in the investment. Other items favorably impacting the tax rate included a tax audit resolution of approximately $140 million and additional tax benefits arising from prior period restructuring provisions.

The difference between the 2000 effective tax rate and the U.S. federal statutory income tax rate, relates primarily to recurring losses in low tax jurisdictions, the recognition of deferred tax asset valuation allowances resulting from our recoverability assessments, as offset by $125 million of additional tax benefits arising from the favorable resolution of tax audits.

Our effective tax rate will change based on nonrecurring events (such as new restructuring actions) as well as recurring factors including the geographical mix of income before taxes. We expect our 2003 consolidated effective tax rate will approximate 40 percent.

Equity in Net Income of Unconsolidated Affiliates: Equity in net income of unconsolidated affiliates is principally related to our 25 percent share of Fuji Xerox income, subsequent to our sale of 25 percent of Fuji Xerox in March 2001. Equity in net income in 2002 of $54 million was in line with our 2001 result of $53 million, as compared with $66 million in 2000. The 2000 results primarily reflected our 50 percent ownership share in Fuji Xerox, partially offset by our $37 million share of a restructuring charge recorded by Fuji Xerox.

Minorities Interest in Earnings of Subsidiaries: Minorities interest in earnings of subsidiaries includes the minority share of subsidiaries that we do not own, as well as dividends on our preferred securities. The increase of $50 million in 2002 to $92 million from 2001, primarily relating to a full year of the quarterly distributions on the Convertible Trust Preferred Securities, issued in November 2001, as more fully discussed in Note 16 to the Consolidated Financial Statements.

Acquisitions: In January 2000, we acquired the Color Printing and Imaging Division of Tektronix, Inc. ("CPID") for $907 million in cash, net of an $18 million purchase price adjustment received in 2001, including $73 million paid by Fuji Xerox for the Asia/Pacific operations. CPID manufactures and sells color printers, ink and related products and supplies. At that time, the acquisition accelerated us to the number two market position in office color printing, improved our reseller and dealer distribution network and provided us with scalable solid ink technology. The acquisition also enabled significant product development and expense synergies with our monochrome printer organization.

Business Performance by Segment: Our reportable segments are consistent with how we manage the business and how we view the markets we serve. Our reportable segments are as follows: Production, Office, DMO, SOHO, and Other. The table below summarizes our business performance by operating segment for the three-year period ended December 31, 2002. Revenues and associated percentage changes, along with operating profits and margins by segment are included. Segment operating profit (loss) excludes certain non-segment items, such as restructuring charges and gains on sales of businesses, as further described in Note 9 to the Consolidated Financial Statements where we present a reconciliation of segment profit/(loss) to pre-tax profit (loss) as presented in our Consolidated Statements of Income.

Operating segment information for 2001 has been adjusted to reflect a change in operating segment structure that was made in 2002. The nature of the changes related primarily to corporate expense and other allocations associated with internal reorganizations made in 2002, as well as decisions concerning direct applicability of certain overhead expenses to the segments. The adjustments increased (decreased) full year 2001 revenues as follows: Production--($16 million), Office--($16 million), DMO--($1 million), SOHO--$3 million and Other--$30 million. The full year 2001 segment profit was increased (decreased) as follows: Production--$12 million, Office--$24 million, DMO--$32 million, SOHO--$2 million and Other--($70 million). The operating segment information for 2000 has not been restated, as it was impracticable to do so. Therefore, we have presented 2002 and 2001 on the new basis and 2002, 2001 and 2000 on the old basis.

	New Basis		Old Basis		
	2002	2001	2002	2001	2000
Total Revenue					
Production	$ 5,615	5,883	$ 5,635	$ 5,899	$ 6,332
Office	6,605	6,910	6,620	6,926	7,060
DMO	1,758	2,026	1,758	2,027	2,619
SOHO	244	410	244	407	599
Other	1,627	1,779	1,592	1,749	2,141
Total	$ 15,849	$ 17,008	$ 15,849	$ 17,008	$ 18,751
Memo: Color	$ 2,803	$ 2,759	$ 2,808	$ 2,762	$ 2,612
Segment Operating Profit (Loss)					
Production	$ 625	466	$ 613	$ 454	$ 463
Office	498	365	493	341	(180)
DMO	62	(125)	53	(157)	(93)
SOHO	82	(195)	82	(197)	(293)
Other	(289)	(143)	(263)	(73)	225
Total	$ 978	$ 368	$ 978	$ 368	$ 122
Operating Margin					
Production	11.1 %	7.9 %	10.9 %	7.7 %	7.3 %
Office	7.5 %	5.3 %	7.4 %	4.9 %	(2.5)%
DMO	3.5 %	(6.2)%	3.0 %	(7.7)%	(3.6)%
SOHO	33.6 %	(47.6)%	33.6 %	(48.4)%	(48.9)%
Other	(17.8)%	(8.0)%	(16.5)%	(4.2)%	10.5 %
Total	6.2 %	2.2 %	6.2 %	2.2 %	0.7 %

Production: Production revenues include production publishing, production printing, color products for the production and graphic arts markets as well as digital and light-lens copiers over 90 pages per minute, sold predominantly through direct sales channels in North America and Europe. Production revenues represented 35 percent (new basis) of both 2002 and 2001 revenues.

2002 Production revenues declined 5 percent from 2001 (new basis), and included a benefit of approximately 1.5 percentage points from currency. High single digit declines in Production monochrome revenues were only partially offset by mid single digit growth in Production color revenues. Production monochrome declines reflect continued customer transition from light-lens to digital equipment, movement to distributed printing and other electronic media and the weak economy. Growth in Production color revenue reflects continued strong growth in our DocuColor 2000 series. The DocuColor 2000 series, launched in 2000, at speeds of 45 and 60 pages per minute established an industry standard by producing near offset-quality, full color prints including customized one-to-one printing at a variable cost of less than 10 cents per page. The series was complemented by the launch of the DocuColor 6060 during the second half of 2002. Mid-Range color revenue also increased, fueled by the successful launch of the DocuColor 1632 and DocuColor 2240 midrange printer/copiers in the second half of 2002.

2001 Production revenue declined 7 percent (old basis) from 2000, including an unfavorable one percentage point impact due to currency. Production monochrome revenue declines reflected competitive product introductions, movement to distributed printing and electronic substitutes, and weakness in the worldwide economy. Revenue from our DocuTech production publishing products, which has been continually refreshed and expanded since its 1990 launch, declined in 2001 reflecting the 1999 introduction of a competitive product. In production printing, we have maintained our strong market leadership in both 2002 and 2001, however, revenue decreased reflecting declines in the transaction printing market. 2001 production color revenues increased 2 percent (old basis) from 2000, including strong DocuColor 2000 series growth, partially offset by declines in older products reflecting introduction of competitive offerings and the effects of the weakened worldwide economy in the second half of the year.

2002 Production operating profit of $625 million (new basis) improved $159 million from 2001 and operating margin expanded 3.2 percentage points to 11.1 percent reflecting improvements in gross margin and lower SAG including reduced bad debt levels.

2001 Production operating profit was similar to 2000 and the operating margin improved to 7.7 percent (old basis) as we realized benefits from our Turnaround Program.

Office: Office revenues include our family of Document Centre digital multifunction products, color laser, solid ink and monochrome laser printers, digital and light-lens copiers under 90 pages per minute, and facsimile products sold through direct and indirect sales channels in North America and Europe. Office revenues represented 42 percent (new basis) of 2002 revenues compared with 41 percent in 2001.

2002 Office revenues declined 4 percent (new basis) from 2001 including a one percentage point benefit from currency. Declines in older light lens products were only partially offset by growth in monochrome digital multifunction devices and office color printers. Office color printer revenue grew in the mid single digits reflecting the success of the 2002 launches of the Phaser 6200 laser and 8200 solid ink printers and strong Phaser color printers and Document Centre Color Series 50 post sales revenue growth. Monochrome digital multifunction revenues grew in the mid-single digits reflecting strong post sale growth and the initial benefits of the launch of the Document 500 series in the second half of 2002.

2001 Office revenues declined 2 percent (old basis) from 2000 including a one percent adverse impact from currency. Strong double-digit Office color growth was more than offset by monochrome declines. Office color revenue growth was driven by the Document Centre Color Series 50 and strong color printer equipment sales, including the Phaser 860 solid ink and Phaser 7700 laser printers. 2001 Office monochrome revenues declined as growth in digital multifunction was more than offset by declines in light lens as customers continued to transition to digital technology. This decline was exacerbated further by our reduced participation in very aggressively priced competitive customer bids and tenders in Europe, as we prioritized profitable revenue over market share. Monochrome declines were slightly mitigated by the successful North American launch of the Document Centre 490 in September 2001.

2002 Office operating profit of $498 million (new basis) improved by $133 million from 2001 and the operating margin expanded by 2.2 percentage points to 7.5 percent. The operating profit improvement was driven by improved gross margins, as we focused on more profitable revenue, improved our manufacturing and service productivity and reduced SAG expenses.

2001 operating profit of $341 million (old basis) improved compared to a $180 million loss in 2000, reflecting higher gross margins and decreased SAG expenses due to restructuring activities.

DMO: DMO includes operations in Latin America, the Middle East, India, Eurasia, Russia and Africa. DMO revenues represented 11 percent of 2002 revenues, as compared to 12 percent of 2001 revenues.

2002 DMO revenue declined 13 percent from 2001 entirely due to reductions in post sale revenue as the result of decreases in the amount of equipment at customer locations and a 19 percent currency devaluation in Brazil.

2001 DMO revenue declined 23 percent (old basis) from 2000, with approximately 45 percent of that decline due to the December 2000 sale of our China operations. An additional one-third of the 2001 DMO decline was due to lower post sale revenue, as a result of a lower number of printers and copiers at customer locations and a currency devaluation of 22 percent in Brazil. The remainder of the decline was due to lower equipment revenue, which resulted from implementation of a new business model that emphasizes liquidity and profitable revenue rather than market share.

2002 DMO operating profit of $62 million (new basis), was $187 million better than 2001. The profit improvement was due to lower SAG spending resulting from our cost base actions and lower bad debt levels, as well as, significant gross margin improvement, reflecting our focus on profitability and lower bad debt levels. DMO continued to refine its business model in 2002, by transitioning equipment financing to third parties, improving credit requirements for equipment sale transactions and implementing additional cost reduction actions. In addition, we implemented a strategy to move to distributors in smaller countries, including Jamaica and Nigeria, which we expect will benefit operations by removing fixed costs.

The 2001 DMO loss of $157 million (old basis) was due to the revenue decline from the preceding year, weak gross margins and the currency devaluation in Argentina. These declines were only partially offset by initial cost restructuring benefits.

SOHO: We announced our disengagement from our worldwide SOHO business in June 2001 and sold our remaining equipment inventory by the end of that year. SOHO revenues now consist primarily of profitable consumables for the inkjet printers and personal copiers previously sold through retail channels in North America and Europe.

2002 SOHO segment profit of $82 million (new basis) improved $277 million from 2001 due to the sales of high margin supplies as compared to losses previously incurred on equipment sales. We expect sales of these supplies to decline over time as the existing equipment population is replaced.

The 2001 SOHO segment loss improved by $96 million (old basis) or 32 percent from 2000. Despite a gross margin decline, significant SAG and R&D reductions, following our June 2001 disengagement, resulted in substantially lower operating losses in 2001 and a return to profitability in the fourth quarter.

Other: Over half of the revenues in our Other segment are derived from sales of paper, approximately, one quarter are from Xerox Engineering Systems ("XES"), and the remainder are derived from Xerox Connect ("XConnect"), Xerox Technology Enterprises ("XTE") and other sources including consulting services, royalty and license revenues. XES is a business that sells equipment used for special engineering applications, XConnect is a network service business aimed at optimizing office efficiency and providing solutions and XTE consists of a collection of high technology start-up entities. The Other segment profit (loss) includes the profit (loss) from the previously mentioned sources, equity income received from Fuji Xerox and certain costs which have not been allocated to the businesses including non-financing and other corporate costs.

2002 Other revenues declined 9 percent (new basis), from 2001. Approximately half of the decline was due to lower revenues in XES and XConnect, an additional 15 percent related to lower paper sales consistent with other post sale revenue declines, partially offset by licensing revenue and royalties. XES revenue declined principally due to lower dealer equipment revenue, while XConnect declines were due to a reduced emphasis on third-party equipment installations. The remainder of the declines were consistent with other aspects of our business.

2001 Other revenues of $1,749 million (old basis) declined 18 percent from 2000. Approximately 25 percent of the revenue decline was due to lower paper sales, consistent with our post sale declines. Another 25 percent decline was attributable to lower XTE revenues due to the sale of a business in 2000, the closing of one business in 2001, and the deconsolidation of two small investments during 2001 due to changes in ownership structure and the resultant change to equity accounting. XES revenue represented 20 percent of the decline principally due to increased European competition and lower post sale revenue resulting from lower machine populations. XConnect revenue also accounted for 20 percent of the decline due to a decreased emphasis on third-party equipment installations. The remaining decline was consistent with other aspects of our business.

2002 Other segment loss of $289 million (new basis), increased by $146 million from 2001, principally due to the write-off of internal use software of $106 million, higher pension and benefit expense of $93 million and higher advertising expenses of $62 million. These increased costs were partially offset by lower non-financing interest expense of $130 million, the $33 million beneficial year over year impact of the ESOP expense adjustment and the $50 million profit from licensing revenue.

The 2001 Other segment loss of $73 (old basis) reflects additional ESOP compensation expense necessitated by the elimination of the ESOP dividend of $33 million, higher professional fees related to litigation and SEC issues and related matters of $52 million. 2000 results benefited from the gains on the sales of our North American paper business of $40 million, a 25 percent interest in ContentGuard of $23 million and a $21 million gain on our ScanSoft affiliate's sale of stock.

New Accounting Standards:

During 2002 and 2001, the Financial Accounting Standards Board ("FASB") issued several new accounting standards which effect the recognition and measurement and/or disclosure of business combinations, goodwill and intangible assets, impairment or disposals of long-lived assets, gains on extinguishment of debt, costs associated with exit or disposal activities and stock-based compensation. We have adopted these new standards in whole or in part, as applicable, during the year ended December 31, 2002. The effects of these new standards are discussed in the relevant sections of this MD&A and in more detail in Note 1 to the Consolidated Financial Statements.

In addition, the FASB has recently issued the following applicable standards and interpretations that we have not yet adopted:

- Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"),
- FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"),
- FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46").

We have adopted the disclosure provisions of FIN 45 and FIN 46 as of December 31, 2002.

We do not expect the adoption of SFAS No. 143, FIN 45 and FIN 46 to have a material effect on our financial position or results of operations.

Capital Resources and Liquidity:

References to "Xerox Corporation" below refer to the stand-alone parent company and do not include subsidiaries. References to "we," "our" or "us" refer to Xerox Corporation and its subsidiaries.

Cash Flow Analysis: The following summarizes our cash flows for the years ended December 31, 2002, 2001 and 2000 as reported in our Consolidated Statement of Cash Flows in the accompanying consolidated financial statements ($ in millions):

	2002	2001	2000
Operating cash flows	$ 1,876	$ 1,566	$ 207
Investing cash flows (usage)	197	873	(855)
Financing cash (usage) flows	(3,292)	(189)	2,255
Effect of exchange rate changes on cash	116	(10)	11
(Decrease) increase in cash and cash equivalents	(1,103)	2,240	1,618
Cash and cash equivalents at beginning of year	3,990	1,750	132
Cash and cash equivalents at end of year	$ 2,887	$ 3,990	$ 1,750

2002 Versus 2001: For the year ended December 31, 2002, operating cash flows of $1,876 million include net income before restructuring and other non-cash items of $2,124 million and finance receivable reductions of $754 million due to collection of receivables from prior year's sales without an offsetting receivables increase due to lower equipment sales in 2002, together with a transition to third-party vendor financing arrangements in the Nordic countries, Italy, Brazil and Mexico. These cash flows were partially offset by $442 million of tax payments, including $346 million related to the 2001 sale of half of our interest in Fuji Xerox, $392 million of restructuring related cash payments, approximately $300 million of other working capital uses, primarily related to the October 2002 termination of our U.S. revolving accounts receivable securitization, $127 million of on-lease equipment expenditures and a $138 million cash contribution to our pension plans.

The $310 million improvement in operating cash flow versus 2001 reflects increased finance receivable collections of $666 million, the absence of cash payments related to the 2001 early termination of derivative contracts of $148 million and lower on-lease equipment spending of $144 million. The decline in 2002 on-lease equipment spending reflected declining rental placement activity and populations, particularly in our older-generation light-lens products. These items were partially offset by higher cash taxes of $385 million, higher pension contributions of $96 million and increased working capital uses of over $300 million, much of which was caused by the accounts receivable securitization termination noted above. In addition, cash flow generated by reducing inventory during 2002 occurred at a much slower rate than in 2001 as inventory reductions were offset by increased requirements for new product launches.

Investing cash flows for the year ended December 31, 2002 consisted primarily of proceeds of $200 million from the sale of our Italian leasing business, $53 million related to the sale of certain manufacturing locations to Flextronics, $67 million related to the sale of our interest in Katun and $19 million from the sale of our investment in Prudential common stock. These inflows were partially offset by our capital and internal use software spending of $196 million. Investing cash flows in 2001 largely consisted of the $1,768 million of cash received from sales of businesses, including one half of our interest in Fuji Xerox, our leasing businesses in the Nordic countries and certain manufacturing assets to Flextronics. These cash proceeds were offset by capital and internal use software spending of $343 million, a $255 million payment related to our funding of trusts to replace Ridge Reinsurance letters of credit, $115 million of payments for the funding of escrow requirements related to the lease contracts transferred to GE, $229 million of payments for the funding of escrow requirements related to the 2002 and 2003 scheduled distribution payments for the trust preferred securities and $29 million of payments for other contractual requirements.

Financing activities for the year ended December 31, 2002 consisted of $2.8 billion of debt repayments on the Old Revolver and $710 million on the New Credit Facility, $1.9 billion of other scheduled payments of maturing debt, and dividends of $67 million on our preferred stock. These cash outflows were partially offset by proceeds of $746 million from our 9.75 percent Senior Notes offering and $1.4 billion of net proceeds from secured borrowing activity with GE and other vendor financing partners. Financing activities for the comparable 2001 period consisted of scheduled debt repayments of $2.4 billion and dividends on our common and preferred stock of $93 million. These outflows were offset by net proceeds from secured borrowing activity of $1,350 million and proceeds from the issuance of trust preferred securities of $1.0 billion.

2001 Versus 2000: For the year ended December 31, 2001 operating cash flows of $1,566 million reflected net income before restructuring charges and other non-cash items of $2,312 million (including a net gain of $304 related to the sale of half our interest in Fuji Xerox). Operating cash flow improved significantly compared to 2000, primarily due to working capital improvements. Although our revenue declined, which normally leads to a reduction in receivables and payables balances, our collections of receivables exceeded our payments on accounts payable and other current liability accounts by approximately $500 million. We reduced our inventory balances and spending for on-lease equipment by approximately $480 million. We also had a one-year benefit of approximately $350 million associated with the timing of taxes due on the gain from our sale of half our interest of Fuji Xerox, which we did not have to pay until first quarter 2002. The overall impact of our reported net loss on our operating cash flows, after considering the impacts of non-cash items associated with restructuring charges, provisions, tax valuation allowances and gains did not vary significantly between 2001 and 2000.

Investing cash flows were higher in 2001 primarily due to $1,768 million of cash received from the sales of businesses, including Fuji Xerox and our leasing businesses in the Nordic countries. These cash proceeds were greater than the $640 million received from the sale of businesses in 2000. In 2001 we also reduced capital spending and internal-use software spending significantly. Other factors contributing to the 2001 improvement were the acquisition of CPID in 2000, which utilized cash of $856 million, while in 2001 we were required to fund $628 million of certain escrow and insurance trusts based on contractual requirements.

Our 2001 financing cash flows largely consisted of a net repayment of approximately $1.1 billion of debt, offset by a private placement of $1.0 billion of trust preferred securities. The suspension of dividends on our common and preferred stock also positively impacted our cash flows in 2001. 2000 financing activities consisted of net borrowing of $2.9 billion, which funded the CPID acquisition and increased our cash balance, partially offset by common and preferred stock dividends of $587 million.

Capital Structure and Liquidity: Historically, we have provided equipment financing to a significant majority of our customers. Because the finance leases allow our customers to pay for equipment over time rather than at the date of purchase, we have needed to maintain significant levels of debt to provide operating liquidity, as liquidity generated from receivable collections has generally been used to fund new equipment leases. A significant portion of our debt is directly related to the funding requirements of our financing business.

During the years ended December 31, 2002 and 2001, we originated loans, secured by finance receivables, with cash proceeds of $3,055 million and $2,418 million, respectively. Approximately half of our total finance receivable portfolio has been securitized at December 31, 2002 compared with 24 percent a year earlier. We expect to increase the proportion of our finance receivables which are securitized to approximately 60 percent by the end of 2004. The following table compares finance receivables to financing-related debt as of December 31, 2002 ($ in millions):

	Finance Receivables	Debt/(2)/
Finance Receivables Encumbered by Loans/(1)/:		
GE Loans - U.S. and Canada	$ 2,777	$ 2,642
Merrill Lynch Loan - France	413	377
U.S. Asset-backed notes	247	139
XCC securitizations	101	7
Subtotal - Special Purpose Entities	3,538	3,165
GE Loans - UK	691	529
GE Loans - Other Europe	95	95
Other Europe	113	111
Total	4,437	$ 3,900
Unencumbered Finance Receivables	4,568	
Total Finance Receivables/(3)/	$ 9,005	

(1) Encumbered finance receivables represent the book value of finance receivables that secure each of the indicated loans.
(2) Represents the debt secured by finance receivables, including transactions utilizing special purpose entities, which are described below.
(3) Includes (i) Billed portion of finance receivables, net (ii) Finance receivables, net and (iii) Finance receivables due after one year, net as included in the Consolidated Balance Sheets as of December 31, 2002.

As of December 31, 2002, debt secured by finance receivables was approximately 28 percent of total debt. As we increase the proportion of our finance receivables that are securitized, we expect this percentage to increase to approximately 40 percent by the end of 2004.

The following represents our aggregate debt maturity schedule ($ in millions):

	2003	2004	2005	2006	Thereafter
First Quarter	$ 626	$ 992			
Second Quarter	1,315	907			
Third Quarter	658	910			
Fourth Quarter	1,778	1,100			
Full Year	$4,377	$3,909	$4,016	$ 56	$1,813

Of the full year amounts shown in the above table, $1,887 million and $1,426 million for 2003 and 2004, respectively, relate to debt secured by finance receivables. For a discussion on the contractual maturities of our mandatorily redeemable preferred securities, refer to the section entitled "Contractual Cash Obligations and Other Commercial Commitments and Contingencies."

The following table summarizes our secured and unsecured debt as of December 31, 2002:

New Credit Facility - debt secured within the 20 percent net worth limitation	$ 875/(1)/
New Credit Facility - debt secured outside the 20 percent net worth limitation	50
Debt secured by finance receivables	3,900
Capital leases	40
Debt secured by other assets	90
Total Secured Debt	4,955
New Credit Facility - unsecured	2,565/(1)
Senior Notes	852
Subordinated debt	575
Other Debt	5,224
Total Unsecured Debt	9,216
Total Debt	$ 14,171

(1) The amount of New Credit Facility debt secured under the 20 percent consolidated net worth limitation represents an estimate based on Consolidated Net Worth at December 31, 2002 and the amount of other debt, as defined, secured under the 20 percent limitation. Any change to the amount indicated would correspondingly change the amount of the unsecured portion of the New Credit Facility.

Liquidity, Financial Flexibility and Funding Plans: We manage our worldwide liquidity using internal cash management practices, which are subject to (1) the statutes, regulations and practices of each of the local jurisdictions in which we operate, (2) the legal requirements of the agreements to which we are parties and (3) the policies and cooperation of the financial institutions we utilize to maintain such cash management practices. In 2000, our operational issues were exacerbated by significant competitive and industry changes, adverse economic conditions, and significant technology and acquisition spending. Together, these conditions negatively impacted our liquidity, which from 2000 to 2002 led to a series of credit rating downgrades, eventually to below investment grade. Consequently, our access to capital and derivative markets has been restricted. The downgrades also required us to cash-collateralize certain derivative and securitization arrangements to prevent them from terminating, and to immediately settle terminating derivative contracts. Further, we are required to maintain minimum cash balances in escrow on certain borrowings and letters of credit. In addition, the SEC would not allow us to publicly register any securities offerings while their investigation, which commenced in June 2000, was ongoing. This additional constraint essentially prevented us from raising funds from sources other than unregistered capital markets offerings and private lending or equity sources. Consequently, our credit ratings, which were already under pressure, came under greater pressure since credit rating agencies often include access to capital sources in their rating criteria.

While the 2002 conclusion of the SEC investigation removed our previous inability to access public capital markets, we expect our ability to access unsecured credit sources to remain limited as long as our credit ratings remain below investment grade, and we expect our incremental cost of borrowing will remain relatively high as a result of our credit ratings and could potentially result in our having to increase our level of intercompany lending to our affiliates.

Our current ratings are as follows:

	Senior Secured Debt	Senior Unsecured Debt	Corporate Credit Rating	Outlook
Moody's	B1	B1	B1	Negative
S&P	BB-	B+	BB-	Negative
Fitch	BB-	BB-	BB-	Negative

As a result of the various factors described above, in 2000 we abandoned our historical liquidity practice of repaying debt with available cash and relying on low interest commercial paper borrowings. Instead, we have been accumulating cash in an effort to maintain financial flexibility. We expect to maintain a minimum cash balance of at least $1 billion on an ongoing basis.

Financing Business and Restructuring: In 2000, as part of our Turnaround Program, we announced our intent to exit the financing business, wherever practical, in order to reduce our consolidated debt levels and accelerate the liquidity within our finance receivable portfolios. We altered our strategy in 2002, announcing plans to securitize our finance receivables, thereby retaining the customer relationship and financing income.

Other Turnaround initiatives included selling certain assets, improving operations, and reducing annual costs by over $1 billion. These initiatives are expected to significantly improve our liquidity going forward. We have (1) securitized portions of our existing finance receivables portfolios, (2) implemented vendor financing programs with third parties in the United States, The Netherlands, the Nordic countries, Italy, Brazil and Mexico, (3) announced major initiatives with GE and other third party vendors to securitize our finance receivables in other countries, including the completion of the New U.S. Vendor Financing Agreement (see Note 5 to our Consolidated Financial Statements), (4) sold several non-core assets and (5) reduced our annual costs by $1.7 billion.

As more fully discussed in Note 5 to the Consolidated Financial Statements, we have completed the following securitization initiatives:

- In June 2001, we announced several Framework Agreements with GE under which they became our primary equipment-financing provider in the U.S., Canada, Germany and France. In October 2002 we finalized an eight year U.S. arrangement and funding commenced in the fourth quarter of 2002. We are currently negotiating other GE arrangements under the respective Framework Agreements.

- In April 2001, we sold our leasing businesses in four Nordic countries to a company now owned by GE retained interests in certain finance receivables. These sales are part of an agreement under which that company will provide ongoing, exclusive equipment financing to our customers in those countries.

- In December 2001, we formed a joint venture with De Lage Landen International BV (DLL) which manages equipment financing, billing and collections for our customers' equipment orders in the Netherlands. This joint venture began funding in the first quarter of 2002. DLL owns 51 percent of the venture and provides the funding to support new customer leases. We own the remaining 49 percent of this unconsolidated venture.

- In March 2002, we signed agreements with third parties in Brazil and Mexico under which those third parties became our primary equipment financing providers in those countries. Funding under both of these arrangements commenced in the second quarter of 2002.

- In April 2002, we sold our leasing business in Italy to a company recently acquired by GE, as part of an agreement under which GE will provide on-going, exclusive equipment financing to our customers in Italy.

- In December 2002, we securitized existing state and local government finance receivables in the U.S. with GE.

- In December 2002, we securitized existing finance receivables in France with a 364-day financing with Merrill Lynch (ML). ML intends to replace this financing with a long-term public secured offering during 2003.

- In December 2002, we received a series of financings from our unconsolidated joint venture with DLL, secured by our lease receivables in Holland.

- In December 2002, we received loans from GE secured by finance receivables in Germany.

New Credit Facility: In June 2002, we entered into an Amended and Restated Credit Agreement (the "New Credit Facility") with a group of lenders, replacing our prior $7 billion facility (the "Old Revolver"). At that time, we permanently repaid $2.8 billion of the Old Revolver and subsequently paid $710 million on the New Credit Facility. At December 31, 2002, the New Credit Facility consisted of two tranches of term loans totaling $2.0 billion and a $1.5 billion revolving credit facility that includes a $200 million letter of credit subfacility. At December 31, 2002, $3.5 billion was outstanding under the New Credit Facility. At December 31, 2002 we had no additional borrowing capacity under the New Credit Facility since the entire revolving facility was outstanding, including a $10 million letter of credit under the subfacility. Xerox Corporation is the only borrower of the term loans. The revolving loans are available, without sub-limit, to Xerox Corporation and to Xerox Canada Capital Limited ("XCCL"), Xerox Capital Europe plc ("XCE"), and other foreign subsidiaries as defined. Xerox Corporation is the borrower of all but $50 million of the revolver at December 31, 2002. The size and contractual maturities of the loans are as follows ($ in millions):

	2003	2004	2005	Total
Tranche A Term Loan	$ 400	$ 600	$ 500	$ 1,500
Tranche B Term Loan	5	5	490	500
Revolving Facility	-	-	1,490	1,490
Total	$ 405	$ 605	$ 2,480	$ 3,490

We are required to repay portions of the loans earlier than their scheduled maturities with specified percentages of any proceeds we receive from capital market debt issuances, equity issuances or asset sales during the term of the New Credit Facility, except that the revolving facility cannot be reduced below $1 billion, as a result of such prepayments. Additionally, all loans under the New Credit Facility become due and payable upon the occurrence of a change in control.

Subject to certain limits described in the following paragraph, all obligations under the New Credit Facility are secured by liens on substantially all of the domestic assets of Xerox Corporation and by liens on the assets of substantially all of our U.S. subsidiaries (excluding Xerox Credit Corporation ("XCC")), and are guaranteed by substantially all of our U.S. subsidiaries. In addition, a revolving loan outstanding to XCCL ($50 million at December 31, 2002) is secured by all of its assets, and is guaranteed by certain defined material foreign subsidiaries.

Under the terms of certain of our outstanding public bond indentures, the amount of obligations under the New Credit Facility that can be (1) secured by assets (the "Restricted Assets") of (a) Xerox Corporation and (b) our non-financing subsidiaries that have a consolidated net worth of at least $100 million, without (2) triggering a requirement to also secure those indentures, is limited to the excess of (1) 20 percent of our consolidated net worth (as defined in the public bond indentures) over (2) the outstanding amount of certain other debt that is secured by the Restricted Assets. Accordingly, the amount of New Credit Facility debt secured by the Restricted Assets (the "Restricted Asset Security Amount") will vary from time to time with changes in our consolidated net worth. The amount of security provided under this formula accrues first to the benefit of Tranche B loans and then to the benefit of Tranche A Loans and Revolving Loans, ratably.

The assets of XCE, XCCL and other subsidiaries guaranteeing the New Credit Facility are not Restricted Assets because those entities are not restricted subsidiaries as defined in our public bond indentures. Consequently, the amount of New Credit Facility debt secured by their assets is not subject to the foregoing limits. However, these guarantees are enforceable only to the extent of the New Credit Facility borrowings in Europe and Canada.

The New Credit Facility loans generally bear interest at LIBOR plus 4.50 percent, except that the Tranche B term loan bears interest at LIBOR plus a spread that varies between 4.00 percent and 4.50 percent depending on the amount by which the Restricted Asset Security Amount exceeds the outstanding Tranche B loan.

The New Credit Facility, a copy of which we have filed with the SEC as Exhibits 4 (l)(1) and 99.6 to our Current Reports on Form 8-K dated June 21, 2002 and September 26, 2002, respectively, contains affirmative and negative covenants. The New Credit Facility contains financial covenants that the Old Revolver did not contain. Certain of the more significant covenants under the New Credit Facility are summarized below (this summary is not complete and is in all respects subject to the actual provisions of the New Credit Facility):

- Excess cash of certain foreign subsidiaries and of Xerox Credit Corporation, a wholly-owned subsidiary, must be transferred to Xerox Corporation at the end of each fiscal quarter; for this purpose, "excess cash" generally means cash maintained by certain foreign subsidiaries taken as a whole in excess of their aggregate working capital and other needs in the ordinary course of business (net of sources of funds from third parties), including reasonably anticipated needs for repaying debt and other obligations and making investments in their businesses. In certain circumstances, we are not required to transfer cash to Xerox Corporation, if the transfer cannot be made in a tax efficient manner or if it would be considered a breach of fiduciary duty by the directors of the foreign subsidiary;

- Minimum EBITDA (a quarterly test that is based on rolling four quarters) ranging from $1.0 to $1.3 billion; for this purpose, "EBITDA" (Earnings before interest, taxes, depreciation and amortization) generally means EBITDA (excluding interest and financing income to the extent included in consolidated net income), less any amounts spent for software development that are capitalized;

- Maximum leverage ratio (a quarterly test that is calculated as total adjusted debt divided by EBITDA) ranging from 4.3 to 6.0;

- Maximum capital expenditures (annual test) of $330 million per fiscal year plus up to $75 million of any unused amount carried over from the previous year; for this purpose, "capital expenditures" generally mean the amounts included on our statement of cash flows as "additions to land, buildings and equipment", plus any capital lease obligations incurred;

.. Minimum consolidated net worth ranging from $2.9 billion to $3.1 billion; for this purpose, "consolidated net worth" generally means the sum of the amounts included on our balance sheet as "Common shareholders' equity," "Preferred stock," "Company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company," except that the currency translation adjustment effects and the effects of compliance with FAS 133 occurring after December 31, 2001 are disregarded, the preferred securities (whether or not convertible) issued by us or by our subsidiaries which were outstanding on June 21, 2002 will always be included, and any capital stock or similar equity interest issued after June 21, 2002 which matures or generally becomes mandatorily redeemable for cash or puttable at holders' option prior to November 1, 2005 is always excluded; and

.. Limitations on: (i) issuance of debt and preferred stock; (ii) creation of liens; (iii) certain fundamental changes to corporate structure and nature of business, including mergers; (iv) investments and acquisitions; (v) asset transfers; (vi) hedging transactions other than in those in the ordinary course of business and certain types of synthetic equity or debt derivatives, and (vii) certain types of restricted payments relating to our, or our subsidiaries', equity interests, including payment of cash dividends on our common stock; (viii) certain types of early retirement of debt, and (ix) certain transactions with affiliates, including intercompany loans and asset transfers.

The New Credit Facility generally does not affect our ability to continue to monetize receivables under the agreements with GE and others. Although we cannot pay cash dividends on our common stock during the term of the New Credit Facility, we can pay cash dividends on our preferred stock, provided there is then no event of default. In addition to other defaults customary for facilities of this type, defaults on other debt, or bankruptcy, of Xerox Corporation, or certain of our subsidiaries, would constitute defaults under the New Credit Facility.

At December 31, 2002, we are in compliance with all aspects of the New Credit Facility including financial covenants and expect to be in compliance for at least the next twelve months. Failure to be in compliance with any material provision or covenant of the New Credit Facility could have a material adverse effect on our liquidity and operations.

As previously mentioned, in October 2002, we completed an eight-year agreement in the U.S. (the "New U.S. Vendor Financing Agreement"), under which GE Vendor Financial Services, a subsidiary of GE, became our primary equipment financing provider in the U.S., through monthly securitizations of our new lease originations. In addition to the $2.5 billion already funded by GE prior to this agreement, which is secured by portions of our current U.S. lease receivables. The New U.S. Vendor Financing Agreement calls for GE to provide funding in the U.S. on new lease originations, of up to an additional $5 billion outstanding at anytime, during the eight year term, subject to normal customer acceptance criteria. The $5 billion limit may be increased to $8 billion subject to agreement between the parties. The new agreement contains mutually agreed renewal options for successive two-year periods.

Under this agreement, we expect GE to fund approximately 70 percent of new U.S. lease originations at over-collateralization rates, which vary over time, but are expected to be approximately 10 percent of the net receivables balance. The securitizations will be subject to interest rates calculated at each monthly loan occurrence at yield rates consistent with average rates for similar market based transactions. Consistent with the loans already received from GE, the funding received under this new agreement will be recorded as secured borrowings and the associated receivables will be included in our Consolidated Balance Sheet. GE's commitment to fund under this new agreement is not subject to our credit ratings. There are no credit rating defaults that could impair future funding under this agreement. This agreement contains cross default provisions related to certain financial covenants contained in the New Credit Facility and other significant debt facilities. Any default would impair our ability to receive subsequent funding until the default was cured or a waiver was received. As of December 31, 2002, we were in compliance with all covenants and expect to be in compliance for at least the next twelve months.

In 2002 and 2001, we received financing totaling $1,845 million and $1,175 million, respectively, from GE, secured by lease receivables in the U.S. Net fees of $16 million were capitalized as debt issue costs. In connection with these transactions, $150 million was required to be held in escrow, as security for our continuing obligations under transferred contracts. At December 31, 2002, the remaining balance of $2,323 million was included as debt in our Consolidated Balance Sheet.

In May 2002, we launched the Xerox Capital Services ("XCS") venture with GE, under which XCS now manages our customer administration and leasing activities in the U.S., including various financing programs, credit approval, order processing, billing and collections. We account for XCS as a consolidated entity since we are responsible to fund all of its operations, and, further, all events of termination result in GE receiving their entire equity investment, with total ownership reverting to us.

Summary - Financial Flexibility and Liquidity: With $2.9 billion of cash and cash equivalents on hand at December 31, 2002, we believe our liquidity (including operating and other cash flows we expect to generate) will be sufficient to meet operating cash flow requirements as they occur and to satisfy all scheduled debt maturities for at least the next twelve months. Our ability to maintain sufficient liquidity going forward is highly dependent on achieving expected operating results, including capturing the benefits from restructuring activities, and completing announced finance receivable securitization and other initiatives. There is no assurance that these initiatives will be successful. Failure to successfully

complete these initiatives could have a material adverse effect on our liquidity, operations and financial position, and could require us to consider further measures, including deferring planned capital expenditures, reducing discretionary spending, selling additional assets and, if necessary, restructuring existing debt.

Our access to the public debt markets is expected to be limited to the non-investment grade segment until our debt ratings have been restored to investment grade. Specifically, until our credit ratings improve, we will be unable to access the commercial paper markets or obtain unsecured bank lines of credit. Improvements in our credit ratings depend on (1) our ability to demonstrate sustained profitability growth and operating cash generation and (2) continued progress on our finance receivable securitization initiatives. However, there is no assurance on the timing of when our ratings may be restored to investment grade by the rating agencies.

We intend to access the non-investment grade public debt markets until our credit ratings are restored to investment grade. This, together with possible opportunistic access to the equity or equity-linked markets, can provide significant sources of additional funds until full access to the public debt markets is restored.

Contractual Cash Obligations and Other Commercial Commitments and Contingencies: At December 31, 2002, we had the following contractual cash obligations and other commercial commitments and contingencies:

Contractual Cash Obligations including cumulative preferred securities ($ in millions):

	2003	2004	2005	2006	2007	Thereafter
Long-term debt	$3,980	$3,909	$4,016	$ 56	$ 296	$ 1,517
Short-term debt	397	--	--	--	--	--
Minimum operating lease commitments	238	202	157	124	71	346
Total contractual cash obligations	$4,615	$4,111	$4,173	$ 180	$ 367	$ 1,863

Cumulative Preferred Securities: As of December 31, 2002, we have four series of outstanding preferred securities as summarized below. The redemption requirements and the annual cumulative dividend requirements on our outstanding preferred stock are as follows:

- Series B Convertible Preferred Stock ("ESOP Shares"): The balance at December 31, 2002 was $508 million, net of deferred ESOP benefits, and is redeemable in shares of common stock or cash, at our option, as employees with vested shares leave the Company. Annual cumulative dividend requirements are $6.25 per share. Dividends declared but not yet paid amounted to $11 million at December 31, 2002. At December 31, 2002, we had 7,023,437 shares issued and outstanding.

- 7.5 percent Convertible Trust Preferred Securities: The balance at December 31, 2002 was $1,016 million, and is putable in 2004 in cash or in shares of common stock at a redemption value of $1,035 million at the holders' option. Annual cumulative distribution requirements of approximately $78 million are $3.75 per Preferred Security on 20.7 million securities. The first three years' dividend requirements were funded at issuance and are invested in U.S. Treasury securities held by a separate trust. As of December 31, 2002, $151 million of the original $229 million remained in the trust.

- 8 percent Convertible Trust Preferred Securities: The balance at December 31, 2002 was $640 million, and is redeemable in 2027 at a redemption value of $650 million. Annual cumulative dividend requirements are $80 per security on 650,000 securities or $52 million per year.

- Canadian Deferred Preferred Stock: The balance at December 31, 2002 was $45 million, and is redeemable in 2006. Annual cumulative non-cash dividend requirements will increase this amount to its 2006 redemption value of approximately $56 million.

Other Commercial Commitments and Contingencies:

Flextronics: As previously discussed, in 2001 we outsourced certain manufacturing activities to Flextronics under a five-year agreement. During 2002, we purchased approximately $1 billion of inventory from Flextronics. We anticipate that we will purchase approximately $900 million of inventory from Flextronics during 2003 and expect to increase this level commensurate with our sales in the future.

Fuji Xerox: We had product purchases from Fuji Xerox totaling $727 million, $598 million, and $812 million in 2002, 2001 and 2000, respectively. Our purchase commitments with Fuji Xerox are in the normal course of business and typically have a lead time of three months. We anticipate that we will purchase approximately $700 million of products from Fuji Xerox in 2003.

Other Purchase Commitments: We enter into other purchase commitments with vendors in the ordinary course of business. Our policy with respect to all purchase commitments is to record losses, if any, when they are probable and reasonably estimable. We currently do not have, nor do we anticipate, material loss contracts.

EDS Contract: We have an information management contract with Electronic Data Systems Corp. to provide services to us for global mainframe system processing, application maintenance and enhancements, desktop services and helpdesk support, voice and data network management, and server management. In 2001, we extended the original ten-year contract through June 30, 2009. Although there are no minimum payments required under the contract, we anticipate making the following payments to EDS over the next five years (in millions): 2003--$331; 2004--$320; 2005--$311; 2006--$299; 2007--$288. The estimated payments are the result of an EDS and Xerox Global Demand Case process that has been in place for eight years. Twice a year, using this estimating process based on historical activity, the parties agree on a projected volume of services to be provided under each major element of the contract. Pricing for the base services (which are comprised of global mainframe system processing, application maintenance and enhancements, desktop services and help desk support, voice and data management) were established when the contract was signed in 1994 based on our actual costs in preceding years. The pricing was modified through comparisons to industry benchmarks and through negotiations in subsequent amendments. Prices and services for the period July 1, 2004 through June 30, 2009 are currently being negotiated and should be finalized by December 31, 2003. As such, the amounts above are subject to change. We can terminate the contract with six months notice, as defined in the contract, with no termination fee. We have an option to purchase the assets placed in service under the EDS contract, should we elect to terminate such contract and either operate those assets ourselves or enter a separate contract with a similar service provider.

Pension and Other Post-Retirement Benefit Plans: We sponsor pension and other post-retirement benefit plans. As discussed in Note 13 to the Consolidated Financial Statements, our collective pension plans were underfunded by $2.0 billion at December 31, 2002. Our post-retirement plan, which is a non-funded plan, had a benefit obligation of $1.6 billion at December 31, 2002. Our 2002 cash outlays for these plans were $138 million for pensions and $102 million for other post-retirement plans. Our anticipated cash outlays for 2003 are $170 million for pensions and $115 million for other post-retirement plans.

Other Funding Arrangements:

Special Purpose Entities: From time to time, we have generated liquidity by selling or securitizing portions of our finance and accounts receivable portfolios. We have typically utilized qualified special-purpose entities ("SPEs") in order to implement these transactions in a manner that isolates, for the benefit of the securitization investors, the securitized receivables from our other assets which would otherwise be available to our creditors. These transactions are typically credit-enhanced through over-collateralization. Such use of SPEs is standard industry practice, is typically required by securitization investors and makes the securitizations easier to market. None of our officers, directors or employees or those of any of our subsidiaries or affiliates hold any direct or indirect ownership interests in, or derive personal benefits from, any of these SPEs. We typically act as service agent and collect the securitized receivables on behalf of the securitization investors. Under certain circumstances, we can be terminated as servicing agent, in which event the SPEs may engage another servicing agent and we would cease to receive a servicing fee, although no such circumstances have occurred to date. We are not liable for non-collection of securitized receivables, or otherwise required to make payments to the SPEs except to the limited extent that the securitized receivables did not meet specified eligibility criteria at the time we sold the receivables to the SPEs or we fail to observe agreed upon credit and collection policies and procedures.

Substantially all of our SPE transactions were accounted for as borrowings, with the debt and related assets remaining on our balance sheets. Specifically, in addition to the U.S. and Canadian loans from GE and the ML loan in France discussed above, which utilized SPEs as part of their structures, we have entered into the following similar transactions:

- In 2000 through 2002, Xerox Corporation and Xerox Canada Limited ("XCL") operated securitization facilities that engaged in continuous sales of certain accounts receivable in the U.S. and Canada. The facility allowed up to $315 million and $38 million, respectively, of receivables to be outstanding to investors in the facility. As these receivables were collected, new receivables were purchased. In May 2002, a Moody's downgrade constituted an event of termination under the U.S.agreement, which we allowed to terminate in October 2002. In February 2002, a downgrade of our Canadian debt by Dominion Bond Rating Service caused the event of termination, in turn causing the remaining Canadian facility to no longer purchase receivables, with collections used to repay previously repurchased receivables. This facility was fully repaid in 2002.

- In 1999, XCL securitized certain finance receivables, generating gross proceeds of $345 million. At December 31, 2002, approximately $30 million was outstanding.

In summary, at December 31, 2002, amounts owed by these receivable-related SPEs to their investors totaled $3,195 million, $3,165 million of which is reported as debt in our Consolidated Balance Sheet. A detailed description of these transactions is included in Note 5 to the Consolidated Financial Statements. We also utilized SPEs in our Trust Preferred Securities transactions. Refer to Note 16 to the Consolidated Financial Statements for a description of the Trust Preferred Securities transactions.

Financial Risk Management:

We are exposed to market risk from changes in foreign currency exchange rates and interest rates that could affect our results of operations and financial condition. Our current below investment-grade credit ratings effectively constrain our ability to fully use derivative contracts as part of our risk management strategy described below, especially with respect to interest rate management. Accordingly, our results of operations are exposed to increased volatility. As further discussed in Note 1 to the Consolidated Financial Statements, we adopted SFAS No. 133 as of January 1, 2001. The adoption of SFAS No. 133 has increased the volatility of reported earnings and other comprehensive income. In general, the amount of volatility will vary with the level of derivative and hedging activities and the market volatility during any period.

We have historically entered into certain derivative contracts, including interest rate swap agreements, foreign currency swap agreements, forward exchange contracts and purchased foreign currency options, to manage interest rate and foreign currency exposures. The fair market values of all our derivative contracts change with fluctuations in interest rates and/or currency rates and are designed so that any change in their values is offset by changes in the values of the underlying exposures. Our derivative instruments are held solely to hedge economic exposures; we do not enter into derivative instrument transactions for trading or other speculative purposes and we employ long-standing policies prescribing that derivative instruments are only to be used to achieve a very limited set of objectives.

Our primary foreign currency market exposures include the Japanese Yen, Euro, Brazilian Real, British Pound Sterling and Canadian Dollar. Historically, for each of our legal entities, we have generally hedged foreign currency denominated assets and liabilities, primarily through the use of derivative contracts. Despite our current credit ratings, we have been able to restore significant hedging activities with currency-related derivative contracts during 2002. Although we are still unable to hedge all our currency exposures, we are currently utilizing the re-established capacity primarily to hedge currency exposures related to our foreign-currency denominated debt.

We typically enter into simple unleveraged derivative transactions. Our policy is to use only counterparties with an investment-grade or better rating and to monitor market risk and exposure for each counterparty. We also utilize arrangements allowing us to net gains and losses on separate contracts with all counterparties to further mitigate the credit risk associated with our financial instruments. Based upon our ongoing evaluation of the replacement cost of our derivative transactions and counterparty credit-worthiness, we consider the risk of a material default by a counterparty to be remote.

Due to our credit ratings, many of our derivative contracts and several other material contracts at December 31, 2002 require us to post cash collateral or maintain minimum cash balances in escrow. These cash amounts are reported in our Consolidated Balance Sheets within Other current assets or other long-term assets, depending on when the cash will be contractually released. Such restricted cash amounts totaled $77 million at December 31, 2002.

Assuming a 10 percent appreciation or depreciation in foreign currency exchange rates from the quoted foreign currency exchange rates at December 31, 2002, the potential change in the fair value of foreign currency-denominated assets and liabilities in each entity would be insignificant because all material currency asset and liability exposures were hedged as of December 31, 2002. A 10 percent appreciation or depreciation of the U.S. Dollar against all currencies from the quoted foreign currency exchange rates at December 31, 2002, would have a $349 million impact on our Cumulative Translation Adjustment portion of equity. The amount permanently invested in foreign subsidiaries and affiliates -- primarily Xerox Limited, Fuji Xerox and Xerox do Brasil -- and translated into dollars using the year-end exchange rates, was $3.5 billion at December 31, 2002, net of foreign currency-denominated liabilities designated as a hedge of our net investment.

Interest Rate Risk Management: Virtually all customer-financing assets earn fixed rates of interest, while a significant portion of our debt bears interest at variable rates. Historically we have attempted to manage our interest rate risk by "match-funding" the financing assets and related debt, including through the use of interest rate swap agreements. However, as our credit ratings declined, our ability to continue this practice became constrained.

At December 31, 2002, we had $7 billion of variable rate debt, including the $3.5 billion outstanding under the New Credit Facility and the notional value of our pay-variable interest-rate swaps. The notional value of our offsetting pay-fixed interest-rate swaps was $1.2 billion.

Our loans related to vendor financing, from parties including GE, are secured by customer-financing assets and are designed to mature ratably with our collection of principal payments on the financing assets which secure them. The interest rates on those loans are fixed. As a result, the vendor financing loan programs create natural match-funding of the financing assets to the related debt. As we implement additional finance receivable securitizations and continue to repay existing debt, the portion of our financing assets which is match-funded against related secured debt will increase. On a consolidated basis, including the impact of our hedging activities, weighted-average interest rates for 2002, 2001 and 2000 approximated 5.0 percent, 5.5 percent and 6.2 percent, respectively.

Many of the financial instruments we use are sensitive to changes in interest rates. Interest rate changes result in fair value gains or losses on our term debt and interest rate swaps, due to differences between current market interest rates and the stated interest rates within the instrument. The loss in fair value at December 31, 2002, from a 10 percent change in market interest rates would be approximately $201 million for our interest rate sensitive financial instruments. Our currency and interest rate hedging are typically unaffected by changes in market conditions as forward contracts, options and swaps are normally held to maturity consistent with our objective to lock in currency rates and interest rate spreads on the underlying transactions.

We anticipate continued volatility in our results of operations due to market changes in interest rates and foreign currency rates which we are currently unable to hedge.

Forward-Looking Cautionary Statements:

This Annual Report contains forward-looking statements and information relating to Xerox that are based on our beliefs, as well as assumptions made by and information currently available to us. The words "anticipate," "believe," "estimate," "expect," "intend," "will" and similar expressions, as they relate to us, are intended to identify forward-looking statements. Actual results could differ materially from those projected in such forward-looking statements. Information concerning certain factors that could cause actual results to differ materially is included in our 2002 Annual Report on Form 10-K filed with the SEC. We do not intend to update these forward-looking statements.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders of Xerox Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, cash flows and common shareholders' equity present fairly, in all material respects, the financial position of Xerox Corporation and its subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002.

PricewaterhouseCoopers LLP
Stamford, Connecticut
January 28, 2003, except for Note 15, which is as of March 27, 2003

CONSOLIDATED STATEMENTS OF INCOME

	Year ended December 31, 2002	2001	2000
	(in millions, except per-share		
Revenues			
Sales	$ 6,752	$ 7,443	$ 8,839
Service, outsourcing and rentals	8,097	8,436	8,750
Finance income	1,000	1,129	1,162
Total Revenues	15,849	17,008	18,751
Costs and Expenses			
Cost of sales	4,197	5,170	6,080
Cost of service, outsourcing and rentals	4,530	4,880	5,153
Equipment financing interest	401	457	498
Research and development expenses	917	997	1,064
Selling, administrative and general expenses	4,437	4,728	5,518
Restructuring and asset impairment charges	670	715	475
Gain on sale of half of interest in Fuji Xerox	--	(773)	--
Gain on affiliate's sale of stock	--	(4)	(21)
Gain on sale of China operations	--	--	(200)
Other expenses, net	445	444	551
Total Costs and Expenses	15,597	16,614	19,118
Income (Loss) before Income Taxes (Benefits), Equity Income, Minorities' Interests and Cumulative Effect of Change in Accounting Principle	252	394	(367)
Income taxes (benefits)	60	497	(70)
Income (Loss) before Equity Income, Minorities' Interests and Cumulative Effect of Change in Accounting Principle	192	(103)	(297)
Equity in net income of unconsolidated affiliates	54	53	66
Minorities' interests in earnings of subsidiaries	(92)	(42)	(42)
Income (Loss) before Cumulative Effect of Change in Accounting Principle	154	(92)	(273)
Cumulative effect of change in accounting principle	(63)	(2)	--
Net Income (Loss)	91	(94)	(273)
Less: Preferred stock dividends, net	(73)	(12)	(46)
Income (Loss) available to common shareholders	$ 18	$ (106)	$ (319)
Basic Earnings (Loss) per Share			
Income (Loss) before Cumulative Effect of Change in Accounting Principle	$ 0.11	$ (0.15)	$ (0.48)
Net Earnings (Loss) per Share	$ 0.02	$ (0.15)	$ (0.48)
Diluted Earnings (Loss) per Share			
Income (Loss) before Cumulative Effect of Change in Accounting Principle	$ 0.10	$ (0.15)	$ (0.48)
Net Earnings (Loss) per Share	$ 0.02	$ (0.15)	$ (0.48)

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

CONSOLIDATED BALANCE SHEETS

	December 31, 2002	December 31, 2001
	(in millions)	
Assets		
Cash and cash equivalents	$ 2,887	$ 3,990
Accounts receivable, net	2,072	1,896
Billed portion of finance receivables, net	564	584
Finance receivables, net	3,088	3,338
Inventories	1,222	1,364
Other current assets	1,186	1,428
Total Current Assets	11,019	12,600
Finance receivables due after one year, net	5,353	5,756
Equipment on operating leases, net	459	804
Land, buildings and equipment, net	1,757	1,999
Investments in affiliates, at equity	628	632
Intangible assets, net	360	457
Goodwill	1,564	1,445
Deferred tax assets, long-term	1,592	1,342
Other long-term assets	2,726	2,610
Total Assets	$ 25,458	$ 27,645
Liabilities and Equity		
Short-term debt and current portion of long-term debt	$ 4,377	$ 6,637
Accounts payable	839	704
Accrued compensation and benefits costs	481	451
Unearned income	257	244
Other current liabilities	1,833	1,951
Total Current Liabilities	7,787	9,987
Long-term debt	9,794	10,107
Pension liabilities	1,307	527
Post-retirement medical benefits	1,251	1,233
Other long-term liabilities	1,144	1,764
Total Liabilities	21,283	23,618
Minorities' interests in equity of subsidiaries	73	73
Company-obligated, mandatorily redeemable preferred securities of subsidiary trusts holding solely subordinated debentures of the Company	1,701	1,687
Preferred stock	550	605
Deferred ESOP benefits	(42)	(135)
Common stock, including additional paid in capital	2,739	2,622
Retained earnings	1,025	1,008
Accumulated other comprehensive loss	(1,871)	(1,833)
Total Liabilities and Equity	$ 25,458	$ 27,645

Shares of common stock issued and outstanding were (in thousands) 738,273 and 722,314 at December 31, 2002 and December 31, 2001, respectively.

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31, 2002	2001	2000
	(in millions)		
Cash Flows from Operating Activities:			
Net income (loss)	$ 91	$ (94)	$ (273)
Adjustments required to reconcile net income (loss) to cash flows from operating activities:			
Depreciation and amortization	1,035	1,332	1,244
Impairment of goodwill	63	--	--
Provisions for receivables and inventory	468	748	848
Restructuring and other charges	670	715	502
Deferred tax benefit	(178)	(10)	(130)
Cash payments for restructurings	(392)	(484)	(387)
Gain on early extinguishment of debt	(1)	(63)	--
Gains on sales of businesses and assets	(1)	(765)	(288)
Undistributed equity in income of affiliated companies	(23)	(20)	(25)
Decrease in inventories	16	319	74
Increase in on-lease equipment	(127)	(271)	(506)
Decrease (increase) in finance receivables	754	88	(701)
(Increase) decrease in accounts receivable and billed portion of finance receivables	(266)	189	(385)
Proceeds from sale of accounts receivable, net	--	--	328
Increase (decrease) in accounts payable and accrued compensation and benefits costs	192	(270)	59
(Decrease) increase in income tax liabilities	(204)	452	(291)
(Decrease) increase in other current and long-term liabilities	(254)	(160)	55
Early termination of derivative contracts	39	(148)	(108)
Other, net	(6)	8	191
Net cash provided by operating activities	1,876	1,566	207
Cash Flows from Investing Activities:			
Cost of additions to land, buildings and equipment	(146)	(219)	(452)
Proceeds from sales of land, buildings and equipment	19	69	44
Cost of additions to internal use software	(50)	(124)	(211)
Proceeds from divestitures	340	1,768	640
Acquisitions, net of cash acquired	(4)	18	(856)
Funds released from (placed in) escrow and other restricted cash, net	41	(628)	--
Other, net	(3)	(11)	(20)
Net cash provided by (used in) investing activities	197	873	(855)
Cash Flows from Financing Activities:			
Cash proceeds from new secured financings	3,055	2,418	411
Debt payments on secured financings	(1,662)	(1,068)	(532)
Other changes in debt, net	(4,619)	(2,448)	3,038
Proceeds from issuance of mandatorily redeemable preferred securities	--	1,004	--
Dividends on common and preferred stock	(67)	(93)	(587)
Proceeds from issuances of common stock	4	28	--
Settlements of equity put options, net	--	(28)	(68)
Dividends to minority shareholders	(3)	(2)	(7)
Net cash (used in) provided by financing activities	(3,292)	(189)	2,255
Effect of exchange rate changes on cash and cash equivalents	116	(10)	11
(Decrease) increase in cash and cash equivalents	(1,103)	2,240	1,618
Cash and cash equivalents at beginning of year	3,990	1,750	132
Cash and cash equivalents at end of year	$ 2,887	$ 3,990	$ 1,750

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

CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDERS' EQUITY

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss/(1)/	Total
	(In millions, except share data)					
Balance at December 31, 1999	665,156	$ 667	$ 1,600	$ 1,910	$ (1,224)	$ 2,953
Net loss				(273)		(273)
Translation adjustments					(356)	(356)
Minimum pension liability, net of tax					5	5
Unrealized loss on securities					(5)	(5)
Comprehensive loss						$ (629)
Stock option and incentive plans	940	1	32			33
Xerox Canada exchangeable stock	29					
Convertible securities	2,451	2	28	(8)		22
Cash dividends declared:						
Common stock ($0.65 per share)				(434)		(434)
Preferred stock ($6.25 per share), net of tax benefit				(46)		(46)
Put options, net			(100)			(100)
Other			1	1		2
Balance at December 31, 2000	668,576	670	1,561	1,150	(1,580)	1,801
Net loss				(94)		(94)
Translation adjustments					(210)	(210)
Minimum pension liability, net of tax					(40)	(40)
Unrealized gain on securities					4	4
FAS 133 transition adjustment					(19)	(19)
Net unrealized gains on cash flow hedges					12	12
Comprehensive loss						$ (347)
Stock option and incentive plans	546	1	5			6
Xerox Canada exchangeable stock	312					
Convertible securities	5,865	6	36			42
Cash dividends declared:						
Common stock ($0.05 per share)				(34)		(34)
Preferred stock ($1.56 per share), net of tax benefit				(12)		(12)
Put options, net			4			4
Equity for debt exchanges	41,154	41	270			311
Issuance of unregistered shares	5,861	6	22			28
Other				(2)		(2)
Balance at December 31, 2001	722,314	$ 724	$ 1,898	$ 1,008	$ (1,833)	$ 1,797
Net income				91		91
Translation adjustments (2)					234	234
Minimum pension liability, net of tax					(279)	(279)
Unrealized gain on securities					1	1
Net unrealized gains on cash flow hedges					6	6
Comprehensive income						$ 53
Stock option and incentive plans	2,385	2	10			12
Xerox Canada exchangeable stock	44					
Convertible securities	7,118	7	48			55
Cash dividends declared:						
Preferred stock ($10.94 per share), net of tax benefit				(73)		(73)
Equity for debt exchanges	6,412	6	45			51
Other		(1)		(1)		(2)
Balance at December 31, 2002	738,273	$ 738	$ 2,001	$ 1,025	$ (1,871)	$ 1,893

(1) As of December 31, 2002, Accumulated Other Comprehensive Loss is composed of cumulative translation adjustments of $(1,524), a minimum pension liability of $(346) and cash flow hedging losses of $(1).

(2) Includes reclassification adjustments for foreign currency translation losses of $59, that were realized in 2002 due to the sale of businesses. These amounts were included in accumulated other comprehensive loss in prior periods as unrealized losses. Refer to Note 4 for further discussion.

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

(Dollars in millions, except per-share data and unless otherwise indicated)

Note 1--Summary of Significant Accounting Policies

References herein to "we," "us" or "our" refer to Xerox Corporation and its subsidiaries unless the context specifically requires otherwise.

Description of Business and Basis of Presentation: We are The Document Company, and a leader in the global document market, developing, manufacturing, marketing, servicing and financing a complete range of document equipment, software, solutions and services.

Liquidity, Financial Flexibility and Funding Plans: We manage our worldwide liquidity using internal cash management practices, which are subject to (1) the statutes, regulations and practices of each of the local jurisdictions in which we operate, (2) the legal requirements of the agreements to which we are parties and (3) the policies and cooperation of the financial institutions we utilize to maintain such cash management practices. In 2000, our operational issues were exacerbated by significant competitive and industry changes, adverse economic conditions, and significant technology and acquisition spending. Together, these conditions negatively impacted our liquidity, which from 2000 to 2002 led to a series of credit rating downgrades, eventually to below investment grade. Consequently, our access to capital and derivative markets has been restricted. The downgrades also required us to cash-collateralize certain derivative and securitization arrangements to prevent them from terminating, and to immediately settle terminating derivative contracts. Further, we are required to maintain minimum cash balances in escrow on certain borrowings and letters of credit. In addition, as discussed in Note 15, the SEC would not allow us to publicly register any securities offerings while its investigation, which commenced in June 2000, was ongoing. This additional constraint essentially prevented us from raising funds from sources other than unregistered capital markets offerings and private lending or equity sources. Consequently, our credit ratings, which were already under pressure, came under greater pressure since credit rating agencies often include access to capital sources in their rating criteria.

While the conclusion of the SEC investigation in 2002 removed our previous inability to access public capital markets, we expect our ability to access unsecured credit sources to remain restricted as long as our credit ratings remain below investment grade, and we expect our incremental cost of borrowing to increase as a result of such credit ratings.

In June 2002, we entered into an Amended and Restated Credit Agreement (the "New Credit Facility") with a group of lenders, replacing our prior $7 billion facility (the "Old Revolver"). At that time, we permanently repaid $2.8 billion of the Old Revolver and subsequently paid $710 on the New Credit Facility. At December 31, 2002, the New Credit Facility consisted of two tranches of term loans totaling $2.0 billion and a $1.5 billion revolving credit facility that includes a $200 letter of credit subfacility. At December 31, 2002, $3.5 billion was outstanding under the New Credit Facility. At December 31, 2002 we had no additional borrowing capacity under the New Credit Facility since the entire revolving facility was outstanding, including a $10 letter of credit under the subfacility.

The New Credit Facility contains affirmative and negative covenants. The New Credit Facility contains financial covenants that the Old Revolver did not contain. Certain of the more significant covenants under the New Credit Facility are summarized below (this summary is not complete and is in all respects subject to the actual provisions of the New Credit Facility):

- Excess cash of certain foreign subsidiaries and of Xerox Credit Corporation, a wholly-owned subsidiary, must be transferred to Xerox at the end of each fiscal quarter; for this purpose, "excess cash" generally means cash maintained by certain foreign subsidiaries taken as a whole in excess of their aggregate working capital and other needs in the ordinary course of business (net of sources of funds from third parties), including reasonably anticipated needs for repaying debt and other obligations and making investments in their businesses. In certain circumstances, we are not required to transfer cash to Xerox Corporation, the parent company, if the transfer cannot be made in a tax efficient manner or if it would be considered a breach of fiduciary duty by the directors of the foreign subsidiary;

- Minimum EBITDA (a quarterly test that is based on rolling four quarters) ranging from $1.0 to $1.3 billion; for this purpose, "EBITDA" (Earnings before interest, taxes, depreciation and amortization) generally means EBITDA (excluding interest and financing income to the extent included in consolidated net income), less any amounts spent for software development that are capitalized;

- Maximum leverage ratio (a quarterly test that is calculated as total adjusted debt divided by EBITDA) ranging from 4.3 to 6.0;

- Maximum capital expenditures (annual test) of $330 million per fiscal year plus up to $75 million of any unused amount carried over from the previous year; for this purpose, "capital expenditures" generally mean the amounts included on our statement of cash flows as "additions to land, buildings and equipment, plus any capital lease obligations incurred;

- Minimum consolidated net worth ranging from $2.9 billion to $3.1 billion; for this purpose, "consolidated net worth" generally means the sum of the amounts included on our balance sheet as "common shareholders' equity," "preferred stock," "company-obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company," except that the currency translation adjustment effects and the effects of compliance with FAS 133 occurring after December 31, 2001 are disregarded, the preferred securities (whether or not convertible) issued by us or by our subsidiaries which were outstanding on June 21, 2002 will always be included, and any capital stock or similar equity interest issued after June 21, 2002 which matures or generally becomes mandatorily redeemable for cash or puttable at holders' option prior to November 1, 2005 is always excluded; and

- Limitations on: (i) issuance of debt and preferred stock; (ii) creation of liens; (iii) certain fundamental changes to corporate structure and nature of business, including mergers; (iv) investments and acquisitions; (v) asset transfers; (vi) hedging transactions other than in those in the ordinary course of business and certain types of synthetic equity or debt derivatives, and (vii) certain types of restricted payments relating to our, or our subsidiaries', equity interests, including payment of cash dividends on our common stock; (viii) certain types of early retirement of debt, and (ix) certain transactions with affiliates, including intercompany loans and asset transfers.

The New Credit Facility generally does not affect our ability to continue to monetize receivables under the agreements with GE and others. Although we cannot pay cash dividends on our common stock during the term of the New Credit Facility, we can pay cash dividends on our preferred stock, provided there is then no event of default. In addition to other defaults customary for facilities of this type, defaults on other debt, or bankruptcy, of Xerox Corporation, or certain of our subsidiaries, would constitute defaults under the New Credit Facility.

At December 31, 2002, we are in compliance with all aspects of the New Credit Facility including financial covenants and expect to be in compliance for at least the next twelve months. Failure to be in compliance with any material provision or covenant of the New Credit Facility could have a material adverse effect on our liquidity and operations.

The New Credit Facility generally does not affect our ability to continue to securitize receivables under the agreements we have with General Electric and others, as discussed further in Note 5. Although we cannot pay cash dividends on our common stock during the term of the New Credit Facility, we can pay cash dividends on our preferred stock, provided there is then no event of default. In addition to other defaults customary for facilities of this type, defaults on our other debt, or bankruptcy, or certain of our subsidiaries, would constitute defaults under the New Credit Facility.

At December 31, 2002, we are in compliance with all aspects of the New Credit Facility including financial covenants and expect to be in compliance for at least the next twelve months. Failure to be in compliance with any material provision or covenant of the New Credit Facility could have a material adverse effect on our liquidity and operations.

With $2.9 billion of cash and cash equivalents on hand at December 31, 2002, we believe our liquidity (including operating and other cash flows we expect to generate) will be sufficient to meet operating cash flow requirements as they occur and to satisfy all scheduled debt maturities for at least the next twelve months. Our ability to maintain sufficient liquidity going forward is highly dependent on achieving expected operating results, including capturing the benefits from restructuring activities, and completing announced finance receivables securitizations. There is no assurance that these initiatives will be successful. Failure to successfully complete these initiatives could have a material adverse effect on our liquidity and our operations, and could require us to consider further measures, including deferring planned capital expenditures, reducing discretionary spending, selling additional assets and, if necessary, restructuring existing debt.

We also expect that our ability to fully access commercial paper and other unsecured public debt markets will depend upon improvements in our credit ratings, which in turn depend on our ability to demonstrate sustained profitability growth and operating cash generation and continued progress on our vendor financing initiatives. Until such time, we expect some bank credit lines to continue to be unavailable, and we intend to access other segments of the capital markets as business conditions allow, which could provide significant sources of additional funds until full access to the unsecured public debt markets is restored.

Basis of Consolidation: The consolidated financial statements include the accounts of Xerox Corporation and all of our controlled subsidiary companies. All significant intercompany accounts and transactions have been eliminated. Investments in business entities in which we do not have control, but we have the ability to exercise significant influence over operating and financial policies (generally 20 to 50 percent ownership), are accounted for using the equity method of accounting. Upon the sale of stock of a subsidiary, we recognize a gain or loss in our Consolidated Statements of Income equal to our proportionate share of the corresponding increase or decrease in that subsidiary's equity. Operating results of acquired businesses are included in the Consolidated Statements of Income from the date of acquisition. For further discussion of acquisitions, refer to Note 3.

Certain reclassifications of prior year amounts have been made to conform to the current year presentation.

Income (Loss) before Income Taxes (Benefits), Equity Income, Minorities' Interests and Cumulative Effect of Change in Accounting Principle: Throughout the Notes to the Consolidated Financial Statements, we refer to the effects of certain changes in estimates and other adjustments on Income (Loss) before Income Taxes (Benefits), Equity Income, Minorities' Interests and Cumulative Effect of Change in Accounting Principle. For convenience and ease of reference, that caption in our Consolidated Statements of Income is hereafter referred to as "pre-tax income (loss)."

Use of Estimates: The preparation of our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities, as well as the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are used for, but not limited to: (i) allocation of revenues and fair values in multiple element arrangements; (ii) accounting for residual values; (iii) economic lives of leased assets; (iv) allowance for doubtful accounts; (v) retained interests associated with the sales of accounts or finance receivables; (vi) inventory valuation; (vii) restructuring and other related charges; (viii) asset impairments; (ix) depreciable lives of assets; (x) useful lives of intangible assets and goodwill (in 2002 goodwill is no longer amortized over an estimated useful life, see below for further discussion); (xi) pension and post-retirement benefit plans; (xii) income tax valuation allowances and (xiii) contingency and litigation reserves. Future events and their effects cannot be predicted with certainty; accordingly, our accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes. Actual results could differ from those estimates.

The following table summarizes the more significant charges that require management estimates:

(in millions)	Year ended December 31, 2002	2001	2000
Restructuring provisions and asset impairments	$ 670	$ 715	$ 475
Amortization and impairment of goodwill and intangible assets	99	94	86
Provisions for receivables	353	506	613
Provisions for obsolete and excess inventory	115	242	235
Depreciation and obsolescence of equipment on operating leases	408	657	626
Depreciation of buildings and equipment	341	402	417
Amortization of capitalized software	249	179	115
Pension benefits - net periodic benefit cost	168	99	44
Other post-retirement benefits - net periodic benefit cost	120	130	109
Deferred tax asset valuation allowance provisions	15	247	12

Changes in Estimates: In the ordinary course of accounting for items discussed above, we make changes in estimates as appropriate, and as we become aware of circumstances surrounding those estimates. Such changes and refinements in estimation methodologies are reflected in reported results of operations in the period in which the changes are made and, if material, their effects are disclosed in the Notes to the Consolidated Financial Statements.

New Accounting Standards and Accounting Changes:

Variable Interest Entities: In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB 51" ("FIN 46"). The primary objectives of FIN 46 are to provide guidance on the identification of entities for which control is achieved through means other than through voting rights ("VIEs") and how to determine when and which business enterprise should consolidate the VIE. This new model for consolidation applies to an entity which either (1) the equity investors (if any) do not have a controlling financial interest or (2) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. We do not expect the adoption of this standard to have any impact on our results of operations, financial position or liquidity.

Guarantees: In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN 45")." This interpretation expands the disclosure requirements of guarantee obligations and requires the guarantor to recognize a liability for the fair value of the obligation assumed under a guarantee. In general, FIN 45 applies to contracts or indemnification agreements that contingently require the guarantor to make payments to the guaranteed party based on changes in an underlying instrument that is related to an asset, liability, or equity security of the guaranteed party. Other guarantees are subject to the disclosure requirements of FIN 45 but not to the recognition provisions and include, among others, a guarantee accounted for as a derivative instrument under SFAS 133, a parent's guarantee of debt owed to a third party by its subsidiary or vice versa, and a guarantee which is based on performance. The disclosure requirements of FIN 45 are effective as of December 31, 2002, and require information as to the nature of the guarantee, the maximum potential amount of future payments that the guarantor could be required to make under the guarantee, and the current amount of the liability, if any, for the guarantor's obligations under the guarantee. The recognition requirements of FIN 45 are to be applied prospectively to guarantees issued or modified after December 31, 2002. Significant guarantees that we have entered are disclosed in Note 15. We do not expect the requirements of FIN 45 to have a material impact on our results of operations, financial position or liquidity.

Stock-Based Compensation: In 2002, FASB issued Statement No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123" ("SFAS No. 148") which provides alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, this Statement amends APB Opinion No. 28, "Interim Financial Reporting," to require disclosure about those effects in interim financial information. We adopted SFAS No. 148 in the fourth quarter of 2002. Since we have not changed to a fair value method of stock-based compensation, the applicable portion of this statement only affects our disclosures.

We do not recognize compensation expense relating to employee stock options because we only grant options with an exercise price equal to the fair value of the stock on the effective date of grant. If we had elected to recognize compensation expense using a fair value approach, and therefore determined the compensation based on the value as determined by the modified Black-Scholes option pricing model, the pro forma net (loss) income and (loss) earnings per share would have been as follows:

	2002	2001	2000
Net income (loss)--as reported	$ 91	$ (94)	$ (273)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax.	(83)	(93)	(112)
Net income (loss)--pro forma	$ 8	$ (187)	$ (385)
Basic EPS--as reported	$ 0.02	$ (0.15)	$ (0.48)
Basic EPS--pro forma	(0.09)	(0.28)	(0.65)
Diluted EPS--as reported	0.02	(0.15)	(0.48)
Diluted EPS--pro forma	(0.09)	(0.28)	(0.65)

As reflected in the pro forma amounts in the previous table, the fair value of each option granted in 2002, 2001 and 2000 was $6.34, $2.40 and $7.50, respectively. The fair value of each option was estimated on the date of grant using the following weighted average assumptions:

	2002	2001	2000
Risk-free interest rate	4.8%	5.1%	6.7%
Expected life in years	6.5	6.5	7.1
Expected price volatility	61.5%	51.4%	37.0%
Expected dividend yield	--	2.7%	3.7%

Costs Associated with Exit or Disposal Activities: In 2002, the FASB issued Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS No. 146"). This standard requires companies to recognize costs associated with exit or disposal activities when they are incurred, rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, plant closing, or other exit or disposal activity. SFAS No. 146 is required to be applied prospectively to exit or disposal activities initiated after December 31, 2002, with earlier application encouraged. We adopted SFAS No. 146 in the fourth quarter of 2002. Refer to Note 2 for further discussion.

Gains from Extinguishment of Debt: On April 1, 2002, we adopted the provisions of Statement of Financial Accounting Standards No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS No. 145"). The portion of SFAS No. 145 that is applicable to us resulted in the reclassification of extraordinary gains on extinguishment of debt previously reported in the Consolidated Statements of Income as extraordinary items to Other expenses, net. The effect of this reclassification in the accompanying Consolidated Statements of Income was a decrease to Other expenses, net of $63 and an increase to Income taxes of $25, from amounts previously reported, for the year ended December 31, 2001.

Impairment or Disposal of Long-Lived Assets: In 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"). SFAS No. 144 retains the previously existing accounting requirements related to the recognition and measurement of the impairment of long-lived assets to be held and used, while expanding the measurement requirements of long-lived assets to be disposed of by sale to include discontinued operations. It also expands on the previously existing reporting requirements for discontinued operations to include a component of an entity that either has been disposed of or is classified as held for sale. We adopted SFAS No. 144 on January 1, 2002. The adoption of this standard did not have a material effect on our financial position or results of operations.

Asset Retirement Obligations: In 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations." This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and associated asset retirement costs. We will adopt SFAS No. 143 on January 1, 2003 and do not expect this standard to have any effect on our financial position or results of operations.

Business Combinations: In 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS No. 141"), which requires the use of the purchase method of accounting for business combinations and prohibits the use of the pooling of interests method. We have not historically engaged in transactions that qualify for the use of the pooling of interests method and therefore, this aspect of the new standard will not have an impact on our financial results. SFAS No. 141 also changes the definition of intangible assets acquired in a purchase business combination, providing specific criteria for the initial recognition and measurement of intangible assets apart from goodwill. As a result, the purchase price allocation of future business combinations may be different than the allocation that would have resulted under the previous rules. SFAS No. 141 also requires that upon adoption of Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" ("SFAS No. 142"), we reclassify the carrying amounts of certain intangible assets into or out of goodwill, based on certain criteria. Upon adoption of SFAS No. 142, we reclassified $61 of intangible assets related to acquired workforce to goodwill that was required by this standard.

Goodwill and Other Intangible Assets: Goodwill represents the cost of acquired businesses in excess of the fair value of identifiable tangible and intangible net assets purchased, and prior to 2002 was amortized on a straight-line basis over periods ranging from 5 to 40 years. Other intangible assets represent the fair value of identifiable intangible assets acquired in purchase business combinations and include an acquired customer base, distribution network, technology and trademarks. Intangible assets are amortized on a straight-line basis over periods ranging from 7 to 25 years. We adopted SFAS No. 142 on January 1, 2002 and as a result, goodwill is no longer amortized.

SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets subsequent to their initial recognition. This statement recognizes that goodwill has an indefinite life and will no longer be subject to periodic amortization. However, goodwill is to be tested at least annually for impairment, using a fair value methodology, in lieu of amortization. The provisions of this standard also required that amortization of goodwill related to equity investments be discontinued, and that these goodwill amounts continue to be evaluated for impairment in accordance with Accounting Principles Board Opinion No. 18 "The Equity Method of Accounting for Investments in Common Stock."

SFAS No. 142 also requires performance of annual and transitional impairment tests on goodwill using a two-step approach. The first step is to identify a potential impairment and the second step is to measure the amount of any impairment loss. The first step requires a comparison of the carrying value of reporting units, as defined, to the fair value of these units. The standard requires that if a reporting unit's fair value is below its carrying value, a potential goodwill impairment exists and we would be required to complete the second step of the transitional impairment test to quantify the amount of the potential goodwill impairment charge. Based on the results of the first step of the transitional impairment test, we identified potential goodwill impairments in the reporting units included in our Developing Markets Operations ("DMO") operating segment. We subsequently completed the second step of the transitional goodwill impairment test, which required us to estimate the implied fair value of goodwill for each DMO reporting unit by allocating the fair value of each reporting unit to all of the reporting unit's assets and liabilities. The fair value of the reporting units giving rise to the transitional impairment loss was estimated using the present value of future expected cash flows. Because the carrying amount of each reporting unit's assets and liabilities (excluding goodwill) exceeded the fair value of each reporting unit, we recorded a goodwill impairment charge of $63. This non-cash charge was recorded as a cumulative effect of change in accounting principle, in the accompanying Consolidated Statements of Income, as of January 1, 2002.

The following tables illustrate the pro-forma impact of the adoption of SFAS No. 142. Net Loss for the years ended December 31, 2001 and 2000, as adjusted for the exclusion of amortization expense, were as follows:

	For the Year Ended December 31, 2001	For the Year Ended December 31, 2000
Reported Net Loss	$ (94)	$ (273)
Add: Amortization of goodwill, net of income taxes	59	58
Adjusted Net Loss	$ (35)	$ (215)

Basic and Diluted Earnings per Share for the years ended December 31, 2001 and 2000, as adjusted for the exclusion of amortization expense, were as follows:

	For the Year Ended December 31, 2001	For the Year Ended December 31, 2000
Reported Net Loss per Share (Basic and Diluted)	$ (0.15)	$ (0.48)
Add: Amortization of goodwill, net of income taxes	0.09	0.09
Adjusted Net Loss per Share (Basic and Diluted)	$ (0.06)	$ (0.39)

Intangible assets totaled $360 and $457, net of accumulated amortization of $98 and $62 as of December 31, 2002 and 2001, respectively. All intangible assets relate to the Office operating segment and were comprised of the following as of December 31, 2002:

As of December 31, 2002:	Amortization Period	Gross Carrying Amount (1)	Accumulated Amortization	Net Amount
Installed customer base	17.5 years	$ 209	$ 33	$ 176
Distribution network	25 years	123	15	108
Existing technology	7 years	103	41	62
Trademarks	7 years	23	9	14
		$ 458	$ 98	$ 360

(1) Balances exclude the amount of $61 related to acquired workforce intangible asset, that was classified to goodwill as of January 1, 2002.

Amortization expense related to intangible assets was $36, $40 and $55 for the years ended December 31, 2002, 2001 and 2000, respectively (including $4 of amortization in 2001 on the acquired workforce prior to reclassification). Amortization expense related to these intangible assets is expected to remain approximately $36 annually through 2007.

The following table presents the changes in the carrying amount of goodwill, by operating segment, for the year ended December 31, 2002:

	Production	Office	DMO	Other	Total
Balance at January 1, 2002 (1)	$605	$710	$ 70	$121	$1,506
Foreign currency translation adjustment	82	55	(3)	--	134
Impairment charge	--	--	(63)	--	(63)
Divestitures	(4)	--	(1)	--	(5)
Other	--	(5)	(3)	--	(8)
Balance at December 31, 2002	$683	$760	$ --	$121	$1,564

(1) Balances include the amount of $61 related to acquired workforce intangible asset, that was classified to goodwill as of January 1, 2002.

Derivatives and Hedging: Effective January 1, 2001, we adopted Statement of Financial Accounting Standards, No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), which requires companies to recognize all derivatives as assets or liabilities measured at their fair value, regardless of the purpose or intent of holding them. Gains or losses resulting from changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction. Changes in fair value for derivatives not designated as hedging instruments and the ineffective portions of hedges are recognized in earnings in the current period. The adoption of SFAS No. 133 resulted in a net cumulative after-tax loss of $2 in the accompanying Consolidated Statement of Income and a net cumulative after-tax loss of $19 in Accumulated Other Comprehensive Income which is included in the accompanying Consolidated Balance Sheet. Further, as a result of recognizing all derivatives at fair value, including the differences between the carrying values and fair values of related hedged assets, liabilities and firm commitments, we recognized a $361 increase in assets and a $382 increase in liabilities. Refer to Note 12 to the Consolidated Financial Statements for further discussion.

Revenue Recognition: In the normal course of business, we generate revenue through the sale and rental of equipment, service, and supplies and income associated with the financing of our equipment sales. Revenue is recognized when earned. More specifically, revenue related to sales of our products and services is recognized as follows:

Equipment: Revenues from the sale of equipment, including those from sales-type leases, are recognized at the time of sale or at the inception of the lease, as appropriate. For equipment sales that require us to install the product at the customer location, revenue is recognized when the equipment has been delivered to and installed at the customer location. Sales of customer installable and retail products are recognized upon shipment or receipt by the customer according to the customer's shipping terms. Revenues from equipment under other leases and similar arrangements are accounted for by the operating lease method and are recognized as earned over the lease term, which is generally on a straight-line basis.

Service: Service revenues are derived primarily from maintenance contracts on our equipment sold to customers and are recognized over the term of the contracts. A substantial portion of our products are sold with full service maintenance agreements for which the customer typically pays a base service fee plus a variable amount based on usage. As a consequence, we do not have any significant product warranty obligations, including any obligations under customer satisfaction programs.

Supplies: Supplies revenue generally is recognized upon shipment or utilization by customer in accordance with sales terms.

Revenue Recognition Under Bundled Arrangements: We sell most of our products and services under bundled contract arrangements, which contain multiple deliverable elements. These contractual lease arrangements typically include equipment, service, supplies and financing components for which the customer pays a single negotiated price for all elements. These arrangements typically also include a variable component for page volumes in excess of contractual minimums, which are often expressed in terms of price per page, which we refer to as the "cost per copy." In a typical bundled arrangement, our customer is quoted a fixed minimum monthly payment for 1) the equipment, 2) the associated services and other executory costs and 3) the financing element. The fixed minimum monthly payments are multiplied by the number of months in the contract term to arrive at the total fixed minimum payments that the customer is obligated to make ("fixed payments") over the lease term. The payments associated with page volumes in excess of the minimums are contingent on whether or not such minimums are exceeded ("contingent payments"). The minimum contractual committed copy volumes are typically negotiated to equal the customer's estimated copy volume at lease inception. In applying our lease accounting methodology, we consider the fixed payments for purposes of allocating to the fair value elements of the contract. We do not consider the contingent payments for purposes of allocating to the elements of the contract or recognizing revenue on the sale of the equipment, given the inherent uncertainties as to whether such amounts will ever be received. Contingent payments are recognized as revenue in the period when the customer exceeds the minimum copy volumes specified in the contract.

When separate prices are listed in multiple element customer contracts, such prices may not be representative of the fair values of those elements, because the prices of the different components of the arrangement may be modified through customer negotiations, although the aggregate consideration may remain the same. Therefore, revenues under these arrangements are allocated based upon estimated fair values of each element. Our revenue allocation methodology first begins by determining the fair value of the service component, as well as other executory costs and any profit thereon and second, by determining the fair value of the equipment based on comparison of the equipment values in our accounting systems to a range of cash selling prices or, if applicable, other verifiable objective evidence of fair value. We perform extensive analyses of available verifiable objective evidence of equipment fair value based on cash selling prices during the applicable period. The cash selling prices are compared to the range of values included in our lease accounting systems. The range of cash selling prices must support the reasonableness of the lease selling prices, taking into account residual values that accrue to our benefit, in order for us to determine that such lease prices are indicative of fair value. Our interest rates are developed based upon a variety of factors including local prevailing rates in the marketplace and the customer's credit history, industry and credit class. These rates are recorded within our pricing systems. The resultant implicit interest rate, which is the same as our pricing interest rate, unless adjustment to equipment values is required, is then compared to fair market value rates to assess the reasonableness of the fair value allocations to the multiple elements.

Determination of Appropriate Revenue Recognition for Leases: Our accounting for leases involves specific determinations under Statement of Financial Accounting Standards No. 13 "Accounting for Leases" ("SFAS No. 13") which often involve complex provisions and significant judgments. The two primary criteria of SFAS No. 13 which we use to classify transactions as sales-type or operating leases are (1) a review of the lease term to determine if it is equal to or greater than 75 percent of the economic life of the equipment and (2) a review of the minimum lease payments to determine if they are equal to or greater than 90 percent of the fair market value of the equipment. Under our current product portfolio and business strategies, a non-cancelable lease of 45 months or more generally qualifies as a sale. Certain of our lease contracts are customized for larger customers, which results in complex terms and conditions and requires significant judgment in applying the above criteria. In addition to these, there are also other important criteria that are required to be assessed, including whether collectibility of the lease payments is reasonably predictable and whether there are important uncertainties related to costs that we have yet to incur with respect to the lease. In our opinion, our sales-type lease portfolios contain only normal credit and collection risks and have no important uncertainties with respect to future costs. Our leases in our Latin America operations have historically been recorded as operating leases since a majority of these leases are terminated significantly prior to the expiration of the contractual lease term. Specifically, because we generally do not collect the receivable from the initial transaction upon termination or during any subsequent lease term, the recoverability of the lease investment is deemed not to be predictable at lease inception. We continue to evaluate economic, business and political conditions in the Latin American region to determine if certain leases will qualify as sales type leases in future periods.

The critical estimates and judgements that we consider with respect to our lease accounting, are the determination of the economic life and the fair value of equipment, including the residual value. Those estimates are based upon historical experience with all our products. For purposes of estimating the economic life, we consider the most objective measure of historical experience to be the original contract term, since most equipment is returned by lessees at or near the end of the contracted term. The estimated economic life of most of our products is five years since this represents the most frequent contractual lease term for our principal products and only a small percentage of our leases having original terms longer than five years. We believe that this is representative of the period during which the equipment is expected to be economically usable, with normal service, for the purpose for which it is intended. We continually evaluate the economic life of both existing and newly introduced products for purposes of this determination. Residual values are established at lease inception using estimates of fair value at the end of the lease term. Our residual values are established with due consideration to forecasted supply and demand for our various products, product retirement and future product launch plans, end of lease customer behavior, remanufacturing strategies, used equipment markets if any, competition and technological changes.

The vast majority of our leases that qualify as sales-type are non-cancelable and include cancellation penalties approximately equal to the full value of the leased equipment. Certain of our governmental contracts may have cancellation provisions or renewal clauses that are required by law, such as 1) those dependant on fiscal funding outside of a governmental unit's control, 2) those that can be cancelled if deemed in the taxpayer's best interest or 3) those that must be renewed each fiscal year, given limitations that may exist on entering multi- year contracts that are imposed by statute. In these circumstances and in accordance with the relevant accounting literature, we carefully evaluate these contracts to assess whether cancellation is remote or the renewal option is reasonably assured of exercise because of the existence of substantive economic penalties for the customer's failure to renew. Certain of our commercial contracts for multiple units of equipment may include clauses that allow for a return of a limited portion of such equipment (up to 10% of the value of equipment). These return clauses are only available in very limited circumstances as negotiated at lease inception. We account for our estimate of equipment to be returned under these contracts as operating leases.

Aside from the initial lease of equipment to our customers, we may enter subsequent transactions with the same customer whereby we extend the term. We evaluate the classification of lease extensions of sales-type leases using the originally determined economic life for each product. There may be instances where we have lease extensions for periods that are within the original economic life of the equipment. These are accounted for as sales-type leases only when the extensions occur in the last three months of the lease term and they otherwise meet the appropriate criteria of SFAS 13. All other lease extensions of this type are accounted for as direct financing leases. We generally account for lease extensions that go beyond the economic life as operating leases because of important uncertainties as to the amount of servicing and repair costs that we may incur.

Cash and Cash Equivalents: Cash and cash equivalents consist of cash on hand and investments with original maturities of three months or less.

Restricted Cash and Investments: Due to our credit ratings, many of our derivative contracts and several other material contracts require us to post cash collateral or maintain minimum cash balances in escrow. These cash amounts are reported in our Consolidated Balance Sheets within Other current assets or Other long-term assets, depending on when the cash will be contractually released. At December 31, 2002 and 2001, such restricted cash amounts were as follows:

	December 31,	
	2002	2001
Escrow and cash collections related to the secured borrowings with GE - U.S. and Canada	$ 349	$ 199
Escrow related to distribution payments for the 2001 trust preferred securities	155	229
Collateral related to swaps and letters of credit	77	111
Escrow and cash collections related to our asset-backed security transactions and other restricted cash	97	47
Total	$ 678	$ 586

Of these amounts, $263 and $235 were included in Other current assets and $415 and $351, were included in Other long-term assets, as of December 31, 2002 and 2001, respectively. The current amounts are expected to be available for our use within one year. The total increase in restricted cash during 2002 of $92 is included in the Consolidated Statement of Cash Flows as a use of cash of $104 in other, net of Operating Activities and a source of cash of $12 in investing activities (of the total $41).

Securitizations and Transfers of Receivables: From time to time, in the normal course of business, we may securitize or sell finance and accounts receivable with or without recourse and/or discounts. The receivables are removed from the Consolidated Balance Sheet at the time they are sold and the risk of loss has transferred to the purchaser. However, we maintain risk of loss on our retained interest in such receivables. Sales and transfers that do not meet the criteria for surrender of control or were sold to a consolidated special purpose entity (non-qualified special purpose entity) are accounted for as secured borrowings. When we sell receivables in securitizations of finance receivables or accounts receivable, we retain servicing rights, beneficial interests, and, in some cases, a cash reserve account, all of which are retained interests in the

securitized receivables. The value assigned to the retained interests in securitized trade receivables is based on the relative fair values of the interest retained and sold in the securitization. We estimate fair value based on the present value of future expected cash flows using management's best estimates of the key assumptions, consisting of receivable amounts, anticipated credit losses and discount rates commensurate with the risks involved. Gains or losses on the sale of the receivables depend in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the retained interests based on their relative fair value at the date of transfer.

Provisions for Losses on Uncollectible Receivables: The provisions for losses on uncollectible trade and finance receivables are determined principally on the basis of past collection experience applied to ongoing evaluations of our receivables and evaluations of the risks of repayment. Allowances for doubtful accounts on accounts receivable balances were $282 and $306, as of December 31, 2002 and 2001, respectively. Allowances for doubtful accounts on finance receivables were $324 and $368 at December 31, 2002 and 2001, respectively.

Inventories: Inventories are carried at the lower of average cost or realizable values.

Land, Buildings and Equipment and Equipment on Operating Leases: Land, buildings and equipment are recorded at cost. Buildings and equipment are depreciated over their estimated useful lives. Leasehold improvements are depreciated over the shorter of the lease term or the estimated useful life. Equipment on operating leases is depreciated to its estimated residual value over the term of the lease. Depreciation is computed using principally the straight-line method. Significant improvements are capitalized and maintenance and repairs are expensed. Refer to Notes 6 and 7 for further discussion.

Internal Use Software: We capitalize direct costs incurred during the application development stage and the implementation stage for developing, purchasing or otherwise acquiring software for internal use. These costs are amortized over the estimated useful lives of the software, generally three to five years. All costs incurred during the preliminary project stage, including project scoping, identification and testing of alternatives, are expensed as incurred. During 2002 we wrote off $106 of permanently impaired internal-use capitalized software. Refer to Note 7 for further discussion.

Impairment of Long-Lived Assets: We review the recoverability of our long-lived assets, including buildings, equipment, internal-use software and other intangible assets, when events or changes in circumstances occur that indicate that the carrying value of the asset may not be recoverable. The assessment of possible impairment is based on our ability to recover the carrying value of the asset from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to make estimates of these cash flows related to long-lived assets, as well as other fair value determinations.

Research and Development Expenses: Research and development costs are expensed as incurred.

Pension and Post-Retirement Benefit Obligations: We sponsor pension plans in various forms and in various countries covering substantially all employees who meet certain eligibility requirements. Post-retirement benefit plans cover primarily U.S. employees for retirement medical costs. As required by existing accounting rules, we employ a delayed recognition feature in measuring the costs and obligations of pension and post-retirement benefit plans. This allows for changes in the benefit obligations and changes in the value of assets set aside to meet those obligations, to be recognized, not as they occur, but systematically and gradually over subsequent periods. All changes are ultimately recognized, except to the extent they may be offset by subsequent changes. At any point, changes that have been identified and quantified await subsequent accounting recognition as net cost components and as liabilities or assets.

Several statistical and other factors that attempt to anticipate future events are used in calculating the expense, liability and asset values related to our pension and post-retirement benefit plans. These factors include assumptions we make about the discount rate, expected return on plan assets, rate of increase in healthcare costs, the rate of future compensation increases, and mortality, among others. Actual returns on plan assets are not immediately recognized in our income statement, due to the aforementioned delayed recognition feature that we follow in accounting for pensions. In calculating the expected return on the plan asset component of our net periodic pension cost, we apply our estimate of the long term rate of return to the plan assets that support our pension obligations, after deducting assets that are specifically allocated to Transitional Retirement Accounts (which are accounted for based on specific plan terms).

For purposes of determining the expected return on plan assets, we utilize a calculated value approach in determining the value of the pension plan assets, as opposed to a fair market value approach. The primary difference between the two methods relates to, systematic recognition of changes in fair value over time (generally two years) versus immediate recognition of changes in fair value. Our expected rate of return on plan assets is then applied to the calculated asset value to determine the amount of the expected return on plan assets to be used in the determination of the net periodic pension cost. The calculated value approach reduces the volatility in net periodic pension cost that results from using the fair market value approach.

The difference between the actual return on plan assets and the expected return on plan assets is added to, or subtracted from, any cumulative differences that arose in prior years. This amount is a component of the unrecognized net actuarial (gain) loss and is subject to amortization to net periodic pension cost over the remaining service lives of the employees participating in the pension plan.

An additional significant assumption affecting our pension and post-retirement benefit obligations and the net periodic pension and other post-retirement benefit cost is the rate that we use to discount our future anticipated benefit obligations. In estimating this rate, we consider rates of return on high quality fixed-income investments currently available, and expected to be available, during the period to maturity of the pension benefits.

Foreign Currency Translation: The functional currency for most foreign operations is the local currency. Net assets are translated at current rates of exchange, and income, expense and cash flow items are translated at the average exchange rate for the year. The translation adjustments are recorded in Accumulated Other Comprehensive Income. The U.S. dollar is used as the functional currency for certain subsidiaries that conduct their business in U.S. dollars or operate in hyperinflationary economies. A combination of current and historical exchange rates is used in remeasuring the local currency transactions of these subsidiaries, and the resulting exchange adjustments are included in income. Aggregate foreign currency losses were $77 in 2002 and gains were $29 and $103 in 2001 and 2000, respectively, and are included in Other expenses, net in the accompanying Consolidated Statements of Income. Effective January 1, 2002, we changed the functional currency of our Argentina operation from the U.S. dollar to the Peso as a result of operational changes made subsequent to the government's new economic plan.

Note 2--Restructuring Programs

Since early 2000, we have engaged in a series of restructuring programs related to downsizing our employee base, exiting certain businesses, outsourcing certain internal functions and engaging in other actions designed to reduce our cost structure. We accomplished these objectives through the undertaking of restructuring initiatives, two of which, the SOHO Disengagement and the March 2000 Restructuring, are now substantially completed. The execution of the Turnaround Program and the Fourth Quarter 2002 Restructuring Program and related payments of obligations continued through December 31, 2002. As management continues to evaluate the business, there may be supplemental charges for new plan initiatives as well as changes in estimates to amounts previously recorded, as payments are made or actions are completed. Asset impairment charges were incurred in connection with these restructuring actions for those assets made obsolete or redundant as a result of the plans. The restructuring and asset impairment charges in the Consolidated Statements of Income totaled $670, $715 and $475 in 2002, 2001 and 2000, respectively.

The restructuring initiatives and a summary of the impacts on our financial statements were as follows:

RESTRUCTURING ACTION	INITIATION OF PLAN
. Fourth Quarter 2002 Restructuring Program	November 2002
. Turnaround Program	October 2000
. SOHO Disengagement	June 2001
. March 2000 Restructuring	March 2000

Detailed information about each of the above restructuring programs and the applicable accounting rules we applied are outlined below.

Fourth Quarter 2002 Restructuring Program. As more fully discussed in Note 1, on October 1, 2002, we adopted the provisions of SFAS No. 146. During the fourth quarter of 2002, we announced a worldwide restructuring program and subsequently recorded a provision of $402. The fair value of the initial liability was determined by discounting the future cash outflows using our credit-adjusted risk-free borrowing rate of 5.9 percent. The provision consisted of $312 for severance and related costs (including $32 for special termination benefits and pension curtailment charges) and $45 of costs associated with lease terminations and future rental obligations net of estimated future sublease rents. We also recorded $45 for asset impairments associated with the exit activities. Of the total asset impairment charge, $32 relates to the recognition of currency translation adjustment losses on our investment that were recognized in conjunction with the shutdown of a foreign subsidiary. The remaining asset impairment related to the write-off of leasehold improvements in exited facilities. The total included in Restructuring and asset impairment charges in the Consolidated Statements of Income for the Fourth Quarter 2002 Restructuring Program was $402.

Key initiatives of this restructuring include the following:

- Streamlining manufacturing and administrative operations;
- Transitioning to an indirect sales and service model for our Office segment in Europe;
- Implementing an average ten percent reduction in the number of middle and upper managers across all our businesses in the United States;
- Outsourcing work in areas not related to our core business operations and where there is an economic advantage. This includes the outsourcing of certain service functions and moving towards an indirect sales model where it was deemed cost beneficial to do so.
- Implementing a wide-ranging series of initiatives across Developing Markets Operations ("DMO") geographies to improve productivity and reduce costs; and
- Integrating Xerox Engineering Systems ("XES") into our North American and European operations from its previous stand-alone structure.

The severance and other employee separation costs are related to the elimination of approximately 4,700 positions worldwide. Approximately 55 percent, 31 percent, 11 percent and 3 percent of the positions related to the U.S., Europe, Latin America and Canada, respectively. As of December 31, 2002, approximately 1,700 of the 4,700 affected employees had been separated under the program, and a majority of the remainder are expected to be separated in the first quarter of 2003.

SFAS No. 146 requires recognition and measurement of a liability for lease and other contract termination costs. For those lease contracts that are not terminated, a liability must be recorded when the entity ceases using the leased property. This liability is based on remaining rentals over the lease term, net of estimated sublease rentals that can be reasonably obtained for the property, regardless of whether the entity intends to enter a sublease. The sublease rates are based on estimated market rental rates. External factors, such as appraisals, recent rental activities in local markets, history of subleases in the same or similar space and other factors are all considered when estimating sublease rentals. Our estimated lease costs of $45 for properties exited as part of the Fourth Quarter 2002 Restructuring Program are net of future sublease rentals of $19.

The lease termination and asset impairment charge related primarily to the exiting and consolidation of office facilities, distribution centers and warehouses worldwide. The majority of the U.S. consolidation resulted in a provision of $36, and was for facilities located in California and other smaller locations. The remaining provision of $9 related to the consolidation of certain European facilities as a result of the reduction in personnel. The Fourth Quarter Restructuring Program reserve balance at December 31, 2002 of $286 is expected to be substantially utilized in 2003. As mentioned above, we recorded $32 in special termination benefits and pension curtailment charges representing enhanced retirement benefits given to early retirees and the recognition of previously unrecognized pension and other benefit costs that will be paid to such employees. In addition to these pension related costs, we also incur others such as pension settlements. A pension settlement occurs when we make lump-sum cash payments to plan participants in exchange for their rights to receive pension benefits in the future. We are required to recognize a loss, if at the time of the settlement, the assets attributable to those participants included unrecognized losses. We expect that many of the terminated employees will subsequently elect to receive lump-sum cash payments in 2003. In accordance with pension accounting rules, we are not permitted to recognize such gains or losses, until such settlement occurs. We expect 2003 restructuring charges of approximately $115, $90 of which are expected to relate to pension settlements in the Production and Office segments. Such amounts could change based on the actual level of participants who elect to receive the lump sum distributions and the pension asset values as of such date. The balance of the planned 2003 restructuring charges relate to additional severance and cost reduction actions associated with our Xerox Engineering Services ("XES") business in the Other segment.

The following table summarizes the restructuring activity for the Fourth Quarter 2002 Restructuring Program for the year ended December 31, 2002:

	Severance and related costs	Lease Cancellation and Other Costs	Total
Provision, net of accretion	312	45	357
Charges against reserve/(1)/	(71)	-	(71)
Balance December 31, 2002	$ 241	45	$ 286

(1) Includes the impact of currency translation adjustments of $3.

Restructuring and asset impairment charges of $402 for the Fourth Quarter 2002 Restructuring Program were comprised of $145 in our Production segment, $102 in our Office segment, $55 in our DMO segment and $100 in our Other segment.

Turnaround Program. The Turnaround Program began in October to reduce costs, improve operations, transition customer equipment financing to third party vendors and sell certain assets.

In the fourth quarter of 2000, we provided $105, consisting of $71 for severance and related costs and $34 for asset impairments associated with the disposition of Delphax, which supplied high-speed election beam digital printing systems. Over half of these charges related to our Production operating segment, with the remainder relating to our Office, DMO and Other operating segments. During 2001, we provided an additional $403 of restructuring and asset impairment charges, net of reversals of $26. The reversals related to actual employee separation costs being lower than we originally anticipated. This was largely due to employee attrition, prior to fulfilling the services required before severance became payable as well as certain employees that were subsequently redeployed within our other businesses as a result of unrelated attrition in these other businesses. Of the amounts provided, $339 was for severance and other employee separation costs (including $21 for pension curtailment charges), $36 was for lease cancellation and other exit costs and $28 was for asset impairments. The majority of these charges related to our Production and Office operating segments. The lease termination and other exit costs and asset impairments related primarily to manufacturing operations. Included in 2001 restructuring charges are $24, primarily for severance and other employee separation costs, related to the outsourcing of certain Office operating segment manufacturing to Flextronics, as discussed in Note 4.

As of December 31, 2001, we had $223 of Turnaround Program restructuring reserves remaining, primarily related to employee severance as a result of our downsizing efforts. During the year ended December 31, 2002, we provided an additional $253 (including special termination benefits and pension curtailments of $27), net of $33 reversals. The reversals are related to employee attrition prior to severance payments, lower costs of outplacement programs and other costs. These provisions were primarily for severance and other employee separation costs affecting our Production and Office operating segments, as well as a minor amount of lease termination and other costs. The 2002 charge related to the elimination of redundant resources and the consolidation of activities into other existing operations, bringing the total eliminated positions, since the inception of the Turnaround Program, to approximately 11,200. As of December 31, 2002, substantially all the 11,200 affected employees had separated under the program. The Turnaround Program reserve balance at December 31, 2002 was $131, which is expected to be substantially utilized in the first half of 2003. The total net costs included in Restructuring and asset impairment charges in the Consolidated Statements of Income for the Turnaround Program were $253, $403 and $105 in 2002, 2001 and 2000, respectively.

The following table summarizes the restructuring activity for the Turnaround Program for the two years ended December 31, 2002:

	Severance and related costs	Lease Cancellation and Other Costs	Total
Turnaround Program Restructuring Costs:			
Balance December 31, 2000/(1)/	$ 71	$ --	$ 71
Provision	364	37	401
Reversal	(25)	(1)	(26)
Charges/(2)/	(219)	(4)	(223)
Balance December 31, 2001	191	32	223
Provision	261	25	286
Reversal	(28)	(5)	(33)
Charges/(2)/	(320)	(25)	(345)
Balance December 31, 2002	$ 104	$ 27	$131

/(1)/ There were no charges against reserves for the Turnaround Program in 2000.
/(2)/ Includes the impact of currency translation adjustments of $12 and ($8) for the years ended December 31, 2002 and 2001, respectively.

SOHO Disengagement. In 2001, we began a separate restructuring program associated with the disengagement from our worldwide small office/ home office ("SOHO") business. In connection with exiting this business in 2001, we recorded a provision of $239, net of reversals of $26. Reversals were primarily related to a higher than anticipated number of employees re-deployed and better than expected experience in certain contract terminations. The charge included provisions for the elimination of approximately 1,200 positions worldwide by the end of 2001, the closing of facilities and the write down of certain assets to net realizable value. The restructuring provision associated with this action included $164 for asset impairments, $49 for lease terminations, purchase commitments and other exit costs, and $26 for severance and employee separation costs. An additional provision of $34 related to excess inventory was recorded as a charge to Cost of Sales in our Consolidated Statements of Income.

During the fourth quarter 2001, we depleted our inventory of personal inkjet and xerographic printers, copiers, facsimile machines and multifunction devices which were sold primarily through retail channels to small offices, home offices and personal users (consumers). We continue to provide service, support and supplies, including the manufacturing of such supplies, for customers who currently own these products during a phase-down period to meet customer needs.

During 2002, we recorded a charge of $10 primarily for asset impairment charges for a change in the estimated recoverability of the Ireland SOHO facility. The total net costs included in Restructuring and asset impairment charges in the Consolidated Statements of Income for the SOHO disengagement were $10 and $239 in 2002 and 2001, respectively. Charges against the reserve were $17 and $52 in 2002 and 2001, respectively. The SOHO disengagement program had been substantially completed as of December 31, 2002, with $6 of reserves remaining for severance and lease cancellation costs.

March 2000 Restructuring. In March 2000, we announced details of a worldwide restructuring program and recorded charges of $489 which included severance and employee separation costs of $424 related to the elimination of 5,200 positions worldwide, asset impairments of $30 and other exit costs of $35. An additional provision of $84 related to excess inventory primarily resulting from the planned consolidation of certain warehousing operations was recorded as a charge to Cost of sales. In late 2000, as a result of weakening business conditions, poor operating results and a change in focus of our new senior management team toward increasing liquidity, we re-evaluated the remaining plan elements. As a result of this re-evaluation, we reversed $120 of the original charge. The amount reversed consisted of $97 related to severance costs associated with approximately 1,000 positions and $23 related to other costs. The most significant reversals related to an aggregated $72 for the abandonment of our plans to outsource warehouse facilities in North America, as well as the outsourcing of a product manufacturing line. As 2000 progressed and the Turnaround Program was announced, new senior management determined that the costs required to complete the planned actions for both of these initiatives and the estimated payback periods were not in line with their objectives. Based on the changes in facts and circumstances, we determined that the reserve should be reversed. The remaining $48 of reversals related to attrition, as well as management's assessment of remaining employee terminations, in light of the newly announced Turnaround Program, which involved $71 of new severance charges in the fourth quarter of 2000. During 2001, we recorded additional provisions of $83 which included $68 for severance and related costs, asset impairments of $13 and other exit costs of $2 for instances when the actual cost of certain initiatives exceeded the amount estimated at the time of the original charge. We also recorded reversals of $17 associated with the cancellation of certain service and manufacturing initiatives. We provided an additional $5 in 2002 to complete certain severance-related actions. We recorded asset impairments of $13 and $30 in 2001 and 2000, respectively. The total net costs included in Restructuring and asset impairment charges in the Consolidated Statements of Income for the March 2000 Restructuring were $5, $66 and $369 in 2002, 2001 and 2000, respectively. Charges against the reserve were $17, $204 and $176 in 2002, 2001 and 2000, respectively. As of December 31, 2002, the March 2000 Restructuring Program had been completed.

1998 Restructuring. During 2001, we recorded additional provisions for changes in estimates of $15 and reversals of $8, primarily as a result of changes in certain manufacturing initiatives. The total net costs included in Restructuring and asset impairment charges in the Consolidated Statements of Income for the 1998 Restructuring was $7 and $1 in 2001 and 2000, respectively. Charges against the reserve were $24, $76 and $247 in 2002, 2001 and 2000, respectively. As of December 31, 2002, the 1998 Restructuring Program had been completed.

Reconciliation of Restructuring Charges to Statements of Cash Flows. The following is a reconciliation of charges to the restructuring reserves for all restructuring actions to the amounts reported in the Consolidated Statement of Cash Flows as Cash payments for restructurings:

	2002	2001	2000
Charges to reserve, all programs	$(474)	$(555)	$(423)
Non-cash items:			
Special termination benefits and pension curtailment	59	21	--
Effects of foreign currency and other non-cash charges	23	50	36
Cash payments for restructurings	$(392)	$(484)	$(387)

Note 3--Acquisitions

CPID Division of Tektronix, Inc.: In January 2000, we and Fuji Xerox completed the acquisition of the Color Printing and Imaging Division of Tektronix, Inc. ("CPID"). CPID manufactures and sells color printers, ink and related products, and supplies. The original aggregate consideration paid of $925 in cash, including $73 paid directly by Fuji Xerox, was subject to purchase price adjustments pending the finalization of net asset values. During 2001, we were reimbursed $18 in cash upon finalization of these values which was recorded as a reduction to goodwill in the accompanying Consolidated Balance Sheets. The acquisition was accounted for in accordance with the purchase method of accounting.

The excess of cash paid over the fair value of net assets acquired was allocated to identifiable intangible assets and goodwill using a discounted cash flow approach. The value of the identifiable intangible assets included $27 for purchased in-process research and development that was expensed in 2000. The charge represented the fair value of certain acquired research and development projects that were determined not to have reached technological feasibility as of the date of the acquisition, and was determined based on a methodology that utilized the projected after-tax cash flows of the products expected to result from in-process research and development activities and the stage of completion of the individual projects. Other identifiable intangible assets acquired were exclusive of intangible assets acquired by Fuji Xerox, and included the installed customer base, the distribution network, the existing technology, the workforce (which was transferred to goodwill upon adopting SFAS No. 142) and trademarks. These identifiable assets are included in Intangibles assets, net in the accompanying Consolidated Balance Sheets.

The other identifiable intangible assets acquired are being amortized on a straight-line basis over the estimated useful lives which range from 7 to 25 years. During 2001, certain intangible asset useful lives were revised. As a result of these revisions, we recorded an additional $9 in amortization expense during 2001. The goodwill recorded in connection with this transaction was being amortized on a straight-line basis (over 25 years) through December 31, 2001. On January 1, 2002, we adopted the provisions of SFAS No. 142 and the amortization of goodwill was discontinued. Refer to Note 1 for further discussion of the adoption of SFAS No. 142.

In connection with this acquisition, we recorded approximately $45 for anticipated costs associated with exiting certain activities of the acquired operations. These activities included: (i) the consolidation of duplicate distribution facilities; (ii) the rationalization of the service organization and (iii) the exiting of certain lines of the CPID business. The costs associated with these activities included inventory write-offs, severance charges, contract cancellation costs and fixed asset impairment charges. During 2001, we revised our originally planned initiatives related to the acquired European service organization and our estimate of the costs to complete the exit from our distribution facilities in Europe. These changes, along with certain other changes, resulted in the reversal of $9 of the originally recorded reserves, with a corresponding reduction in goodwill.

Note 4--Divestitures and Other Sales

Nigeria: In December 2002, we sold our remaining investment in Nigeria for a nominal amount and recognized a loss of $35, primarily representing cumulative translation adjustment losses which were previously unrealized.

Licensing Agreement: In September 2002, we signed a license agreement with a third party, related to a nonexclusive license for the use of certain of our existing patents. In October 2002, we received proceeds of $50 and granted the license. We have no continuing obligation or other commitments to the third party and recorded the income associated with this transaction as revenue in Service, outsourcing and rentals in the accompanying Consolidated Statement of Income.

Katun Corporation: In July 2002, we sold our 22 percent investment in Katun Corporation, a supplier of aftermarket copier/printer parts and supplies, for net proceeds of $67. This sale resulted in a pre-tax gain of $12, which is included in Other expenses, net, in the accompanying Consolidated Statements of Income. After-tax, the sale was essentially break-even, as the taxable basis of Katun was lower than our carrying value on the sale date resulting in a high rate of income tax.

Italy Leasing Business: In April 2002, we sold our leasing business in Italy to a company now owned by General Electric ("GE") for $200 in cash plus the assumption of $20 of debt. This sale is part of an agreement under which GE, as successor, will provide ongoing, exclusive equipment financing to our customers in Italy. The total pre-tax loss on this transaction, which is included in Other expenses, net, in the accompanying Consolidated Statements of Income, was $27 primarily related to recognition of cumulative translation adjustment losses and final sale contingency settlements.

Prudential Insurance Company Common Stock: In the first quarter of 2002, we sold common stock of Prudential Insurance Company, associated with that company's demutualization. In connection with this sale, we recognized a pre-tax gain of $19 that is included in Other Expenses, net, in the accompanying Consolidated Statements of Income.

Delphax: In December 2001, we sold Delphax Systems and Delphax Systems, Inc. ("Delphax") to Check Technology Canada LTD and Check Technology Corporation for $16. The transaction was essentially break-even. Delphax designs, manufactures and supplies high-speed electron beam imaging digital printing systems and related parts, supplies and services.

Nordic Leasing Business: In April 2001, we sold our leasing businesses in four Nordic countries to a company now owned by GE, for $352 in cash and retained interests in certain finance receivables for total proceeds of approximately $370 which approximated book value. These sales are part of an agreement under which that company will provide ongoing, exclusive equipment financing to our customers in those countries.

Fuji Xerox Interest: In March 2001, we sold half of our ownership interest in Fuji Xerox to Fuji Photo Film Co., Ltd ("Fuji Film") for $1.3 billion in cash. In connection with the sale, we recorded a pre-tax gain of $773. Under the agreement, Fuji Film's ownership interest in Fuji Xerox increased from 50 percent to 75 percent. Our ownership interest decreased to 25 percent and we retain significant rights as a minority shareholder. We have product distribution and technology agreements that ensure that both parties have access to each other's portfolio of patents, technology and products. Fuji Xerox continues to provide products to us as well as collaborate with us on R&D.

Xerox China: In December 2000, we sold our China operations to Fuji Xerox for $550. In connection with the sale, Fuji Xerox also assumed $118 of indebtedness. We recorded a pre-tax gain of $200 in connection with this transaction. Prior to the sale, our China operations had revenue of $262 in 2000, which is included in the accompanying Consolidated Statement of Income. While Fuji Xerox is our affiliate, we believe the negotiations for this transaction were similar to those that would have been entered into with an unaffiliated third party, both in terms of price and conditions. Both parties were represented by separate legal counsel.

Commodity Paper Product Line: In June 2000, we entered an agreement with Georgia Pacific, to sell our U.S. and Canadian commodity paper product line and customer list and recorded a pre-tax gain of $40 which is included in Other expenses, net, which represented the proceeds from the sale. We also granted a ten-year exclusive license related to the use of the Xerox brand name on future paper sales in exchange for a fair value royalty agreement. In conjunction with the sale, we also became an agent of Georgia Pacific for which we earn a market-based commission on sales of commodity paper. Subsequently, in January 2003, we discontinued the agency relationship without penalty, and resumed direct commodity paper sales.

ContentGuard: In April 2000, we sold a 25 percent ownership interest in our wholly-owned subsidiary, ContentGuard, to Microsoft, Inc. for $50 and recognized a pre-tax gain of $23, which is included in Other expenses, net in the accompanying Consolidated Statements of Income. An additional pre-tax gain of $27 was deferred, pending the achievement of certain performance criteria. In May 2002, we repaid Microsoft $25, as the performance criteria had not been achieved. In connection with the sale, ContentGuard also received $40 from Microsoft for a non-exclusive license of its patents and other intellectual property and a $25 advance against future royalty income from Microsoft on sales of products incorporating ContentGuard's technology. The license payment is being amortized over the ten-year life of the license agreement due to continuing obligations we have, related to our majority ownership of ContentGuard. The royalty advance will be recognized in income as earned. These amounts are not refundable.

Flextronics Manufacturing Outsourcings: In the fourth quarter of 2001, we entered into purchase and supply agreements with Flextronics, a global electronics manufacturing services company. Under the agreements, Flextronics purchased related inventory, property and equipment. Pursuant to the purchase agreement, we sold our operations in Toronto, Canada; Aguascalientes, Mexico, Penang, Malaysia, Venray, The Netherlands and Resende, Brazil to Flextronics in a series of transactions, which were completed in 2002. In total, approximately 4,100 Xerox employees in certain of these operations transferred to Flextronics. Total proceeds from the sales in 2002 and 2001 were $167, plus the assumption of certain liabilities, representing a premium over book value. The premium is being amortized over the life of the supply contract.

Under the supply agreement, Flextronics manufactures and supplies equipment and components, including electronic components, for the Office segment of our business. This represents approximately 50 percent of our overall worldwide manufacturing operations. The initial term of the Flextronics supply agreement is five years subject to our right to extend for two years. Thereafter it will automatically be renewed for one-year periods, unless either party elects to terminate the agreement. We have agreed to purchase from Flextronics most of our requirements for certain products in specified product families. We also must purchase certain electronic components from Flextronics, so long as Flextronics meets certain pricing requirements. Flextronics must acquire inventory in anticipation of meeting our forecasted requirements and must maintain sufficient manufacturing capacity to satisfy such forecasted requirements. Under certain circumstances, we may become obligated to repurchase inventory that remains unused for more than 180 days, becomes obsolete or upon termination of the supply agreement. Our remaining manufacturing operations are primarily located in Rochester, NY for our high end production products and consumables and Wilsonville, OR for consumable supplies and components for the Office segment products.

Note 5--Receivables, Net

Finance Receivables: Finance receivables result from installment arrangements and sales-type leases arising from the marketing of our equipment. These receivables are typically collateralized by a security interest in the underlying assets. The components of Finance receivables, net at December 31, 2002 and 2001 follow:

	2002	2001
Gross receivables	$ 10,685	$ 11,466
Unearned income	(1,628)	(1,834)
Unguaranteed residual values	272	414
Allowance for doubtful accounts	(324)	(368)
Finance receivables, net	9,005	9,678
Less: Billed portion of finance receivables, net	(564)	(584)
Current portion of finance receivables not billed, net	(3,088)	(3,338)
Amounts due after one year, net	$ 5,353	$ 5,756

Contractual maturities of our gross finance receivables subsequent to December 31, 2002 follow (including those already billed of $564):

2003	2004	2005	2006	2007	Thereafter
$ 4,359	$ 2,869	$ 2,031	$ 982	$ 349	$ 95

Our experience has shown that a portion of these finance receivables will be prepaid prior to maturity. Accordingly, the preceding schedule of contractual maturities should not be considered a forecast of future cash collections. In addition, our strategy of exiting, in some geographies, the business of direct financing of customers' purchases may result in further acceleration of the collection of these receivables as a result of associated asset sales or securitizations.

Vendor Financing Initiatives: In 2001, we announced several Framework Agreements with GE, under which GE would become our primary equipment-financing provider in the U.S., Canada, Germany and France. In connection therewith, in October 2002, we completed an eight-year agreement in the U.S. (the "New U.S. Vendor Financing Agreement"), under which GE Vendor Financial Services, a subsidiary of GE, became the primary equipment financing provider in the U.S., through monthly securitizations of our new lease originations. In addition to the $2.5 billion already funded by GE prior to this agreement, which is secured by portions of our current lease receivables in the U.S., the New U.S. Vendor Financing Agreement calls for GE to provide funding in the U.S. on new lease originations, of up to an additional $5 billion outstanding at anytime, during the eight year term, subject to normal customer acceptance criteria. The $5 billion limit may be increased to $8 billion, subject to agreement between the parties. The new agreement contains mutually agreed renewal options for successive two-year periods.

Under the agreement, GE is expected to securitize approximately 70 percent of new U.S. lease originations at over-collateralization rates, which will vary over time, but are expected to be approximately 10 percent of the net receivables balance. The securitizations will be subject to interest rates calculated at each monthly loan occurrence at yield rates consistent with average rates for similar market based transactions. Refer to Note 11 for further information on interest rates. Consistent with the loans already received from GE, the funding received under this new agreement will be recorded as secured borrowings and the associated receivables will be included in our Consolidated Balance Sheet. GE's commitment to fund under this new agreement is not subject to our credit ratings. There are no credit rating defaults that could impair future funding under this agreement. This agreement contains cross default provisions related to certain financial covenants contained in the New Credit Facility and other significant debt facilities. Any default would impair our ability to receive subsequent funding until the default was cured or waived but does not accelerate previous borrowings. As of December 31, 2002, we were in compliance with all covenants and expect to be in compliance for at least the next twelve months.

In 2002 and 2001, we received financing totaling $1,845 million and $1,175 million, respectively, from GE, secured by lease receivables in the U.S. Net fees of $9 million and $7 million have been capitalized as debt issue costs during the years ended December 31, 2002 and 2001, respectively. In connection with these transactions, $150 million is in escrow, as security for our continuing obligations under the transferred contracts. At December 31, 2002, the remaining balance was $2,323 million and is included in debt in our Consolidated Balance Sheet.

In May 2002, we launched the Xerox Capital Services ("XCS") venture with GE, under which XCS now manages our customer administration and leasing activities in the U.S., including various financing programs, credit approval, order processing, billing and collections. We account for XCS as a consolidated entity since we are responsible to fund all of its operations, and, further, all events of termination result in GE receiving back their entire equity investment and total ownership reverting to us.

France Secured Borrowings: In December 2002, we received $362, net of escrow requirements, in financing from Merrill Lynch Capital Markets Bank Limited and Merrill Lynch International Bank Limited (subsidiaries of Merrill Lynch) secured by some of our lease receivables in France. At December 31, 2002, the remaining balance is $377 and is included in debt in our Consolidated Balance Sheet.

The Netherlands Secured Borrowings: Beginning in the second half of 2002, we received a series of financings from our unconsolidated joint venture with De Lage Landen International BV (DLL) secured by some of our lease receivables in The Netherlands. At December 31, 2002, the remaining balance is $112 and is included in debt in our Consolidated Balance Sheet.

Germany Secured Borrowings: In May 2002, we entered into an agreement to transfer part of our financing operations in Germany to GE. In conjunction with this transaction, we received loans from GE secured by lease receivables in Germany. Initial cash proceeds of $79 were net of $15 of escrow requirements. As part of the transaction we transferred leasing employees to a GE entity which will also finance certain new leasing business in the future. We currently consolidate this joint venture since we retain substantive rights related to the borrowings. At December 31, 2002, the remaining balance, which includes additional proceeds received since May 2002, is $95 and is included in debt in our Consolidated Balance Sheet.

United Kingdom Secured Borrowings: During 2002 and 2001, we received $268 and $885, respectively, in financing from GE Capital Equipment Finance Limited (a subsidiary of GE), secured by our portfolios of lease receivables in the United Kingdom. At December 31, 2002, the remaining balance of $529 is included in debt in our Consolidated Balance Sheets.

Canada Secured Borrowings: In 2002, we received $443 of financing from GE, secured by lease receivables in Canada. Cash proceeds of $428 were net of $8 of escrow requirements and $7 of fees. At December 31, 2002, the remaining balance is $319 and is included in debt in our Consolidated Balance Sheet.

U.S. Asset-backed Securities Transaction: In July 2001, we transferred U.S. lease contracts to a consolidated trust, which in turn sold $513 of floating-rate asset-backed notes (notes). We received cash proceeds of $480, net of $3 of expenses and fees. An additional $30 of proceeds are being held in reserve by the trust until the notes are repaid, which is currently estimated to be in or around August 2003. Since the trust is consolidated in our financial statements, we effectively recorded the proceeds received as a secured borrowing. At December 31, 2002, the remaining balance was $139 and is included as debt in our Consolidated Balance Sheet.

In 2000, we transferred domestic lease contracts to a special purpose entity ("SPE") as part of a financing transaction, for gross proceeds of $411. The proceeds received were accounted for as a secured borrowing. At December 31, 2002, the remaining balance was $7 and is included in debt in our Consolidated Balance Sheet.

As of December 31, 2002, $4,218 of Finance receivables and $219 of Billed finance receivables are held as collateral in various trusts and SPEs, as security for the borrowings noted above. Total outstanding debt being secured by these receivables at December 31, 2002 was $3,900. The SPEs are consolidated in our financial statements due to their holding non-financial assets and other conditions which preclude sale accounting. Although the transferred assets are included in our total assets, we received an opinion from outside legal counsel that the trusts and SPEs to which the assets were transferred were deemed bankruptcy remote. As a result, the assets of the trust are not available to satisfy any of our other obligations.

Accounts Receivable: In 2000, we established two revolving accounts receivable securitization facilities in the U.S. and Canada aggregating $330. The facilities enabled us to sell, on an ongoing basis, undivided interests in a portion of our accounts receivable in exchange for cash.

In May 2002, a credit rating agency downgrade caused a termination event under our U.S. trade receivable securitization facility. The undivided interest sold under the U.S. trade receivable securitization facility amounted to $290 at December 31, 2001 and was accounted for as a sale of receivables. We continued to sell receivables into the U.S trade receivable securitization facility pending renegotiation of the facility as a result of this termination event. In October 2002, the facility was terminated and no additional receivables were sold to the facility. As a result, in October the counter-party received $231 of collections from the pool of the then-existing receivables within the facility, which represented their remaining undivided interest balance. No new receivables were purchased by the counterparty and we have no further obligations as such facility has been terminated.

The Canadian accounts receivable facility, also accounted for as a sale of receivables, had undivided interests of $36 at December 31, 2001. It was impacted by a downgrade in our credit rating in February 2002, which led to a similar termination event. The Canadian accounts receivable facility was not renegotiated and the balance of the undivided interests was fully settled through collections in the first quarter of 2002.

Note 6--Inventories and Equipment on Operating Leases, Net

The components of inventories at December 31, 2002 and 2001 were as follows:

	2002	2001
Finished goods	$ 961	$ 960
Work in process	66	97
Raw materials	195	307
Total inventories	$1,222	$1,364

Equipment on operating leases and similar arrangements consists of our equipment rented to customers and depreciated to estimated salvage value at the end of the lease term. The transfer of equipment on operating leases from our inventories is presented in our Consolidated Statements of Cash Flows in the operating activities section as a non-cash adjustment. Equipment on operating leases and the related accumulated depreciation at December 31, 2002 and 2001 were as follows:

	2002	2001
Equipment on operating leases	$ 2,002	$ 2,433
Less: Accumulated depreciation	(1,543)	(1,629)
Equipment on operating leases, net	$ 459	$ 804

Depreciable lives generally vary from three to four years consistent with our planned and historical usage of the equipment subject to operating leases. Depreciation and obsolescence expense was $408, $657 and $626 for the years ended December 31, 2002, 2001 and 2000, respectively. Our equipment operating lease terms vary, generally from 12 to 36 months. Scheduled minimum future rental revenues on operating leases with original terms of one year or longer are:

2003	2004	2005	2006	Thereafter
$472	$126	$57	$20	$3

Total contingent rentals on operating leases, consisting principally of usage charges in excess of minimum contracted amounts, for the years ended December 31, 2002, 2001 and 2000 amounted to $187, $235 and $286, respectively.

Note 7--Land, Buildings and Equipment, Net

The components of land, buildings and equipment, net at December 31, 2002 and 2001 were as follows:

	Estimated Useful Lives (Years)	2002	2001
Land		$ 54	$ 58
Buildings and building equipment	25 to 50	1,077	1,080
Leasehold improvements	Lease term	412	425
Plant machinery	5 to 12	1,551	1,713
Office furniture and equipment	3 to 15	1,057	1,159
Other	4 to 20	107	147
Construction in progress		129	129
Subtotal		4,387	4,711
Less: accumulated depreciation		(2,630)	(2,712)
Land, buildings and equipment, net		$ 1,757	$ 1,999

Depreciation expense was $341, $402, and $417 for the years ended December 31, 2002, 2001 and 2000, respectively. We lease certain land, buildings and equipment, substantially all of which are accounted for as operating leases. Total rent expense under operating leases for the years ended December 31, 2002, 2001 and 2000 amounted to $299, $332, and $344, respectively. Future minimum operating lease commitments that have remaining non-cancelable lease terms in excess of one year at December 31, 2002 follow:

2003	2004	2005	2006	2007	Thereafter
$238	$202	$157	$124	$71	$346

In certain circumstances, we sublease space not currently required in operations. Future minimum sublease income under leases with non-cancelable terms in excess of one year amounted to $45 at December 31, 2002.

Capitalized direct costs associated with developing, purchasing or otherwise acquiring software for internal use are included in Other long-term assets in our Consolidated Balance Sheet. These costs are amortized on a straight-line basis over the expected useful life of the software, beginning when the software is implemented. The software useful lives generally vary from 3 to 5 years. Capitalized software balances, net of accumulated amortization, were $341 and $479 at December 31, 2002 and 2001, respectively. Amortization expense, including impairment charges, was $215, $132 and $86 for the years ended December 31, 2002, 2001 and 2000, respectively.

In 2001, we extended our information technology contract with Electronic Data Systems Corp. ("EDS") for five years through June 30, 2009. Services to be provided under this contract include support of global mainframe system processing, application maintenance, desktop and helpdesk support, voice and data network management and server management. There are no minimum payments due EDS under the contract. Payments to EDS, which are recorded in SAG, were $357, $445 and $555 for the years ended December 31, 2002, 2001 and 2000, respectively.

Note 8--Investments in Affiliates, at Equity

Investments in corporate joint ventures and other companies in which we generally have a 20 to 50 percent ownership interest at December 31, 2002 and 2001 were as follows:

	2002	2001
Fuji Xerox/(1)/	$563	$532
Other investments	65	100
Investments in affiliates at equity	$628	$632

/(1)/ Our investment in Fuji Xerox of $563 at December 31, 2002, differs from our implied 25 percent interest in the underlying net assets, or $627, due primarily to our deferral of gains resulting from sales of assets by us to Fuji Xerox, partially offset by goodwill we allocated to the Fuji Xerox investment at the time we acquired our remaining 20 percent of Xerox Limited from The Rank Group (plc). We cannot recognize such gains related to our portion of ownership interest in Fuji Xerox.

Fuji Xerox is headquartered in Tokyo and operates in Japan and other areas of the Pacific Rim, Australia and New Zealand. As discussed in Note 4, we sold half our interest in Fuji Xerox to Fuji Photo Film Co., Ltd. in March 2001.

Condensed financial data of Fuji Xerox for its last three years follow:

	2002/(1)/	2001/(1)/	2000
Summary of Operations:			
Revenues	$ 7,539	$ 7,684	$ 8,398
Costs and expenses	7,181	7,316	8,076
Income before income taxes	358	368	322
Income taxes	134	167	146
Minorities interests	36	35	36
Net Income	$ 188	$ 166	$ 140
Balance Sheet Data			
Assets			
Current assets	$ 2,976	$ 2,783	
Non-current assets	3,862	3,455	
Total Assets	$ 6,838	$ 6,238	
Liabilities and Shareholders' Equity			
Current Liabilities	$ 2,152	$ 2,242	
Long-term debt	868	796	
Other non-current liabilities	1,084	632	
Minorities' interests in equity of subsidiaries	227	201	
Shareholders' equity	2,507	2,367	
Total liabilities and shareholders' equity	$ 6,838	$ 6,238	

(1) Fuji Xerox changed its fiscal year end in 2001 from December 31 to March 31. The 2002 and 2001 condensed financial data consists of the last three months of Fuji Xerox's fiscal year 2002 and 2001 and the first nine months in fiscal year 2003 and 2002, respectively.

We have a technology agreement with Fuji Xerox whereby we receive royalty payments and rights to access their patent portfolio in exchange for access to our patent portfolio. We have arrangements with Fuji Xerox whereby we purchase inventory from and sell inventory to Fuji Xerox. Pricing of the transactions under these arrangements is based upon negotiations conducted at arm's length. Certain of these inventory pruchases and sales are the result of mutual research and development arrangements. Our purchase commitments with Fuji Xerox are in the normal course of business and typically have a lead time of three months. Purchases from and sales to Fuji Xerox for the three years ended December 31, 2002 were as follows:

	2002	2001	2000
Sales	$113	$132	$178
Purchases	$727	$598	$812

Note 9--Segment Reporting

Our reportable segments are consistent with how we manage the business and how we view the markets we serve. Our reportable segments are as follows: Production, Office, DMO, SOHO, and Other. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies.

The Production segment includes our DocuTech family of products, production printing, color products for the production and graphic arts markets and light-lens copiers over 90 pages per minute sold to Fortune 1000, graphic arts and government, education and other public sector customers predominantly through direct sales channels in North America and Europe.

The Office segment includes our family of Document Centre digital multifunction products, color laser, solid ink and monochrome laser desktop printers, digital and light-lens copiers under 90 pages per minute, and facsimile products sold through direct and indirect sales channels in North America and Europe. The Office market is comprised of global, national and mid-size commercial customers as well as government, education and other public sector customers.

The DMO segment includes our operations in Latin America, the Middle East, India, Eurasia, Russia and Africa. This segment includes sales of products that are typical to the aforementioned segments, however management serves and evaluates these markets on an aggregate geographic, rather than product, basis.

The SOHO segment includes inkjet printers and personal copiers sold through indirect channels in North America and Europe to small offices, home offices and personal users (consumers). As more fully discussed in Note 2, in June 2001 we announced the disengagement from the worldwide SOHO business.

The segment classified as Other, includes several units, none of which met the thresholds for separate segment reporting. This group primarily includes Xerox Supplies Group ("XSG") (predominantly paper), Xerox Engineering Systems ("XES") Xerox Connect ("Xconnect"), Xerox Technology Enterprises ("XTE") and consulting services, royalty and license revenues. Other segment profit (loss) includes the operating results from paper sales and these entities, other less significant businesses, our equity income from Fuji Xerox, and certain costs which have not been allocated to the businesses including non-financing interest and other non-allocated costs. Other segments' total assets include XES, XSG, and our investment in Fuji Xerox.

Operating segment information for 2001 has been adjusted to reflect a change in operating segment structure that was made in 2002. The nature of the changes related primarily to corporate expense and other allocations associated with internal reorganizations made in 2002, as well as decisions concerning direct applicability of certain overhead expenses to the segments. The adjustments increased (decreased) full year 2001 revenues as follows: Production--($16), Office--($16), DMO--($1), SOHO--$3 and Other--$30. The full year 2001 segment profit was increased (decreased) as follows: Production--$12, Office--$24, DMO--$32, SOHO--$2 and Other--($70). The operating segment information for 2000 has not been restated, as it was impracticable to do so. Therefore, we have presented 2002 and 2001 on the new basis and 2002, 2001 and 2000 on the old basis.

Operating segment selected financial information, using the new basis of presentation as discussed above, for the years ended December 31, 2002 and 2001 was as follows:

	Production	Office	DMO	SOHO	Other	Total
2002						
Information about profit or loss						
Revenues from external customers	$ 5,110	$ 5,980	$ 1,742	$231	$1,786	$14,849
Finance income	505	490	16	--	(11)	1,000
Intercompany revenues	--	135	--	13	(148)	--
Total segment revenues	$ 5,615	$ 6,605	$ 1,758	$244	$1,627	$15,849
Interest expense/(1)/	$ 198	$ 182	$ 17	$ --	$ 354	$ 751
Segment profit (loss)/(2)(3)/	625	498	62	82	(289)	978
Equity in net income of unconsolidated affiliates	--	--	5	--	49	54
Information about assets						
Investments in affiliates, at equity	9	8	22	--	589	628
Total assets	10,756	11,213	1,121	213	2,155	25,458
Cost of additions to land, buildings and equipment	62	64	6	1	13	146

	Production	Office	DMO	SOHO	Other	Total
2001						
Information about profit or loss						
Revenues from external customers	$ 5,320	$ 6,323	$ 2,000	$405	$1,831	$15,879
Finance income	563	537	26	1	2	1,129
Intercompany revenues	--	50	--	4	(54)	--
Total segment revenues	$ 5,883	$ 6,910	$ 2,026	$410	$1,779	$17,008
Interest expense/(1)/	$ 274	$ 247	$ 48	$ --	$ 368	$ 937
Segment profit (loss)/(2)(3)/	466	365	(125)	(195)	(143)	368
Equity in net income of unconsolidated affiliates	--	--	4	--	49	53
Information about assets						
Investments in affiliates, at equity	7	6	12	--	607	632
Total assets	11,214	11,905	1,671	492	2,363	27,645
Cost of additions to land, buildings and equipment	60	74	32	23	30	219

(1) Interest expense includes equipment financing interest as well as non-financing interest, which is a component of Other expenses, net.

(2) Other segment profit (loss) includes net corporate expenses of $235 and $71 for the years ended December 31, 2002 and 2001, respectively.

(3) Depreciation and amortization expense is recorded in cost of sales, research and development expenses and selling, administrative and general expenses and is included in the segment profit (loss) above. This information is not identified and reported separately to our chief operating decision-maker. These expenses are recorded by our operating units in the accounting records based on individual assessments as to how the related assets are used. The separate identification of this information for purposes of segment disclosure is impracticable, as it is not readily available and the cost to develop it would be excessive.

Operating segment selected financial information, using the prior year's basis of presentation, as discussed above, for the years ended December 31, 2002, 2001 and 2000 was as follows:

	Production	Office	DMO	SOHO	Other	Total
2002						
Information about profit or loss						
Revenues from external customers	$ 5,130	$ 5,995	$ 1,742	$ 231	$ 1,751	$ 14,849
Finance income	505	490	16	--	(11)	1,000
Intercompany revenues	--	135	--	13	(148)	--
Total segment revenues	$ 5,635	$ 6,620	$ 1,758	$ 244	$ 1,592	$ 15,849
Interest expense/(1)/	$ 198	$ 182	$ 17	$ --	$ 354	$ 751
Segment profit (loss)/(2)(3)/	613	493	53	82	(263)	978
Equity in net income of unconsolidated affiliates	--	--	5	--	49	54
Information about assets						
Investments in affiliates, at equity	9	8	22	--	589	628
Total assets	10,756	11,213	1,121	213	2,155	25,458
Cost of additions to land, buildings and equipment	62	64	6	1	13	146
2001						
Information about profit or loss						
Revenues from external customers	$ 5,336	$ 6,340	$ 2,001	$ 402	$ 1,800	$ 15,879
Finance income	563	536	26	1	3	1,129
Intercompany revenues	--	50	--	4	(54)	--
Total segment revenues	$ 5,899	$ 6,926	$ 2,027	$ 407	$ 1,749	$ 17,008
Interest expense/(1)/	$ 274	$ 247	$ 48	$ --	$ 368	$ 937
Segment profit (loss)/(2)(3)/	454	341	(157)	(197)	(73)	368
Equity in net income of unconsolidated affiliates	--	--	4	--	49	53
Information about assets						
Investments in affiliates, at equity	7	6	12	--	607	632
Total assets	11,214	11,905	1,671	492	2,407	27,689
Cost of additions to land, buildings and equipment	60	74	32	23	30	219
2000						
Information about profit or loss						
Revenues from external customers	$ 5,749	$ 6,518	$ 2,573	$ 592	$ 2,157	$ 17,589
Finance income	583	528	46	1	4	1,162
Intercompany revenues	--	14	--	6	(20)	--
Total segment revenues	$ 6,332	$ 7,060	$ 2,619	$ 599	$ 2,141	$ 18,751
Interest expense/(1)/	$ 275	$ 235	$ 103	$ --	$ 477	$ 1,090
Segment profit (loss)/(2)(3)/	463	(180)	(93)	(293)	225	122
Equity in net income (loss) of unconsolidated affiliates/(4)/	(2)	(2)	4	--	103	103
Information about assets						
Investments in affiliates, at equity	7	6	13	--	1,244	1,270
Total assets	11,158	11,362	2,240	806	2,687	28,253
Cost of additions to land, buildings and equipment	132	122	88	90	20	452

/(1)/ Interest expense includes equipment financing interest as well as non-financing interest, which is a component of Other expenses, net.

/(2)/ Other segment profit (loss) includes net corporate expenses of $227, $35 and $116 for the years ended December 31, 2002, 2001 and 2000, respectively.

/(3)/ Depreciation and amortization expense is recorded in cost of sales, research and development expenses and selling, administrative and general expenses and is included in the segment profit (loss) above. This information is not identified and reported separately to our chief operating decision-maker. These expenses are recorded by our operating units in the accounting records based on individual assessments as to how the related assets are used. The separate identification of this information for purposes of segment disclosure is impracticable, as it is not readily available and the cost to develop it would be excessive.

/(4)/ Excludes our $37 share of a restructuring charge recorded by Fuji Xerox.

The following is a reconciliation of segment profit to total company pre-tax income (loss):

	Years ended December 31, 2002	2001	2000
Total segment profit	$ 978	$ 368	$ 122
Unallocated items:			
Restructuring and asset impairment charges	(670)	(715)	(475)
Gain on early extinguishment of debt	--	63	--
Restructuring related inventory write-down charges	(2)	(42)	(84)
In process research and development charges	--	--	(27)
Gains on sales of Fuji Xerox interest and China Operations	--	773	200
Allocated item:			
Equity in net income of unconsolidated affiliates	(54)	(53)	(103)
Pre-tax income (loss)	$ 252	$ 394	$ (367)

Geographic area data follow:

	Revenues			Long-Lived Assets (1)		
	2002	2001	2000	2002	2001	2000
United States	$ 9,897	$10,034	$10,706	$1,524	$1,880	$2,423
Europe	4,425	5,039	5,511	718	767	940
Other Areas	1,527	1,935	2,534	379	706	1,052
Total	$15,849	$17,008	$18,751	$2,621	$3,353	$4,415

(1) Long-lived assets are comprised of (i) land, buildings and equipment, net, (ii) on-lease equipment, net, and (iii) internal and external-use capitalized software costs, net.

Note 10--Net Investment in Discontinued Operations

Our net investment in discontinued operations is included in the Consolidated Balance Sheets in Other long-term assets and totaled $728 and $749 at December 31, 2002 and 2001, respectively. Our net investment is primarily related to the disengagement from our former insurance holding company, Talegen Holdings, Inc. ("Talegen").

Reinsurance Obligation: Xerox Financial Services, Inc. ("XFSI"), a wholly owned subsidiary, continues to provide aggregate excess of loss reinsurance coverage (the Reinsurance Agreements) to two of the former Talegen units, Crum and Forster Inc. ("C&F") and The Resolution Group, Inc. ("TRG") through Ridge Reinsurance Limited ("Ridge Re"), a wholly-owned subsidiary of XFSI. The coverage limits for these two remaining Reinsurance Agreements total $578, which is exclusive of $234 in C&F coverage that Ridge Re reinsured during the fourth quarter of 1998.

We, and XFSI, have guaranteed that Ridge Re will meet all its financial obligations under the two remaining Reinsurance Agreements. Although unlikely, XFSI may be required, under certain circumstances, to purchase, over time, additional redeemable preferred shares of Ridge Re, up to a maximum of $301.

During 2001, we replaced $660 of letters of credit, which supported Ridge Re ceded reinsurance obligations, with trusts which included the then existing Ridge Re investment portfolio of approximately $405 plus $255 in cash. During 2002, Ridge Re repaid $20 of this cash to us and expects to repay the remaining $235 during 2003 at the time of the expected novation of the C&F reinsurance contract to another insurance company. These trusts are required to provide security with respect to aggregate excess of loss reinsurance obligations under the two remaining Reinsurance Agreements. At December 31, 2002 and 2001, the balance of the investments in the trusts, consisting of U.S. government, government agency and high quality corporate bonds, was $759 and $684, respectively.

Our remaining net investment in Ridge Re was $325 and $319 at December 31, 2002 and 2001, respectively. Based on Ridge Re's current projections of investment returns and reinsurance payment obligations, we expect to fully recover our remaining investment. The projected reinsurance payments are based on actuarial estimates.

Performance-Based Instrument: In connection with the sale of TRG in 1997, we received a $462 performance-based instrument as partial consideration. Cash distributions are paid on the instrument, based on 72.5 percent of TRG's available cash flow as defined in the sale agreement. For the years ended December 31, 2002 and 2001, we have received cash distributions of $24 and $28, respectively. The recovery of this instrument is dependent upon the sufficiency of TRG's available cash flows. Based on current cash flow projections, we expect to fully recover the $410 remaining balance of this instrument.

During 2002, the ultimate parent of TRG sought approval from us to affect a change in business structure of the entities it holds by combining an insurance subsidiary of TRG with one of its other insurers. In order to obtain our approval and enhance the cash flow capabilities of TRG, the ultimate parent of TRG has entered into a subscription agreement with TRG to purchase an established number of shares of this instrument each year from TRG beginning in 2003 and continuing through 2017.

Note 11--Debt

Short-Term Debt: Short-term borrowings at December 31, 2002 and 2001 were as follows:

	Weighted Average Interest Rates at December 31, 2002	Weighted Average Interest Rates at December 31, 2001	2002	2001
Notes payable	6.22%	11.07%	$ 20	$ 53
Euro secured borrowing	3.27%	--%	377	--
Total short-term debt			397	53
Current maturities of long-term debt			3,980	6,584
Total			$4,377	$6,637

Debt Classification: At December 31, 2002, our debt has been classified in the Consolidated Balance Sheet based on the contractual maturity dates of the underlying debt instruments or as of the earliest put date available to the debt holders. At December 31, 2001, our debt was classified in the same manner, except that $3.5 billion of the aggregate $7.0 billion Revolving credit agreement, which was due in 2002, was classified as long-term because subsequent to December 31, 2001, but prior to the issuance of the financial statements, we refinanced that debt on a long-term basis under the New Credit Facility.

We defer costs associated with debt issuance over the applicable term or to the first redemption date, in the case of convertible debt or debt with a put feature. Total deferred debt issuance costs included in Other long-term assets were $133 and $33 as of December 31, 2002 and 2001, respectively. These costs are amortized as interest expense in our Consolidated Statement of Income.

Long-Term Debt: Long-term debt by final contractual maturity date at December 31, 2002 and 2001 was as follows:

	Weighted Average Interest Rates at 12/31/02	2002	2001
U.S. Operations			
Xerox Corporation (parent company)			
Guaranteed ESOP notes due 2001-2003	-----	$ ----	$ 135
Notes due 2002	-----	----	300
Notes due 2003	5.62%	883	896
Notes due 2004	7.15	196	197
Euro notes due 2004	3.50	315	266
Notes due 2006	7.25	15	15
Notes due 2007	7.38	25	25
Notes due 2008	1.41	25	25
Senior Notes due 2009	9.75	626	----
Euro Senior Notes due 2009	9.75	226	----
Notes due 2011	7.01	50	50
Notes due 2014	9.00	19	----
Notes due 2016	7.20	255	255
Convertible notes due 2018/(1)/	3.63	556	579
New Credit Facility	6.15	3,440	4,675
Other debt due 2001-2018	6.97	40	93
Subtotal		6,671	7,511
Xerox Credit Corporation			
Notes due 2002	-----	$ ----	$ 229
Yen notes due 2002	-----	----	381
Notes due 2003	6.61	463	465
Yen notes due 2005	1.50	845	762
Yen notes due 2007	2.00	255	231
Notes due 2008	6.45	25	25
Notes due 2012	7.11	125	125
Notes due 2013	6.50	59	60
Notes due 2014	6.06	50	50
Notes due 2018	7.00	25	25
Revolving credit agreement	-----	----	1,020
Subtotal		1,847	3,373
Other US Operations/(2,3)/			
Secured borrowings due 2002-2006	5.03	2,462	1,639
Secured borrowings due 2001-2003	3.25	7	154
Subtotal		2,469	1,793
Total U.S. operations		10,987	12,677

International Operations	Weighted Average Interest Rates at 12/31/02	2002	2001
Xerox Capital (Europe) plc:			
Euros due 2001-2008	5.25%	784	661
Japanese yen due 2001-2005	1.30	84	229
U.S. dollars due 2001-2008	5.89	523	1,022
Revolving credit agreement (U.S. dollars)	--	-	805
Subtotal		1,391	2,717
Other International Operations:			
Pound Sterling secured borrowings/(3)/ due 2001-2003	6.24	529	521
Euro secured borrowings...	7.78	206	-
Canadian dollars secured borrowings due 2003-2005	5.63	319	-
Revolving credit agreement	6.45	50	500
Other debt due 2001-2008	10.07	292	276
Subtotal		1,396	1,297
Total international operations		2,787	4,014
Subtotal		13,774	16,691
Less current maturities		(3,980)	(6,584)
Total long-term debt		$9,794	$10,107

/(1)/ This debt contains a put option that may be exercisable in 2003 (see below).
/(2)/ Includes debt of special purpose entities that are consolidated in our financial statements.
/(3)/ Refer to Note 5 for further discussion of secured borrowings.

Consolidated Long-Term Debt Maturities: Scheduled payments due on long-term debt for the next five years and thereafter follow:

2003	2004	2005	2006	2007	Thereafter
$ 3,980	$ 3,909	$ 4,016	$ 56	$ 296	$ 1,517

Certain of our debt agreements allow us to redeem outstanding debt prior to scheduled maturity, although the New Credit Facility generally prohibits early repayment of debt. The actual decision as to early redemption, when and if possible, will be made at the time the early redemption option becomes exercisable and will be based on liquidity, prevailing economic and business conditions, and the relative costs of new borrowing.

Convertible Debt due 2018: In 1998, we issued convertible subordinated debentures for net proceeds of $575. The original scheduled amount due at maturity in April 2018 was $1,012 which corresponded to an effective interest rate of 3.625 percent per annum, including 1.003 percent payable in cash semiannually beginning in October 1998. These debentures are convertible at any time at the option of the holder into 7.808 shares of our common stock per 1,000 dollars principal amount at maturity of the debentures. This debt contains a put option which requires us to purchase any debenture, at the option of the holder, on April 21, 2003, for a price of 649 dollars per 1,000 dollars principal amount at maturity of the debentures. We may elect to settle the obligation in cash, shares of common stock, or any combination thereof. During 2002, we retired $32 of this convertible debt through the exchange of approximately 4 million shares of common stock valued at $31. During 2001, we retired $58 of this convertible debt through the exchange of approximately 6 million shares of common stock valued at $49. As a result of these retirements, the amount due at December 31, 2002 is $556 and is projected to accrete to $863 upon maturity in April 2018.

Debt-for-Equity Exchanges: During 2002, we exchanged an aggregate of $52 of debt through the exchange of 6.4 million shares of common stock valued at $51 using the fair market value at the date of exchange. A gain of $1 was recorded in connection with these transactions. During 2001, we retired $374 of long-term debt through the exchange of 41 million shares of common stock valued at $311. A gain of $63 was recorded in connection with these transactions. The gains were recorded in Other expenses, net in our Consolidated Statements of Income. The shares were valued using the daily volume-weighted average price of our common stock over a specified number of days prior to the exchange, based on contractual terms.

Lines of Credit: As of December 31, 2001, we had $7 billion of loans outstanding under a fully-drawn revolving credit agreement (Old Revolver) due October 22, 2002, which we entered into in 1997 with a group of lenders.

In June 2002, we entered into an Amended and Restated Credit Agreement (the "New Credit Facility") with a group of lenders, replacing our prior $7 billion facility (the "Old Revolver"). At that time, we permanently repaid $2.8 billion of the Old Revolver and subsequently paid $710 on the New Credit Facility. At December 31, 2002, the New Credit Facility consisted of two tranches of term loans totaling $2.0 billion and a $1.5 billion revolving credit facility that includes a $200 letter of credit subfacility. At December 31, 2002, $3.5 billion was outstanding under the New Credit Facility. At December 31, 2002 we had no additional borrowing capacity under the New Credit Facility since the entire revolving facility was outstanding, including a $10 letter of credit under the subfacility. Xerox, the parent company, is currently, and expects to remain, the borrower of all the loans. The Revolving Facility is available, without sub-limit, to Xerox and to certain subsidiaries including Xerox Canada Capital Limited, Xerox Capital Europe plc, and other foreign subsidiaries as defined.

We could be required to repay portions of the loans earlier than their scheduled maturities with specified percentages of any proceeds we receive from capital market debt issuances, equity issuances or asset sales during the term of the New Credit Facility, except that the revolving loan commitment cannot be reduced below $1 billion as a result of such prepayments. Additionally, all loans under the New Credit Facility become due and payable upon the occurrence of a change in control.

The New Credit Facility loans bear interest at LIBOR plus 4.50 percent, except that a $500 term-loan tranche bears interest at LIBOR plus a spread that varies between 4.00 percent and 4.50 percent, depending on the amount secured.

In connection with the New Credit Facility we incurred fees and other expenses of $120 which have been capitalized and are being amortized over its term on a basis consistent with the scheduled repayments in relation to the total amount of the loan facility.

Subject to certain limits, all obligations under the New Credit Facility are currently secured by liens on substantially all domestic assets of Xerox Corporation and substantially all our U.S. subsidiaries (other than Xerox Credit Corporation) and are guaranteed by substantially all our U.S. subsidiaries. In addition, revolving loans outstanding from time to time to Xerox Capital (Europe) plc (XCE) (none at December 31, 2002) are also secured by all XCE's assets and are guaranteed on an unsecured basis by certain foreign subsidiaries that directly or indirectly own all the outstanding stock of XCE. Revolving loans outstanding from time to time to Xerox Canada Capital Limited (XCCL) ($50 at December 31, 2002) are secured by all XCCL's assets and are guaranteed on an unsecured basis by our material Canadian subsidiaries, as defined.

The New Credit Facility contains affirmative and negative covenants which are more fully discussed in Note 1.

At December 31, 2002, we are in compliance with all aspects of the New Credit Facility including financial covenants and expect to be in compliance for at least the next twelve months. Failure to be in compliance with any material provision or covenant of the New Credit Facility could have a material adverse effect on our liquidity and operations.

We are required to make scheduled amortization payments of $202.5 on each of March 31, 2003 and September 30, 2003, and $302.5 on each of March 31, 2004 and September 30, 2004. In addition, mandatory prepayments are required from a portion of any proceeds we receive from certain asset transfers or debt or equity issuances, as those terms are defined in the New Credit Facility. Any such prepayments would be credited toward the scheduled amortization payments in direct order of maturity.

Senior Notes. In January 2002, we completed an unregistered offering in the U.S. ($600) and Europe ((euro)225) of 9.75 percent senior notes due in 2009 ("Senior Notes") and received net cash proceeds of $746, which included $559 and (euro)209. The senior notes were issued at a 4.833 percent discount and pay interest semiannually on January 15 and July 15. In March 2002, we filed a registration statement to exchange senior registered notes for these unregistered senior notes. This registration statement has not yet been declared effective. The terms of the debt include increases in the interest rate to the extent the registration is delayed. Such increases will be up to 0.50 percent and will be effective until the registration effectiveness is complete. As of January 17, 2003, the interest rate increased to 10.0 percent. Fees of $16 million incurred in connection with this offering have been capitalized as debt issue costs and are being amortized over the term of the notes. These Senior Notes are guaranteed by certain of our U.S. subsidiaries and contain several affirmative and negative covenants similar to those in the New Credit Facility, but taken as a whole are less restrictive than those in the New Credit Facility. We were in compliance with these covenants at December 31, 2002.

Guarantees. At December 31, 2002, we have guaranteed $1.9 billion of indebtedness of our foreign wholly-owned subsidiaries. This debt is included in our Consolidated Balance Sheet as of such date.

Interest. Interest paid by us on our short- and long-term debt amounted to $772, $1,074, and $1,050 for the years ended December 31, 2002, 2001 and 2000, respectively.

Interest expense and interest income consisted of:

	Year Ended December 31,		
	2002	2001	2000
Interest expense /(1)/	$ 751	$ 937	$ 1,090
Interest income /(2)/	(1,077)	(1,230)	(1,239)

/(1)/ Includes Equipment financing interest, as well as non-financing interest expense that is included in Other expenses, net in the Consolidated Statements of Income.

/(2)/ Includes Finance income, as well as other interest income that is included in Other expenses, net in the Consolidated Statements of Income.

Equipment financing interest is determined based on a combination of actual interest expense incurred on financing debt, as well as our estimated cost of funds, applied against the estimated level of debt required to support our financed receivables. The estimate is based on an assumed ratio of debt as compared to our finance receivables. This ratio ranges from 80-90% of our average finance receivables. This methodology has been consistently applied for all periods presented.

A summary of the Other cash changes in debt, net as shown on the consolidated statements of cash flows for the three years ended December 31, 2002 follows:

	2002	2001	2000
Cash payments on notes payable, net	$ (33)	$ (141)	$(1,277)
Cash proceeds from long-term debt, net /(1)/	1,053	89	10,131
Cash payments on long-term debt	(5,639)	(2,396)	(5,816)
Total other cash changes in debt, net	$(4,619)	$(2,448)	$ 3,038

/(1)/ Includes payment of debt issuance costs.

Note 12--Financial Instruments

We are exposed to market risk from changes in foreign currency exchange rates and interest rates that could affect our results of operations and financial condition. Our current below investment-grade credit ratings effectively constrain our ability to fully use derivative contracts as part of our risk management strategy described below, especially with respect to interest rate management. Accordingly, our results of operations are exposed to increased volatility. As further discussed in Note 1, we adopted SFAS No. 133, as of January 1, 2001. The adoption of SFAS No. 133 has increased the volatility of reported earnings and other comprehensive income. In general, the amount of volatility will vary with the level of derivative and hedging activities and the market volatility during any period.

We have historically entered into certain derivative contracts, including interest rate swap agreements, foreign currency swap agreements, forward exchange contracts and purchased foreign currency options, to manage interest rate and foreign currency exposures. The fair market values of all our derivative contracts change with fluctuations in interest rates and/or currency rates and are designed so that any change in their values is offset by changes in the values of the underlying exposures. Our derivative instruments are held solely to hedge economic exposures; we do not enter into derivative instrument transactions for trading or other speculative purposes and we employ long-standing policies prescribing that derivative instruments are only to be used to achieve a very limited set of objectives.

Our primary foreign currency market exposures include the Japanese Yen, Euro, Brazilian Real, British Pound Sterling and Canadian Dollar. Historically, for each of our legal entities, we have generally hedged foreign currency denominated assets and liabilities, primarily through the use of derivative contracts. Despite our current credit ratings, we have been able to restore significant economic hedging activities with currency-related derivative contracts during 2002. Although we are still unable to hedge all our currency exposures, we are currently utilizing the re-established capacity primarily to hedge currency exposures related to our foreign-currency denominated debt.

We typically enter into simple unleveraged derivative transactions. Our policy is to use only counterparties with an investment-grade or better credit rating and to monitor market risk and exposure for each counterparty. We also utilize arrangements allowing us to net gains and losses on separate contracts with all counterparties to further mitigate the credit risk associated with our financial instruments. Based upon our ongoing evaluation of the replacement cost of our derivative transactions and counterparty credit-worthiness, we consider the risk of a material default by a counterparty to be remote.

Due to our credit ratings, many of our derivative contracts and several other material contracts at December 31, 2002 require us to post cash collateral or maintain minimum cash balances in escrow. These cash amounts are reported in our Consolidated Balance Sheets as within Other current assets or Other long-term assets, depending on when the cash will be contractually released. Such restricted cash amounts totaled $77 at December 31, 2002.

Interest Rate Risk Management: Virtually all customer-financing assets earn fixed rates of interest, while a significant portion of our debt bears interest at variable rates. Historically we have attempted to manage our interest rate risk by "match-funding" the financing assets and related debt, including through the use of interest rate swap agreements. However, as our credit ratings declined, our ability to continue this practice became constrained.

At December 31, 2002, we had $7.0 billion of variable rate debt, including the $3.5 billion outstanding under the New Credit Facility and the notional value of our pay-variable interest-rate swaps. The notional value of our offsetting pay-fixed interest-rate swaps was $1.2 billion.

Our loans related to vendor financing, from parties including GE, are secured by customer-financing assets and are designed to mature ratably with our collection of principal payments on the financing assets which secure them. Additionally, the interest rates on all these loans are fixed. As a result, the vendor financing loan programs we have implemented create natural match-funding of the financing assets to the related loans. As we implement additional vendor financing opportunities and continue to repay existing debt, the portion of our financing assets which is match-funded against related secured debt will increase.

Single Currency Interest Rate Swaps: At December 31, 2002 and 2001 we had outstanding single currency interest rate swap agreements with aggregate notional amounts of $3,820 and $4,415, respectively. The net asset fair values at December 31, 2002 and 2001 were $121 and $52, respectively.

Foreign Currency Interest Rate Swaps: In cases where we issue foreign currency-denominated debt, we enter into cross-currency interest rate swap agreements if possible, whereby we swap the proceeds and related interest payments with a counterparty. In return, we receive and effectively denominate the debt in local functional currencies.

At December 31, 2002 and 2001, we had outstanding cross-currency interest rate swap agreements with aggregate notional amounts of $879 and $1,481, respectively. The net asset fair values at December 31, 2002 and 2001 were $21 and $17, respectively. Of the outstanding agreements at December 31, 2002, the largest single currency hedged was the Japanese yen. Contracts denominated in Japanese yen, Pound sterling and Euros accounted for over 95 percent of our cross-currency interest rate swap agreements.

The aggregate notional amounts of interest rate swaps by maturity date and type at December 31, 2002 follow:

Single Currency Swaps	2003	2004	2005	2006	Thereafter	Total
Pay fixed/receive variable	$ 139	$ 275	$ 172	$ 22	$ 250	$ 858
Pay variable/receive fixed	825	1,287	--	--	850	2,962
Total	$ 964	$1,562	$ 172	$ 22	$1,100	$3,820
Interest rate paid	0.79%	3.19%	6.61%	6.02%	5.37%	3.38%
Interest rate received	2.30	5.00	2.23	2.84	7.45	4.89

Cross Currency Swaps	2003	2004	2005	2006	Thereafter	Total
Pay fixed/receive variable	$ 257	$ 87	$ 8	$ --	$ --	$ 352
Pay variable/receive fixed	--	--	--	406	122	528
Total	$ 257	$ 87	$ 8	$ 406	$ 122	$ 880
Interest rate paid	5.02%	5.97%	6.85%	2.53%	2.93%	3.69%
Interest rate received	1.42	1.42	1.42	1.50	2.00	1.54

The majority of the variable portions of our swaps pay interest based on spreads against LIBOR or the European Interbank Rate.

Derivatives Marked-to-Market Results: While our existing portfolio of interest rate derivative instruments is intended to economically hedge interest rate risks to the extent possible, differences between the contract terms of our derivatives and the underlying related debt reduce our ability to obtain hedge accounting in accordance with SFAS No. 133. This results in mark-to-market valuation of the majority of our derivatives directly through earnings, which accordingly leads to increased earnings volatility. During 2002 and 2001, we recorded net gains of $12 and net losses of $2, respectively, from the mark-to-market valuation of interest rate derivatives for which we did not apply hedge accounting.

Fair Value Hedges: During 2002, pay variable/receive fixed interest rate swaps with a notional amount of $600 and associated with the Senior Notes due in 2009, were designated and accounted for as fair value hedges. The swaps were structured to hedge the fair value of the debt by converting it from a fixed rate instrument to a variable based instrument. Since the hedging relationship qualified under SFAS No. 133, no ineffective portion was recorded to earnings during 2002. During 2001, certain Japanese yen/U.S. dollar cross-currency interest rate swaps with a notional amount of 65 billion yen were designated and accounted for as fair value hedges. The net ineffective portion recorded to earnings during 2001 was a loss of $7 and is included in Other expenses, net in the accompanying Consolidated Statements of Income. All components of each derivatives gain or loss were included in the assessment of hedge effectiveness. Hedge accounting was discontinued in the fourth quarter 2001 after the swaps were terminated and moved to a different counterparty, because the new swaps did not satisfy certain SFAS No. 133 requirements.

Foreign Exchange Risk Management:

Currency Derivatives: We utilize forward exchange contracts and purchased option contracts to hedge against the potentially adverse impacts of foreign currency fluctuations on foreign currency denominated assets and liabilities. Changes in the value of these currency derivatives are recorded in earnings together with the offsetting foreign exchange gains and losses on the underlying assets and liabilities.

We also utilize currency derivatives to hedge anticipated transactions, primarily forecasted purchases of foreign-sourced inventory and foreign currency lease, interest and other payments. These contracts generally mature in six months or less. Although these contracts are intended to economically hedge foreign currency risks to the extent possible, differences between the contract terms of our derivatives and the underlying forecasted exposures reduce our ability to obtain hedge accounting in accordance with SFAS No. 133. Accordingly, the changes in value for a majority of these derivatives are recorded directly through earnings.

During 2002, 2001 and 2000, we recorded aggregate exchange losses of $77 and gains of $29 and $103, respectively. This reflects the changes in the values of all our foreign currency derivatives, for which we did not apply hedge accounting, together with exchange gains and losses on foreign currency underlying assets and liabilities.

At December 31, 2002 and 2001, we had outstanding forward exchange and purchased option contracts with gross notional values of $3,319 and $3,900, respectively. The net asset (liability) fair values of our currency derivatives at December 31, 2002 and 2001 were $(50) and $8, respectively. The following is a summary of the primary hedging positions held as of December 31, 2002:

Currency Hedged (Buy/Sell)	Gross Notional Value	Fair Value Asset/ (Liability)
US Dollar/Euro	$ 791	$ (45)
Euro/Pound Sterling	730	5
Yen/US Dollar	584	4
Pound Sterling/Euro	360	(7)
Canadian Dollar/Euro	109	(14)
US Dollar/Brazil Real	104	6
US Dollar/Canadian Dollar	90	1
Yen/Pound Sterling	89	2
All Other	462	(2)
Total	$ 3,319	$ (50)

Accumulated Other Comprehensive Income ("AOCI"): The following is a summary of changes in AOCI resulting from the application of SFAS No. 133 during 2002 and 2001:

For the Year Ended December 31, 2002	Opening Balance	Transition Gains (Losses)	Net Gains (Losses)	Reclass to Statement of Operations*	Closing Balance
Variable Interest Paid	$ (15)	$ --	$ --	$ 15	$ --
Foreign Currency Interest Payments	(2)	--	(1)	1	(2)
Pre-tax Subtotal	(17)	--	(1)	16	(2)
Tax Expense	8	--	--	(7)	1
Fuji Xerox, net	2	--	--	(2)	--
Total	$ (7)	$ --	$ (1)	$ 7	$ (1)
For the Year Ended December 31, 2001					
Variable Interest Paid	$ --	$ (35)	$ --	$ 20	$ (15)
Inventory Purchases	--	--	(5)	5	--
Foreign Currency Interest Payments	--	--	(4)	2	(2)
Pre-tax Subtotal	--	(35)	(9)	27	(17)
Tax Expense	--	14	4	(10)	8
Fuji Xerox, net	--	2	--	--	2
Total	$ --	$ (19)	$ (5)	$ 17	$ (7)

* Includes reclassification of $7 in 2002 and $12 in 2001 of the after-tax transition loss of $19.

During 2002 and 2001, certain forward contracts used to hedge Euro denominated interest payments were designated and accounted for as cash flow hedges. Accordingly, the change in value of these derivatives is included in the rollforward of AOCI above. No amount of ineffectiveness was recorded to the Consolidated Statements of Income during 2002 or 2001 for our designated cash flow hedges and all components of each derivatives gain or loss are included in the assessment of hedge effectiveness. The amount reclassified to earnings during 2001 and 2002 represents the recognition of deferred gains or losses along with the underlying hedged transactions.

Net Investment Hedges: We also utilize derivative instruments and non-derivative financial instruments to hedge against the potentially adverse impacts of foreign currency fluctuations on certain of our investments in foreign entities. During 2001, $18 of net after-tax gains related to hedges of our net investments in Xerox Brazil and Fuji Xerox were recorded in the cumulative translation adjustments account. The amounts recorded during 2002 were less than $1.

Fair Value of Financial Instruments. The estimated fair values of our financial instruments at December 31, 2002 and 2001 follow:

	2002		2001	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	$ 2,887	$ 2,887	$ 3,990	$ 3,990
Accounts receivable, net	2,072	2,072	1,896	1,896
Short-term debt	4,377	3,837	6,637	6,503
Long-term debt	9,794	9,268	10,107	9,261

The fair value amounts for Cash and cash equivalents and Accounts receivable, net approximate carrying amounts due to the short maturities of these instruments.

The fair value of Short and Long-term debt was estimated based on quoted market prices for these or similar issues or on the current rates offered to us for debt of similar maturities. The difference between the fair value and the carrying value represents the theoretical net premium or discount we would pay or receive to retire all debt at such date. We have no plans to retire significant portions of our debt prior to scheduled maturity.

Note 13--Employee Benefit Plans

We sponsor numerous pension and other post-retirement benefit plans, primarily retiree health, in our U.S. and international operations. Information regarding our benefit plans is presented below:

	Pension Benefits		Other Benefits	
	2002	2001	2002	2001
Change in Benefit Obligation				
Benefit obligation, January 1	$ 7,606	$ 8,255	$ 1,481	$ 1,314
Service cost	180	174	26	28
Interest cost	(210)	(184)	96	99
Plan participants' contributions	18	19	3	--
Plan amendments	(31)	--	(139)	--
Actuarial loss	736	76	191	136
Currency exchange rate changes	327	(99)	--	(3)
Divestitures	(1)	--	--	--
Curtailments	2	34	8	(1)
Special termination benefits	39	--	2	--
Benefits paid/settlements	(735)	(669)	(105)	(92)
Benefit obligation, December 31	$ 7,931	$ 7,606	$ 1,563	$ 1,481
Change in Plan Assets				
Fair value of plan assets, January 1	$ 7,040	$ 8,626	$ --	$ --
Actual return on plan assets	(768)	(843)	--	--
Employer contribution	138	42	102	92
Plan participants' contributions	18	19	3	--
Currency exchange rate changes	271	(135)	--	--
Divestitures	(1)	--	--	--
Benefits paid	(735)	(669)	(105)	(92)
Fair value of plan assets, December 31	$ 5,963	$ 7,040	$ --	$ --
Funded status (including under-funded and non-funded plans)	(1,968)	(566)	(1,563)	(1,481)
Unamortized transition assets	--	(1)	--	--
Unrecognized prior service cost	(27)	8	(134)	(2)
Unrecognized net actuarial (gain) loss	1,843	434	445	250
Net amount recognized	$ (152)	$ (125)	$(1,252)	$(1,233)

Amounts recognized in the Consolidated Balance Sheets consist of:	Pension Benefits 2002	Pension Benefits 2001	Other Benefits 2002	Other Benefits 2001
Prepaid benefit cost	$ 656	$ 597	$ --	$ --
Accrued benefit liability	(1,277)	(785)	(1,252)	(1,233)
Intangible asset	7	7	--	--
Accumulated other comprehensive income	462	56	--	--
Net amount recognized	$ (152)	$ (125)	$(1,252)	$(1,233)
Under-funded or non-funded plans				
Aggregate benefit obligation	$7,865	$5,778	$ 1,563	$ 1,481
Aggregate fair value of plan assets	$5,878	$5,039	$ --	$ --
Plans with under-funded or non-funded accumulated benefit obligations				
Aggregate accumulated benefit obligation	$5,188	$4,604		
Aggregate fair value of plan assets	$4,008	$4,157		

	Pension Benefits 2002	Pension Benefits 2001	Pension Benefits 2000	Other Benefits 2002	Other Benefits 2001	Other Benefits 2000
Weighted average assumptions as of December 31						
Discount rate	6.2%	6.8%	7.0%	6.5%	7.2%	7.5%
Expected return on plan assets	8.8	8.9	8.9			
Rate of compensation increase	3.9	3.8	3.8			

Our domestic retirement defined benefit plans provide employees a benefit at the greater of (i) the benefit calculated under a highest average pay and years of service formula, (ii) the benefit calculated under a formula that provides for the accumulation of salary and interest credits during an employee's work life, or (iii) the individual account balance from the Company's prior defined contribution plan (Transitional Retirement Account or TRA).

	Pension Benefits 2002	Pension Benefits 2001	Pension Benefits 2000	Other Benefits 2002	Other Benefits 2001	Other Benefits 2000
Components of Net Periodic Benefit Cost						
Defined benefit plans						
Service cost	$180	$174	$167	$ 26	$ 28	$24
Interest cost/(1)/	(210)	(184)	453	96	99	85
Expected return on plan assets/(2)/	134	81	(522)	--	--	--
Recognized net actuarial loss	7	7	4	3	3	--
Amortization of prior service cost	3	9	4	(5)	--	--
Recognized net transition asset	(1)	(14)	(16)	--	--	--
Recognized curtailment/settlement loss (gain)	55	26	(46)	--	--	--
Net periodic benefit cost	168	99	44	120	130	109
Special termination benefits	27	--	--	2	--	--
Defined contribution plans	10	21	14	--	--	--
Total	$205	$120	$ 58	$122	$130	$109

/(1)/ Interest cost includes interest expense on non-TRA obligations of $238, $216 and $225 and interest (income) expense directly allocated to TRA participant accounts of $(448), $(400) and $228 for the years ended December 31, 2002, 2001 and 2000, respectively.

/(2)/ Expected return on plan assets includes expected investment income on non-TRA assets of $314, $319 and $294 and actual investment (losses) income on TRA assets of $(448), $(400) and $228 for the years ended December 31, 2002, 2001 and 2000, respectively.

During 2002, we incurred special termination benefits and recognized curtailment/settlement losses as a result of restructuring programs. Accordingly, the special termination benefit cost of $29, and $18 of the total recognized settlement/curtailment loss amount of $55 is included as a restructuring charge in our Consolidated Statements of Income.

Pension plan assets consist of both defined benefit plan assets and assets legally restricted to the TRA accounts. The combined investment results for these plans, along with the results for our other defined benefit plans, are shown above in the actual return on plan assets caption. To the extent that investment results relate to TRA, such results are charged directly to these accounts as a component of interest cost.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. For measurement purposes, a 13.8 percent annual rate of increase in the per capita cost of covered health care benefits was assumed for 2003, decreasing gradually to 5.2 percent in 2008 and thereafter.

A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	One-percentage-point increase	One-percentage-point decrease
Effect on total service and interest cost components	$ 5	$ (4)
Effect on post-retirement benefit obligation	$64	$ (54)

Employee Stock Ownership Plan ("ESOP") Benefits.: In 1989, we established an ESOP and sold to it 10 million shares of Series B Convertible Preferred Stock ("Convertible Preferred") of the Company for a purchase price of $785. Each ESOP share is presently convertible into six common shares of our common stock (the "Convertible Preferred"). The Convertible Preferred has a $1 par value and a guaranteed minimum value of $78.25 per share and accrues annual dividends of $6.25 per share, which are cumulative if earned. When the ESOP was established, the ESOP borrowed the purchase price from a group of lenders. The ESOP debt was included in our Consolidated Balance Sheets as debt because we guaranteed the ESOP borrowings. A corresponding and offsetting amount was classified as Deferred ESOP benefits and represented our commitment to future compensation expense related to the ESOP benefits as well as an offset to the preferred shares included in equity. In the second quarter of 2002, we repaid the outstanding balance of ESOP debt of $135. We recorded an intercompany receivable from the ESOP trust, in connection with our repayment of the ESOP debt, which eliminates in consolidation. Accordingly, the repayment of the ESOP debt effectively represents a retirement of third party debt and therefore such debt is no longer included in our Consolidated Balance Sheets. The repayment of debt did not affect the recognition of compensation expense associated with the ESOP; however, interest expense was lower in 2002.

In connection with our decision in 2001 to eliminate the quarterly dividends on our common stock, dividends on the Convertible Preferred were suspended in July 2001. The ESOP requires pre-determined debt service obligations for each period to be funded by a combination of dividends and employee contributions over the term of the plan. The dividends do not affect our Consolidated Statements of Income, while the contributions are recorded as expense in such statements. As a result of the suspension of dividends, we were required, under the terms of the plan, to increase our contributions to the ESOP trust in order to meet the pre-determined amount of debt service obligations. In addition, since the dividend requirement on the Convertible Preferred is cumulative, dividends continued to accumulate in arrears until dividends were reinstated. As of the end of the third quarter of 2002, the cumulative dividend amounted to $67, including $11 representing the third quarter 2002 dividend requirement. In September 2002, the payment of Cumulative Preferred dividends was reinstated by our Board of Directors and $67 of Convertible Preferred dividends were declared. This resulted in a reversal of the previously accrued incremental compensation expense of $67 ($32 of which related to 2001). During the fourth quarter of 2002, dividends of $11 were declared. These were paid in January 2003. There was no corresponding earnings per share improvement in 2002 since the EPS calculation requires deduction of dividends declared from reported net income in arriving at net income available to common shareholders.

Information relating to the ESOP trust for the three years ended December 31, 2002 follows:

	2002	2001	2000
Interest on ESOP Borrowings	$ 5	$ 15	$ 24
Dividends declared on Convertible Preferred Stock	78	13	53
Cash contribution to the ESOP	31	88	49
Compensation expense	10	89	48

We recognize ESOP costs based on the amount committed to be contributed to the ESOP plus related trustee, finance and other charges.

Note 14--Income and Other Taxes

Income (loss) before income taxes for the three years ended December 31, 2002 was as follows:

	2002	2001	2000
Domestic income (loss)	$ 167	$(126)	$ 76
Foreign income (loss)	85	520	(443)
Income (loss) before income taxes	$ 252	$ 394	$(367)

Provisions (benefits) for income taxes for the three years ended December 31, 2002 were as follows:

	2002	2001	2000
Federal income taxes			
Current	$ 86	$ 31	$(18)
Deferred	(35)	(117)	(95)
Foreign income taxes			
Current	145	474	73
Deferred	(141)	114	(45)
State income taxes			
Current	7	2	5
Deferred	(2)	(7)	10
Income taxes	$ 60	$497	$(70)

A reconciliation of the U.S. federal statutory income tax rate to the effective income tax rate for the three years ended December 31, 2002 follows:

	2002	2001	2000
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
Foreign earnings taxed at different rates	22.3	41.0	(48.3)
Sale of partial ownership interest in Fuji Xerox	--	29.5	--
Goodwill amortization	--	2.6	(3.0)
Tax-exempt income	(3.8)	(3.3)	4.3
State taxes, net of federal benefit	1.3	(0.8)	(1.1)
Audit resolutions and other examination items - net	(22.1)	(35.6)	34.1
Dividends on Employee Stock Ownership Plan shares	(9.3)	(1.0)	3.7
Effect of tax law change	(6.3)	(2.7)	--
Change in valuation allowance for deferred tax assets	5.8	62.9	(3.2)
Other	0.9	(1.5)	(2.4)
Effective income tax rate	23.8%	126.1%	19.1%

The difference between the 2002 effective tax rate of 23.8 percent and the U.S. federal statutory income tax rate relates primarily to the recognition of tax benefits from the favorable resolution of a foreign tax audit, tax law changes as well as the retroactive declaration of ESOP dividends. Such benefits are offset, in part, by tax expense recorded for the ongoing examination in India, the sale of our interest in Katun Corporation as well as recurring losses in certain jurisdictions where we are not providing tax benefits.

The difference between the 2001 effective tax rate of 126.1 percent and the U.S. federal statutory income tax rate relates primarily to the recognition of deferred tax asset valuation allowances resulting from our recoverability assessments, the taxes incurred in connection with the sale of our partial interest in Fuji Xerox and recurring losses in low tax jurisdictions. The gain for tax purposes on the sale of Fuji Xerox was disproportionate to the gain for book purposes as a result of a lower tax basis in the investment. Other items favorably impacting the tax rate included a tax audit resolution and additional tax benefits arising from prior period restructuring provisions.

The difference between the 2000 effective tax rate of 19.1 percent and the U.S. federal statutory income tax rate relates primarily to recurring losses in low tax jurisdictions, the recognition of deferred tax asset valuation allowances resulting from our recoverability assessments and additional tax benefits arising from the favorable resolution of tax audits.

On a consolidated basis, we paid a total of $442, $57 and $354 in income taxes to federal, foreign and state jurisdictions in 2002, 2001 and 2000, respectively.

Total income tax expense (benefit) for the three years ended December 31, 2002 was allocated as follows:

	2002	2001	2000
Income taxes (benefits) on income (loss)	$ 60	$497	$(70)
Tax benefit included in minorities' interests/(1)/	(55)	(23)	(20)
Cumulative effect of change in accounting principle	--	1	--
Common shareholders' equity/(2)/	(173)	1	38
Total	$(168)	$476	$(52)

/(1)/ Benefit relates to preferred securities' dividends as more fully described in Note 16.

/(2)/ For dividends paid on shares held by the ESOP, tax effects of items in accumulated other comprehensive loss and tax benefit on nonqualified stock options.

In substantially all instances, deferred income taxes have not been provided on the undistributed earnings of foreign subsidiaries and other foreign investments carried at equity. The amount of such earnings included in consolidated retained earnings at December 31, 2002 was approximately $5 billion. These earnings have been permanently reinvested and we do not plan to initiate any action that would precipitate the payment of income taxes thereon. It is not practicable to estimate the amount of additional tax that might be payable on the foreign earnings. As a result of the March 31, 2001 disposition of one-half of our ownership interest in Fuji Xerox, the investment no longer qualifies as a foreign corporate joint venture. Accordingly, deferred taxes are required to be provided on the undistributed earnings of Fuji Xerox, arising subsequent to such date, as we no longer have the ability to ensure permanent reinvestment.

The tax effects of temporary differences that give rise to significant portions of the deferred taxes at December 31, 2002 and 2001 were as follows:

	2002	2001
Tax effect of future tax deductions		
Research and development	$1,142	$1,007
Post-retirement medical benefits	487	464
Depreciation	475	438
Net operating losses	416	295
Other operating reserves	230	202
Tax credit carryforwards	204	185
Restructuring reserves	174	122
Allowance for doubtful accounts	162	182
Deferred compensation	159	180
Other	356	207
	3,805	3,282
Valuation allowance	(524)	(474)
Total deferred tax assets	$3,281	$2,808
Tax effect of future taxable income		
Installment sales and leases	$ (376)	$ (358)
Unearned income	(987)	(820)
Other	(76)	(150)
Total deferred tax liabilities	(1,439)	(1,328)
Total deferred taxes, net	$1,842	$1,480

The above amounts are classified as current or long-term in the Consolidated Balance Sheets in accordance with the asset or liability to which they relate. Current deferred tax assets at December 31, 2002 and 2001 amounted to $449 and $548, respectively.

The deferred tax assets for the respective periods were assessed for recoverability and, where applicable, a valuation allowance was recorded to reduce the total deferred tax asset to an amount that will, more likely than not, be realized in the future. The valuation allowance for deferred tax assets as of January 1, 2001 was $187. The net change in the total valuation allowance for the years ended December 31, 2002 and 2001 was an increase of $50 and $287, respectively. The valuation allowance relates to certain foreign net operating loss carryforwards, foreign tax credit carryforwards and deductible temporary differences for which we have concluded it is more likely than not that these items will not be realized in the ordinary course of operations.

Although realization is not assured, we have concluded that it is more likely than not that the deferred tax assets for which a valuation allowance was determined to be unnecessary will be realized in the ordinary course of operations based on scheduling of deferred tax liabilities and projected income from operating activities. The amount of the net deferred tax assets considered realizable, however, could be reduced in the near term if actual future income or income tax rates are lower than estimated, or if there are differences in the timing or amount of future reversals of existing taxable or deductible temporary differences.

At December 31, 2002, we had tax credit carryforwards of $204 available to offset future income taxes, of which $159 is available to carryforward indefinitely while the remaining $45 will begin to expire, if not utilized, in 2004. We also had net operating loss carryforwards for income tax purposes of $262 that will expire in 2003 through 2012, if not utilized, and $1.9 billion available to offset future taxable income indefinitely.

At December 31, 2002, our Brazilian operations had assessments for indirect and other taxes which, inclusive of interest, were approximately $260. These assessments related principally to the internal transfer of inventory. We do not agree with these assessments and intend to vigorously defend our position. We, as supported by the opinion of legal counsel, do not believe that the ultimate resolution of these assessments will materially impact our results of operations, financial position or cash flows.

We are subject to ongoing tax examinations and assessments in various jurisdictions. Accordingly, we provide for additional tax expense based upon the probable outcomes of such matters. In addition, when applicable, we adjust the previously recorded tax expense to reflect examination results.

From 1995 through 1998, we incurred capital losses from the disposition of our insurance group operations. Such losses were disallowed under the tax law existing at the time of the respective dispositions. As a result of IRS regulations issued in 2002, some portion of the losses may now be claimed subject to certain limitations. We have filed amended tax returns for 1995 through 1998 reporting $1.2 billion of additional capital losses. As of December 31, 2002, we have $425 of capital gains available to be offset by the capital losses during the relevant periods and anticipate a potential tax benefit of approximately $150 to be recognized in a future period. The additional losses claimed and related tax benefits are subject to formal review by the U.S. government which is currently in process. We have not recognized any tax benefit of these losses pending the completion of this review. Any resulting capital loss carryforwards will expire, if not utilized, by 2003.

Note 15--Litigation, Regulatory Matters and Other Contingencies

Guarantees, Indemnifications and Warranty Liabilities:

As more fully discussed in Note 1, we apply the disclosure provisions of FIN 45 to our agreements that contain guarantee or indemnification clauses. These disclosure provisions expand those required by SFAS No. 5 "Accounting for Contingencies", by requiring that guarantors disclose certain types of guarantees, even if the likelihood of requiring the guarantor's performance is remote. As of December 31, 2002, we have accrued our estimate of liability incurred under these indemnification arrangements and guarantees. The following is a description of arrangements in which we are a guarantor.

Indemnifications provided as part of sales and purchases of businesses and real estate assets - We are a party to a variety of agreements pursuant to which we may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in the context of contracts that we entered into for the sale or purchase of businesses or real estate assets, under which we customarily agree to hold the other party harmless against losses arising from a breach of representations and covenants. These relate to such matters as adequate title to assets sold, intellectual property rights, specified environmental matters, and certain income taxes. In each of these circumstances, our payment is conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow us to challenge the other party's claims. Further, our obligations under these agreements may be limited in terms of time and/or amount, and in some instances, we may have recourse against third parties for certain payments we made.

Patent indemnifications - In most sales transactions to resellers of our products, we indemnify against possible claims of patent infringement caused by our products or solutions. These indemnifications usually do not include limits on the claims, provided the claim is made pursuant to the procedures required in the sales contract.

For the indemnification agreements discussed above, it is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of our obligations and the unique facts and circumstances involved in each agreement. Historically, payments we have made under these agreements did not have a material effect on our business, financial condition or results of operations.

Residual value guarantees - For certain vendor-financing relationships, we have guaranteed the leasing company for the residual value position they have taken subject to the lease. The amount of these guarantees are insignificant at December 31, 2002, but may be material in future periods to the extent we offer additional guarantees.

Indemnification of Officers and Directors - Our corporate by-laws require that, except to the extent expressly prohibited by law, we must indemnify our officers and directors against judgments, fines, penalties and amounts paid in settlement, including legal fees and all appeals, incurred in connection with civil or criminal action or proceedings, as it relates to their services to Xerox Corporation and our subsidiaries. The by-laws provide no limit on the amount of indemnification. As permitted under the State of New York, we have purchased directors and officers insurance coverage to cover claims made against the directors and officers during the applicable policy periods. The amounts and types of coverage have varied from period to period as dictated by market conditions. The current policy provides $105 of coverage and has no deductible. The litigation matters and regulatory actions described below involve certain of the Company's current and former directors and officers, all of whom are covered by the aforementioned indemnity and if applicable, the current and prior period insurance policies. However, certain indemnification payments may not be covered under our director's and officer's insurance coverage.

Product Warranty Liabilities:

In connection with our normal sales of equipment, including those under sales-type lease, we generally do not issue product warranties. Our arrangements typically involve a separate full service maintenance agreement with the customer. The agreements generally extend over a period equivalent to the lease term or the expected useful life under a cash sale. The service agreements involve the payment of fees in return for our performance of repairs and maintenance. As a consequence, we do not have any significant product warranty obligations including any obligations under customer satisfaction programs.

In few circumstances, particularly in certain cash sales, we may issue a limited product warranty if negotiated by the customer. We also issue warranties for certain of our lower-end products in the Office segment, where full service maintenance agreements are not available. In these instances, we record warranty obligations at the time of the sale.

The following table summarizes product warranty activity recorded for the year ended December 31, 2002.

	Balance December 31, 2001	Provisions, Changes & Other	Payments	Balance December 31, 2002
Product warranty liabilities	$46	$51	$(72)	$25

The decrease in product warranty liabilities at December 31, 2002, as compared with December 31, 2001, is primarily due to our exit from the SOHO business in 2001.

Legal Matters:

As more fully discussed below, we are a defendant in numerous litigation and regulatory matters involving securities law, patent law, environmental law, employment law and the Employee Retirement Income Security Act ("ERISA"). Should these matters result in a change in our determination as to an unfavorable outcome, result in a final adverse judgment or be settled for significant amounts, they could have a material adverse effect on our results of operations, cash flows and financial position in the period or periods in which such determination, judgment or settlement occurs.

Litigation Against the Company:

In re Xerox Corporation Securities Litigation: A consolidated securities law action (consisting of 17 cases) is pending in the United States District Court for the District of Connecticut. Defendants are the Company, Barry Romeril, Paul Allaire and G. Richard Thoman. The consolidated action purports to be a class action on behalf of the named plaintiffs and all other purchasers of common stock of the Company during the period between October 22, 1998 through October 7, 1999 ("Class Period"). The amended consolidated complaint in the action alleges that in violation of Section 10(b) and/or 20(a) of the Securities Exchange Act of 1934, as amended ("1934 Act"), and SEC Rule 10b-5 thereunder, each of the defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of the Company's common stock during the Class Period by disseminating materially false and misleading statements and/or concealing material facts. The amended complaint further alleges that the alleged scheme: (i) deceived the investing public regarding the economic capabilities, sales proficiencies, growth, operations and the intrinsic value of the Company's common stock; (ii) allowed several corporate insiders, such as the named individual defendants, to sell shares of privately held common stock of the Company while in possession of materially adverse, non-public information; and (iii) caused the individual plaintiffs and the other members of the purported class to purchase common stock of the Company at inflated prices. The amended consolidated complaint seeks unspecified compensatory damages in favor of the plaintiffs and the other members of the purported class against all defendants, jointly and severally, for all damages sustained as a result of defendants' alleged wrongdoing, including interest thereon, together with reasonable costs and expenses incurred in the action, including counsel fees and expert fees. On September 28, 2001, the court denied the defendants' motion for dismissal of the complaint. On November 5, 2001, the defendants answered the complaint. On or about January 7, 2003, the plaintiffs filed a motion for class certification. That motion is currently pending.The individual defendants and we deny any wrongdoing and intend to vigorously defend the action. Based on the stage of the litigation, it is not possible to estimate the amount of loss or range of possible loss that might result from an adverse judgment or a settlement of this matter.

Christine Abarca, et al. v. City of Pomona, et al. (Pomona Water Cases): On June 24, 1999, the Company was served with a summons and complaint filed in the Superior Court of the State of California for the County of Los Angeles. The complaint was filed on behalf of 681 individual plaintiffs claiming damages as a result of our alleged disposal and/or release of hazardous substances into the soil, air and groundwater. Subsequently, six additional complaints were filed in the same court on behalf of another 459 plaintiffs, with the same claims for damages as the June 1999 action. All seven cases have been served on the Company, the Company denies liability and it is actively defending against them. Plaintiffs in all seven cases further allege that they have been exposed to such hazardous substances by inhalation, ingestion and dermal contact, including but not limited to hazardous substances contained within the municipal drinking water supplied by the City of Pomona and the Southern California Water Company. Plaintiffs' claims against the Company include personal injury, wrongful death, property damage, negligence, trespass, nuisance, fraudulent concealment, absolute liability for ultra-hazardous activities, civil conspiracy, battery and violation of the California Unfair Trade Practices Act. Damages are unspecified. The seven cases against the Company ("Abarca Group") have been coordinated with approximately 13 unrelated cases against other defendants which involve alleged contaminated groundwater and drinking water in the San Gabriel Valley area of Los Angeles County. In all of those cases, plaintiffs have sued both the providers of drinking water and the industrial defendants who they contend contaminated the water. The body of groundwater involved in the Abarca cases, and allegedly contaminated by the Company, is separate and distinct from the body of groundwater that is involved in the San Gabriel Valley cases, and there is no allegation that the Company is involved in the San Gabriel Valley cases. Nonetheless, the court ordered both groups of cases to be coordinated because both groups concern allegations of groundwater and drinking water contamination, have similar theories of liability alleged against the defendants, and involve a number of similar legal issues, thus apparently making it more efficient, in the view of the court, for all of them to be handled by one judge. Discovery has begun and no trial date has been set. Based on the stage of the litigation, it is not possible to estimate the amount of loss or range of possible loss that might result from an adverse judgment or a settlement of this matter.

Carlson v. Xerox Corporation, et al.: A consolidated securities law action (consisting of 21 cases) is pending in the United States District Court for the District of Connecticut against the Company, KPMG and Paul A. Allaire, G. Richard Thoman, Anne M. Mulcahy, Barry D. Romeril, Gregory Tayler and Philip Fishbach. On September 11, 2002, the court entered an endorsement order granting plaintiffs' motion to file a third consolidated amended complaint. The defendants' motion to dismiss the second consolidated amended complaint was denied, as moot. According to the third consolidated amended complaint, plaintiffs purport to bring this case as a class action on behalf of an expanded class consisting of all persons and/or entities who purchased Xerox common stock and/or bonds during the period between February 17, 1998 through June 28, 2002 and who were purportedly damaged thereby ("Class"). The third consolidated amended complaint sets forth two claims: one alleging that each of the Company, KPMG, and the individual defendants violated Section 10(b) of the 1934 Act and SEC Rule 10b-5 thereunder; the other alleging that the individual defendants are also allegedly liable as "controlling persons" of the Company pursuant to Section 20(a) of the 1934 Act. Plaintiffs claim that the defendants participated in a fraudulent scheme that operated as a fraud and deceit on purchasers of the Company's common stock and bonds by disseminating materially false and misleading statements and/or concealing material adverse facts relating to various of the Company's accounting and reporting practices and financial condition. The plaintiffs further allege that this scheme deceived the investing public regarding the true state of the Company's financial condition and caused the plaintiffs and other members of the alleged Class to purchase the Company's common stock and bonds at artificially inflated prices, and prompted a SEC investigation that led to the April 11, 2002 settlement which, among other things, required the Company to pay a $10 penalty and restate its financials for the years 1997 - 2000 (including restatement of financials previously corrected in an earlier restatement which plaintiffs contend was improper). The third consolidated amended complaint seeks unspecified compensatory damages in favor of the plaintiffs and the other Class members against all defendants, jointly and severally, including interest thereon, together with reasonable costs and expenses, including counsel fees and expert fees. On December 2, 2002, the Company and the individual defendants filed a motion to dismiss the complaint. That motion is currently pending. The individual defendants and we deny any wrongdoing and intend to vigorously defend the action. Based on the stage of the litigation, it is not possible to estimate the amount of loss or range of possible loss that might result from an adverse judgment or a settlement of this matter.

Bingham v. Xerox Corporation, et al: A lawsuit filed by James F. Bingham, a former employee of the Company, is pending in the Superior Court of Connecticut, Judicial District of Waterbury (Complex Litigation Docket) against the Company, Barry D. Romeril, Eunice M. Filter and Paul Allaire. The complaint alleges that the plaintiff was wrongfully terminated in violation of public policy because he attempted to disclose to senior management and to remedy alleged accounting fraud and reporting irregularities. The plaintiff further claims that the Company and the individual defendants violated the Company's policies/commitments to refrain from retaliating against employees who report ethics issues. The plaintiff also asserts claims of defamation and tortious interference with a contract. He seeks: (i) unspecified compensatory damages in excess of $15 thousand, (ii) punitive damages, and (iii) the cost of bringing the action and other relief as deemed appropriate by the court. The parties are engaged in discovery. The individuals and we deny any wrongdoing and intend to vigorously defend the action. Based on the stage of the litigation, it is not possible to estimate the amount of loss or range of possible loss that might result from an adverse judgment or a settlement of this matter.

Berger, et al. v. RIGP: A class was certified in an action originally filed in the United States District Court for the Southern District of Illinois on July 25, 2000 against the Company's Retirement Income Guarantee Plan ("RIGP"). The RIGP represents the primary U.S. pension plan for salaried employees. Plaintiffs bring this action on behalf of themselves and an alleged class of over 25,000 persons who received lump sum distributions from RIGP after January 1, 1990. Plaintiffs assert violations of the ERISA, claiming that the lump sum distributions were improperly calculated. On July 3, 2001, the court granted the Plaintiffs' motion for summary judgment, finding the lump sum calculations violated ERISA. Although the damages sought were not specified in the complaint, the Plaintiffs submitted papers in December 2001 claiming $284 in damages. On September 30, 2002, the court entered a final judgment on damages, stating it would adopt plaintiffs' methodology for calculating such damages. RIGP denies any wrongdoing and has appealed the District Court's rulings with respect to both liability and damages. We believe, based on advice of legal counsel, that it is probable that on appeal that the judgment will be overturned. We cannot estimate the amount of loss that might result from this matter. If the appeal should ultimately not prevail, we would have to accrue the full amount of the expense associated with the judgment as if the judgment were directly against the Company. Any final judgment after appeal would be paid from RIGP assets. However, such payment may require the Company to make additional contributions to RIGP in the future based on a potential shortfall in plan assets available to pay other plan liabilities.

Florida State Board of Administration, et al. v. Xerox Corporation, et al.: A securities law action brought by four institutional investors, namely the Florida State Board of Administration, the Teachers' Retirement System of Louisiana, Franklin Mutual Advisers and PPM America, Inc., is pending in the United States District Court for the District of Connecticut against the Company, Paul Allaire, G. Richard Thoman, Barry Romeril, Anne Mulcahy, Philip Fishbach, Gregory Tayler and KPMG. The plaintiffs bring this action individually on their own behalves. In an amended complaint filed on October 3, 2002, one or more of the plaintiffs allege that each of the Company, the individual defendants and KPMG violated Sections 10(b) and 18 of the 1934 Act, SEC Rule 10b-5 thereunder, the Florida Securities Investors Protection Act, Fl. Stat. ss. 517.301, and the Louisiana Securities Act, R.S. 51:712(A). The plaintiffs further claim that the individual defendants are each liable as "controlling persons" of the Company pursuant to Section 20 of the 1934 Act and that each of the defendants is liable for common law fraud and negligent misrepresentation. The complaint generally alleges that the defendants participated in a scheme and course of conduct that deceived the investing public by disseminating materially false and misleading statements and/or concealing material adverse facts relating to the Company's financial condition and accounting and reporting practices. The plaintiffs contend that in relying on false and misleading statements allegedly made by the defendants, at various times from 1997 through 2000 they bought shares of the Company's common stock at artificially inflated prices. As a result, they allegedly suffered aggregated cash losses in excess of $200. The plaintiffs further contend that the alleged fraudulent scheme prompted a SEC investigation that led to the April 11, 2002 settlement which, among other things, required the Company to pay a $10 penalty and restate its financials for the years 1997 - 2000 including restatement of financials previously corrected in an earlier restatement which plaintiffs contend was false and misleading. The plaintiffs seek, among other things, unspecified compensatory damages against the Company, the individual defendants and KPMG, jointly and severally, including prejudgment interest thereon, together with the costs and disbursements of the action, including their actual attorneys' and experts' fees. On December 2, 2002, the Company and the individual defendants filed a motion to dismiss all claims in the complaint that are in common with the claims in the Carlson action. That motion is currently pending. The individual defendants and we deny any wrongdoing alleged in the complaint and intend to vigorously defend the action. Based on the stage of the litigation, it is not possible to estimate the amount of loss or range of possible loss that might result from an adverse judgment or a settlement of this matter.

In Re Xerox Corp. ERISA Litigation: On July 1, 2002, a class action complaint captioned Patti v. Xerox Corp. et al. was filed in the United States District Court for the District of Connecticut (Hartford) alleging violations of the ERISA. Three additional class actions (Hopkins, Uebele and Saba) were subsequently filed in the same court making substantially similar claims. On October 16, 2002, the four actions were consolidated as In Re Xerox Corporation ERISA Litigation. On November 15, 2002, a consolidated amended complaint was filed. A fifth class action (Wright) was filed in the District of Columbia. It has been transferred to Connecticut where it will be consolidated with the other actions. The purported class includes all persons who invested or maintained investments in the Xerox Stock Fund in the Xerox 401(k) Plans (either salaried or union) during the proposed class period, May 12, 1997 through November 15, 2002, and allegedly exceeds 50,000 persons. The defendants include Xerox Corporation and the following individuals or groups of individuals during the proposed class period: the Plan Administrator, the Board of Directors, the Fiduciary Investment Review Committee, the Joint Administrative Board, the Finance Committee of the Board of Directors, and the Treasurer. The complaint claims that all the foregoing defendants were "named" or "de facto" fiduciaries of the Plan under ERISA and, as such, were obligated to protect the Plan's assets and act in the best interest of Plan participants. The complaint alleges that the defendants failed to do so and thereby breached their fiduciary duties. Specifically, plaintiffs claim that the defendants failed to provide accurate and complete material information to participants concerning Xerox stock, including accounting practices which allegedly

artificially inflated the value of the stock, and misled participants regarding the soundness of the stock and the prudence of investing retirement benefits in Xerox stock. Plaintiff also claims that defendants failed to ensure that Plan assets were invested prudently, to monitor the other fiduciaries and to disregard Plan directives they knew or should have known were imprudent. The complaint does not specify the amount of damages sought. However, it asks that the losses to the Plan be restored, which it describes as "millions of dollars." It also seeks other legal and equitable relief, as appropriate, to remedy the alleged breaches of fiduciary duty, as well as interest, costs and attorneys' fees. We and the other defendants deny any wrongdoing and intend to vigorously defend the action. Based on the stage of the litigation, it is not possible to estimate the amount of loss or range of possible loss that might result from an adverse judgment or a settlement of this matter.

Digwamaje et al. v. IBM et al: A purported class action was filed in the United States District Court for the Southern District of New York on September 27, 2002. Service of the complaint on the Company was deemed effective as of December 6, 2002. The defendants include Xerox and 80 other corporate defendants who are accused of providing material assistance to the apartheid government in South Africa from 1948 to 1994, by engaging in commerce in South Africa and with the South African government and by employing forced labor, thereby violating both international and common law. Specifically, plaintiffs claim violations of the Alien Tort Claims Act, the Torture Victims Protection Act and RICO. They also assert human rights violations and crimes against humanity. Plaintiffs seek compensatory damages in excess of $200 billion and punitive damages in excess of $200 billion. The foregoing damages are being sought from all defendants, jointly and severally. Xerox intends to vigorously defend the action and plans to file a motion to dismiss the complaint. Based upon the stage of the litigation, it is not possible to estimate the amount of loss or range of possible loss that might result from an adverse judgment or a settlement of this matter.

Arbitration between MPI Technologies, Inc. and Xerox Canada Ltd. and Xerox Corporation: On November 15, 2001, MPI Technologies, Inc. ("MPI") sent to the American Arbitration Association a Demand for Arbitration of a dispute arising under an Agreement made as of March 15, 1994 between MPI and Xerox Canada Ltd. ("XCL") to which the Company later became a party ("Agreement"). The Demand for Arbitration claimed that XCL and the Company owed royalties to MPI for software licensed under the Agreement and initially alleged damages "estimated to be in excess of $30 million." In a subsequent claim submitted in the arbitration proceedings, MPI has alleged damages of $68.9 for royalties owed, $35.0 for breach of fiduciary duty, $35.0 in punitive damages and unspecified damages and injunctive relief with respect to a claim of copyright infringement. The parties have selected three arbitrators and have agreed to conduct the arbitration in Canada. On January 13 and 14, 2003, the arbitrators heard argument on the motion of the Company and XCL to dismiss for lack of jurisdiction MPI's claims for copyright infringement, breach of fiduciary duty and for punitive damages. The arbitration panel ruled on February 14, 2003 that it had jurisdiction to hear all three issues. On March 14, 2003 the Company and XCL petitioned the Ontario courts to re-decide the issue of the panel's jurisdiction to hear copyright infringement claims. The Company and XCL deny any liability or wrongdoing, including any royalties owed, intend to assert a counterclaim against MPI for overpayment of royalties and intend to vigorously defend the claim. Based on the stage of the arbitration, it is not possible to estimate the amount of loss or the range of possible loss that might result from an adverse ruling or a settlement of this matter.

Accuscan, Inc. v. Xerox Corporation: On April 11, 1996, an action was commenced by Accuscan, Inc. ("Accuscan"), in the United States District Court for the Southern District of New York, against the Company seeking unspecified damages for infringement of a patent of Accuscan which expired in 1993. The suit, as amended, was directed to facsimile and certain other products containing scanning functions and sought damages for sales between 1990 and 1993. On April 1, 1998, the jury entered a verdict in favor of Accuscan for $40. However, on September 14, 1998, the court granted our motion for a new trial on damages. The trial ended on October 25, 1999 with a jury verdict of $10. Our motion to set aside the verdict or, in the alternative, to grant a new trial was denied by the court. We appealed to the Court of Appeals for the Federal Circuit ("CAFC") which found the patent not infringed, thereby terminating the lawsuit subject to an appeal which has been filed by Accuscan to the U.S. Supreme Court. The decision of the U.S. Supreme Court was to remand the case (along with eight others) back to the CAFC to consider its previous decision based on the Supreme Court's May 28, 2002 ruling in the Festo case. We deny any liability or wrongdoing and intend to vigorously defend the action.

Derivative Litigation Brought on Behalf of the Company:

In re Xerox Derivative Actions: A consolidated putative shareholder derivative action is pending in the Supreme Court of the State of New York, County of New York against several current and former members of the Board of Directors including William F. Buehler, B.R. Inman, Antonia Ax:son Johnson, Vernon E. Jordan, Jr., Yotaro Kobayashi, Hilmar Kopper, Ralph Larsen, George J. Mitchell, N.J. Nicholas, Jr., John E. Pepper, Patricia Russo, Martha Seger, Thomas C. Theobald, Paul Allaire, G. Richard Thoman, Anne Mulcahy and Barry Romeril, and KPMG. The plaintiffs purportedly brought this action in the name of and for the benefit of the Company, which is named as a nominal defendant, and its public shareholders.

The second consolidated amended complaint alleges that each of the director defendants breached their fiduciary duties to the Company and its shareholders by, among other things, ignoring indications of a lack of oversight at the Company and the existence of flawed business and accounting practices within the Company's Mexican and other operations; failing to have in place sufficient controls and procedures to monitor the Company's accounting practices; knowingly and recklessly disseminating and permitting to be disseminated, misleading information to shareholders and the investing public; and permitting the Company to engage in improper accounting practices. The plaintiffs further allege that each of the director defendants breached his/her duties of due care and diligence in the management and administration of the Company's affairs and grossly mismanaged or aided and abetted the gross mismanagement of the Company and its assets. The second amended complaint also asserts claims of negligence, negligent misrepresentation, breach of contract and breach of fiduciary duty against KPMG. Additionally, plaintiffs claim that KPMG is liable to Xerox for contribution, based on KPMG's share of the responsibility for any injuries or damages for which Xerox is held liable to plaintiffs in related pending securities class action litigation. On behalf of the Company, the plaintiffs seek a judgment declaring that the director defendants violated and/or aided and abetted the breach of their fiduciary duties to the Company and its shareholders; awarding the Company unspecified compensatory damages against the director defendants, individually and severally, together with pre-judgement and post-judgement interest at the maximum rate allowable by law; awarding the Company punitive damages against the director defendants; awarding the Company compensatory damages against KPMG; and awarding plaintiffs the costs and disbursements of this action, including reasonable attorneys' and experts' fees. On December 16, 2002, the Company and the individual defendants answered the complaint. The individual defendants deny the wrongdoing alleged and intend to vigorously defend the litigation.

Pall v. Buehler, et al.: On May 16, 2002, a shareholder commenced a derivative action in the United States District Court for the District of Connecticut against KPMG. The Company was named as a nominal defendant. Plaintiff purported to bring this action derivatively in the right, and for the benefit, of the Company. He contended that he is excused from complying with the prerequisite to make a demand on the Xerox Board of Directors, and that such demand would be futile, because the directors are disabled from making a disinterested, independent decision about whether to prosecute this action. In the original complaint, plaintiff alleged that KPMG, the Company's former outside auditor, breached its duties of loyalty and due care owed to Xerox by repeatedly acquiescing in, permitting and aiding and abetting the manipulation of Xerox's accounting and financial records in order to improve the Company's publicly reported financial results. He further claimed that KPMG committed malpractice and breached its duty to use such skill, prudence and diligence as other members of the accounting profession commonly possess and exercise. Plaintiff claimed that as a result of KPMG's breaches of duties, the Company has suffered loss and damage. On May 29, 2002, plaintiff amended the complaint to add as defendants the present and certain former directors of the Company. He added claims against each of them for breach of fiduciary duty, and separate additional claims against the directors who are or were members of the Audit Committee of the Board of Directors, based upon the alleged failure, inter alia, to implement, supervise and maintain proper accounting systems, controls and practices. The amended derivative complaint demands a judgment declaring that the defendants have violated and/or aided and abetted the breach of fiduciary and professional duties to the Company and its shareholders; awarding the Company unspecified compensatory damages, together with pre-judgment and post-judgment interest at the maximum rate allowable by law; awarding the Company punitive damages; and awarding the plaintiff the costs and disbursements of the action, including reasonable attorneys' and experts' fees. On August 16, 2002, the individual defendants and Xerox filed a motion to dismiss the action. That motion is currently pending. The individual defendants deny the wrongdoing alleged and intend to vigorously defend the litigation.

Lerner v. Allaire, et al.: On June 6, 2002, a shareholder, Stanley Lerner, commenced a derivative action in the United States District Court for the District of Connecticut against Paul A. Allaire, William F. Buehler, Barry D. Romeril, Anne M. Mulcahy and G. Richard Thoman. The plaintiff purports to bring the action derivatively, on behalf of the Company, which is named as a nominal defendant. Previously, on June 19, 2001, Lerner made a demand on the Board of Directors to commence suit against certain officers and directors to recover unspecified damages and compensation paid to these officers and directors. In his demand, Lerner contended, inter alia, that management was aware since 1998 of material accounting irregularities and failed to take action and that the Company has been mismanaged. At its September 26, 2001 meeting, the Board of Directors appointed a special committee to consider, investigate and respond to the demand. In this action, plaintiff alleges that the individual defendants breached their fiduciary duties of care and loyalty by disguising the true operating performance of the Company through improper undisclosed accounting mechanisms between 1997 and 2000. The complaint alleges that the defendants benefited personally, through compensation and the sale of company stock, and either participated in or approved the accounting procedures or failed to supervise adequately the accounting activities of the Company. The plaintiff demands a judgment declaring that defendants intentionally breached their fiduciary duties to the Company and its shareholders; awarding unspecified compensatory damages to the Company against the defendants, individually and severally, together with pre-judgment and post-judgment interest; awarding the Company punitive damages; and awarding the plaintiff the costs and disbursements of the action, including reasonable attorneys' and experts' fees. On September 18, 2002, the individual defendants and Xerox filed a motion to dismiss the action, or alternatively to stay the action pending the disposition of In re Xerox Derivative Actions. That motion is currently pending. The individual defendants deny the wrongdoing alleged and intend to vigorously defend the litigation.

Other Matters:

Xerox Corporation v. 3Com Corporation, et al.: On April 28, 1997, we commenced an action against Palm for infringement of the Xerox "Unistrokes" handwriting recognition patent by the Palm Pilot using "Graffiti." On January 14, 1999, the U.S. Patent and Trademark Office ("PTO") granted the first of two 3Com/Palm requests for reexamination of the Unistrokes patent challenging its validity. The PTO concluded its reexaminations and confirmed the validity of all 16 claims of the original Unistrokes patent. On June 6, 2000, the judge narrowly interpreted the scope of the Unistrokes patent claims and, based on that narrow determination, found the Palm Pilot with Graffiti did not infringe the Unistrokes patent claims. On October 5, 2000, the Court of Appeals for the Federal Circuit reversed the finding of no infringement and sent the case back to the lower court to continue toward trial on the infringement claims. On December 20, 2001, the District Court granted our motions on infringement and for a finding of validity thus establishing liability. On December 21, 2001, Palm appealed to the CAFC. We moved for a trial on damages and an injunction or bond in lieu of injunction. The District Court denied our motion for a temporary injunction, but ordered a $50 bond to be posted to protect us against future damages until the trial. Palm issued a $50 irrevocable letter of credit in favor of Xerox. In January 2003, after the oral argument, Palm announced that it would stop including Graffiti in its future operating systems. On February 20, 2003, the Court of Appeals affirmed the infringement of the Unistrokes patent by Palm's handheld devices and that Xerox will be entitled to an injunction if the validity of the patent is favorably determined. It remanded the validity issues back to the District Court for further validity analysis.

Xerox Corporation v. Business Equipment Research & Test Laboratories, Inc. On July 9, 2002, the Company filed an action in U.S. District Court for the Western District of New York against Business Equipment Research & Test Laboratories, Inc. and one of its owners (collectively "BERTL") alleging libel per se, trade libel, tortious interference with prospective business relationship, unfair competition, breach of contract, violation of the federal Computer Fraud and Abuse Act, deceptive acts and practices and conversion. On December 11, 2002, Xerox filed an amended complaint, alleging the same claims with greater specificity. Xerox seeks unspecified damages, injunctive relief and a declaratory judgment that Xerox has not infringed BERTL's trademarks or copyrights, breached any agreement with BERTL or engaged in unfair competition. On January 24, 2003, BERTL filed its answer and sixteen counterclaims against Xerox Corporation and XCL, totaling $53; comprising $33 in compensatory damages and $20 in punitive damages in the aggregate. BERTL also moved to dismiss seven of Xerox's nine claims. BERTL's counterclaims against Xerox principally allege infringement of copyrights, appropriation of trade secrets, defamation and breach of contract. The Company and XCL deny any wrongdoing and intend to vigorously pursue the Company's claims and defend the counterclaims Based on the stage of the litigation, it is not possible to assess the probable outcome of the litigation, including the amount of any loss or range of possible loss that might result from an adverse ruling on the counterclaim in this matter.

U.S. Attorney's Office Investigation: As we announced on September 23, 2002, we learned that the U.S. attorney's office in Bridgeport, Conn., is conducting an investigation into matters relating to Xerox. We have not been advised by the U.S. attorney's office regarding the nature, scope or timing of the investigation. We are cooperating and providing documents, as requested.

Securities and Exchange Commission Investigation and Review: On April 1, 2002, we announced that we had reached a settlement with the SEC on the previously disclosed proposed allegations related to matters that had been under investigation since June 2000. As a result, on April 11, 2002, the SEC filed a complaint, which we simultaneously settled by consenting to the entry of an Order enjoining us from future violations of Section 17(a) of the Securities Act of 1933, Sections 10(b), 13(a) and 13(b) of the 1934 Act and Rules 10b-5, 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder, requiring payment of a civil penalty of $10, and imposing other ancillary relief. We neither admitted nor denied the allegations of the complaint. The $10 civil penalty is included in Other Expenses, net in 2002 in the Consolidated Statement of Income. Under the terms of the settlement, in 2001 we restated our financial statements for the years 1997 through 2000.

As part of the settlement, a special committee of our Board of Directors has retained Michael H. Sutton, former Chief Accountant of the SEC, as an independent consultant to review our material accounting controls and policies. Mr. Sutton commenced his review in July 2002. On February 21, 2003, Mr. Sutton delivered his final report, together with observations and recommendations, to members of the special committee. According to the terms of the settlement, the special committee has 60 days to review the report and submit it to our full Board of Directors and the SEC. Within 60 days of that submission, the Board of Directors must report to the SEC the decisions taken as a result of the recommendations.

Other Matters: It is our policy to carefully investigate, often with the assistance of outside advisers, allegations of impropriety that may come to our attention. If the allegations are substantiated, appropriate prompt remedial action is taken, and where appropriate, public disclosure is made. In India, we have learned of certain improper payments made over a period of years in connection with sales to government customers by employees of our now majority-owned subsidiary in that country. This activity was terminated when we became aware of it. We have investigated the activity and reported it to the staff of the SEC and the Department of Justice, and are cooperating with their follow-up inquiries. In addition, various agencies of the Indian government are also investigating the issue. We do not believe that this matter will have any material impact on our consolidated financial statements. Separately, we learned that less than $200 thousand was misappropriated from our Indian subsidiary during early 2002 which was not properly reflected in our subsidiary's books. The matter is currently being investigated. Certain transactions of our unconsolidated South African affiliate that appear to have been improperly recorded as part of an effort to sell supplies outside of its authorized territory have been investigated and a report of the results has been received by the Board of Directors of the South African affiliate. Disciplinary actions have been taken, and the adjustments to our financial statements were not material. Following an investigation we have determined that certain inter-company and other balances in the local books and records of our majority-owned affiliate in Nigeria could not be substantiated. The Company's records did not reflect these amounts and the local books have been adjusted to be consistent with them. This adjustment has had no effect on our financial statements. This matter has been reported to the SEC and the Department of Justice. We are in the process of liquidating ("winding-up") this company in connection with the December 2002 sale of our interest in the Nigerian business to our local partner.

Note 16--Preferred Securities

As of December 31, 2002, we have four series of outstanding preferred securities. In total we are authorized to issue 22 million shares of cumulative preferred stock, $1 par value.

Convertible Preferred Stock: As more fully discussed in Note 13 to the Consolidated Financial Statements, in 1989 we sold 10 million shares of our Series B Convertible Preferred Stock ("ESOP Shares") for $785 in connection with the establishment of our ESOP. This debt was repaid in 2002. As employees with vested ESOP shares leave the Company, we redeem those shares. We have the option to settle such redemptions with either shares of common stock or cash, but have historically settled in common stock.

Outstanding preferred stock related to our ESOP at December 31, 2002 and 2001 follows (shares in thousands):

	2002		2001	
	Shares	Amount	Shares	Amount
Convertible Preferred Stock	7,023	$550	7,730	$605

Preferred Stock Purchase Rights: We have a shareholder rights plan designed to deter coercive or unfair takeover tactics and to prevent a person or persons from gaining control of us without offering a fair price to all shareholders. Under the terms of the plan, one-half of one preferred stock purchase right ("Right") accompanies each share of outstanding common stock. Each full Right entitles the holder to purchase from us one three-hundredth of a new series of preferred stock at an exercise price of $250. Within the time limits and under the circumstances specified in the plan, the Rights entitle the holder to acquire either our common stock, the stock of the surviving company in a business combination, or the stock of the purchaser of our assets, having a value of two times the exercise price. The Rights, which expire in April 2007, may be redeemed prior to becoming exercisable by action of the Board of Directors at a redemption price of $.01 per Right. The Rights are non-voting and, until they become exercisable, have no dilutive effect on the earnings per share or book value per share of our common stock.

Company-obligated, Mandatorily Redeemable Preferred Securities of Subsidiary Trusts Holding Solely Subordinated Debentures of the Company: The components of Company-obligated, mandatorily redeemable preferred securities of subsidiary trusts holding solely subordinated debentures of the Company at December 31, 2002 and 2001 follow:

	2002	2001
Trust II	$1,016	$1,005
Trust I	640	639
Deferred Preferred Stock	45	43
Total	$1,701	$1,687

Trust II: In 2001, Xerox Capital Trust II ("Capital II"), a trust sponsored and wholly-owned by us, issued 20.7 million 7.5 percent convertible trust preferred securities (the "Trust Preferred Securities") to investors for an aggregate liquidation amount of $1,035 and 0.6 million shares of common securities to us for an aggregate liquidation amount of $32. With the proceeds from these securities, Capital II purchased $1,067 aggregate principal amount of 7.5 percent convertible junior subordinated debentures due 2021 of Xerox Funding LLC II ("Funding"), a wholly-owned subsidiary of ours. With the proceeds from these securities, Funding purchased $1,067 aggregate principal amount of 7.5 percent convertible junior subordinated debentures due 2021 of the Company. Capital II's assets consist principally of Funding's debentures, and Funding's assets consist principally of our debentures. On a consolidated basis, we received net proceeds of $1,004, which was net of $31 of fees and expenses. The initial carrying value is being accreted to liquidation value through Minorities' interests in earnings of subsidiaries over three years to the earliest redemption date. As of December 31, 2002, the carrying value had accreted to $1,016. We used the net proceeds from the issuance of our debentures for general corporate purposes, including the payment of our indebtedness. Our debentures, along with those of Funding, and related income statement effects are eliminated in our consolidated financial statements. Distributions on the Trust Preferred Securities are charged, net of tax, to Minorities' interests in earnings of subsidiaries and, together with the accretion noted above, amounted to $54 after-tax ($89 pre-tax) and $2 after-tax ($4 pre-tax) in 2002 and 2001, respectively. We have effectively guaranteed, fully and unconditionally, on a subordinated basis, the payment and delivery by Funding, of all amounts due on the Funding debentures and the payment and delivery by Capital II of all amounts due on the Trust Preferred Securities, in each case to the extent required under the terms of the securities.

The Trust Preferred Securities accrue and pay cash distributions quarterly at a rate of 7.5 percent per annum of the stated liquidation amount of fifty dollars per trust preferred security. Concurrently, with the initial issuance of the Trust Preferred Securities, Funding issued 0.2 million common securities to us, for an aggregate liquidation amount of $229. Funding used the proceeds to purchase, and deposit with a pledge, trustee U.S. treasuries in order to secure Funding's obligations under its debentures through the distribution payment date (November 27, 2004). As of December 31, 2002 and 2001, the balance of these securities was $151 and $229, respectively, and is included in both Other current assets and Other long-term assets in the Consolidated Balance Sheets. The Trust Preferred Securities are convertible at any time, at the option of the investors, into 5.4795 shares of our common stock per Trust Preferred Security, subject to adjustment. The Trust Preferred Securities are mandatorily redeemable upon the maturity of the debentures on November 27, 2021 at fifty dollars per Trust Preferred Security plus accrued and unpaid distributions. Investors may require us to cause Capital II to purchase all or a portion of the Trust Preferred Securities on December 4, 2004, and November 27, 2006, 2008, 2011 and 2016 at a price of fifty dollars per Trust Preferred Security, plus accrued and unpaid distributions. In addition, if we undergo a change in control on or before December 4, 2004, investors may require us to cause Capital II to purchase all or a portion of the Trust Preferred Securities. In either case, the purchase price for such Trust Preferred Securities may be paid in cash or our common stock, or a combination thereof. If the purchase price or any portion thereof consists of common stock, investors will receive such common stock at a value of 95 percent of its then prevailing market price. Capital II may redeem all, but not part, of the Trust Preferred Securities for cash, prior to December 4, 2004, only if specified changes in tax and investment law occur, at a redemption price of 100 percent of their liquidation amount plus accrued and unpaid distributions. On or at anytime after December 4, 2004, Capital II may redeem all or a portion of the Trust Preferred Securities for cash at declining redemption prices, with an initial redemption price of 103.75 percent of their liquidation amount.

Trust I: In 1997, a trust that we sponsored and wholly-own, issued $650 aggregate liquidation amount of preferred securities (the "Original Preferred Securities") to investors and 20,103 shares of common securities to us. The proceeds were invested by the trust in $670 aggregate principal amount of our then newly issued 8 percent Junior Subordinated Debentures due 2027 (the "Original Debentures"). Pursuant to a registration statement that we, along with the trust, filed with the Securities and Exchange Commission in 1997, the Original Preferred Securities, with an aggregate liquidation preference amount of $644, and the Original Debentures with a principal amount of $644, were exchanged for a like amount of preferred securities (together with the Original Preferred Securities, the "Preferred Securities") and 8 percent Junior Subordinated Debentures due 2027 (together with the Original Debentures, the "Debentures") which were registered under the Securities Act of 1933. The Debentures represent all the assets of the trust. The Debentures and related income statement effects are eliminated in our consolidated financial statements.

The Preferred Securities accrue and pay cash distributions semiannually at a rate of 8 percent per annum of the stated liquidation amount of one thousand dollars per Preferred Security. These distributions are recorded in Minorities' interests in earnings of subsidiaries in the Consolidated Statements of Income. We have guaranteed (the "Guarantee"), on a subordinated basis, distributions and other payments due on the Preferred Securities. The Guarantee and our obligations under the Debentures and in the indenture pursuant to which the Debentures were issued and our obligations under the Amended and Restated Declaration of Trust governing the trust, taken together, provide a full and unconditional guarantee of amounts due on the Preferred Securities.

The Preferred Securities are mandatorily redeemable upon the maturity of the Debentures on February 1, 2027, or earlier to the extent of any redemption by us of any Debentures. The redemption price in either such case will be one thousand dollars per share plus accrued and unpaid distributions to the date fixed for redemption. Total net proceeds were $637, net of $13 in fees and expenses. The initial carrying value is being accreted to liquidation value over the remaining term. As of December 31, 2002 and 2001 the initial carrying value had accreted to $640 and $639, respectively.

Deferred Preferred Stock: In 1996, a subsidiary of ours issued 2 million deferred preferred shares for Canadian (Cdn.) $50 ($37 U.S.). These shares are mandatorily redeemable on February 28, 2006 for Cdn. $90 (equivalent to $57 U.S. at December 31, 2002). The difference between the redemption amount and the proceeds from the issue is being amortized on a straight-line basis, through the redemption date, to Minorities' interests in earnings of subsidiaries in the Consolidated Statements of Income. As of December 31, 2002, $12 remained to be amortized. We have guaranteed the redemption value.

Note 17--Common Stock

We have 1.75 billion authorized shares of common stock, $1 par value after shareholders approved an increase of 0.7 billion shares on September 9, 2002. At December 31, 2002 and 2001, 127 million and 113 million shares, respectively, were reserved for issuance under our incentive compensation plans. In addition, at December 31, 2002, 57 million common shares were reserved for the conversion of convertible debt, 36 million common shares were reserved for conversion of ESOP-related Convertible Preferred Stock and 113 million common shares were reserved for the conversion of Convertible Trust Preferred Securities.

Stock Option and Long-term Incentive Plans: In October 2002, we adopted the additional disclosure provisions of SFAS No. 148. See Note 1 for further discussion. We have a long-term incentive plan whereby eligible employees may be granted non-qualified stock options, shares of common stock (restricted or unrestricted) and performance/incentive unit rights. Beginning in 1998 and subject to vesting and other requirements, performance/incentive unit rights are typically paid in our common stock. The value of each performance/ incentive unit is based on the growth in earnings per share during the year in which granted. Performance/ incentive units ratably vest in the three years after the year awarded. Compensation expense recorded for performance/incentive units at December 31, 2000 was $5. No amounts were recorded in 2002 and 2001 as the required 2000 performance/incentive measures were not met. This plan was discontinued in 2001.

We granted 1.6 million, 1.9 million and 0.4 million shares of restricted stock to key employees for the years ended December 31, 2002, 2001 and 2000, respectively. No monetary consideration is paid by employees who receive restricted shares. Compensation expense for restricted grants is based upon the grant date market price and is recorded over the vesting period which on average ranges from one to three years. Compensation expense recorded for restricted grants was $17, $15 and $18 in 2002, 2001 and 2000, respectively.

Stock options and rights are settled with newly issued or, if available, treasury shares of our common stock. Stock options generally vest in three years and expire between eight and ten years from the date of grant. The exercise price of the options is equal to the market value of our common stock on the effective date of grant.

At December 31, 2002 and 2001, 43.2 million and 39.7 million shares, respectively, were available for grant of options or rights. The following table provides information relating to the status of, and changes in, options granted:

Employee Stock Options	2002 Stock Options	2002 Average Option Price	2001 Stock Options	2001 Average Option Price	2000 Stock Options	2000 Average Option Price
Outstanding at January 1	68,829	$29	58,233	$35	43,388	$42
Granted	14,286	10	15,085	5	19,338	22
Cancelled	(5,668)	34	(4,479)	28	(4,423)	38
Exercised	(598)	5	(10)	5	(70)	22
Outstanding at December 31	76,849	26	68,829	29	58,233	35
Exercisable at end of year	45,250		36,388		23,346	

Options outstanding and exercisable at December 31, 2002 were as follows:

Range of Exercise Prices	Options Outstanding: Number Outstanding	Options Outstanding: Weighted Average Remaining Contractual Life	Options Outstanding: Weighted Average Exercise Price	Options Exercisable: Number Exercisable	Options Exercisable: Weighted Average Exercise Price
$4.75 to $6.98	12,730	8.16	$4.85	3,983	$4.76
7.13 to 10.69	14,554	8.97	10.12	252	7.78
10.72 to 15.27	468	7.59	12.87	164	14.68
16.91 to 23.25	18,982	5.37	21.51	15,025	21.44
25.81 to 36.70	11,668	4.13	31.29	8,861	32.94
41.72 to 60.95	18,447	4.34	52.99	16,965	53.47
$4.75 to $60.95	76,849	6.09	$25.58	45,250	$34.13

Note 18--Earnings Per Share

Basic earnings per share is computed by dividing income available to common shareholders (the numerator) by the weighted-average number of common shares outstanding (the denominator) for the period. Diluted earnings per share assumes that any dilutive convertible preferred shares, convertible subordinated debentures, and convertible securities outstanding were converted, with related preferred stock dividend requirements and outstanding common shares adjusted accordingly. It also assumes that outstanding common shares were increased by shares issuable upon exercise of those stock options for which market price exceeds the exercise price, less shares which could have been purchased by us with the related proceeds. In periods of losses, diluted loss per share is computed on the same basis as basic loss per share as the inclusion of any other potential shares outstanding would be anti-dilutive.

When computing diluted EPS, we are required to assume conversion of the ESOP preferred shares into common stock if we are profitable. The conversion guarantees that each ESOP preferred share be converted into shares worth a minimum value of $78.25. As long as our common stock price is above $13.04 per share, the conversion ratio is 6 to 1. As our share price falls below this amount, the conversion ratio increases.

A reconciliation of the numerators and denominators of the basic and diluted EPS calculation follows:

	2002			2001			2000		
	Income	Shares	Per-Share Amount	(Loss) Income	Shares	Per-Share Amount	(Loss) Income	Shares	Per-Share Amount
	(Shares in thousands)								
Basic EPS									
Net income (loss) before cumulative effect of change in accounting principle ...	$ 154			$ (92)			$ (273)		
Accrued dividends on preferred stock, net ...	(73)			(12)			(46)		
Basic EPS before cumulative effect of change in accounting principle	$ 81	731,280	$ 0.11	$ (104)	704,181	$(0.15)	$ (319)	667,581	$(0.48)
Cumulative effect of change in accounting principle	(63)	731,280	(0.09)	(2)	704,181	--	--		
Basic EPS	$ 18	731,280	0.02	$ (106)	704,181	$(0.15)	$ (319)	667,581	$(0.48)
Diluted EPS before cumulative effect of change in accounting principle	$ 81	807,144	$ 0.10	$ (104)	704,181	$(0.15)	$ (319)	667,581	$(0.48)
Cumulative effect of change in accounting principle	(63)	807,144	(0.08)	(2)	704,181	--	--		
Diluted EPS	$ 18	807,144	$ 0.02	$ (106)	704,181	$(0.15)	$ (319)	667,581	$(0.48)

A reconciliation of the individual weighted average shares outstanding was as follows:

	2002	2001	2000
Weighted -average common shares outstanding:			
Basic	731,280	704,181	667,581
Stock options	5,401	-	-
ESOP Preferred stock	70,463	-	-
Diluted	807,144	704,181	667,581

The 2002, 2001 and 2000 computation of diluted loss per share did not include the effects of 63, 69 and 58 million issued and outstanding stock options, respectively, because either: i) their respective exercise prices were greater than the corresponding market value per share of our common stock or ii) where the respective exercise prices were less than the corresponding market value per share of our common stock, the inclusion of such options would have been anti-dilutive.

In addition, the following securities that could potentially dilute basic EPS in the future were not included in the computation of diluted EPS because to do so would have been anti-dilutive for 2002, 2001 and 2000 (in thousands of shares):

	2002	2001	2000
Convertible preferred stock	--	78,473	50,605
Mandatorily redeemable preferred securities--Trust II	113,426	113,426	--
3.625% Convertible subordinated debentures	7,129	7,129	7,903
Other convertible debt	1,992	1,992	5,287
Total	122,547	201,020	63,795

Note 19--Financial Statements of Subsidiary Guarantors

As indicated in Note 11, in January 2002, we completed an unregistered offering in the U.S. ($600) and Europe ((euro)225) of 9.75 percent senior notes (the "Senior Notes") due in 2009.

The Senior Notes are guaranteed by certain of our subsidiaries (the "Subsidiary Guarantees"), including Palo Alto Research Center Incorporated, Talegen Holdings, Inc., Xerox Credit Corporation, Xerox Export, LLC, Xerox Finance, Inc., Xerox Financial Services, Inc., Xerox Imaging Systems, Inc., Xerox International Joint Marketing, Inc., Xerox Latin-American Holdings, Inc., and Xerox Connect, Inc (the "Guarantor Subsidiaries"). The Subsidiary Guarantees provide that each Guarantor Subsidiary will fully and unconditionally guarantee the obligations of Xerox Corporation ("the Parent Company") under the Senior Notes on a joint and several basis. Each Subsidiary Guarantor is wholly-owned by the Parent Company. The following supplemental financial information sets forth, on a condensed consolidating basis, the balance sheets, statements of income and statements of cash flows for the Parent Company, the Guarantor Subsidiaries, the Non-Guarantor Subsidiaries and total consolidated Xerox Corporation and subsidiaries as of December 31, 2002 and 2001 and for the years ended December 31, 2002, 2001 and 2000.

Condensed Consolidating Statements of Income
For the Year Ended December 31, 2002

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
Revenues					
Sales	$ 3,396	$ 62	$ 3,294	$ -	$ 6,752
Service, outsourcing and rentals	4,589	71	3,437	-	8,097
Finance income	294	276	530	(100)	1,000
Intercompany revenues	327	29	484	(840)	-
Total Revenues	8,606	438	7,745	(940)	15,849
Costs and Expenses					
Cost of sales	2,019	50	2,282	(154)	4,197
Cost of service, outsourcing and rentals	2,507	51	1,986	(14)	4,530
Equipment financing interest	119	128	254	(100)	401
Intercompany cost of sales	294	3	379	(676)	-
Research and development expenses	804	47	78	(12)	917
Selling, administrative and general expenses	2,607	47	1,783	-	4,437
Restructuring and asset impairment charges	95	1	574	-	670
Other expenses (income), net	255	(44)	234	-	445
Total Costs and Expenses	8,700	283	7,570	(956)	15,597
Income (Loss) before Income Taxes (Benefits), Equity Income, Minorities' Interests and Cumulative Effect of Change in Accounting Principle	(94)	155	175	16	252
Income taxes (benefits)	(17)	70	1	6	60
Income (Loss) before Equity Income, Minorities' Interests and Cumulative Effect of Change in Accounting Principle	(77)	85	174	10	192
Equity in net income of unconsolidated affiliates	(6)	12	53	(5)	54
Equity in net income of consolidated affiliates	237	-	-	(237)	-
Minorities' interests in earnings of subsidiaries	-	-	-	(92)	(92)
Income (Loss) before Cumulative Effect of Change in Accounting Principle	154	97	227	(324)	154
Cumulative effect of change in accounting principle	63	-	(62)	62	(63)
Net Income (Loss)	$ 91	$ 97	$ 165	$ (262)	$ 91

Condensed Consolidating Balance Sheets
As of December 31, 2002

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
Assets					
Cash and cash equivalents	$ 1,672	$ 13	$ 1,202	$ -	$ 2,887
Accounts receivable, net	714	20	1,338	-	2,072
Billed portion of finance receivables, net	341	-	223	-	564
Finance receivables, net	392	374	2,322	-	3,088
Inventories	683	3	544	(8)	1,222
Other current assets	554	285	413	(66)	1,186
Total Current Assets	4,356	695	6,042	(74)	11,019
Finance receivables, due after one year, net	712	651	3,990	-	5,353
Equipment on operating leases, net	209	-	265	(15)	459
Land, buildings and equipment, net	1,058	13	686	-	1,757
Investments in affiliates, at equity	32	41	555	-	628
Investments in and advances to consolidated subsidiaries	7,842	-	686	(8,528)	-
Other long-term assets	1,412	737	2,168	1	4,318
Intangible assets, net	360	-	-	-	360
Goodwill	491	296	777	-	1,564
Total Assets	$ 16,472	$ 2,433	$ 15,169	$ (8,616)	$ 25,458
Liabilities and Equity					
Short-term debt and current portion of long-term debt	$ 1,880	$ 410	$ 2,087	$ -	$ 4,377
Accounts payable	447	7	385	-	839
Other current liabilities	793	370	1,268	140	2,571
Total Current Liabilities	3,120	787	3,740	140	7,787
Long-term debt	4,791	1,442	3,561	-	9,794
Intercompany payables, net	3,304	(3,097)	(194)	(13)	-
Other long-term liabilities	2,856	7	832	7	3,702
Total Liabilities	14,071	(861)	7,939	134	21,283
Minorities' interest in equity of subsidiaries	-	-	-	73	73
Company-obligated, mandatorily redeemable preferred securities of subsidiary trusts holding solely subordinated debentures of the Company	-	-	1,701	-	1,701
Preferred stock	550	-	-	-	550
Deferred ESOP benefits	(42)	-	-	-	(42)
Common stock, including additional paid-in capital	2,739	2,632	4,995	(7,627)	2,739
Retained earnings	1,025	665	2,181	(2,846)	1,025
Accumulated other comprehensive loss	(1,871)	(3)	(1,647)	1,650	(1,871)
Total Liabilities and Equity	$ 16,472	$ 2,433	$ 15,169	$ (8,616)	$ 25,458

Condensed Consolidating Statements of Cash Flows
For the Year Ending December 31, 2002

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Total Company
Net cash provided by (used in) operating activities	$ 2,761	$ 155	$ (1,040)	$ 1,876
Net cash (used in) provided by investing activities	(1,667)	1,664	200	197
Net cash (used in) provided by financing activities	(1,836)	(1,807)	351	(3,292)
Effect of exchange rate changes on cash and cash equivalents	-	-	116	116
Decrease (increase) in cash and cash equivalents	(742)	12	(373)	(1,103)
Cash and cash equivalents at beginning of year	2,414	1	1,575	3,990
Cash and cash equivalents at end of year	$ 1,672	$ 13	$ 1,202	$ 2,887

Condensed Consolidating Statements of Income
For the Year Ended December 31, 2001

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
Revenues					
Sales	$ 3,765	$ 213	$ 3,465	$ -	$ 7,443
Service, outsourcing and rentals	4,783	70	3,583	-	8,436
Finance income	248	400	481	-	1,129
Intercompany revenues	386	9	1,082	(1,477)	-
Total Revenues	9,182	692	8,611	(1,477)	17,008
Costs and Expenses					
Cost of sales	2,429	198	2,696	(153)	5,170
Cost of service, outsourcing and rentals	2,716	73	2,112	(21)	4,880
Equipment financing interest	(60)	314	203	-	457
Intercompany cost of sales	344	8	921	(1,273)	-
Research and development expenses	930	-	80	(13)	997
Selling, administrative and general expenses	2,664	53	2,011	-	4,728
Restructuring and asset impairment charges	329	-	386	-	715
Gain on sale of half of interest in Fuji Xerox	26	-	(799)	-	(773)
Gain on affiliate's sale of stock	(4)	-	-	-	(4)
Other (income) expenses, net	(62)	(31)	537	-	444
Total Costs and Expenses	9,312	615	8,147	(1,460)	16,614
(Loss) Income before Income Taxes (Benefits), Equity Income, Minorities' Interests and Cumulative Effect of Change in Accounting Principle	(130)	77	464	(17)	394
Income taxes (benefits)	(129)	45	588	(7)	497
Income (Loss) before Equity Income, Minorities' Interests and Cumulative Effect of Change in Accounting Principle	(1)	32	(124)	(10)	(103)
Equity in net income of unconsolidated affiliates	(7)	10	46	4	53
Equity in net income of consolidated affiliates	(84)	-	-	84	-
Minorities' interests in earnings of subsidiaries	-	-	-	(42)	(42)
Income (Loss) before Cumulative Effect of Change in Accounting Principle	(92)	42	(78)	36	(92)
Cumulative effect of change in accounting principle	(2)	(3)	-	3	(2)
Net Income (Loss)	$ (94)	$ 39	$ (78)	$ 39	$ (94)

Condensed Consolidating Balance Sheets
As of December 31, 2001

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
Assets					
Cash and cash equivalents	$ 2,414	$ 1	$ 1,575	$ -	$ 3,990
Accounts receivable, net	598	19	1,279	-	1,896
Billed portion of finance receivables, net	357	-	227	-	584
Finance receivables, net	288	1,039	2,011	-	3,338
Inventories	703	2	651	8	1,364
Other current assets	746	366	349	(33)	1,428
Total Current Assets	5,106	1,427	6,092	(25)	12,600
Finance receivables, due after one year, net	415	1,798	3,543	-	5,756
Equipment on operating leases, net	302	-	534	(32)	804
Land, buildings and equipment, net	1,188	4	807	-	1,999
Investments in affiliates, at equity	74	26	532	-	632
Investments in and advances to consolidated subsidiaries	6,964	-	471	(7,435)	-
Other long-term assets	1,102	712	2,138	-	3,952
Intangible assets, net	443	-	14	-	457
Goodwill	498	296	651	-	1,445
Total Assets	$ 16,092	$ 4,263	$ 14,782	$ (7,492)	$ 27,645
Liabilities and Equity					
Short-term debt and current portion of long-term debt	$ 2,490	$ 1,764	$ 2,383	$ -	$ 6,637
Accounts payable	353	6	345	-	704
Other current liabilities	591	369	1,651	35	2,646
Total Current Liabilities	3,434	2,139	4,379	35	9,987
Long-term debt	4,973	1,766	3,368	-	10,107
Intercompany payables, net	2,619	(2,860)	260	(19)	-
Other long-term liabilities	2,799	51	672	2	3,524
Total Liabilities	13,825	1,096	8,679	18	23,618
Minorities' interest in equity of subsidiaries	-	-	-	73	73
Company-obligated, mandatorily redeemable preferred securities of subsidiary trusts holding solely subordinated debentures of the Company	-	-	1,687	-	1,687
Preferred stock	605	-	-	-	605
Deferred ESOP benefits	(135)	-	-	-	(135)
Common stock, including additional paid-in capital	2,622	2,605	2,075	(4,680)	2,622
Retained earnings	1,008	573	4,085	(4,658)	1,008
Accumulated other comprehensive loss	(1,833)	(11)	(1,744)	1,755	(1,833)
Total Liabilities and Equity	$ 16,092	$ 4,263	$ 14,782	$ (7,492)	$ 27,645

Condensed Consolidating Statements of Cash Flows
For the Year Ending December 31, 2001

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Total Company
Net cash provided by (used in) operating activities	$ 3,603	$ 4	$ (2,041)	$ 1,566
Net cash (used in) provided by investing activities	(1,545)	1,235	1,183	873
Net cash provided by (used in) financing activities	(641)	(1,233)	1,685	(189)
Effect of exchange rate changes on cash and cash equivalents	-	-	(10)	(10)
Increase (decrease) in cash and cash equivalents	1,417	6	817	2,240
Cash and cash equivalents at beginning of year	997	(5)	758	1,750
Cash and cash equivalents at end of year	$ 2,414	$ 1	$ 1,575	$ 3,990

Condensed Consolidating Statements of Income
For the Year Ended December 31, 2000

	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
Revenues					
Sales	$ 4,173	$ 272	$ 4,394	$ -	$ 8,839
Service, outsourcing and rentals	4,834	81	3,835	-	8,750
Finance income	205	441	516	-	1,162
Intercompany revenues	467	10	994	(1,471)	-
Total Revenues	9,679	804	9,739	(1,471)	18,751
Costs and Expenses					
Cost of sales	2,628	254	3,345	(147)	6,080
Cost of service, outsourcing and rentals	2,863	84	2,227	(21)	5,153
Equipment financing interest	(22)	290	230	-	498
Intercompany cost of sales	455	10	875	(1,340)	-
Research and development expenses	951	-	127	(14)	1,064
Selling, administrative and general expenses	2,930	69	2,519	-	5,518
Restructuring and asset impairment charges	274	3	198	-	475
Gain on sale of China operations	(119)	-	(81)	-	(200)
Gain on sale of affiliates stock	(21)	-	-	-	(21)
Other (income) expenses, net	(52)	2	595	6	551
Total Costs and Expenses	9,887	712	10,035	(1,516)	19,118
(Loss) Income before Income Taxes (Benefits), Equity Income and Minorities' Interests	(208)	92	(296)	45	(367)
Income taxes (benefits)	(236)	61	88	17	(70)
(Loss) Income before Equity Income and Minorities' Interests	28	31	(384)	28	(297)
Equity in net income of unconsolidated affiliates	(24)	8	78	4	66
Equity in net income of consolidated affiliates	(277)	-	-	277	-
Minorities' interests in earnings of subsidiaries	-	-	-	(42)	(42)
Net (Loss) Income	$ (273)	$ 39	$ (306)	$ 267	$ (273)

Condensed Consolidating Statements of Cash Flows
For the Year Ending December 31, 2000

	Parent Company	Guarantor Subsidiaries	Non Guarantor Subsidiaries	Total Company
Net cash provided by (used in) operating activities	$ (1,073)	$ 76	$ 1,204	$ 207
Net cash (used in) provided by investing activities	(99)	(624)	(132)	(855)
Net cash provided by (used in) financing activities	2,151	545	(441)	2,255
Effect of exchange rate changes on cash and cash equivalents	-	-	11	11
Increase (decrease) in cash and cash equivalents	979	(3)	642	1,618
Cash and cash equivalents at beginning of year	18	(2)	116	132
Cash and cash equivalents at end of year	$ 997	$ (5)	$ 758	$ 1,750

QUARTERLY RESULTS OF OPERATIONS (Unaudited)
In millions, except per-share data

2002/(1)/	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Revenues	$3,858	$3,952	$3,793	$4,246	$15,849
Costs and Expenses/(3)/	3,919	3,791	3,617	4,270	15,597
(Loss) Income before Income Taxes (Benefits), Equity Income, Minorities' Interests and Cumulative Effect of Change in Accounting Principle	(61)	161	176	(24)	252
Income taxes (benefits)	(23)	64	77	(58)	60
Equity in net income of unconsolidated affiliates	11	15	17	11	54
Minorities' interests in earnings of subsidiaries	(24)	(25)	(17)	(26)	(92)
(Loss) Income before Cumulative Effect of Change in Accounting Principle	(51)	87	99	19	154
Cumulative effect of change in accounting principle	(63)	--	--	--	(63)
Net (Loss) Income	$ (114)	$ 87	$ 99	$ 19	$ 91
Basic (Loss) Earnings per share before Cumulative Effect of Change in Accounting Principle	$(0.07)	$ 0.12	$ 0.05	$ 0.01	$ 0.11
Basic (Loss) Earnings per Share/(2)/	$(0.16)	$ 0.12	$ 0.05	$ 0.01	$ 0.02
Diluted (Loss) Earnings per Share before Cumulative Effect of Change in Accounting Principle	$(0.07)	$ 0.11	$ 0.04	$ 0.01	$ 0.10
Diluted (Loss) Earnings per Share/(2)/	$(0.16)	$ 0.11	$ 0.04	$ 0.01	$ 0.02
2001					
Revenues	$4,291	$4,283	$4,052	$4,382	$17,008
Costs and Expenses/(3)//(4)/	3,626	4,535	4,157	4,296	16,614
Income (Loss) before Income Taxes (Benefits), Equity Income, Minorities' Interests and Cumulative Effect of Change in Accounting Principle	665	(252)	(105)	86	394
Income taxes (benefits)	437	(124)	(45)	229	497
Equity in net income of unconsolidated affiliates	3	31	--	19	53
Minorities' interests in earnings of subsidiaries	(7)	(10)	(9)	(16)	(42)
Income (Loss) before Cumulative Effect of Change in Accounting Principle	224	(107)	(69)	(140)	(92)
Cumulative effect of change in accounting principle	(2)	--	--	--	(2)
Net Income (Loss)	$ 222	$ (107)	$ (69)	$ (140)	$ (94)
Basic Earnings (Loss) per Share/(2)/	$ 0.31	$(0.15)	$(0.10)	$(0.19)	$ (0.15)
Diluted Earnings (Loss) per Share/(2)/	$ 0.28	$(0.15)	$(0.10)	$(0.19)	$ (0.15)

/(1)/ The amounts reported above have been revised from the amounts originally included in the Form 10-Qs to reflect the correction of interest expense as reported in a Form 8-K filed on December 20, 2002. The pre-tax amounts were adjusted to increase expenses by $8 for the first quarter, $9 for the second quarter and $10 for the third quarter and increase net loss by $5 for the first quarter and reduce net income by $6 for the second and third quarters.

/(2)/ The sum of quarterly (loss) earnings per share may differ from the full-year amounts due to rounding, or in the case of diluted earnings per share, because securities that are anti-dilutive in certain quarters may not be anti-dilutive on a full-year basis.

/(3)/ Costs and expenses included restructuring and asset impairment charges of $146, $53, $63 and $408 for the first, second, third and fourth quarters of 2002, respectively. Restructuring and asset impairment charges of $129, $295, $63 and $228 were incurred in the corresponding four quarters of 2001, respectively.

/(4)/ Costs and expenses for the first quarter of 2001 included gains on the sale of half our interest in Fuji Xerox of $769.

FIVE YEARS IN REVIEW

	2002	2001(2)	2000	1999	1998
	(Dollars in millions, except per-share data)				
Per-Share Data(1)					
Earnings (Loss) from continuing operations(1)					
Basic(1)	$ 0.02	$ (0.15)	$ (0.48)	$ 1.20	$ (0.32)
Diluted(1)	0.02	(0.15)	(0.48)	1.17	(0.32)
Common dividends declared	--	0.05	0.65	0.80	0.72
Operations					
Revenues	$ 15,849	$ 17,008	$ 18,751	$ 18,995	$ 18,777
Sales	6,752	7,443	8,839	8,967	8,996
Service, outsourcing, and rentals	8,097	8,436	8,750	8,853	8,742
Finance Income	1,000	1,129	1,162	1,175	1,039
Research and development expenses	917	997	1,064	1,020	1,045
Selling, administrative and general expenses	4,437	4,728	5,518	5,204	5,314
Income (Loss) from continuing operations(1)	91	(94)	(273)	844	23
Net income (loss)(1)	91	(94)	(273)	844	(167)
Financial Position					
Cash and cash equivalents	$ 2,887	$ 3,990	$ 1,750	$ 132	$ 79
Accounts and finance receivables, net	11,077	11,574	13,067	13,487	13,272
Inventories	1,222	1,364	1,983	2,344	2,554
Equipment on operating leases, net	459	804	1,266	1,423	1,650
Land, buildings and equipment, net	1,757	1,999	2,527	2,458	2,366
Investment in discontinued operations	728	749	534	1,130	1,669
Total assets	25,458	27,645	28,253	27,803	27,775
Consolidated capitalization					
Short-term debt and current portion of long-term debt	4,377	6,637	3,080	4,626	4,221
Long-term debt	9,794	10,107	15,557	11,521	11,104
Total debt	14,171	16,744	18,637	16,147	15,325
Minorities' interests in equity of subsidiaries	73	73	87	75	81
Obligation for equity put options	--	--	32	--	--
Company-obligated, mandatorily redeemable preferred securities of subsidiary trusts holding solely subordinated debentures of the Company	1,701	1,687	684	681	679
Preferred stock	550	605	647	669	687
Deferred ESOP benefits	(42)	(135)	(221)	(299)	(370)
Common shareholders' equity	1,893	1,797	1,801	2,953	3,026
Total capitalization	18,346	20,771	21,667	20,226	19,428
Selected Data and Ratios					
Common shareholders of record at year-end	57,300	59,830	59,879	55,766	52,001
Book value per common share	$ 2.56	$ 2.49	$ 2.68	$ 4.42	$ 4.59
Year-end common stock market price	$ 8.05	$ 10.42	$ 4.63	$ 22.69	$ 59.00
Employees at year-end	67,800	78,900	91,500	93,600	91,800
Gross margin	42.4%	38.2%	37.4%	42.3%	44.3%
Sales gross margin	37.8%	30.5%	31.2%	37.2%	40.5%
Service, outsourcing, and rentals gross margin	44.0%	42.2%	41.1%	44.7%	46.6%
Finance gross margin	59.9%	59.5%	57.1%	63.0%	58.2%
Working capital	$ 3,232	$ 2,340	$ 4,928	$ 2,965	$ 2,959
Current ratio	1.4	1.2	1.8	1.3	1.3
Cost of additions to land, buildings and equipment	$ 146	$ 219	$ 452	$ 594	$ 566
Depreciation on buildings and equipment	$ 341	$ 402	$ 417	$ 416	$ 362

(1) Income (Loss) from continuing operations and Net income (loss), as well as Basic and Diluted Earnings per Share for the year ended December 31, 2002, exclude the effect of amortization of goodwill in accordance with the adoption of Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets." For additional information regarding the adoption of this standard and its effects on Income from continuing operations, Net income (loss) and Earnings (Loss) per share, refer to Note 1 to the Consolidated Financial Statements under the heading "Adoption of New Accounting Standards - Goodwill and Other Intangible Assets."

(2) In March 2001, we sold half of our ownership interest in Fuji Xerox to Fuji Photo Film Co. Ltd. For $1.3 billion in cash. In connection with the sale, we recorded a pre-tax gain of $773. As a result, our ownership percentage decreased from 50 percent to 25 percent. Refer to Note 4 to the Consolidated Financial Statements under the caption "Fuji Xerox Interest" for further information.

EXHIBIT 21

Subsidiaries of Xerox Corporation

The following companies are subsidiaries of Xerox Corporation as of December 31, 2002. A subsidiary is a company in which Xerox Corporation or a subsidiary of Xerox Corporation holds 50% or more of the voting stock. The names of a number of other subsidiaries have been omitted as they would not, if considered in the aggregate as a single subsidiary, constitute a significant subsidiary:

Name of Subsidiary	Incorporated In
AMTX, Inc.	Delaware
Bradley Company	Ohio
Carmel Valley, Inc.	Delaware
Chrystal Software, Inc.	Delaware
ContentGuard Holdings, Inc.	Delaware (16)
ContentGuard, Inc.	Delaware
Copicentro N.V.	Netherlands Antilles
FairCopy Services Inc.	Canada
Fourth Xerox Receivables LLC	Delaware
GroupFire, Inc.	California
Gyricon Media Inc.	Delaware (18)
Gyricon Media LLC	Delaware (17)
IGHI, Inc.	Delaware
Xerox Global Services Limited	United Kingdom
Delphax Systems GmbH	Germany
InConcert, Inc.	Delaware
Infotonics Technology Center Inc.	New York (19)
Institute for Research on Learning	Delaware
Intelligent Electronics, Inc.	Pennsylvania
Xerox Connect, Inc.	Pennsylvania
Jeremiad Co.	Delaware
Kapwell Holdings, Ltd.	Bermuda
Proyectos Inverdoco, C.A.	Venezuela
Leeroit S.A.	Ecuador
LiveWorks, Inc.	Delaware
Low-Complexity Manufacturing Group, Inc.	Delaware
New PARC LLC	Delaware
Pacific Services and Development Corporation	Delaware
Inversiones San Simon, S.A.	Venezuela
Estacionamiento Bajada III, C.A.	Venezuela
PageCam, Inc.	Delaware
Palo Alto Research Center Incorporated	Delaware
PixelCraft, Inc.	Delaware
Securities Information Center, Inc.	Delaware
SCC Burton Corporation	Delaware
79861 Ontario Inc.	Ontario
Terabank Systems, Inc.	Delaware
The Xerox Foundation	Delaware
Third Xerox Receivables LLC	Delaware
Uppercase, Inc.	Delaware
XDI, Inc.	Delaware
Xerox Antilliana N.V.	Netherlands Antilles
Xerox Antilliana (Aruba) N.V.	Aruba
Xerox Antilliana (St. Maarten) N.V.	Netherlands Antilles
Xerox Argentina, I.C.S.A.	Argentina
Xerox Canada Capital Ltd.	Canada
Xerox Canada Inc.	Ontario
832667 Ontario Inc.	Ontario

Name of Subsidiary	Incorporated In
1192990 Ontario Inc.	Ontario
1324029 Ontario Inc.	Ontario
1343175 Ontario Inc.	Ontario
Xerox (Barbados) SRL	Barbados (15)
Xerox (Barbados) Leasing SRL	Barbados
Xerox Business Centre (Ireland) Limited	Ireland
Xerox Electronic (Ireland) Limited	Ireland
Xerox Finance (Luxembourg) Sarl	Luxembourg
Xerox Hardware (Ireland) Limited	Ireland
Xerox Toner (Ireland) Limited	Ireland
Xerox Canada Acceptance Inc.	Canada
Xerox Canada Facilities Management Ltd.	Ontario
Xerox Canada Finance Inc.	Ontario
Xerox Canada Leasing Partnership	Ontario (20)
Xerox Canada Ltd.	Canada (4)
965905 Alberta Ltd.	Alberta
Ionographic Operations Partnership	Massachusetts (22)
Xerox Canada Manufacturing & Research Inc.	Ontario
Xerox Capital, LLC	Turks & Caicos Islands (9)
Xerox Capital de Mexico, S.A. de C.V.	Mexico
Xerox Capital Services LLC	Delaware (21)
Xerox Capital Trust I	Delaware (11)
Xerox Capital Trust II	Delaware
Xerox de Chile S.A.	Chile
Xerox de Colombia S.A.	Colombia
Xerox Color Printing, Inc.	Delaware
Xerox de Costa Rica, S.A.	Costa Rica
Xerox Developing Markets Limited	Bermuda
Sidh Securities Limited	Mauritius
Xerox Dominicana, C. por A.	Dominican Republic
Xerox del Ecuador, S.A.	Ecuador
Xerox de El Salvador, S.A. de C.V.	El Salvador
Xerox Export, LLC	Delaware
Xerox Finance, Inc.	Delaware
Xerox (Austria) Holdings GmbH	Austria
Xerox Investments Holding (Bermuda) Limited	Bermuda
Xerox Financial Services, Inc.	Delaware
Ridge Reinsurance Limited	Bermuda
Talegen Holdings, Inc.	Delaware
Talegen Properties, Inc.	Delaware
Xerox Credit Corporation	Delaware
Fifth XCC Receivables LLC	Delaware
Xerox Foreign Sales Corporation	Barbados
Xerox Funding Corporation	Delaware
Xerox Funding LLC II	Delaware
Xerox de Guatemala, S.A.	Guatemala
XGUA Servicios, Ltda.	Guatemala
Xerox d'Haiti, S.A.	Haiti
Xerox de Honduras, S.A.	Honduras
Xerox Holding LLC	Delaware
Xerox Equipment LLC	Delaware
Xerox Funding LLC	Delaware
Xerox Equipment Lease Owner Trust 2001-1	Delaware
Xerox Imaging Systems, Inc.	Delaware
Xerox International Joint Marketing, Inc.	Delaware
Xerox International Partners	California (10)
Xerox International Realty Corporation	Delaware
Xerox Canada Realty Inc.	Ontario (3)
Xerox Investments Europe B.V.	Netherlands
Xerox Holdings (Ireland) Limited	Ireland
Xerox (Europe) Limited	Ireland
Bipolar Limited	Ireland

Name of Subsidiary	Incorporated In
Xerox Channels Limited	Ireland
Xerox Ink Jet (Ireland) Limited	Ireland
Xerox Ink Tanks (Ireland) Limited	Ireland
Xerox XF Holdings (Ireland) Limited	Ireland
Xerox Finance (Cyprus) Limited	Cyprus
Xerox Finance (Ireland) Limited	United Kingdom
Xerox Leasing Ireland Limited	Jersey
Xerox Israel Ltd.	Israel
Xerox UK Holdings Limited	United Kingdom
Triton Business Finance Limited	United Kingdom
Xerox Engineering Systems Europe Limited	United Kingdom
Xerox Research (UK) Limited	United Kingdom
Xerox Trading Enterprises Limited	United Kingdom
Xerox Overseas Holdings Limited	United Kingdom
Xerox Business Equipment Limited	United Kingdom
Xerox Computer Services Limited	United Kingdom
Xerox Mailing Systems Limited	United Kingdom0
Xerox Capital (Europe) plc	United Kingdom (13)
XRO Limited	United Kingdom
Nemo (AKS) Limited	United Kingdom
XRI Limited	United Kingdom
RRXH Limited	United Kingdom (12)
RRXO Limited	United Kingdom
RRXIL Limited	United Kingdom (6)
Xerox Holding (Nederland) B.V.	Netherlands
Xerox Manufacturing (Nederland) B.V.	Netherlands
Xerox Office Printing Distribution B.V.	Netherlands
Xerox XHB Limited	Bermuda (6)
Xerox XIB Limited	Bermuda (6)
Xerox Limited	United Kingdom (6)
City Paper Limited	United Kingdom
Continua Limited	United Kingdom
Continua S.A.	France
Continua Sanctum Limited	United Kingdom
Xerox Property Services Limited	United Kingdom
NV Xerox Credit S.A.	Belgium
NV Xerox Management Services S.A.	Belgium
N.V. Xerox S.A.	Belgium
The Xerox (UK) Trust	United Kingdom
Westbourne Limited	United Kingdom
Xerox AB	Sweden
RE Forvaltning AB	Sweden
Amanuens Document AB	Sweden
Xerox AG	Switzerland
Xerox Office Supplies AG	Switzerland
Xerox A/S	Denmark
Xerox Finans	Denmark
Xerox AS	Norway
Xerox Austria GmbH	Austria
Xerox Business Services GmbH	Austria
Xerox Leasing GmbH	Austria
Xerox Office Supplies GmbH	Austria
Xerox Beograd d.o.o.	Yugoslavia
Xerox Bulgaria	Bulgaria
Xerox Buro Araciari Ticaret ve Servis A.S.	Turkey
Xerox Channels Limited	United Kingdom
Xerox (C.I.S.) LLC	Russia
Xerox Credit AB	Sweden
XEROX CZECH Republic s r.o.	Czech Republic
Xerox Direct Rhein-Main GmbH	Germany
Xerox Espana-The Document Company, S.A.U.	Spain
Xerox Renting S.A.U.	Spain
Xerox de Financiacion S.A.U., E.F.C.	Spain

Name of Subsidiary	Incorporated In
Xerox Office Supplies S.A.U.	Spain
Xerox Exports Limited	United Kingdom
Xerox Fabricacion S.A.U.	Spain
Xerox Finance AG	Switzerland
Xerox Finance (Nederland) BV	Netherlands
Xerox GmbH	Germany
Xerox Dienstleistungsgesellschaft GmbH	Germany
Xerox Leasing Deutschland GmbH	Germany
Xerox Office Printing GmbH	Germany
Xerox Hellas AEE	Greece
Xerox Hungary Ltd	Hungary
Xerox (Ireland) Limited	Ireland
Xerox Modicorp Ltd	India (8)
Xerox (Nederland) BV	Netherlands
"Veco" Beheer Onroerend Goed BV	Netherlands
Xerox Document Supplies BV	Netherlands
Xerox Rentalease BV	Netherlands
Xerox Services BV	Netherlands
Xerox (Nigeria) Limited	Nigeria
Xerox Office Printing S.A.S	France
Xerox Oy	Finland
Asunto Oy Kristiinanvalli	Finland
Xerox Pensions Limited	United Kingdom
Xerox Polska Sp.zo.o	Poland
Xerox Portugal Equipamentos de Escritorio, Limitada	Portugal
CREDITEX - Aluguer de Equipamentos S.A.	Portugal
Xerox Professional Services Limited	United Kingdom
Xerox (Romania) Echipmante Si Servici S.A.	Romania
Xerox (Romania) SRL	Romania
Xerox Slovenia d.o.o.	Slovenia
Xerox South Africa (Proprietary) Limited	South Africa (23)
Laser Facilities (Proprietary) Limited	South Africa (23)
Letlapa Xerox (Pty) Ltd.	South Africa (23)
University Document Management Services (Proprietary) Limited	South Africa (23)
Xerox Namibia (Proprietary) Limited	South Africa (23)
Xerox S.p.A.	Italy
Xerox Telebusiness GmbH	Germany
Xerox - THE DOCUMENT COMPANY S.A.S.	France
Xerobail S.A.	France
Xerox Document Services SNC	France
Set Electronique SA	France
SCI Hieroglyphe	France
Set Belgium (EPC)	Belgium
Set Engineering SA	France
Set Italia	Italy
Set R&D Belgium (EES)	Belgium
Set UK Limited	United Kingdom
Xerox Business Services SNC	France
Xerox Document Supplies SNC	France
Xerox (UK) Limited	United Kingdom
Bessemer Trust Limited	United Kingdom
Inserco Manufacturing Limited	United Kingdom
Xerox Finance Limited	United Kingdom
Xerox Office Supplies Limited	United Kingdom
Xerox (R & S) Limited	United Kingdom
Xerox (Ukraine) Ltd LLC	Ukraine
Xexco Trading Limited	United Kingdom
Xerox West Africa Limited	United Kingdom
Xerox Latinamerican Holdings, Inc.	Delaware
Xerox Lease Funding LLC	Delaware
Xerox Lease Equipment LLC	Delaware
Xerox Mexicana, S.A. de C.V.	Mexico

Name of Subsidiary	Incorporated In
Xerox Middle East Investments (Bermuda) Limited	Bermuda
Bessemer Insurance Limited	Bermuda
Reprographics Egypt Limited	Egypt
Xerox Egypt S.A.E.	Egypt
Xerox Finance Leasing S.A.E.	Egypt
Xerox Equipment Limited	Bermuda
Xerox Maroc S.A.	Morocco (2)
Xerox Products Limited	Bermuda
Xerox de Nicaragua, S.A.	Nicaragua
Xerox de Panama, S.A.	Panama
Xerox del Paraguay SRL	Paraguay
Xerox Participacoes Ltda.	Brazil
Xerox do Brasil Ltda.	Brazil
Astor Administracao De Bens e Participacoes Ltda.	Brazil (1)
Centro de Desenvolvimiento de Sistemas de Vitoria S/A	Brazil
J.D.R. Vitoria Equipamentos S.A.	Brazil
Xerox Comercio e Industria Ltda	Brazil
Modern High Tech Web SA	Brazil
Xerox Desenvolvimento de Sistemas e de Technologia Ltda	Brazil
Xerox del Peru, S.A.	Peru
Xerox Real Estate Services, Inc.	New York
Xerox Realty Corporation	Delaware
Lansdowne Residential LLC	Virginia
Xerox Realty Corp. (California)	California
XRC Realty Corp. West	California
Xerox Servicios Tecnicos, C.A.	Venezuela
Xerox de Venezuela, C.A.	Venezuela (5)
Xerox Special Holding LLC	Delaware
Xerox Special Funding LLC	Delaware
Xerox Special Equipment LLC	Delaware
Xerox Trinidad Limited	Trinidad
Xerox Uruguay S.A.	Uruguay
Xerox XBS Warehouse Holding LLC	Delaware
Xerox XBS Warehouse Funding LLC	Delaware
Xerox XBS Warehouse Funding II LLC	Delaware
Xerox Zona Libre, S.A.	Panama
XES Merger Corp.	Delaware
XESystems Foreign Sales Corporation	Barbados
XESystems, Inc.	Delaware
XE Holdings, Inc.	Delaware
Xerox Engineering Systems AG	Switzerland
Xerox Engineering Systems Espanola SA	Spain
Xerox Engineering Systems SpA	Italy
Xerox ColografX Systems, Inc.	California
Synergix Image Solutions Suzhou Co. Ltd.	China
Xerox Engineering Systems B.V.	Netherlands
Xerox Engineering Systems GmbH	Germany
Xerox Engineering Systems N.V.	Belgium
Xerox Engineering Systems S.A.	France
XESystems Canada Inc.	Ontario
XESystems UK Limited	United Kingdom
Xerox Engineering Systems Limited	United Kingdom
Xtended Memory Systems	California

(1) Owned 40.01% by Xerox do Brasil, Ltda. and 59.99% by Xerox (Barbados) SRL and 2 shares by Carlos A. Salles.

(2) Owned 99.9% by XMEIBL and .1% by several individuals.

(3) 1,000 shares held by Xerox Canada Inc. and 9,000 shares held by Xerox International Realty Corporation.

(4) Owned 65% by Xerox Canada Inc. and 35% by Xerox Canada Finance Inc.

(5) Owned 21.32% by Kapwell, Ltd., 65.43% by Xerox Servicios Tecnicos, C.A., and 13.25% by Inversiones San Simon, S.A..

(6) Includes indirect holdings.

(8) Xerox Corporation has an indirect economic interest in 18.199% of XM through EMCO Finivest Limited, which is a controlled subsidiary of Spicecorp Ltd (formerly Modicorp Ltd) the joint venture partner. Xerox Corporation also owns an additional 4.421% through its wholly-owned subsidiary Xerox Developing Markets Limited. The total ownership by Xerox Corporation is 68.199%.

(9) Owned 99.9% by Xerox Corporation and .1% by Pacific Services and Development Corporation, a wholly-owned subsidiary of Xerox Corporation.

(10) Xerox International Partners is a California general partnership between FX Global, Inc. (49%) and Xerox International Joint Marketing, Inc. (51%).

(11) Xerox Capital Trust I is a Delaware statutory business trust which is 100% beneficially owned by Xerox Corporation. The Trust is a special purpose financing vehicle.

(12) 50% owned by XRI Limited.

(13) Owned 99% by Xerox Overseas Holdings Limited and 1% by Mitcheldean Enterprise Workshops Limited as nominee for Xerox Overseas Holdings Limited.

(15) Owned 88.27% by Xerox Canada Inc. and 11.73% by Xerox Corporation. (16) Owned 75% by Xerox Corporation and 25% by Microsoft Corporation. (17) Owned 78.2% by Xerox Corporation, 17.7% by e-PaperSign, LLC, 4% by New Ventures and .1% by Gyricon Media Inc.

(18) Owned 50% by Xerox Corporation and 50% by e-PaperSign, LLC.

(19) This a not-for-profit corporation which will act as a research and development consortium of businesses and universities. The initial members are Xerox, Corning, Kodak, University of Rochester, RIT and Cornell.

(20) Xerox Canada Leasing Partnership is an Ontario partnership between Xerox Canada Inc. (99%) and Xerox Canada Finance Inc (1%).

(21) Owned 19% by Xerox Corporation and 79% by GE Capital Information Technology Solutions, Inc.

(22) Owned 66.995% by Xerox Canada Ltd. and 33.005% by Xerox Canada Inc. (23) Xerox does not have voting control and all South African entities are deconsolidated.

Exhibit 23

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (No. 33-32215, 333-73173 and 333-101164) and Form S-8 (No. 333-93269, 333-09821, 333-22059, 333-22037, 333-22313, 333-35790, 33-65269, 33-44314, 2-86275, 2-86274) of Xerox Corporation of our report dated January 28, 2003, except for Note 15 which is as of March 27, 2003 relating to the financial statements, which appears in the 2002 Annual Report to Shareholders, which is incorporated in this Annual Report on Form 10-K. We also consent to the incorporation by reference of our report dated January 28, 2003 relating to the financial statement schedule, which appears in this Form 10-K.

/s/ PRICEWATERHOUSECOOPERS LLP

PricewaterhouseCoopers LLP
Stamford, CT
March 31, 2003

Exhibit 99.1

CERTIFICATION OF CEO AND CFO PURSUANT TO
18 U.S.C. § 1350,
AS ADOPTED PURSUANT TO
§ 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Form 10-K of Xerox Corporation (the “Company”) for the year ending December 31, 2002, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), Anne M. Mulcahy, Chairman of the Board and Chief Executive Officer of the Company, and Lawrence A. Zimmerman, Senior Vice President and Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, to the best of his/her knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ANNE M. MULCAHY

Anne M. Mulcahy
Chief Executive Officer
March 31, 2003

/s/ LAWRENCE A. ZIMMERMAN

Lawrence A. Zimmerman
Chief Financial Officer
March 31, 2003

This certification accompanies this Report pursuant to § 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of § 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by §906 has been provided to Xerox Corporation and will be retained by Xerox Corporation and furnished to the Securities and Exchange Commission or its staff upon request.