1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation

The consolidated financial statements include all majority-owned subsidiaries in which Lucent Technologies Inc. ("Lucent" or "the Company") exercises control. Investments in which Lucent exercises significant influence, but which it does not control (generally a 20% to 50% ownership interest), are accounted for under the equity method of accounting. All material intercompany transactions and balances have been eliminated. Except as otherwise noted, all amounts and disclosures have been restated to reflect only Lucent's continuing operations (see Note 3).

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying disclosures. Actual results could differ from those estimates. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary.

Foreign Currency Translation

For operations outside the U.S. that prepare financial statements in currencies other than the U.S. dollar, results of operations and cash flows are translated at average exchange rates during the period, and assets and liabilities are translated at end-of-period exchange rates. Translation adjustments are included as a separate component of accumulated other comprehensive income (loss) in shareowners' equity.

Revenue Recognition

Revenue from product sales of hardware and software is generally recognized when persuasive evidence of an agreement exists, delivery has occurred, the fee is fixed and determinable, and collection of the resulting receivable, including receivables of customers to which Lucent has provided customer financing, is probable. The determination of whether the collectibility of receivables is reasonably assured is based upon an assessment of the creditworthiness of the customers and Lucent's ability to sell the receivable. In instances where collection or sale of a receivable is not reasonably assured, revenue and the related costs are deferred. The value allocated to elements in a multiple element arrangement is based on objective evidence of relative fair values of each element. Services revenues are generally recognized at time of performance. Revenues and estimated profits on long-term contracts are generally recognized under the percentage-of-completion method of accounting using either a units-of-delivery or a cost-to-cost methodology. Profit estimates are revised periodically based on changes in facts; any losses on contracts are recognized immediately. Lucent makes certain sales through multiple distribution channels including resellers and distributors. For products sold through these distribution channels, revenue is generally recognized when the product is sold by the reseller or distributor to the end user.

Research and Development and Software Development Costs

Research and development costs are charged to expense as incurred. However, the costs incurred for the development of computer software that will be sold, leased or otherwise marketed are capitalized when technological feasibility has been established. These capitalized costs are subject to an ongoing assessment of recoverability based on anticipated future revenues and changes in hardware and software technologies. Costs that are capitalized include direct labor and related overhead.

Amortization of capitalized software development costs begins when the product is available for general release. Amortization is provided on a product-by-product basis on the straight-line method over periods not exceeding two years. Unamortized capitalized software development costs determined to be in excess of net realizable value of the product are expensed immediately.

Effective October 1, 1999, Lucent adopted Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"). As a result, certain costs of computer software developed or obtained for internal use have been capitalized as part of other assets and are amortized over a three-year period. The impact of adopting SOP 98-1 was a reduction of costs and operating expenses of $206 for the fiscal year ended September 30, 2000.

Cash and Cash Equivalents

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents. These primarily consist of money market funds and to a lesser extent certificates of deposit and commercial paper.

Inventories

Inventories are stated at the lower of cost (determined principally on a first-in, first-out basis) or market.

Contracts in Process

Contracts in process are stated at cost plus accrued profits less progress billings. Net contracts in process balances include unbilled receivables of $358 and $1,272 at September 30, 2001 and 2000, respectively, which are generally billable and collectible within one year.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is determined using a combination of accelerated and straight-line methods over the estimated useful lives of the various asset classes. Useful lives for buildings and building improvements, furniture and fixtures and machinery and equipment principally range from 10 to 40 years, five to 10 years and two to 10 years, respectively.

Financial Instruments

Lucent uses various financial instruments, including foreign exchange forward and option contracts and interest rate swap agreements to manage risk to Lucent by generating cash flows that offset the cash flows of certain transactions in foreign currencies or underlying financial instruments in relation to their amount and timing. Lucent's derivative financial instruments are for purposes other than trading. Lucent's non-derivative financial instruments include letters of credit, commitments to extend credit and guarantees of debt. See Note 5 and Note 15 for further discussions on derivative financial instruments and hedging activities.

Lucent's investment portfolio consists of equity investments accounted for under the cost and equity methods as well as equity investments in publicly held companies that are generally concentrated in the high-technology communications industry. These investments are included in other assets. Marketable equity securities with readily determinable fair values are classified as available-for-sale securities and reported at fair value. Unrealized gains and losses on the changes in fair value of these securities are reported, net of tax, as a component of accumulated other comprehensive income (loss) until sold (see Note 8). At the time of sale, any such gains or losses are recognized in Other income (expense) – net. All equity investments are periodically reviewed to determine if declines in fair value below cost basis are other-than-temporary. Significant and sustained decreases in quoted market prices, a series of historic and projected operating losses by the investee or other factors are considered as part of the review. If the decline in fair value has been determined to be other-than-temporary, an impairment loss is recorded in Other income (expense) – net and the individual security is written down to a new cost basis.

Securitizations and Transfers of Financial Instruments

Sales, transfers and securitizations of financial instruments are accounted for under Statement of Financial Accounting Standards ("SFAS") No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS 140"). From time to time, Lucent may sell trade receivables and notes receivable with or without recourse and/or discounts in the normal course of business. The receivables are removed from the Consolidated Balance Sheet at the time they are sold. Sales and transfers that do not meet the criteria for surrender of control under SFAS 140 are accounted for as secured borrowings.

The value assigned to undivided interests retained in securitized trade receivables is based on the relative fair values of the interest retained and sold in the securitization. Fair values are measured by the present value of estimated future cash flows of the securitization facility. See Note 16 for further discussions on securitizations and transfers of financial instruments.

Goodwill and Other Acquired Intangibles

Goodwill and other acquired intangibles are amortized on a straight-line basis over the periods benefited, principally in the range of five to 10 years. Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for as purchases.

Impairment of Goodwill and Other Long-Lived Assets

Goodwill and other long-lived assets are reviewed for impairment whenever events such as product discontinuance, plant closures, product dispositions or other changes in circumstances indicate that the carrying amount may not be recoverable. When such events occur, Lucent compares the carrying amount of the assets to undiscounted expected future cash flows. If this comparison indicates that there is an impairment, the amount of the impairment is typically calculated using discounted expected future cash flows. The discount rate applied to these cash flows is based on Lucent's weighted average cost of capital, which represents the blended after-tax costs of debt and equity.

Reclassifications

Certain prior year amounts have been reclassified to conform to the fiscal year 2001 presentation.

2. Business Restructuring Charges and Asset Impairments

On January 24, 2001 and on July 24, 2001, Lucent announced phase I and phase II of its restructuring program. Under the restructuring program, Lucent exited certain non-strategic wireless, optical networking and switching and access product lines and streamlined its cost structure in various businesses and corporate operations. This resulted in a pretax charge to earnings totaling $11,416 for the year ended September 30, 2001. The charge includes restructuring costs of $4,767 and asset write-downs of $6,649. Asset write-downs include inventory write-downs of $1,259, which are recorded as a component of Costs. Lucent expects to complete the restructuring program by the end of fiscal year 2002.

The following table displays the activity and balances of the restructuring reserve account for the year ended September 30, 2001:

		Deductions		*September 30, 2001*
	Total Charge	*Net cash payments*	*Non-cash charges*	*reserve*
RESTRUCTURING COSTS				
Employee separations	$ 3,440	$ 179	$ 2,673	$ 588
Contract settlements	944	334	–	610
Facility closings	304	8	–	296
Other	79[a]	(46)[a]	–	125
Total restructuring costs	4,767	475	2,673	1,619
ASSET WRITE-DOWNS				
Goodwill and other acquired intangibles	4,081	–	4,081	–
Inventory[b]	1,259	–	1,259	–
Capitalized software	362	–	362	–
Property, plant and equipment, net	425	–	425	–
Other	522	–	522	–
Total asset write-downs	6,649	–	6,649	–
Total	$11,416	$475	$9,322	$1,619

(a) Includes proceeds from the sale of a product line.

(b) At September 30, 2001, the unutilized inventory reserve for restructuring was $689.

Employee Separations

Lucent recorded charges during fiscal year 2001 associated with voluntary and involuntary employee separations totaling approximately 39,000 employees, including 8,500 related to a voluntary early-retirement offer to qualified U.S. paid management employees. As of September 30, 2001, approximately 23,700 of these employees had been terminated. In addition 5,300 of employee separations since December 31, 2000, not included in above amounts, were achieved through attrition and divestiture of businesses. The majority of the remaining employee separations are expected to be completed by the end of the second fiscal quarter of 2002. Employee separations impact all of Lucent's business groups and geographic regions. Of the 39,000 employee separations, approximately 70% are management and 60% are involuntary.

The non-cash portion of the employee separations charge reflects $2,113 of net pension and postretirement termination benefits to certain U.S. employees expected to be funded through Lucent's pension assets and $560 for net pension, postretirement and postemployment benefit curtailment charges. Curtailment charges were recognized since a significant number of expected years of future service of present plan participants either were or will be eliminated (see Note 12).

Contract Settlements

Contract settlements include settlements of purchase commitments with suppliers of $508 and contract renegotiations or cancellations of contracts with customers of $436. Approximately 50% of total purchase commitments relate to the rationalization of certain optical networking products, including charges relating to the discontinuance of the Chromatis product portfolio. Customer settlements include charges associated with switching and access product rationalizations and the Company's strategic decision to limit its investment in research and development in certain wireless technologies.

Facility Closings

Facility closings reflect the costs associated with the consolidation of offices and production facilities as a result of employee separations, product rationalizations and the transition to contract manufacturing.

Goodwill and Other Acquired Intangibles

Impairment losses related to the write-down of goodwill and other acquired intangibles to their fair value was estimated by discounting the expected future cash flows. These impairment charges largely relate to the write-off of $3,707 of goodwill relating to the discontinuance of the Chromatis product portfolio, the write-off of acquired intangibles related to the impairment of the TeraBeam investment and rationalizations of products associated with the DeltaKabel, Stratus and Ignitus acquisitions (see Note 4).

Inventory

Inventory write-downs resulted primarily from optical networking, switching and access and wireless product rationalizations and discontinuances.

Other Asset Write-downs

The remainder of the asset write-downs consisted of property, plant and equipment, capitalized software and other assets associated with Lucent's product and system rationalizations resulting in sales of assets, closures and consolidation of offices, research and development facilities and factories.

3. Agere Initial Public Offering and Discontinued Operations

On December 29, 2000, Lucent completed the sale of its power systems business (see Note 4). On April 2, 2001, Agere Systems Inc. ("Agere"), Lucent's microelectronics business, completed an initial public offering ("IPO") of 600 million shares of Class A common stock, resulting in net proceeds of $3,440 to Agere. As a result of the IPO and the planned spin-off of Agere described below, Lucent recorded an increase to shareowners' equity of $922. In addition, on April 2, 2001, Morgan Stanley exercised its overallotment option to purchase an additional 90 million shares of Agere Class A common stock from Lucent. Morgan Stanley exchanged $519 of Lucent commercial paper for the Agere common shares. This transaction resulted in a gain of $141, which is included in the estimated loss on disposal of Agere. After the exercise of the overallotment option by Morgan Stanley, Lucent owned 57.8% of Agere common stock. If Lucent satisfies certain conditions and terms under its credit facilities (see Note 10), it intends to spin-off Agere through a tax-free distribution to its shareowners. The Company has historically reported Agere and the power systems business as part of a single significant segment. Accordingly, Lucent's consolidated financial statements for all periods presented have been reclassified to reflect Agere and the power systems business as a discontinued business segment in accordance with Accounting Principles Board Opinion No. 30.

On September 30, 2000, Lucent completed the spin-off of Avaya Inc., Lucent's former enterprise networks business, in a tax-free distribution to its shareowners. The historical carrying amount of the net assets transferred to Avaya was recorded as a stock dividend of $1,009. As a result of the final transfer of assets and liabilities to Avaya, the stock dividend was adjusted by $47 and reflected as a reduction to additional paid-in-capital during fiscal year 2001. This segment has also been treated as a discontinued operation.

Summarized financial information for the discontinued operations is as follows:

	Years ended September 30,		
	2001	**2000**	**1999**
REVENUES			
Agere and power systems	$ 3,838	$ 4,909	$ 3,624
Avaya	–	7,607	8,157
Total revenues	$ 3,838	$12,516	$11,781
INCOME (LOSS) FROM DISCONTINUED OPERATIONS (NET OF TAXES)			
Agere and power systems[a]	$ (151)	$ 248	$ 657
Avaya[b]	–	303	455
Loss on disposal of Agere[a]	(3,021)	–	–
Loss on disposal of Avaya[b]	–	(765)	–
Income (loss) from discontinued operations	$(3,172)	$ (214)	$ 1,112

NET ASSETS OF DISCONTINUED OPERATIONS (AGERE AND POWER SYSTEMS)	September 30, **2001**	**2000**
Current assets	$ 4,022	$ 1,583
Current liabilities	4,427[c]	949
Net current assets (liabilities) of discontinued operations	$ (405)	$ 634
Long-term assets	$ 2,625	$ 6,050
Long-term liabilities	1,323[d]	418
Net long-term assets of discontinued operations	$ 1,302	$ 5,632

(a) Agere and power systems' income (loss) from discontinued operations includes income tax provisions of $107, $398 and $296 for fiscal years ended September 30, 2001, 2000 and 1999, respectively.

The loss on disposal of Agere, net of a tax provision of $39, is composed of Lucent's 57.8% share of the estimated net losses and separation costs of the microelectronics business from the measurement date through the planned spin-off date, partially offset by a gain of $141 associated with Lucent's debt exchange on April 2, 2001, as noted above. The loss on disposal of Agere includes Lucent's share of a $2,762 impairment charge for goodwill and other acquired intangibles primarily associated with the product portfolios of the Ortel Corporation, Herrmann Technology, Inc., and Agere, Inc. acquisitions and costs associated with Agere's restructuring initiatives, separation expenses related to the IPO and expected spin-off and inventory provisions of $563, $99 and $409, respectively. Major components of the restructuring charge include $386 for the rationalization of under-utilized manufacturing facilities and other restructuring-related activities, and $177 for work force reductions. In addition, Agere has recorded a $538 tax valuation allowance for its deferred tax assets.

(b) Avaya's income from discontinued operations for the years ended September 30, 2000 and 1999 is net of applicable income taxes of $160 and $256, respectively. Income from discontinued operations includes an allocation of Lucent's interest expense totaling $64 and $91 for the fiscal years ended September 30, 2000 and 1999, respectively, based upon the amount of debt assumed by Avaya. Approximately $780 of commercial paper borrowings was assumed by Avaya as part of the spin-off transaction. The loss on disposal of Avaya, net of a tax benefit of $238, reflects the costs directly associated with the spin-off and the net loss of Avaya between the measurement date and the spin-off date of September 30, 2000. The loss includes those components of the Avaya reorganization plan, including a business restructuring charge and directly-related asset write-downs of $545, recorded during the year, along with transaction costs of $56 for the spin-off. Major components of this restructuring charge include $365 for employee separation and $101 for real estate consolidation.

(c) Includes $2,500 of short-term debt assumed by Agere (see Note 10) and $565 of reserves associated with Lucent's share of Agere's estimated future losses through the planned spin-off date. On October 4, 2001, Agere repaid $1,000 of this debt.

(d) Amounts are shown net of the minority interest in the net assets of Agere of $1,026 at September 30, 2001.

Summarized cash flow information for the discontinued operations is as follows:

	Years ended September 30,		
	2001	**2000**	**1999**
Net cash provided by operating activities of discontinued operations	$ 517	$ 1,640	$1,269
Net cash used in investing activities of discontinued operations	(744)	(1,366)	(812)
Net cash used in financing activities of discontinued operations	(9)	(470)	(621)
Net cash used in discontinued operations	$(236)	$ (196)	$ (164)

4. Business Dispositions and Combinations

Dispositions

On December 29, 2000, Lucent completed the sale of its power systems business to Tyco International Ltd. for approximately $2,538 in cash. In connection with the sale, Lucent recorded an extraordinary gain of $1,182 (net of tax expense of $780).

On August 31, 2001, Lucent received $572 from the closing of its transaction with Celestica Corporation to transition Lucent's manufacturing operations in Oklahoma City, Oklahoma and Columbus, Ohio. At closing, Lucent entered into a five-year supply agreement for Celestica to be the primary manufacturer of its switching and access and wireless networking systems products. Until the inventory is sold to an end user, inventory associated with the transaction remains in Lucent's inventory balance, with a corresponding liability for proceeds received. This inventory amounted to approximately $310 at September 30, 2001. Additionally, Lucent may be required to repurchase up to $90 of this inventory not used within one year of the transaction. The work force related to these two operations is expected to be reduced and/or transferred to Celestica. As a result, Lucent recorded non-cash termination and curtailment charges of approximately $378 during the fiscal year ended September 30, 2001, which were included as a component of Lucent's employee separation restructuring costs (see Note 2).

Acquisitions

There were no acquisitions by Lucent in the fiscal year ended September 30, 2001.

The following table presents information about acquisitions by Lucent in the fiscal years ended September 30, 2000 and 1999. All of these acquisitions were accounted for under the purchase method of accounting, and the acquired technology valuation included existing technology, purchased in-process research and development ("IPRD") and other intangibles. All IPRD charges were recorded in the quarter in which the transaction was completed. On a pro forma basis, if the fiscal year 2000 acquisitions had occurred on October 1, 1999, the amortization of goodwill and other acquired intangibles would have increased by approximately $675 for the fiscal year ended September 30, 2000.

							Amortization period (in years)		
2000	Acquisition date	Purchase price	Goodwill	Existing technology	Other intangibles	IPRD (after-tax)	Goodwill	Existing technology	Other intangibles
Spring Tide[a]	9/00	$1,315 Stock & options	$1,075	$143	$ 14	$131	7	7	7
Chromatis[b] [f]	6/00	4,756 Stock & options	4,223	n/a	186	428	7	n/a	2-7
DeltaKabel[c] [f]	4/00	52 Cash	56	n/a	n/a	n/a	6	n/a	n/a
1999									
Stratus[d] [f]	10/98	$ 917 Stock & options	$ 0	$130	$ 4	$267*	n/a	10	3
Other[e]	various	125 Cash & notes	79	14	12	23	5-10	4-7	7-8

(a) Spring Tide Networks was a provider of network switching equipment.

(b) Chromatis Networks Inc. was a supplier of metropolitan optical networking systems.

(c) DeltaKabel Telecom cv was a developer of cable modem and Internet protocol (IP) telephony products and services for the European market.

(d) Stratus Computer, Inc. was a manufacturer of fault-tolerant computer systems, acquired by Ascend Communications, Inc. ("Ascend").

(e) Other acquisitions include WaveAccess Ltd.; Quadritek Systems, Inc.; XNT Systems, Inc.; Quantum Telecom Solutions, Inc.; and InterCall Communications and Consulting, Inc.

(f) In connection with Lucent's restructuring program, an impairment charge for goodwill and other acquired intangibles was recorded in fiscal year 2001 relating to these acquisitions (see Note 2).

n/a Not applicable.

* $24 of IPRD was subsequently reversed in March 1999.

In connection with the acquisitions of Spring Tide and Chromatis, certain key employees were entitled to receive additional Lucent common stock based on the achievement of specified milestones. Lucent recorded compensation expense for these milestones when it was deemed probable that the milestones were met.

Included in the purchase price for the acquisitions was IPRD, which was a non-cash charge to earnings as this technology had not reached technological feasibility and had no future alternative use. The remaining purchase price was allocated to tangible assets and intangible assets, including goodwill and other acquired intangibles, less liabilities assumed.

The value allocated to IPRD was determined using an income approach that included an excess earnings analysis reflecting the appropriate cost of capital for the investment. Estimates of future cash flows related to the IPRD were made for each project based on Lucent's estimates of revenue, operating expenses and income taxes from the project. These estimates were consistent with historical pricing, margins and expense levels for similar products.

Revenues were estimated based on relevant market size and growth factors, expected industry trends, individual product sales cycles and the estimated life of each product's underlying technology. Estimated operating expenses, income taxes and charges for the use of contributory assets were deducted from estimated revenues to determine estimated after-tax cash flows for each project. Estimated operating expenses include cost of goods sold; selling, general and administrative expenses; and research and development expenses. The research and development expenses include estimated costs to maintain the products once they have been introduced into the market and generate revenues and costs to complete the in-process research and development.

The discount rates utilized to discount the projected cash flows were based on consideration of Lucent's weighted average cost of capital, as well as other factors including the useful life of each project, the anticipated profitability of each project, the uncertainty of technology advances that were known at the time and the stage of completion of each project.

Management is primarily responsible for estimating the fair value of the assets and liabilities acquired, and has conducted due diligence in determining the fair value. Management has made estimates and assumptions that affect the reported amounts of assets, liabilities and expenses resulting from such acquisitions. Actual results could differ from those amounts.

TeraBeam Corporation

On April 9, 2000, Lucent and TeraBeam Corporation entered into an agreement to develop TeraBeam's fiberless optical networking system that provides high-speed data networking between local and wide area networks. Under the agreement, Lucent paid cash and contributed research and development assets, intellectual property and free-space optical products, valued in the aggregate at $450. On September 26, 2001, Lucent and TeraBeam agreed to terminate most of the existing arrangements between the parties. Pursuant to this agreement, the 30% interest that Lucent holds in the venture that develops the fiberless optical networking system will be exchanged for a 15% interest in TeraBeam Corporation in the second quarter of fiscal year 2002. As a result of exiting the original arrangement and its evaluation of the restructured investment as of September 30, 2001, Lucent wrote off its remaining investment and goodwill and other acquired intangibles of $328, which is included as part of Lucent's fiscal year 2001 business restructuring charge (see Note 2).

Ignitus Communications LLC

On April 4, 2000, Lucent acquired the remaining 44% of Ignitus Communications LLC, a start-up company that focuses on high-speed optical communications at the network edge, for approximately $33. Lucent previously owned 56% of the company. In connection with Lucent's restructuring program, an impairment charge for goodwill and other acquired intangibles was recorded in fiscal year 2001 relating to the product rationalization of the technology acquired from Ignitus (see Note 2).

SpecTran Corporation

On July 21, 1999, Lucent began its cash tender offer for the outstanding shares of SpecTran Corporation, a designer and manufacturer of specialty optical fiber and fiber-optic products. The tender offer expired on August 31, 1999, and Lucent thereafter accepted and paid for shares giving it a 61% interest in SpecTran. The acquisition was accounted for under the purchase method of accounting. On February 4, 2000, Lucent acquired the remaining shares of SpecTran, resulting in a total purchase price of approximately $68. SpecTran Corporation is part of Lucent's optical fiber business, which Lucent sold on November 16, 2001 (see Note 19).

Pooling-of-Interests Mergers

The following table presents information about material mergers by Lucent accounted for under the pooling-of-interests method of accounting in the fiscal years ended September 30, 2000 and 1999:

	Merger date	*Total shares of common stock issued*	*Description of business*
2000			
Excel Switching Corporation ("Excel")	11/99	22 million	Developer of programmable switches
International Network Services ("INS") [(a)]	10/99	49 million	Provider of network consulting, design and integration services
1999			
Ascend [(b)]	6/99	371 million	Developer, manufacturer and seller of wide area networking equipment
Kenan Systems Corporation	2/99	26 million	Developer of third-party billing and customer care software

(a) INS previously had a June 30 fiscal year-end. In order to conform the fiscal year-ends for INS and Lucent, INS's results of operations and cash flows for the three months ended September 30, 1999, were not reflected in Lucent's financial statements for the first quarter of fiscal year 2000. INS's revenue and net income for the three months ended September 30, 1999 were $100 and $11, respectively. At September 30, 2000, retained earnings includes an adjustment to reflect the net income recognized by INS for the three months ended September 30, 1999.

(b) Lucent assumed Ascend stock options equivalent to approximately 65 million shares of Lucent common stock. In connection with the merger, Lucent recorded a third fiscal quarter 1999 charge to operating expenses of approximately $79 (non-tax deductible) for merger-related costs, primarily fees for investment bankers, attorneys, accountants and financial printing. For the nine months ended June 30, 1999, Ascend's historical revenue and net income of $1,610 and $66, respectively, are included in Lucent's historical revenues and income (loss) from continuing operations, respectively, for the year ended September 30, 1999. Intercompany transactions between Lucent and Ascend for the nine months ended June 30, 1999 of $138 and $86 have been eliminated from revenues and income (loss) from continuing operations, respectively, for the year ended September 30, 1999.

Lucent has also completed other pooling transactions. The historical operations of these entities were not material to Lucent's consolidated results of operations either on an individual or aggregate basis; therefore, prior periods have not been restated for these mergers.

5. Accounting Changes

Staff Accounting Bulletin 101, "Revenue Recognition in Financial Statements" ("SAB 101")

In December 1999, the Securities and Exchange Commission issued SAB 101, which provides guidance on the recognition, presentation and disclosure of revenues in financial statements. During the fourth quarter of fiscal year 2001, Lucent implemented SAB 101 retroactively to the beginning of fiscal year 2001, resulting in a cumulative effect of a change in accounting principle of a $68 loss (net of a tax benefit of $45), or $0.02 loss per basic and diluted share, and a reduction in the 2001 loss from continuing operations of $11, or $0.00 per basic and diluted share. For the fiscal year ended September 30, 2001, Lucent recognized $116 in revenue that is included in the cumulative effect adjustment as of October 1, 2000. The cumulative effect adjustment results primarily from the change in revenue recognized on intellectual property license agreements that included settlements for which there was no objective evidence of the fair value of the settlement. Under SAB 101, in the absence of objective evidence of fair value of the settlement, revenue is recognized prospectively over the remaining term of the intellectual property license agreement. In addition, revenue recognition was deferred for certain products for multiple element agreements where certain services, primarily installation and integration, were deemed to be essential to the functionality of delivered elements.

Following are pro forma amounts showing the effects if the accounting change were applied retroactively:

	Years ended September 30,	
	2000	**1999**
Income from continuing operations	$1,419	$2,333
Basic earnings per share – continuing operations	$ 0.44	$ 0.75
Diluted earnings per share – continuing operations	$ 0.43	$ 0.72
Net income	$1,151	$4,753
Basic earnings per share	$ 0.36	$ 1.53
Diluted earnings per share	$ 0.35	$ 1.48

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133")

Effective October 1, 2000, Lucent adopted SFAS 133, and its corresponding amendments under SFAS 138. SFAS 133 requires Lucent to measure all derivatives, including certain derivatives embedded in other contracts, at fair value and to recognize them in the Consolidated Balance Sheet as an asset or liability, depending on Lucent's rights or obligations under the applicable derivative contract. For derivatives designated as fair value hedges, the changes in the fair value of both the derivative instrument and the hedged item are recorded in Other income (expense)-net. For derivatives designated as cash flow hedges, the effective portions of changes in fair value of the derivative are reported in other comprehensive income ("OCI") and are subsequently reclassified into Other income (expense)-net when the hedged item affects Other income (expense)-net. Changes

in fair value of derivative instruments not designated as hedging instruments and ineffective portions of hedges are recognized in Other income (expense)-net in the period incurred. The adoption of SFAS 133 as of October 1, 2000, resulted in a cumulative after-tax reduction in net loss of $30 (net of a $17 tax provision), or $0.01 per basic and diluted share, and an $11 credit to OCI. The reduction in net loss is primarily attributable to derivatives not designated as hedging instruments, including foreign currency embedded derivatives, equity warrants and other derivatives.

6. Supplementary Financial Information

Supplementary Statements of Operations Information:

	Years ended September 30,		
	2001	**2000**	**1999**
DEPRECIATION AND AMORTIZATION			
Depreciation of property, plant and equipment	$ 1,065	$ 908	$ 776
Amortization of goodwill	805	283	224
Amortization of other acquired intangibles	116	79	72
Amortization of software development costs	501	395	235
Other amortization	49	2	(25)
Total depreciation and amortization	$2,536	$1,667	$1,282
OTHER INCOME (EXPENSE) – NET			
Interest income	$ 255	$ 118	$ 129
Minority interests in earnings of consolidated subsidiaries	(81)	(50)	(27)
Net losses from equity method investments	(60)	(31)	(3)
Other than temporary write-downs of investments	(266)	(14)	–
Loss on foreign currency transactions	(58)	(18)	(8)
Net gains on sales and settlements of financial instruments	34	347	270
Write-off of embedded derivative asset	(42)	–	–
Miscellaneous – net	(139)	(19)	(4)
Other income (expense) – net	$ (357)	$ 333	$ 357

Supplementary Cash Flow Information:

	Years ended September 30,		
	2001	**2000**	**1999**
Interest payments, net of amounts capitalized	$ 490	$ 356	$ 316
Income tax payments, net	$ 161	$ 34	$ 712
ACQUISITIONS OF BUSINESSES			
Fair value of assets acquired, net of cash acquired	$ –	$ 59	$ 299
Less: Fair value of liabilities assumed	–	7	123
Acquisitions of businesses, net of cash acquired	$ –	$ 52	$ 176

Non-cash Transactions

On April 2, 2001, Morgan Stanley exchanged $519 of Lucent's commercial paper for 90 million shares of Agere common stock (see Note 3) and Agere assumed from Lucent $2,500 of debt maturing within one year (see Note 10).

Supplementary Balance Sheet Information:

	September 30,	
	2001	**2000**
INVENTORIES		
Completed goods	$ 1,693	$ 2,810
Work in process	492	863
Raw materials	1,461	1,427
Inventories	$ 3,646	$ 5,100
PROPERTY, PLANT AND EQUIPMENT – NET		
Land and improvements	$ 320	$ 309
Buildings and improvements	3,088	3,092
Machinery, electronic and other equipment	5,636	6,109
Total property, plant and equipment	9,044	9,510
Less: accumulated depreciation	4,628	4,464
Property, plant and equipment – net	$4,416	$5,046
GOODWILL AND OTHER ACQUIRED INTANGIBLES – NET		
Goodwill	$ 1,239	$ 5,778
Other acquired intangibles	227	685
Goodwill and other acquired intangibles – net	$1,466	$6,463
INCLUDED IN OTHER ASSETS		
Capitalized software	$ 583	$ 687
Internal use software	$ 261	$ 302
INCLUDED IN OTHER CURRENT LIABILITIES		
Deferred income	$ 655	$ 287
Advance billings, progress payments and customer deposits	$ 795	$ 719

7. Earnings (Loss) Per Common Share

Basic earnings (loss) per common share is calculated by dividing net income (loss) applicable to common shareowners by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) applicable to common shareowners per share further reflects all potential issuances of common stock. Amounts applicable to common shareowners reflect the dividends and accretion on Lucent's redeemable convertible preferred stock (see Note 11).

Years ended September 30,

	2001	2000	1999
EARNINGS (LOSS) PER COMMON SHARE – BASIC			
Income (loss) from continuing operations	$ (4.18)	$ 0.44	$ 0.76
Income (loss) from discontinued operations	(0.93)	(0.06)	0.36
Extraordinary gain	0.35	–	–
Cumulative effect of accounting changes	(0.01)	–	0.42
Net income (loss) applicable to common shareowners	$ (4.77)	$ 0.38	$ 1.54
EARNINGS (LOSS) PER COMMON SHARE – DILUTED			
Income (loss) from continuing operations	$ (4.18)	$ 0.43	$ 0.74
Income (loss) from discontinued operations	(0.93)	(0.06)	0.34
Extraordinary gain	0.35	–	–
Cumulative effect of accounting changes	(0.01)	–	0.41
Net income (loss) applicable to common shareowners	$ (4.77)	$ 0.37	$ 1.49
WEIGHTED AVERAGE NUMBER OF COMMON SHARES (IN MILLIONS)			
Common shares – basic	3,400.7	3,232.3	3,101.8
Effect of dilutive securities:			
Stock options	–	88.5	109.5
Other	–	5.1	7.2
Weighted average number of common shares – diluted	3,400.7	3,325.9	3,218.5

Diluted earnings (loss) per share for the year ended September 30, 2001 does not include the effect of the following potential common shares, because their effect would reduce the loss per share from continuing operations (in millions):

Stock options	24
Redeemable convertible preferred stock	309
Other	6
Total	339

In addition, options where the exercise price was greater than the average market price of the common shares of 407.0 million, 41.0 million and 5.5 million for the years ended September 30, 2001, 2000 and 1999, respectively, were excluded from the computation of diluted earnings (loss) per share.

8. Comprehensive Income (Loss)

Comprehensive income (loss) represents net income (loss) plus the results of certain shareowners' equity changes not reflected in the Consolidated Statements of Operations.

The after-tax components of accumulated other comprehensive income (loss) are as follows:

	Foreign currency translation adjustment	*Net unrealized holding gains/(losses) on investments*	*Minimum pension liability adjustments*	*Net unrealized holding gains/(losses) on derivative instruments*	*Total accumulated other comprehensive income (loss)*
Beginning balance, October 1, 1998	$ (280)	$18	$(21)	$ –	$(283)
Current-period change	(33)	61	11	–	39
Ending balance, September 30, 1999	(313)	79	(10)	–	(244)
Current-period change	(185)	(4)	2	–	(187)
Amounts transferred to Avaya	64	–	2	–	66
Ending balance, September 30, 2000	(434)	75	(6)	–	(365)
Cumulative effect of accounting change – SFAS 133	–	9	–	2	11
Current-period change	(33)	(45)	(8)	(1)	(87)
Ending balance, September 30, 2001	$(467)	$39	$(14)	$ 1	$(441)

Foreign currency translation adjustments are not generally adjusted for income taxes as they relate to indefinite investments in non-U.S. subsidiaries.

9. Income Taxes

The following table presents the principal reasons for the difference between the effective tax (benefit) rate on continuing operations and the U.S. federal statutory income tax (benefit) rate:

Years ended September 30,

	2001	2000	1999
U.S. federal statutory income tax (benefit) rate	(35.0)%	35.0%	35.0%
State and local income tax (benefit) rate, net of federal income tax effect	(3.8)%	1.9%	2.8%
Foreign earnings and dividends taxed at different rates	2.4 %	(0.4)%	(1.0)%
Research credits	(1.0)%	(4.5)%	(3.1)%
Acquisition-related costs [a]	9.0 %	10.3%	4.8%
Other differences – net	(0.4)%	(3.1)%	(0.4)%
Effective income tax (benefit) rate	(28.8)%	39.2%	38.1%

(a) Includes non-tax deductible IPRD, goodwill amortization and impairments (including goodwill write-offs recognized under the restructuring program), and merger-related costs.

The following table presents the U.S. and non-U.S. components of income (loss) from continuing operations before income taxes and the provision (benefit) for income taxes:

	Years ended September 30,		
	2001	**2000**	**1999**
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES			
U.S.	$ (19,089)	$ 2,055	$ 3,360
Non-U.S.	(815)	302	465
Income (loss) from continuing operations before income taxes	$(19,904)	$2,357	$3,825
PROVISION (BENEFIT) FOR INCOME TAXES			
Current			
Federal	$ 21	$ 159	$ 362
State and local	–	9	(14)
Non-U.S.	180	265	172
Subtotal	201	433	520
Deferred			
Federal	(5,183)	405	761
State and local	(679)	85	201
Non-U.S.	(73)	1	(26)
Subtotal	(5,935)	491	936
Provision (benefit) for income taxes	$ (5,734)	$ 924	$1,456

The components of deferred tax assets and liabilities are as follows:

	September 30,	
	2001	**2000**
DEFERRED INCOME TAX ASSETS		
Bad debt and customer financing reserves	$ 1,004	$ 82
Inventory reserves	685	314
Business restructuring reserves	632	–
Other operating reserves	536	407
Postretirement and other benefits	2,386	2,352
Net operating loss/credit carryforwards	2,538	240
Other	636	364
Valuation allowance	(742)	(197)
Total deferred tax assets	$7,675	$3,562
DEFERRED INCOME TAX LIABILITIES		
Pension	$ 1,971	$ 2,480
Property, plant and equipment	5	417
Other	521	734
Total deferred tax liabilities	$2,497	$3,631

As of September 30, 2001, Lucent had tax credit carryforwards of $898 and federal, state and local, and non-U.S. net operating loss carryforwards of $1,640 (tax-effected), most of which expire primarily after the year 2019. As of September 30, 2001, Lucent has recorded valuation allowances totaling $742 against these carryforwards, primarily in certain state and foreign jurisdictions in which Lucent has concluded it is more likely than not that these carryforwards would not be realized. Although realization is not assured, Lucent has concluded that it is more likely than not that the remaining deferred tax assets will be realized based on the scheduling of deferred tax liabilities and projected taxable income. The amount of the net deferred tax assets actually realized, however, could vary if there are differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the actual amounts of future taxable income.

Lucent has not provided for U.S. deferred income taxes or foreign withholding taxes on $4,180 of undistributed earnings of its non-U.S. subsidiaries as of September 30, 2001, since these earnings are intended to be reinvested indefinitely. It is not practical to estimate the amount of additional taxes that might be payable on such earnings.

10. Debt Obligations

	September 30,	
	2001	**2000**
DEBT MATURING WITHIN ONE YEAR		
Commercial paper	$ –	$ 2,475
Long-term debt	–	750
Revolving credit facilities (5.7% weighted average interest rate)	1,000	–
Other	135	243
Total debt maturing within one year	$1,135	$3,468

Weighted average interest rates for commercial paper were 7.4% and 6.3% for the years ended September 30, 2001 and 2000, respectively. Weighted average interest rates for revolving credit facilities were 6.0% for the year ended September 30, 2001.

On February 22, 2001, Lucent completed arrangements for $6,500 of Credit Facilities with financial institutions. These Credit Facilities consist of a replacement for the 364-day $2,000 Credit Facility that expired on February 22, 2001 and a new 364-day $2,500 assumable Credit Facility for Agere ("Assumable Credit Facility"). In addition to these two Credit Facilities, Lucent amended an existing $2,000 Credit Facility expiring in February 2003. Under the 364-day $2,000 Credit Facility, any loans outstanding at maturity may be extended by Lucent to February 26, 2003. The interest rate on the Credit Facilities is based on LIBOR rates plus a spread, which is dependent on Lucent's credit rating. Lucent borrowed $2,500 under the Assumable Credit Facility, which was assumed by Agere on April 2, 2001, the closing of the Agere IPO.

On August 16, 2001, Lucent entered into an amendment to each of the Credit Facilities ("Amendments"). The Amendments modified the financial covenants and certain other conditions and terms, including those necessary to allow the distribution of Agere stock to Lucent shareowners.

The Credit Facilities are secured by liens on substantially all of Lucent's assets ("Collateral"), including the pledge of the Agere stock owned by Lucent. Certain other existing financings and obligations are, and certain future financings and obligations could be, similarly secured during the time the Collateral arrangements for the Credit Facilities are in effect. The Credit Facilities contain affirmative and negative covenants, including financial covenants requiring the maintenance of specified consolidated minimum net worth and earnings before interest, taxes, depreciation and amortization ("EBITDA") levels as defined in the Credit Facilities. In addition, in the event a subsidiary defaults on its debt, as defined in the Credit Facilities, it would constitute a default under Lucent's Credit Facilities.

The total lending commitments under the Credit Facilities are reduced if certain debt reduction transactions are undertaken or if additional funds are generated from specified non-operating sources in excess of $2,500. These sources of funds include the proceeds received from issuing redeemable convertible preferred stock, the proceeds received from the sale of the optical fiber business

(see Note 19), $519 of debt reduction from a debt for equity exchange (see Note 3) and other specified types of transactions. The first $2,000 in excess of the amount above would result in the termination of the 364-day $2,000 Credit Facility. Additional amounts would reduce the total lending commitments under the remaining $2,000 Credit Facility that expires in February 2003, however, the lending commitments under the facility that expires in February 2003, can be reduced to no less than $1,500. After the sale of the optical fiber business on November 16, 2001, Lucent had generated $4,500 from specified non-operating sources, which resulted in a reduction in the total lending commitments on November 20, 2001 to approximately $2,000.

The pledge of Agere stock owned by Lucent can be released and the distribution can occur at Lucent's request if the following terms and conditions as defined under the Credit Facilities are met by Lucent:

- no event of default exists under the Credit Facilities;
- generate positive EBITDA for the fiscal quarter immediately preceding the distribution;
- meet a minimum current asset ratio;
- receipt of $5,000 in cash from certain non-operating sources; and
- the 364-day $2,000 Credit Facility has been terminated and the $2,000 Credit Facility, expiring in February 2003, has been reduced to $1,750 or less.

Lucent cannot resume payment of dividends on its common stock unless it achieves certain credit ratings or EBITDA levels and no event of default exists under the Credit Facilities. Payment of dividends on the common stock is limited to the rate of $0.02 per share per quarter. Lucent is permitted to pay cash dividends on its redeemable convertible preferred stock (see Note 11) if no event of default exists under the Credit Facilities.

	September 30,	
	2001	**2000**
LONG-TERM DEBT		
6.90% notes due July 15, 2001	$ –	$ 750
7.25% notes due July 15, 2006	750	750
5.50% notes due November 15, 2008	500	500
6.50% debentures due January 15, 2028	300	300
6.45% debentures due March 15, 2029	1,360	1,360
7.70% notes due May 19, 2010	20	20
8.00% notes due May 18, 2015	25	25
11.755% notes due July 1, 2006	330	–
Other (8.1% and 6.9% weighted average interest rates, respectively)	56	116
Total long-term debt	3,341	3,821
Less: Unamortized discount	38	41
Amounts maturing within one year	29	750
Long-term debt	$3,274	$3,030

Lucent has an effective shelf registration statement for the issuance of debt securities up to $1,800, of which $1,755 remains available at September 30, 2001.

Aggregate maturities, by year, of the $3,341 in total long-term debt obligations at September 30, 2001 for fiscal year 2002 through fiscal year 2006 and thereafter were $29, $33, $48, $44, $950 and $2,237, respectively.

11. Redeemable Convertible Preferred Stock

Lucent has 250,000,000 shares of preferred stock authorized. On August 6, 2001, Lucent designated and sold 1,885,000 shares of non-cumulative 8% redeemable convertible preferred stock having an initial liquidation preference of $1,000 per share, subject to accretion as described below, in a private placement, resulting in net proceeds of $1,831. The redeemable convertible preferred stock has an annual dividend rate of 8%, payable semi-annually in cash or Lucent common stock at Lucent's option. Any unpaid dividends will increase the liquidation preference at an accretion rate of 10% per year, calculated on a semi-annual basis. From and after the earlier of the Agere spin-off or May 6, 2002, at the holder's option, each share of convertible preferred stock is convertible into Lucent's common stock at an initial conversion price of $7.48 per share, subject to adjustment under certain circumstances, including the Agere spin-off. Although Lucent is prohibited from exercising this right under the current terms of the Credit Facilities, Lucent can, at its option, require all holders to exchange their shares of redeemable convertible preferred stock for convertible subordinated debentures having terms substantially similar to the preferred stock. The redeemable convertible preferred stock is redeemable, at Lucent's option after August 15, 2006 and at the option of the holders on August 2 of 2004, 2007, 2010 and 2016. Provided certain criteria are met, Lucent has the option to redeem the convertible preferred stock for cash or its common stock at a 5% discount from the then current market price or a combination of cash and shares of its common stock. Lucent is obligated to redeem all outstanding preferred shares on August 1, 2031. The initial carrying value is being accreted to liquidation value as a charge to shareowners' equity over the earliest redemption period of three years. Holders of the preferred stock have no voting rights except as required by law, and rank junior to Lucent's debt obligations. In addition, upon dissolution or liquidation of Lucent, holders are entitled to the liquidation preference plus any accrued and unpaid dividends prior to any distribution of net assets to common shareowners.

12. Employee Benefit Plans

Pension and Postretirement Benefits

Lucent maintains defined benefit pension plans covering the majority of its employees and retirees, and postretirement benefit plans for retirees that include health care and dental benefits and life insurance coverage. In fiscal year 2001, Lucent recorded final adjustments to the pension and postretirement asset and obligation amounts that were transferred to Avaya on September 30, 2000. The following information summarizes activity in the pension and postretirement benefit plans for the entire Company, including discontinued operations:

	Pension benefits September 30,		*Postretirement benefits September 30,*	
	2001	**2000**	**2001**	**2000**
CHANGE IN BENEFIT OBLIGATION				
Benefit obligation at October 1	$ 26,113	$ 27,401	$ 8,242	$ 8,604
Service cost	316	478	35	67
Interest cost	1,926	1,915	604	601
Actuarial losses	1,434	370	761	33
Amendments	9	(1)	(58)	–
Benefits paid	(2,788)	(2,294)	(709)	(651)
Settlements	(3)	–	(10)	–
Termination benefits	1,954	–	197	–
Impact of curtailments	715	–	288	–
Benefit obligation assumed by Avaya	174	(1,756)	48	(412)
Benefit obligation at September 30	$29,850	$26,113	$ 9,398	$ 8,242
CHANGE IN PLAN ASSETS				
Fair value of plan assets at October 1	$ 45,262	$ 41,067	$ 4,557	$ 4,467
Actual (loss) return on plan assets	(6,830)	9,791	(827)	654
Company contributions	25	19	17	8
Benefits paid	(2,788)	(2,294)	(709)	(651)
Assets transferred from (to) Avaya	259	(2,984)	36	(255)
Other (including transfer of assets from pension to postretirement plans)	(389)	(337)	366	334
Fair value of plan assets at September 30	$35,539	$45,262	$ 3,440	$ 4,557
Funded (unfunded) status of the plan	$ 5,689	$ 19,149	$ (5,958)	$ (3,685)
Unrecognized prior service cost (credit)	1,228	2,086	(135)	49
Unrecognized transition asset	(103)	(322)	–	–
Unrecognized net (gain) loss	(1,790)	(14,499)	1,035	(1,208)
Net amount recognized	$ 5,024	$ 6,414	$(5,058)	$(4,844)
Amounts recognized in the Consolidated Balance Sheets consist of:				
Prepaid pension costs	$ 4,958	$ 6,238	$ –	$ –
Prepaid pension costs allocated to discontinued operations	122	202	–	–
Accrued benefit liability	(73)	(37)	(4,972)	(4,786)
Accrued benefit liability allocated to discontinued operations	(2)	–	(86)	(58)
Intangible asset	5	5	–	–
Accumulated other comprehensive income	14	6	–	–
Net amount recognized	$ 5,024	$ 6,414	$(5,058)	$(4,844)

Pension plan assets include $17 and $102 of Lucent common stock at September 30, 2001 and 2000, respectively. Postretirement plan assets include $1 and $3 of Lucent common stock at September 30, 2001 and 2000, respectively.

In fiscal year 2001, Lucent recorded charges totaling $2,151 for pension and postretirement termination benefits in connection with voluntary early-retirement offers and other involuntary terminations as part of the business restructuring (see Note 2). Of this amount, $2,113 reflected termination charges associated with Lucent's business restructuring, $28 was associated with Agere's restructuring (discontinued operations) and $10 was associated with Lucent's supplemental pension plan. In fiscal year 2001, Lucent recorded charges of $660 for pension and postretirement curtailments; of which $632 was included in the net business restructuring curtailment charge (see Note 2) and $28 was associated with reductions in postretirement benefits for active management employees.

Components of Net Periodic Benefit Cost:

	Years ended September 30,		
	2001	**2000**	**1999**
PENSION COST (CREDIT)			
Service cost	$ 316	$ 478	$ 509
Interest cost on projected benefit obligation	1,926	1,915	1,671
Expected return on plan assets	(3,373)	(3,229)	(2,957)
Amortization of unrecognized prior service costs	326	362	461
Amortization of transition asset	(222)	(300)	(300)
Amortization of net (gain) loss	(387)	(197)	2
Subtotal	(1,414)	(971)	(614)
Termination benefits	1,954	–	–
Curtailments	562	–	–
Settlements	(12)	–	–
Net pension cost (credit)	$1,090	$ (971)	$ (614)
DISTRIBUTION OF NET PENSION COST (CREDIT)			
Continuing operations	$ 1,064	$(1,113)	$ (779)
Discontinued operations	26	142	165
Net pension cost (credit)	$1,090	$ (971)	$ (614)
POSTRETIREMENT COST			
Service cost	$ 35	$ 67	$ 80
Interest cost on accumulated benefit obligation	604	601	537
Expected return on plan assets	(352)	(338)	(308)
Amortization of unrecognized prior service costs	22	37	53
Amortization of net (gain) loss	(25)	(12)	6
Subtotal	284	355	368
Termination benefits	197	–	–
Curtailments	98	–	–
Settlements	(5)	–	–
Net postretirement benefit cost	$ 574	$ 355	$ 368
DISTRIBUTION OF NET POSTRETIREMENT BENEFIT COST			
Continuing operations	$ 564	$ 291	$ 298
Discontinued operations	10	64	70
Net postretirement benefit cost	$ 574	$ 355	$ 368
PENSION AND POSTRETIREMENT BENEFITS WEIGHTED AVERAGE ASSUMPTIONS AS OF SEPTEMBER 30			
Discount rate	7.0%	7.5%	7.25%
Expected return on plan assets	9.0%	9.0%	9.0%
Rate of compensation increase	4.5%	4.5%	4.5%

Effective October 1, 1998, Lucent changed its method for calculating the market-related value of plan assets used in determining the expected return-on-plan-asset component of annual net pension and postretirement benefit costs. Under the previous accounting method, the calculation of the market-related value of plan assets included only interest and dividends immediately, while all other realized and unrealized gains and losses were amortized on a straight-line basis over a five-year period. The new method used to calculate market-related value includes immediately an amount based on Lucent's historical asset returns and amortizes the difference between that amount and the actual return on a straight-line basis over a five-year period.

The cumulative effect of this accounting change related to periods prior to fiscal year 1999 of $2,150 ($1,308 after-tax, or $0.42 and $0.41 earnings per basic and diluted share, respectively) is a one-time, non-cash credit to fiscal year 1999 earnings. This accounting change also resulted in a reduction in benefit costs in the year ended September 30, 1999 that increased income by $427 ($260 after-tax, or $0.08 earnings per basic and diluted share) as compared with the previous accounting method.

In 1999, Lucent changed its pension plan benefit for management, technical pay plan, and non-represented occupational employees hired on or after January 1, 1999, and certain U.S. employees of companies acquired since October 1, 1996, who were not participating in a defined benefit pension plan. These employees receive a different pension benefit, known as an account balance program, effective January 1, 2000. Expenses related to the account balance program are included in the previous pension cost table.

Lucent has several non-pension postretirement benefit plans. For postretirement health care benefit plans, Lucent assumed an 8.6% weighted average annual health care cost trend rate for 2002, gradually declining to 4.9% (excluding postretirement dental benefits, the annual medical cost trend rate would be 9.1% in 2002 gradually declining to 5.0%). The assumed health care cost trend rate has a significant effect on the amounts reported. A one-percentage-point change in the assumed health care cost trend rate would have the following effects on the entire Company, including discontinued operations:

	1 Percentage Point	
	Increase	*Decrease*
Effect on total of service and interest cost components	$ 25	$ 22
Effect on postretirement benefit obligation	$360	$321

Savings Plans

Lucent's savings plans allow employees to contribute a portion of their compensation on a pretax and/or after-tax basis in accordance with specified guidelines. Lucent matches a percentage of the employee contributions up to certain limits. Savings plan expense amounted to $150, $228 and $318 for the years ended September 30, 2001, 2000 and 1999, respectively. Lucent's savings plan expense charged to continuing operations was $125, $161 and $222 for the years ended September 30, 2001, 2000 and 1999, respectively.

Employee Stock Ownership Plan

Lucent's leveraged Employee Stock Ownership Plan ("ESOP") previously funded the employer contributions to the Long-Term Savings and Security Plan for non-management employees. The ESOP obligation is reported as a reduction in additional paid-in capital. During 2001, the remaining shares of Lucent common stock in the ESOP were allocated to participants.

13. Stock Compensation Plans

Lucent has stock-based compensation plans under which outside directors and certain employees receive stock options and other equity-based awards. The plans provide for the grant of stock options, stock appreciation rights, performance awards, restricted stock awards and other stock unit awards.

Stock options generally are granted with an exercise price equal to 100% of the market value of a share of common stock on the date of grant, have two-to-10-year terms and vest within four years from the date of grant. Subject to customary antidilution adjustments and certain exceptions, the total number of shares of common stock authorized for option grants under the plans, including options granted in acquisitions, was 963 million shares at September 30, 2001.

In connection with certain of Lucent's acquisitions, outstanding stock options held by employees of acquired companies became exercisable, according to their terms, for Lucent common stock effective at the acquisition date. These options did not reduce the shares available for grant under any of Lucent's other option plans. For acquisitions accounted for as purchases, the fair value of these options was generally included as part of the purchase price. As of July 1, 2000, Lucent began recording deferred compensation related to unvested options held by employees of companies acquired in a purchase acquisition, in accordance with the Financial Accounting Standards Board ("FASB") Interpretation No. 44. Unamortized deferred compensation expense was $5 and $34 at September 30, 2001 and 2000, respectively. The deferred expense calculation and future amortization is based on the graded vesting schedule of the awards.

Lucent established an Employee Stock Purchase Plan ("ESPP") effective October 1, 1996. Under the terms of this ESPP, eligible employees could have up to 10% of eligible compensation deducted from their pay to purchase common stock. The per share purchase price was 85% of the average high and low per share trading price of common stock on the New York Stock Exchange ("NYSE") on the last trading day of each month. In fiscal years 2001, 2000 and 1999, 17.6 million, 7.8 million and 7.5 million shares, respectively, were purchased under this ESPP and the employer stock purchase plans of acquired companies, at weighted average per share prices of $10.04, $46.75 and $43.60, respectively. This ESPP expired on June 30, 2001.

Effective July 1, 2001, Lucent established a new ESPP ("2001 ESPP"). Under the terms of the 2001 ESPP, eligible employees may have up to 10% of eligible compensation deducted from their pay to purchase common stock during an offering period, consisting of four purchase periods, generally six months long. An employee may purchase up to 500 shares on the last trading date of each purchase period. The per share purchase price is 85% of the average high and low per share trading price of common stock on the NYSE on either the employee's entry date for the relevant offering period, or on the last trading day of the relevant purchase period, whichever is lower. The amount that may be offered pursuant to this new plan is 250 million shares. As of September 30, 2001, no shares were purchased under the 2001 ESPP.

Lucent has adopted the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS 123") and, as permitted under SFAS 123, applies Accounting Principles Board Opinion No. 25 ("APB 25") and related interpretations in accounting for its plans. Compensation expense recorded under APB 25 was $147, $49 and $50 for the years ended September 30, 2001, 2000 and 1999, respectively. If Lucent had elected to adopt the optional recognition provisions of SFAS 123 for its stock option and purchase plans, net income (loss) and earnings (loss) per share would have been changed to the pro forma amounts indicated below:

Years ended September 30,

	2001	2000	1999
NET INCOME (LOSS)			
As reported	$(16,198)	$1,219	$4,789
Pro forma	$(17,172)	$ 452	$4,239
EARNINGS (LOSS) PER SHARE-BASIC			
As reported	$ (4.77)	$ 0.38	$ 1.54
Pro forma	$ (5.05)	$ 0.14	$ 1.37
EARNINGS (LOSS) PER SHARE-DILUTED			
As reported	$ (4.77)	$ 0.37	$ 1.49
Pro forma	$ (5.05)	$ 0.13	$ 1.27

The pro forma information presented above includes Lucent's share of Agere's compensation expense related to Agere stock options issued to Agere employees subsequent to the IPO. As of September 30, 2001, Agere had 142.8 million stock options outstanding at a weighted average exercise price per share of $5.81.

The fair value of stock options used to compute pro forma net income (loss) and earnings (loss) per share disclosures is the estimated fair value at grant date using the Black-Scholes option-pricing model with the following assumptions:

	Years ended September 30,		
	2001	2000	1999
Dividend yield	0.49%	0.23%	0.10%
Expected volatility – Lucent	60.2%	39.2%	33.8%
– Acquisitions[a]	n/a	55.3%	58.2%
Risk-free interest rate	4.9%	6.5%	5.2%
Expected holding period (in years)	2.4	2.9	3.7

(a) Pre-merger assumptions for companies acquired in a pooling-of-interests.

n/a Not applicable.

The fair value of the employee's purchase rights under the 2001 ESPP is calculated using the Black-Scholes model, with the following assumptions for fiscal year 2001: dividend yield of 0%; expected life of four, 10, 16 and 22 months corresponding to each purchase period in the initial offering period; expected volatility of 85% for the four- and 10-month purchase periods and 104% for the 16- and 22-month periods; and risk-free interest rates ranging from 3.2% to 4.1% in each period. The weighted average fair value of those purchase rights granted in fiscal year 2001 was $3.53.

The weighted average fair value of stock options, calculated using the Black-Scholes option-pricing model, granted during the years ended September 30, 2001, 2000 and 1999 is $4.59, $16.15 and $16.65 per share, respectively.

Presented below is a summary of the status of Lucent stock options and the related activity for the years ended September 30, 2001, 2000 and 1999:

	Shares (in thousands)	*Weighted average exercise price per share*
Options outstanding at October 1, 1998	267,133	$19.40
Granted/assumed[a]	61,944	47.68
Exercised	(30,951)	12.20
Forfeited/expired	(11,834)	23.16
Options outstanding at September 30, 1999	286,292	$26.15
Granted/assumed[a]	285,798	47.95
Exercised	(74,963)	15.38
Forfeited/expired	(38,815)	41.56
Options outstanding at September 30, 2000	458,312	$40.20
Options outstanding at September 30, 2000 after spin-off adjustments[b]	431,509	$ 39.34
Granted	347,557	12.56
Exercised	(10,496)	4.73
Forfeited/expired	(85,957)	37.77
Options outstanding at September 30, 2001[c]	682,613	$26.43

(a) Includes options converted in acquisitions.

(b) Effective with the spin-off of Avaya on September 30, 2000, unvested Lucent stock options held by Avaya employees were converted into Avaya stock options. For remaining unexercised Lucent stock options, the number of Lucent stock options and the exercise price were adjusted to preserve the intrinsic value of the stock options that existed prior to the spin-off.

(c) Lucent stock options held by Agere employees will convert to Agere stock options upon Lucent's intended spin-off of Agere.

The following table summarizes the status of stock options outstanding and exercisable at September 30, 2001:

	Stock options outstanding			*Stock options exercisable*	
Range of exercise prices per share	*Shares (in thousands)*	*Weighted average remaining contractual life (years)*	*Weighted average exercise price per share*	*Shares (in thousands)*	*Weighted average exercise price per share*
$0.01 to $11.72	143,826	5.0	$ 7.87	50,405	$ 9.45
$11.73 to $12.15	131,566	4.5	$ 12.14	50,110	$ 12.14
$12.16 to $23.18	131,917	5.6	$ 16.57	46,419	$ 17.24
$23.19 to $42.18	144,679	3.6	$ 37.72	106,015	$ 39.88
$42.19 to $101.73	130,625	8.3	$ 58.73	52,730	$ 58.32
Total	682,613		$26.43	305,679	$30.06

Other stock unit awards are granted under certain award plans. The following table presents the total number of shares of common stock represented by awards granted to employees for the years ended September 30, 2001, 2000 and 1999:

	Years ended September 30,		
	2001	**2000**	**1999**
Other stock unit awards granted (in thousands)	5,400	858	532
Weighted average market value of shares granted during the period	$13.64	$59.23	$31.82

14. Operating Segments

Lucent operates in the global telecommunications networking industry and designs, develops, manufactures and services communication systems, software and related products. Lucent has reported the results of operations related to Agere, its power systems business and Avaya as discontinued operations (see Note 3). Agere and the power systems business were previously disclosed within the Microelectronics and Communications Technologies segment. Avaya was previously disclosed as the Enterprise Networks segment. Lucent's remaining operations include two reportable segments: Products and Services. The two reportable segments are managed separately. The Products segment provides public networking systems and software to telecommunications service providers and public network operators around the world and optical fiber for applications in the communications and computing industries. The Services segment includes the full life cycle of planning and design, consulting and integration support services as well as network engineering, provisioning, installation and warranty support. Prior years' data has been reclassified to reflect the current segment structure.

Performance measurement and resource allocation for the reportable operating segments are based on many factors. The primary financial measure is contribution margin, which includes the revenues, costs and expenses directly controlled by the reportable segment. In addition, contribution margin includes allocations of the provision for uncollectibles and customer financings, the related assets of which are managed on a common basis. Contribution margin for reportable segments excludes certain personnel costs including those related to pension and postretirement and certain other costs related to shared services such as general corporate functions and regional sales and marketing, which are managed on a common basis in order to realize economies of scale and efficient use of resources. Contribution margin for reportable segments also excludes acquisition-related costs such as goodwill and other acquired intangibles amortization, IPRD and other costs from business acquisitions and, in fiscal year 2001, business restructuring charges and asset impairments. However, the related goodwill and acquired technology asset balances are reflected in each reportable segment and in Other as appropriate. The accounting policies of the reportable segments are essentially the same as those applied in the consolidated financial statements to the extent that the related items are included within contribution margin (see Note 1). Intersegment sales are based on current market prices and are not material. All intersegment profit is eliminated in consolidation.

During July 2001, Lucent announced that it is realigning its business into two customer focused segments: an Integrated Network Solutions unit, targeting wireline customers, and a Mobility Solutions unit, targeting wireless customers, which will result in a change in its reportable segments during the first quarter of fiscal year 2002.

The following tables present Lucent's revenues and contribution margin by reportable operating segment and a reconciliation of the totals reported for the contribution margin of the segments to Operating income (loss):

Years ended September 30,

	2001	2000	1999
EXTERNAL REVENUES			
Products	$ 16,847	$ 23,361	$ 21,822
Services	4,162	4,926	4,211
Total reportable segments	21,009	28,287	26,033
Other[a]	285	617	960
Total external revenues	$ 21,294	$28,904	$26,993
CONTRIBUTION MARGIN			
Products	$ (3,448)	$ 5,015	$ 7,031
Services	(501)	531	685
Total reportable segments	(3,949)	5,546	7,716
Business restructuring charges and asset impairments	(11,416)	–	–
Acquisition/integration-related costs	–	(620)	(514)
Goodwill and other acquired intangibles amortization	(921)	(362)	(296)
Regional sales and marketing expenses	(2,046)	(2,444)	(2,309)
Other[a]	(697)	246	(811)
Operating income (loss)	$(19,029)	$ 2,366	$ 3,786

(a) Other primarily includes the results from other smaller units, eliminations of internal business and unallocated costs of shared services. In addition, Other includes the Company's remaining consumer products business in fiscal years 2000 and 1999, which was sold in the second quarter of fiscal year 2000.

Supplemental Segment Information:

Years ended September 30,

	2001	2000	1999
ASSETS			
Products	$ 7,479	$ 13,738	$ 7,677
Services	633	721	326
Total reportable segments[a]	8,112	14,459	8,003
Other[b]	25,552	33,053	26,243
Total assets	$ 33,664	$47,512	$34,246
CAPITAL EXPENDITURES			
Products	$ 870	$ 1,068	$ 845
Services	28	88	31
Total reportable segments	898	1,156	876
Other[b]	492	759	511
Total capital expenditures	$ 1,390	$ 1,915	$ 1,387
DEPRECIATION AND AMORTIZATION			
Products	$ 1,046	$ 995	$ 778
Services	58	43	28
Total reportable segments [c]	1,104	1,038	806
Other[b]	1,432	629	476
Total depreciation and amortization	$ 2,536	$ 1,667	$ 1,282

(a) Assets included in reportable segments consist primarily of inventory, property, plant and equipment and goodwill and other acquired intangibles.

(b) Other consists principally of cash and cash equivalents, deferred income taxes, receivables, prepaid pension costs, property, plant and equipment supporting corporate and research operations, other assets and net assets from discontinued operations.

(c) Depreciation and amortization for reportable segments excludes goodwill and other acquired intangibles amortization, which is included in Other.

Products and Services Revenues

The table below presents external revenues for groups of similar products and services:

	Years ended September 30,		
	2001	2000	1999
Switching and access	$ 5,598	$ 10,767	$ 10,482
Optical networking	3,206	3,298	3,551
Wireless	5,234	6,108	5,502
Optical fiber	2,023	1,842	1,149
Services	4,162	4,926	4,211
Other [a]	1,071	1,963	2,098
Totals	$21,294	$28,904	$26,993

(a) Principally includes billing and customer care software products, messaging products and, in fiscal years 2000 and 1999, the consumer products business.

Geographic Information

	External revenues [a]			Long-lived assets [b]		
	Years ended September 30,			September 30,		
	2001	2000	1999	2001	2000	1999
U.S.	$ 13,776	$ 19,829	$ 18,407	$ 5,261	$ 10,283	$ 4,200
Non-U.S. countries	7,518	9,075	8,586	621	1,226	1,137
Totals	$21,294	$28,904	$26,993	$ 5,882	$11,509	$ 5,337

(a) Revenues are attributed to geographic areas based on the location of customers.

(b) Represents property, plant and equipment, net and goodwill and other acquired intangibles, net.

Concentrations

Historically, Lucent has relied on a limited number of customers for a substantial portion of its total revenues. Revenues from Verizon accounted for approximately 17%, 14% and 11% of consolidated revenues in the years ended September 30, 2001, 2000 and 1999, respectively, principally in the Products segment. Revenues from AT&T accounted for approximately 11% and 16% of consolidated revenues in the years ended September 30, 2000 and 1999, respectively, principally in the Products segment. Lucent expects a significant portion of its future revenues to continue to be generated by a limited number of customers. The loss of any of these customers or any substantial reduction in orders by any of these customers could materially and adversely affect Lucent's operating results. Lucent does not have a concentration of available sources of supply materials, labor, services or other rights that, if eliminated suddenly, could impact its operations severely. The transition of manufacturing operations to several contract manufacturers may cause a concentration in fiscal year 2002 (see Note 17).

15. Financial Instruments

Fair Values

The carrying values of cash and cash equivalents, investments, receivables, payables and debt maturing within one year contained in the Consolidated Balance Sheets approximate fair value.

The carrying values of foreign exchange forward and option contracts at September 30, 2001 equals their fair value (see Derivative Financial Instruments) and the carrying values and estimated fair values of foreign exchange forward and option contracts at September 30, 2000 were $31 and $32, respectively, for assets and $8 and $13, respectively, for liabilities.

The carrying value and estimated fair value of long-term debt at September 30, 2001 were $3,274 and $2,324, respectively, and at September 30, 2000 were $3,030 and $2,731, respectively.

Fair values of foreign exchange forward and option contracts and long-term debt are determined using quoted market rates.

Credit Risk and Market Risk

By their nature, all financial instruments involve risk, including credit risk for non-performance by counterparties. The contract or notional amounts of these instruments reflect the extent of involvement Lucent has in particular classes of financial instruments. The maximum potential loss may exceed any amounts recognized in the Consolidated Balance Sheets. However, Lucent's maximum exposure to credit loss in the event of non-performance by the other party to the financial instruments for commitments to extend credit and financial guarantees is limited to the amount drawn and outstanding on those instruments.

Exposure to credit risk is controlled through credit approvals, credit limits and continuous monitoring procedures and reserves for losses are established when deemed necessary. Lucent seeks to limit its exposure to credit risks in any single country or region, although Lucent's customers are primarily in the telecommunications service provider industry.

All financial instruments inherently expose the holders to market risk, including changes in currency and interest rates. Lucent manages its exposure to these market risks through its regular operating and financing activities and when appropriate, through the use of derivative financial instruments.

Derivative Financial Instruments

Foreign Currency Risk

Lucent conducts its business on a multinational basis in a wide variety of foreign currencies. The objective of Lucent's foreign currency risk management policy is to preserve the economic value of cash flows in non-functional currencies. Toward this end, Lucent's policy is to hedge all significant booked and firmly committed cash flows identified as creating foreign currency exposure on a rolling 12-month basis. In addition, Lucent typically hedges a portion of its exposure resulting from identified anticipated cash flows, providing the flexibility to deal with the variability of longer-term forecasts as well as changing market conditions, in which the cost of hedging may be excessive relative to the level of risk involved.

To manage this risk, Lucent enters into various foreign exchange forward and option contracts. In some cases, Lucent may hedge foreign exchange risk in certain sales and purchase contracts by embedding terms in the contracts that affect the ultimate amount of cash flows under the contract. Principal currencies hedged as of September 30, 2001 are as follows:

	Forward and option contracts		*Embedded foreign currency derivative instruments*	
Currency	*Notional amount*	*Fair value asset (liability)*	*Notional amount*	*Fair value asset*
Euros	$488	$4	$ 9	$ –
Danish kroner	235	2	–	–
Brazilian real	163	(4)	27	9
Australian dollar	132	6	–	–
New Zealand dollar	89	4	–	–
Japanese yen	23	(6)	–	–

Lucent's policy is to designate certain freestanding foreign currency derivatives as hedging instruments under SFAS 133 against its intercompany and external foreign-currency-denominated loans. These exposures make up a large proportion of the notional value of Lucent's total foreign currency risk and are well defined as to amounts and timing of repayments. The derivatives hedging these exposures are designated as cash flow hedging instruments for anticipated cash flows not to exceed 12 months. Lucent will continue to hedge all other types of foreign currency risk to preserve the economic cash flows of the Company in accordance with corporate risk management policies but generally does not expect to designate related derivative instruments as hedges under SFAS 133 for cost/benefit reasons. Accordingly, the changes in fair value of these undesignated freestanding foreign currency derivative instruments are recorded in other income (expense) – net in the period of change and have not been material to Lucent due to the short maturities of these instruments.

Lucent's foreign currency embedded derivatives consist of sales and purchase contracts with cash flows indexed to changes in or denominated in a currency that neither party to the contract uses as their functional currency. Changes in the fair value of these embedded derivatives were not significant during the year ended September 30, 2001.

Prior to the adoption of SFAS 133, foreign exchange forward contracts were designated as hedges for firmly committed or forecasted sales and purchases that were expected to occur in less than one year. Gains and losses on all derivative contracts were either deferred in other current assets and liabilities or were recognized in other income (expense) – net depending upon the nature of the transaction hedged and the type of derivative instrument used. These gains and losses were not material to the consolidated financial statements at September 30, 2000.

Interest Rate Risk

Lucent uses a combination of financial instruments, including medium-term and short-term financings, variable-rate debt instruments and to a lesser extent, interest rate swaps to manage its interest rate mix of the total debt portfolio and related overall cost of borrowing. To manage this mix in a cost-effective manner, Lucent, from time to time, may enter into interest rate swap agreements, in which it agrees to exchange various combinations of fixed and/or variable interest rates based on agreed upon notional amounts. The objective of maintaining this mix of fixed and floating rate debt allows Lucent to manage its overall value of cash flows attributable to its debt instruments. There were no material interest rate swaps in effect at September 30, 2001 and 2000.

Other Derivatives

From time to time, Lucent may obtain warrants to purchase equity securities in other companies to complement its investment portfolio. Warrants that provide for net share settlement are considered to be derivative instruments and are generally not eligible to be designated as hedging instruments as there is no corresponding underlying exposure. The fair value of these warrants was not material at September 30, 2001.

Non-Derivative and Off-Balance Sheet Instruments

Requests for providing commitments to extend credit and financial guarantees are reviewed and approved by senior management. Management regularly reviews all outstanding commitments, letters of credit and financial guarantees, and the results of these reviews are considered in assessing the adequacy of Lucent's reserve for possible credit and guarantee losses.

The following table presents Lucent's non-derivative and off-balance sheet instruments for amounts drawn, available but not drawn and not available to be drawn. These instruments may expire without being drawn upon. Therefore, the amounts available but not drawn and not available do not necessarily represent future cash flows. The amounts drawn on these instruments are generally collateralized by substantially all of the assets of the respective creditors.

	September 30, 2001		
	Total loans and guarantees	*Loans*	*Guarantees*
Drawn commitments	$ 2,956	$ 2,528	$ 428
Available but not drawn	1,447	1,411	36
Not available	911	655	256
Total	$5,314	$4,594	$ 720

	September 30, 2000		
	Total loans and guarantees	*Loans*	*Guarantees*
Drawn commitments	$ 2,034	$ 1,263	$ 771
Available but not drawn	3,872	3,270	602
Not available	2,196	2,121	75
Total	$8,102	$6,654	$1,448

Commitments to Extend Credit

Commitments to extend credit to third parties are conditional agreements generally having fixed expiration or termination dates and specific interest rates and purposes. In certain situations, credit may not be available for draw down until certain conditions precedent are met.

Guarantees of Debt

From time to time, Lucent guarantees the financing for product purchases by customers. Requests for providing such guarantees are reviewed and approved by senior management. Certain financial guarantees are assigned to a third-party reinsurer.

Letters of Credit

Letters of credit are purchased guarantees that ensure Lucent's performance or payment to third parties in accordance with specified terms and conditions, which amounted to $900 and $897 as of September 30, 2001 and 2000, respectively. The estimated fair value of letters of credit are $12 and $2 as of September 30, 2001 and 2000, respectively, which are valued based on fees paid to obtain the obligations.

16. Securitizations and Transfers of Financial Instruments

In June 2001, Lucent established a $750 revolving accounts receivable securitization facility expiring in June 2003. Under the terms of the facility, Lucent may sell an undivided interest in collateralized accounts receivable from specified customers in exchange for cash and a subordinated retained interest in the remaining outstanding accounts receivables. At September 30, 2001, unrelated third parties held an undivided interest of $286 in the collateralized accounts receivables. The balance of retained interests is included in Receivables and varies based on changes in Lucent's credit ratings and the credit ratings of the customers included in the securitization facility, changes in the sufficiency of eligible accounts receivable and concentration of credit risk among obligors. Accordingly, unfavorable changes in these factors require Lucent to repurchase undivided interests in securitized accounts receivable and favorable changes in the factors allow Lucent to sell additional undivided interests in accounts receivable. In order to maintain the facility level, Lucent must continue to generate eligible accounts receivable sufficient to support such level under the terms of the facility. This facility was reduced to $500 on October 19, 2001.

Lucent services these securitized receivables for a fee that approximates Lucent's cost of servicing and such fees were not significant. The investors in the securitized receivables have no recourse to Lucent's other assets as a result of debtors' defaults except for the retained interests in the collateralized accounts receivable.

The following table provides the cash flows in the year ended September 30, 2001 related to this securitization facility:

Proceeds from receivables initially securitized	$ 435
Proceeds from collections reinvested in revolving securitization	1,913
Repurchases of undivided interests	182
Average securitized balance during the 94 days that receivables were securitized in 2001	1,188

The following table provides the valuation of retained interests at September 30, 2001:

Total securitized balance	$1,277
Fair value of retained interests in outstanding receivables	939
Discount for time value	7
Net reserve for credit losses	13

Retained interests are valued based on the historical payment patterns and the discount rate implicit in the underlying invoices. The expected reserve for credit losses is 1.27%. A discount is imputed based on the expected number of days that receivables will remain outstanding and a discount rate commensurate with the risks involved. Assuming hypothetical simultaneous unfavorable variations of up to 20% in credit losses and the discount rate used, the pretax impact on the value of retained interests would not be significant.

In September 2000, Lucent and a third-party financial institution arranged for the creation of a non-consolidated Special Purpose Trust ("Trust") for the purpose of allowing Lucent from time to time to sell on a limited-recourse basis up to a maximum of $970 of customer finance loans and receivables ("Loans") at any given point in time through a wholly owned bankruptcy-remote subsidiary, which in turn would sell the Loans to the Trust. Lucent had originally intended to periodically sell Loans to the Trust, however, due to Lucent's credit downgrade in February 2001, Lucent is unable to sell additional Loans to the Trust, as defined by agreements between Lucent and the Trust. Lucent has also agreed, in the case of foreign currency denominated Loans and Loans with a fixed interest rate, to indemnify the Trust for foreign exchange losses and losses due to movements in interest rates (if any) if hedging instruments have not been entered into for such Loans. Lucent will receive a fee from the Trust for either arranging hedging instruments or providing the indemnity. Lucent will continue to service, administer and collect the Loans on behalf of the Trust and receive a fee for performance of these services until the Loans are either fully collected or sold by the Trust to an unrelated third party. Lucent also receives a fee for referring Loans to the Trust that the Trust purchased from Lucent. Cash flows received from (paid to) the Trust during 2001 and 2000 were as follows:

Years ended September 30,

	2001	2000
Proceeds from sales of loans	$ 382	$575
Repurchases of loans	(355)	–
Losses on sales of loans and other costs	(7)	(4)
Fees received	6	–
Servicing advances	(8)	–
Reimbursements of servicing advances	8	–

In September 1999, a subsidiary of Lucent sold approximately $625 of accounts receivable from one large non-U.S. customer to a non-consolidated qualified special purpose entity ("QSPE") which, in turn, sold an undivided ownership interest in these receivables to entities managed by an unaffiliated financial institution. Additionally, Lucent transferred a designated pool of qualified accounts receivable of approximately $700 to the QSPE as collateral for the initial sale. During December 1999, Lucent repurchased $408 of the $625 of accounts receivable, the previously reported arrangement was terminated and Lucent established a new arrangement whereby its subsidiary sold $750 of accounts receivable (including the repurchased receivables) to a consortium of banks with limited recourse.

17. Commitments and Contingencies

In the normal course of business, Lucent is subject to proceedings, lawsuits and other claims, including proceedings under laws and government regulations related to environmental, labor, product and other matters. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Consequently, the ultimate aggregate amount of monetary liability or financial impact with respect to these matters at September 30, 2001, cannot be ascertained. While these matters could affect the operating results of any one quarter when resolved in future periods and while there can be no assurance with respect thereto, management believes that after final disposition, any monetary liability or financial impact to Lucent, from matters other than those described in the next paragraph, beyond that provided for at September 30, 2001 would not be material to the annual consolidated financial statements.

Lucent and certain of its former officers are defendants in several purported shareowner class action lawsuits for alleged violations of federal securities laws, which have been consolidated in a single action. Specifically, the complaint alleges, among other things, that beginning in late October 1999, Lucent and certain of its officers misrepresented Lucent's financial condition and failed to disclose material facts that would have an adverse impact on Lucent's future earnings and prospects for growth. This action seeks compensatory and other damages, and costs and expenses associated with the litigation. This action is in the early stages and Lucent is unable to determine its potential impact on the consolidated financial statements. Lucent intends to defend this action vigorously. In July 2001, a purported class action complaint was filed under ERISA alleging, among other things, that Lucent and certain unnamed officers breached their fiduciary duties with respect to Lucent's employee savings plans claiming that the defendants were aware that Lucent stock was inappropriate for retirement investment and continued to offer such stock as a plan investment option. The complaint seeks damages, injunctive and equitable relief, interest and fees and expenses associated with the litigation. In August 2001, a separate purported class action complaint was filed under ERISA alleging, among other things, that Lucent breached its fiduciary duties with respect to its employee benefit and compensation plans by offering Lucent stock as an investment to employees participating in the plans despite the fact that Lucent allegedly knew it was experiencing significant business problems. The August complaint seeks a declaration that Lucent breached its fiduciary duties to plan participants, an order compelling Lucent to return all losses to the plans, injunctive relief to prevent future breaches of fiduciary duties, as well as costs and expenses associated with litigation. Both actions are in the early stages and the Company is unable to determine the potential impact of either case on the consolidated financial statements. Lucent intends to defend these actions vigorously.

Separation Agreements

In connection with the formation of Lucent from certain units of AT&T Corp. and the associated assets and liabilities of those units and AT&T's distribution of its remaining interest in Lucent to its shareowners, Lucent, AT&T and NCR Corporation executed and delivered the Separation and Distribution Agreement, dated as of February 1, 1996, as amended and restated, and certain related agreements. The Separation and Distribution Agreement, among other things, provides that Lucent will indemnify AT&T and NCR for all liabilities relating to Lucent's business and operations and for all contingent liabilities relating to Lucent's business and operations or otherwise assigned to Lucent. In addition to contingent liabilities relating to the present or former business of Lucent, any contingent liabilities relating to AT&T's discontinued computer operations (other than those of NCR) were assigned to Lucent. The Separation and Distribution Agreement provides for the sharing of contingent liabilities not allocated to one of the parties, in the following proportions: AT&T: 75%, Lucent: 22%, and NCR: 3%. The Separation and Distribution Agreement also provides that each party will share specified portions of contingent liabilities related to the business of any of the other parties that exceed specified levels.

In connection with the spin-off of Avaya, Lucent and Avaya executed and delivered a Contribution and Distribution Agreement ("CDA") that provides for indemnification by each company with respect to contingent liabilities primarily relating to their respective businesses or otherwise assigned to each, subject to certain sharing provisions. In the event the aggregate value of all amounts paid by each company, in respect of any single contingent liability or any set or group of related contingent liabilities, is in excess of $50 each company will share portions in excess of the threshold amount based on agreed-upon percentages. The CDA also provides for the sharing of certain contingent liabilities, specifically: (1) any contingent liabilities that are not primarily contingent liabilities of Lucent or contingent liabilities associated with the businesses attributed to Avaya; (2) certain specifically identified liabilities, including liabilities relating to terminated, divested or discontinued businesses or operations; and (3) shared contingent liabilities within the meaning of the Separation and Distribution Agreement with AT&T Corp.

In connection with the intended spin-off of Agere and the contribution to it of certain businesses Lucent and Agere entered into a Separation and Distribution Agreement ("SDA") that provides for indemnification by each company with respect to contingent liabilities primarily relating to their respective businesses or otherwise assigned to each, subject to certain sharing provisions. In the event the aggregate value of all amounts paid by each company, in respect of any single contingent liability or any set or group of related contingent liabilities, is in excess of net insurance proceeds, each company will share portions in excess of the threshold amount based on agreed-upon percentages. The SDA also provides for the sharing of certain contingent liabilities, specifically: (1) any contingent liabilities that are not primarily contingent liabilities of Lucent or contingent liabilities associated with the businesses attributed to Agere; (2) certain specifically identified liabilities, including liabilities relating to terminated, divested or discontinued businesses or operations; and (3) shared contingent liabilities within the meaning of the Separation and Distribution Agreement with AT&T Corp.

Other Commitments

In connection with the intended spin-off of Agere, Lucent entered into a purchase agreement that governs the purchase of goods and services by Lucent from Agere. Under the agreement, Lucent committed to purchase at least $2,800 of products from Agere over a three-year period beginning February 1, 2001. In limited circumstances, Lucent's purchase commitment may be reduced or the term may be extended. For the period February 1, 2001 through September 30, 2001, Lucent's purchases under this agreement were $325. Agere and Lucent are currently discussing ways to restructure Lucent's obligations under the agreement.

In connection with Lucent's transaction with Celestica (see Note 4), Lucent entered into a five-year supply agreement whereby Celestica will be the primary manufacturer for Lucent's switching and access and wireless products in North America.

Environmental Matters

Lucent's current and historical operations are subject to a wide range of environmental protection laws. In the United States, these laws often require parties to fund remedial action regardless of fault. Lucent has remedial and investigatory activities under way at numerous current and former facilities. In addition, Lucent was named a successor to AT&T as a potentially responsible party ("PRP") at numerous "Superfund" sites pursuant to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA") or comparable state statutes. Under the Separation and Distribution Agreement with AT&T, Lucent is responsible for all liabilities primarily resulting from or relating to the operation of Lucent's business as conducted at any time prior to or after the Separation from AT&T including related businesses discontinued or disposed of prior to the Separation, and Lucent's assets including, without limitation, those associated with these sites. In addition, under such Separation and Distribution Agreement, Lucent is required to pay a portion of contingent liabilities paid out in excess of certain amounts by AT&T and NCR, including environmental liabilities.

It is often difficult to estimate the future impact of environmental matters, including potential liabilities. Lucent records an environmental reserve when it is probable that a liability has been incurred and the amount of the liability is reasonably estimable. This practice is followed whether the claims are asserted or unasserted. Management expects that the amounts reserved will be paid out over the periods of remediation for the applicable sites, which typically range from five to 30 years. Reserves for estimated losses from environmental remediation are, depending on the site, based primarily on internal or third-party environmental studies and estimates as to the number, participation level and financial viability of any other PRPs, the extent of the contamination and the nature of required remedial actions. Accruals are adjusted as further information develops or circumstances change. The amounts provided for in Lucent's consolidated financial statements for environmental reserves are the gross undiscounted amounts of such reserves, without deductions for insurance or third-party indemnity claims. In those cases where insurance carriers or third-party indemnitors have agreed to pay any amounts and management believes that collectibility of such amounts is probable, the amounts are reflected as receivables in the consolidated financial

statements. Although Lucent believes that its reserves are adequate, there can be no assurance that the amount of capital expenditures and other expenses which will be required relating to remedial actions and compliance with applicable environmental laws will not exceed the amounts reflected in Lucent's reserves or will not have a material adverse effect on Lucent's financial condition, results of operations or cash flows. Any possible loss or range of possible loss that may be incurred in excess of that provided for at September 30, 2001 cannot be estimated.

Lease Commitments

Lucent leases land, buildings and equipment under agreements that expire in various years through 2020. Rental expense, net of sublease rentals, under operating leases was $476, $420 and $341 for the years ended September 30, 2001, 2000 and 1999, respectively. Future minimum lease payments due under non-cancelable operating leases at September 30, 2001 for fiscal year 2002 through fiscal year 2006 and thereafter were $304, $248, $205, $165, $117 and $727, respectively.

18. Recent Pronouncements

In June 2001, the FASB issued SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." Under these new standards, all acquisitions subsequent to June 30, 2001 must be accounted for under the purchase method of accounting, and purchased goodwill is no longer amortized over its useful life. Rather, goodwill will be subject to a periodic impairment test based upon its fair value.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). SFAS 143 establishes accounting standards for recognition and measurement of a liability for the costs of asset retirement obligations. Under SFAS 143, the costs of retiring an asset will be recorded as a liability when the retirement obligation arises, and will be amortized to expense over the life of the asset.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and discontinued operations.

Lucent is currently evaluating the impact of these pronouncements to determine the effect, if any, they may have on the consolidated financial position and results of operations. Lucent is required to adopt each of these standards in the first quarter of fiscal year 2003.

19. Subsequent Event– Sale of Optical Fiber Business

On November 16, 2001, Lucent completed the sale of its optical fiber business to The Furukawa Electric Co., Ltd. for $2,300, approximately $200 of which was in CommScope, Inc. securities. The transaction will result in a gain in the first quarter of fiscal year 2002. In addition, Lucent entered into an agreement on July 24, 2001 to sell two Chinese joint ventures – Lucent Technologies Shanghai Fiber Optic Co., Ltd. and Lucent Technologies Beijing Fiber Optic Cable Co., Ltd. – to Corning Incorporated for $225. This transaction, which is subject to U.S. and foreign governmental approvals and other customary closing conditions, is expected to close by the end of the first quarter of fiscal year 2002.

20. Quarterly Information (Unaudited)

	First	Second	Third	Fourth[i]	Total
YEAR ENDED SEPTEMBER 30, 2001 AS RESTATED FOR SAB 101					
Revenues	$ 4,346	$ 5,907	$ 5,886	$ 5,155	$ 21,294
Gross margin	$ 681	$ 485	$ 829	$ 63	$ 2,058
Loss from continuing operations	$(1,575)	$(3,388)[b]	$(1,878)[c]	$(7,329)[d]	$(14,170)
Loss from discontinued operations	(5)	(308)	(1,360)	(1,499)	(3,172)
Loss before extraordinary item and cumulative effect of accounting changes	$(1,580)	$(3,696)	$(3,238)	$(8,828)	$(17,342)
Net loss	$ (464)[a]	$(3,696)	$(3,238)	$(8,800)[e]	$(16,198)
Loss per common share – basic and diluted [f]:					
Loss from continuing operations	$ (0.47)	$ (1.00)[b]	$ (0.55)[c]	$ (2.16)[d]	$ (4.18)
Loss from discontinued operations	(0.00)	(0.09)	(0.40)	(0.44)	(0.93)
Loss before extraordinary item and cumulative effect of accounting changes	$ (0.47)	$ (1.09)	$ (0.95)	$ (2.60)	$ (5.11)
Net loss applicable to common shareowners	$ (0.14)[a]	$ (1.09)	$ (0.95)	$ (2.59)[e]	$ (4.77)
Dividends per share	$ 0.02	$ 0.02	$ 0.02	$ 0.00	$ 0.06
AS PREVIOUSLY REPORTED QUARTERLY					
Revenues	$ 4,354	$ 5,915	$ 5,819		
Gross margin	$ 682	$ 499	$ 814		
Loss from continuing operations	$(1,574)	$(3,380)	$(1,887)		
Net loss	$ (395)	$(3,688)	$(3,247)		
Loss per common share – basic and diluted [f]:					
Loss from continuing operations	$ (0.47)	$ (0.99)[b]	$ (0.55)[c]		
Net loss	$ (0.12)	$ (1.08)	$ (0.95)		
YEAR ENDED SEPTEMBER 30, 2000					
Revenues	$ 7,090	$ 7,230	$7, 412	$ 7,172	$ 28,904
Gross margin	$ 3,214	$ 2,939	$ 3,134	$ 2,427	$ 11,714
Income (loss) from continuing operations	$ 979[g]	$ 462	$ 286[h]	$ (294)[i]	$ 1,433
Income (loss) from discontinued operations	270	293	(587)	(190)	(214)
Net income (loss)	$ 1,249	$ 755	$ (301)	$ (484)	$ 1,219
Earnings (loss) per common share – basic:					
Income (loss) from continuing operations	$ 0.31[g]	$ 0.15	$ 0.09[h]	$ (0.09)[i]	$ 0.44
Income (loss) from discontinued operations	0.09	0.09	(0.18)	(0.05)	(0.06)
Net income (loss)	$ 0.40	$ 0.24	$ (0.09)	$ (0.14)	$ 0.38
Earnings (loss) per common share – diluted:					
Income (loss) from continuing operations	$ 0.30[g]	$ 0.14	$ 0.09[h]	$ (0.09)[f][i]	$ 0.43
Income (loss) from discontinued operations	0.08	0.09	(0.18)	(0.05)[f]	(0.06)
Net income (loss)	$ 0.38	$ 0.23	$ (0.09)	$ (0.14)[f]	$ 0.37
Dividends per share	$ 0.04	$ 0.00	$ 0.02	$ 0.02	$ 0.08

(a) Includes an extraordinary gain of $1,154 ($0.34 per basic and diluted share) related to the sale of the power systems business, a gain from a cumulative effect of accounting change of $30 ($0.01 per basic and diluted share) related to the adoption of SFAS 133 and a loss from a cumulative effect of accounting change of $68 ($0.02 loss per basic and diluted share) related to the adoption of SAB 101.

(b) Includes total business restructuring and one-time charges of $2,710, of which $536 of inventory write-downs are included in Gross margin.

(c) Includes total business restructuring and one-time charges of $684, of which $143 of inventory write-downs are included in Gross margin.

(d) Includes total business restructuring and one-time charges of $8,022, of which $580 of inventory write-downs are included in Gross margin.

(e) Includes an extraordinary gain of $28 ($0.01 per basic and diluted share) related to the sale of the power systems business.

(f) As a result of the loss reported from continuing operations, potentially dilutive securities have been excluded from the calculation of diluted earnings (loss) per share because their effect would be antidilutive. In addition, the fourth fiscal quarter loss per common share from continuing operations and the net loss per share includes the $28 impact of preferred dividends and accretion.

(g) Includes a gain of $189 associated with the sale of an equity investment and a charge of $61 primarily associated with the mergers with INS, Excel and Xedia.

(h) Includes a charge of $428 of IPRD related to the acquisition of Chromatis.

(i) Includes a charge of $131 of IPRD related to the acquisition of Spring Tide.

(j) During the fourth quarter of fiscal year 2001, Lucent implemented SAB 101 retroactively to the beginning of fiscal year 2001, resulting in a loss from a cumulative effect of accounting change of $68 ($0.02 loss per basic and diluted share). Results for the first three quarters of fiscal year 2001 have been restated. On a pro forma basis, had Lucent adopted SAB 101 prior to October 1, 2000, revenue, gross margin, loss from continuing operations and net loss for the fourth quarter of fiscal year 2000 would have been $7,220, $2,407, $306 and $496, respectively, and basic and diluted loss from continuing operations per share and net loss per share would have been $0.09 and $0.15, respectively.