A. Summary of Significant Accounting Policies

Principles of Consolidation. The consolidated financial statements include the accounts of Alcoa and companies more than 50% owned. Investments in other entities are accounted for principally on the equity basis.

The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America and require management to make certain estimates and assumptions. These may affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. They may also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates upon subsequent resolution of identified matters.

Cash Equivalents. Cash equivalents are highly liquid investments purchased with an original maturity of three months or less.

Inventory Valuation. Inventories are carried at the lower of cost or market, with cost for a substantial portion of U.S. and Canadian inventories determined under the last-in, first-out (LIFO) method. The cost of other inventories is principally determined under the average-cost method. See Note D for additional detail.

Properties, Plants and Equipment. Properties, plants and equipment are recorded at cost. Depreciation is recorded principally on the straight-line method at rates based on the estimated useful lives of the assets, averaging 33 years for structures and between 5 and 25 years for machinery and equipment. Profits or losses from the sale of assets are included in other income. Repairs and maintenance are charged to expense as incurred. Interest related to the construction of qualifying assets is capitalized as part of the construction costs. Depletion is taken over the periods during which the estimated mineral reserves are extracted. See Notes E and R for additional detail.

Amortization of Intangibles. The excess purchase price over the net tangible assets of businesses acquired is reported as goodwill in the Consolidated Balance Sheet. Goodwill and other intangibles have been amortized on a straight-line basis over not more than 40 years. The carrying value of goodwill and other intangibles is evaluated periodically in relation to the operating performance and future undiscounted cash flows of the underlying businesses. Adjustments are made if the sum of expected future net cash flows is less than book value. See Note F for additional information. See Recently Adopted Accounting Standards regarding the accounting for goodwill and intangibles amortization effective January 1, 2002.

Revenue Recognition. Alcoa recognizes revenue when title, ownership and risk of loss pass to the customer. In 2000, Alcoa changed its method of accounting for revenue recognition in accordance with the provisions of Staff Accounting Bulletin 101, "Revenue Recognition in Financial Statements." The application of this method of accounting for revenue recognition resulted in a cumulative effect charge to income of $5 (net of taxes and minority interests of $3) in 2000. The change did not have a significant effect on revenues or results of operations for the year ended December 31, 2000. The pro forma amounts, assuming that the new revenue recognition method was applied retroactively to prior periods, were not materially different from the amounts shown in the Statement of Consolidated Income for the year ended December 31, 1999.

Environmental Expenditures. Expenditures for current operations are expensed or capitalized, as appropriate. Expenditures relating to existing conditions caused by past operations, and which do not contribute to future revenues, are expensed. Liabilities are recorded when remedial efforts are probable and the costs can be reasonably estimated. The liability may include costs such as site investigations, consultant fees, feasibility studies, outside contractor and monitoring expenses. Estimates are not discounted or reduced by potential claims for recovery. Claims for recovery are recognized when received. The estimates also include costs related to other potentially responsible parties to the extent that Alcoa has reason to believe such parties will not fully pay their proportionate share. The liability is periodically reviewed and adjusted to reflect current remediation progress, prospective estimates of required activity and other factors that may be relevant, including changes in technology or regulations. See Note T for additional information.

Stock-Based Compensation. Alcoa accounts for stock-based compensation in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, compensation cost is not recognized on options granted. Disclosures required with respect to alternative fair value measurement and recognition methods prescribed by Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," are presented in Note M.

Derivatives and Hedging. Effective January 1, 2001, Alcoa adopted SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities," as amended. The fair values of all outstanding derivative instruments are recorded on the balance sheet in other current and noncurrent assets and liabilities at December 31, 2001. The transition adjustment on January 1, 2001 resulted in a net charge of $4 (after tax and minority interests), which was recorded in other comprehensive income.

Derivatives are held as part of a formally documented risk management (hedging) program. Alcoa's hedging activities are subject to the management, direction and control of the Strategic Risk Management Committee (SRMC). SRMC is composed of the chief executive officer, the chief financial officer and other officers and employees that the chief executive officer may select from time to time. SRMC reports to the Board of Directors on the scope of its derivative activities. All derivatives are straightforward and are held for purposes other than trading. Alcoa measures hedge effectiveness by formally assessing, at least quarterly, the historical and probable future high correlation of changes in the fair value or expected future cash flows of the hedged item. The ineffective portions are recorded in other income or expense in the current period. To the extent that Alcoa uses options contracts as hedging instruments, effectiveness is assessed based on changes in the intrinsic value of the option. If the hedging relationship ceases to be highly effective or it becomes probable that an expected transaction will no longer occur, gains or losses on the derivative are recorded in other income or expense.

Changes in the fair value of derivatives are recorded in current earnings along with the change in the fair value of the underlying hedged item if the derivative is designated as a fair value hedge or in other comprehensive income if the derivative is designated as a cash flow hedge. If no hedging relationship is designated, the derivative is marked to market through earnings.

Cash flows from financial instruments are recognized in the statement of cash flows in a manner consistent with the underlying transactions.

Prior to the adoption of SFAS No. 133, gains and losses related to transactions that qualified for hedge accounting, including closed futures contracts, were deferred and reflected in earnings when the underlying physical transactions took place. The deferred gains or losses were reflected on the balance sheet in other current and noncurrent assets and liabilities.

Past accounting convention also required that certain positions be marked to market. Mark-to-market gains and losses were recorded in other income. As a result of the change in accounting under SFAS No. 133, these contracts were re-designated and qualified as hedges on January 1, 2001. See Note S for additional information.

Foreign Currency. The local currency is the functional currency for Alcoa's significant operations outside the U.S., except in Canada, where the U.S. dollar is used as the functional currency. The determination of the functional currency for Alcoa's operations is made based on the appropriate economic and management indicators.

Effective July 1, 1999, the Brazilian real became the functional currency for translating the financial statements of Alcoa's 59%-owned Brazilian subsidiary, Alcoa Aluminio S.A. (Aluminio). Economic factors and circumstances related to Aluminio's operations had changed significantly due to the devaluation of the real in the 1999 first quarter. Under SFAS No. 52, "Foreign Currency Translation," the change in these facts and circumstances required a change in Aluminio's functional currency. As a result of the change, Alcoa's accumulated other comprehensive loss (unrealized translation adjustments) and minority interests accounts were reduced by $156 and $108, respectively. These amounts were driven principally by a reduction in fixed assets and resulted in decreases in Aluminio's depreciation expense of $30 in 2001 and 2000 and $15 in 1999.

Recently Adopted Accounting Standards. Alcoa adopted SFAS No. 141, "Business Combinations" for all business combinations after June 30, 2001. This standard requires that all business combinations be accounted for using the purchase method, and it further clarifies the criteria for recognition of intangible assets separately from goodwill. Since June 30, 2001, there have been no material business combinations.

Effective January 1, 2002, Alcoa will adopt SFAS No. 142, "Goodwill and Other Intangible Assets" for existing goodwill and other intangible assets. This standard eliminates the amortization of goodwill and intangible assets with indefinite useful lives and requires annual testing for impairment. This standard requires the assignment of assets acquired and liabilities assumed, including goodwill, to reporting units for purposes of goodwill impairment testing. Under the provisions of this standard, any impairment of goodwill as well as the unamortized balance of negative goodwill will be written off and recognized as a cumulative effect of a change in accounting principle effective January 1, 2002. Alcoa had unamortized goodwill of $5,733 at December 31, 2001, and had recorded net goodwill amortization expense of $170, $122 and $39 for the years ended December 31, 2001, 2000 and 1999, respectively. The company is currently evaluating the cumulative effect and ongoing impact of the application of SFAS No. 142 on the consolidated financial statements.

Effective January 1, 2002, Alcoa will adopt SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement supersedes or amends existing accounting literature related to the impairment and disposal of long-lived assets. Management is currently developing a plan to apply the provisions of this standard to its operations on an ongoing basis.

Recently Issued Accounting Standards. In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations." This statement establishes standards for accounting for obligations associated with the retirement of tangible long-lived assets. The standard is required to be adopted by Alcoa beginning on January 1, 2003. Management is currently assessing the details of the standard and is preparing a plan of implementation.

Reclassification. Certain amounts in previously issued financial statements were reclassified to conform to 2001 presentations.

B. Special Items

During 2001, Alcoa recorded charges of $566 ($355 after tax and minority interests) as a result of a restructuring plan. The company completed a strategic review of its primary products and fabricating businesses aimed at optimizing and aligning its manufacturing systems with customer needs, while positioning the company for stronger profitability. The total charge of $566 consisted of a charge of $212 ($114 after tax and minority interests) in the second quarter of 2001 and a charge of $354 ($241 after tax and minority interests) in the fourth quarter of 2001. These charges consisted of asset write-downs ($372 pretax), employee termination and severance costs ($178 pretax) related to workforce reductions of approximately 10,400 employees, and exit costs ($16 pretax). The second quarter charge was primarily due to actions taken in Alcoa's primary products businesses because of economic and competitive conditions. These actions included the shutdown of three facilities in the U.S. Alcoa expects to complete these actions by mid-2002. The fourth quarter charge was primarily due to actions taken in Alcoa's fabricating businesses. These actions included the shutdown of 15 facilities in the U.S. and Europe. Alcoa expects to complete these actions by the end of 2002.

Pretax restructuring charges consisted of:

	Asset Write-Downs	Employee Termination and Severance Costs	Other	Total
2001:				
Total restructuring charges	$ 372	$178	$16	$ 566
Cash payments	(3)	(32)	(5)	(40)
Noncash charges	(314)	—	—	(314)
Reserve balance at December 31, 2001	$ 55	$146	$11	$ 212

Asset write-downs of $372 were primarily recorded as a direct result of the company's decision to close certain facilities. The asset write-downs consisted primarily of structures and machinery and equipment, as well as related selling or disposal costs, and were comprised of $145 related to assets that will be phased out and $227 of assets that could be disposed of immediately. Assets to be phased out consisted of $46 of assets in the Flat-Rolled Products segment, $78 of assets in the Engineered Products segment and $21 at corporate. Assets to be disposed of consisted of $110 of assets in the Alumina and Chemicals segment, $84 of assets in the Primary Metals segment, $23 of assets in the Engineered Products segment, $4 in the Other group and $6 at corporate.

Assets to be phased out will be removed from service by mid-2002. Fair values of assets were determined based on expected future cash flows or appraised values. Expected operating cash flows during the phaseout period were not significant and did not have a material impact on the determination of the amount of the write-down.

Assets that could be disposed of immediately will be sold or vacated by the end of 2002. The remaining carrying amount of these assets was approximately $80 at December 31, 2001. The results of operations related to these assets were not material.

Employee termination and severance costs of $178 were recorded as management implemented workforce reductions of 10,400 hourly and salaried employees at various manufacturing facilities – primarily located outside of the U.S. – due to weak market conditions and the shutdowns of several manufacturing facilities. These workforce reductions primarily consisted of a combination of early retirement incentives and involuntary severance programs. As of December 31, 2001, approximately 4,000 employees had been terminated.

The $16 of exit costs were recorded for activities associated with the shutdowns above, which will be substantially complete by the end of 2002.

C. Acquisitions and Divestitures

In May of 2000, Alcoa completed a merger with Reynolds Metals Company (Reynolds) by issuing approximately 135 million shares of Alcoa common stock at a value of $33.30 per share to Reynolds stockholders. The transaction was valued at approximately $5,900, including debt assumed of $1,297. The purchase price included the conversion of outstanding Reynolds options to Alcoa options as well as other direct costs of the acquisition. The goodwill of approximately $2,100 resulting from the purchase price allocation was being amortized over a 40-year period.

As part of the merger with Reynolds, Alcoa agreed to divest Reynolds' interests in the alumina refineries in Worsley, Australia; Stade, Germany; and Sherwin, Texas as well as 25% of Reynolds' interest in the aluminum smelter located in Longview, Washington.

The consolidated financial statements have been prepared in accordance with Emerging Issues Task Force (EITF) 87-11, "Allocation of Purchase Price to Assets to be Sold." Under EITF 87-11, at December 31, 2000, the fair value of net assets to be divested were reported as assets held for sale in the balance sheet, and the results of operations from these assets of $19 (after tax) were not included in the Statement of Consolidated Income. In 2001, the results of operations from these assets were not material, and there were no significant adjustments to the purchase price allocation as a result of these divestitures.

The sale of Sherwin was completed in December 2000; the sales of Worsley and 100% of Longview were completed in the first quarter of 2001; and the sale of Stade was completed in the second quarter of 2001. There were no gains or losses on the sales of these assets.

In November of 2001, Alcoa contributed net assets of approximately $200 of Reynolds Aluminum Supply Company (RASCO), the metals distribution business acquired in the Reynolds acquisition, to a joint venture in which Alcoa retains a 50% equity interest.

In May and June of 2000, Alcoa completed the acquisitions of Cordant Technologies Inc. (Cordant) and Howmet International Inc. (Howmet), a majority-owned company of Cordant. Under the agreement and tender offer, Alcoa paid $57 for each outstanding share of Cordant common stock and $21 for each outstanding share of Howmet common stock. The total value of the transactions was approximately $3,300, including the assumption of debt of $826. The purchase price includes the conversion of outstanding Cordant and Howmet options to Alcoa options as well as other direct costs of the acquisition. In April of 2001, Alcoa completed the sale of Thiokol, a business acquired in the Cordant transaction, to Alliant Techsystems Inc. for net proceeds of $698 in cash, which included a working capital adjustment, and recognized a $55 pretax gain that is included in other income. The goodwill of approximately $2,200 resulting from the purchase price allocation, after considering the impact of the Thiokol sale, was being amortized over a 40-year period.

The following unaudited pro forma information for the years ended December 31, 2000 and 1999 assumes that the acquisitions of Reynolds and Cordant had occurred at the beginning of 2000 and 1999. Adjustments that have been made to arrive at the pro forma totals include those related to acquisition financing; the amortization of goodwill; the elimination of transactions among Alcoa, Reynolds and Cordant; and additional depreciation related to the increase in basis that resulted from the transactions. Tax effects from the pro forma adjustments previously noted have been included at the 35% U.S. statutory rate.

(Unaudited)	2000	1999
Sales	$25,636	$23,369
Net income	1,514	1,148
Earnings per share:		
Basic	$ 1.86*	$ 1.32
Diluted	1.84*	1.30

* Includes the cumulative effect adjustment of the accounting change for revenue recognition

The pro forma results are not necessarily indicative of what actually would have occurred if the transactions had been in effect for the periods presented, are not intended to be a projection of future results and do not reflect any cost savings that might be achieved from the combined operations.

In October of 2000, Alcoa completed the acquisition of Luxfer Holdings plc's aluminum plate, sheet and soft-alloy extrusion manufacturing operations and distribution businesses of British Aluminium

Limited, a wholly owned subsidiary of Luxfer. Alcoa paid approximately $271 in cash. The allocation of the purchase price resulted in goodwill of approximately $121, which was being amortized over a 40-year period. Had the British Aluminium acquisition occurred at the beginning of 2000 or 1999, net income for those years would not have been materially different.

Alcoa completed a number of other acquisitions in 2001, 2000 and 1999. Net cash paid for other acquisitions was $159, $488 and $122 in 2001, 2000 and 1999, respectively. None of these transactions had a material impact on Alcoa's financial statements.

Alcoa's acquisitions have been accounted for using the purchase method. The purchase price has been allocated to the assets acquired and liabilities assumed based on their estimated fair market values. Any excess purchase price over the fair market value of the net assets acquired has been recorded as goodwill. For all of Alcoa's acquisitions, operating results have been included in the Statement of Consolidated Income since the dates of the acquisitions.

D. Inventories

December 31	2001	2000
Finished goods	$ 691	$ 814
Work in process	734	806
Bauxite and alumina	410	311
Purchased raw materials	531	562
Operating supplies	165	210
	$2,531	$2,703

Approximately 47% of total inventories at December 31, 2001 were valued on a LIFO basis. If valued on an average-cost basis, total inventories would have been $605 and $658 higher at the end of 2001 and 2000, respectively. During 2000, LIFO inventory quantities were reduced, which resulted in a partial liquidation of the LIFO bases. The impact of this liquidation increased net income by $31, or four cents per share, in 2000.

E. Properties, Plants and Equipment, at Cost

December 31	2001	2000
Land and land rights, including mines	$ 390	$ 384
Structures	5,318	5,329
Machinery and equipment	15,779	16,063
	21,487	21,776
Less: accumulated depreciation and depletion	10,554	9,750
	10,933	12,026
Construction work in progress	1,049	824
	$11,982	$12,850

F. Other Assets

December 31	2001	2000
Investments, principally equity investments	$1,384	$ 954
Assets held for sale	—	1,473
Intangibles, net of accumulated amortization of $323 in 2001 and $238 in 2000	674	821
Noncurrent receivables	44	118
Deferred income taxes	445	360
Deferred charges and other	1,301	1,534
	$3,848	$5,260

G. Other Noncurrent Liabilities and Deferred Credits

December 31	2001	2000
Deferred alumina sales revenue	$ 204	$ 212
Environmental remediation	357	369
Deferred credits	278	317
Other noncurrent liabilities	1,129	1,228
	$1,968	$2,126

H. Debt

December 31	2001	2000
Commercial paper, variable rate, (1.9% and 6.6% average rates)	$ 220	$1,510
5.75% Notes	—	250
6.625% Notes, due 2002	57	114
9% Bonds, due 2003	21	21
Floating-rate notes, due 2004 (2.2% average rate)	500	—
6.125% Bonds, due 2005	200	200
7.25% Notes, due 2005	500	500
5.875% Notes, due 2006	500	—
6.625% Notes, due 2008	150	150
7.375% Notes, due 2010	1,000	1,000
6.50% Notes, due 2011	1,000	—
6% Notes, due 2012	1,000	—
6.50% Bonds, due 2018	250	250
6.75% Bonds, due 2028	300	300
Tax-exempt revenue bonds ranging from 1.6% to 7.3%, due 2002–2033	341	347
Medium-term notes, due 2002–2013 (8.0% and 8.3% average rates)	224	334
Alcoa Fujikura Ltd.		
Variable-rate term loan (6.3% average rate)	—	190
Alcoa Aluminio		
7.5% Export notes, due 2008	165	184
Variable-rate notes (8.2% average rate)	—	3
Other	63	61
	6,491	5,414
Less: amount due within one year	103	427
	$6,388	$4,987

The amount of long-term debt maturing in each of the next five years is $103 in 2002, $91 in 2003, $563 in 2004, $979 in 2005 and $586 in 2006.

In May 2001, Alcoa issued $1,500 of notes. Of these notes, $1,000 mature in 2011 and carry a coupon rate of 6.50%, and $500 mature in 2006 and carry a coupon rate of 5.875%. In December 2001, Alcoa issued $1,500 of notes. This issue consisted of $1,000 of notes that mature in 2012 and carry a coupon rate of 6%, and $500 of floating-rate notes that mature in 2004. The proceeds from these borrowings were used to refinance debt, primarily commercial paper, and for general corporate purposes.

In 2000, Alcoa issued $1,500 of notes. Of these notes, $1,000 mature in 2010 and carry a coupon rate of 7.375%, and $500 mature in 2005 and carry a coupon rate of 7.25%.

In April 2001, Alcoa refinanced the $2,490 revolving-credit facility that was to expire in April 2001 and the $510 revolving-credit facility that expires in April 2005. These facilities were refinanced into a $2,000 revolving-credit agreement that expires in April 2002 and a $1,000 revolving-credit agreement that expires in April 2005. Alcoa also has a $1,000 revolving-credit facility that expires in August 2003. Under these agreements, a certain ratio of indebtedness to consolidated net worth must be maintained. Commercial paper of $220 and $1,510 at December 31, 2001 and 2000, respectively, was classified as long-term debt because it is backed by the revolving-credit facilities. There were no amounts outstanding under these facilities at December 31, 2001. The interest rate on these facilities, if drawn upon, is Libor plus 19 basis points, which is subject to adjustment if Alcoa's credit rating changes, to a maximum interest rate of Libor plus 40 basis points.

Aluminio's export notes are collateralized by receivables due under an export contract. Certain financial ratios must be maintained, including the maintenance of a minimum debt service ratio as well as a certain level of tangible net worth of Aluminio and its subsidiaries.

Short-term borrowings of $142 at December 31, 2001 consisted of bank and other borrowings. Short-term borrowings of $2,719 at December 31, 2000 consisted of commercial paper of $2,201, extendible commercial notes of $280 and bank and other borrowings of $238. The weighted average interest rate on short-term borrowings was 2.5% in 2001 and 6.6% in 2000.

I. Minority Interests

The following table summarizes the minority shareholders' interests in the equity of consolidated subsidiaries.

December 31	2001	2000
Alcoa of Australia	$ 431	$ 462
Alcoa Aluminio	222	256
Alcoa World Alumina and Chemicals	175	260
Alcoa Fujikura Ltd.	277	309
Other majority-owned companies	208	227
	$1,313	$1,514

J. Commitments and Contingencies

Various lawsuits, claims and proceedings have been or may be instituted or asserted against Alcoa, including those pertaining to environmental, product liability, and safety and health matters. While the amounts claimed may be substantial, the ultimate liability cannot now be determined because of the considerable uncertainties that exist. Therefore, it is possible that results of operations or liquidity in a particular period could be materially affected by certain contingencies. However, based on facts currently available, management believes that the disposition of matters that are pending or asserted will not have a materially adverse effect on the financial position of the company.

Aluminio is a 27.23% participant in Machadinho, a hydroelectric construction project in Brazil. Aluminio has guaranteed up to 39% of the project's total debt of approximately $315. Beginning in February 2002, Aluminio is committed to taking a share of the output of the completed project for 30 years at cost, including cost of financing the project. In the event that other participants in this project fail to fulfill their financial responsibilities, Aluminio may be required to fund a portion of the deficiency. In accordance with the agreement, if Aluminio funds any such deficiency, its participation and share of the output from the project will increase proportionately.

Aluminio also entered into agreements to participate in four additional hydroelectric construction projects in Brazil that are scheduled to be completed at various dates ranging from 2005 to 2008. Aluminio's share of the output from the hydroelectric facilities, when completed, ranges from 20% to 39.5%. Total costs for all four projects are estimated at $1,400, with Aluminio's share of total project costs totaling approximately 30%. The plans for financing these projects have not yet been finalized. Aluminio may be required to provide guarantees of project financing or commit to additional investments as these projects progress. At December 31, 2001, Aluminio had provided $13 of guarantees on two of the hydroelectric construction projects in the form of performance bonds.

Aluminio accounts for its investments in these hydroelectric projects on the equity method. Aluminio's investment in these projects was $108 and $48 at December 31, 2001 and 2000, respectively.

Alcoa of Australia (AofA) is party to a number of natural gas and electricity contracts that expire between 2002 and 2020. Under these take-or-pay contracts, AofA is obligated to pay for a minimum amount of natural gas or electricity even if these commodities are not required for operations. Commitments related to these contracts total $176 in 2002, $180 in 2003, $185 in 2004, $178 in 2005, $154 in 2006 and $2,243 thereafter. Expenditures under these contracts totaled $179 in 2001, $188 in 2000 and $179 in 1999.

On January 9, 2002, Alcoa raised its equity stake in Elkem ASA, a Norwegian metals producer, above 40% which, under Norwegian law, required Alcoa to initiate an unconditional cash tender offer for the remaining outstanding shares of Elkem. Under the tender offer, which expires on February 22, 2002, Alcoa will pay approximately $17.40 for each outstanding share of Elkem. Alcoa's potential cash commitment if all outstanding shares are tendered is approximately $515.

Alcoa has standby letters of credit related to environmental, insurance and other activities. The total amount committed under these letters of credit, which expire at various dates in 2002, was $181 at December 31, 2001.

K. Cash Flow Information

Cash payments for interest and income taxes follow.

	2001	2000	1999
Interest	$418	$388	$225
Income taxes	548	419	394

The details of cash payments related to acquisitions follow.

	2001	2000	1999
Fair value of assets acquired	$184	$14,991	$ 282
Liabilities assumed	(24)	(7,075)	(159)
Stock options issued	—	(182)	—
Stock issued	—	(4,502)	—
Cash paid	160	3,232	123
Less: cash acquired	1	111	1
Net cash paid for acquisitions	$159	$ 3,121	$ 122

L. Segment and Geographic Area Information

Alcoa is primarily a producer of aluminum products. Its segments are organized by product on a worldwide basis. Alcoa's management reporting system evaluates performance based on a number of factors; however, the primary measure of performance is the after-tax operating income (ATOI) of each segment. Nonoperating items such as interest income, interest expense, foreign exchange gains/losses, the effects of LIFO inventory accounting, minority interests and special items are excluded from segment ATOI. In addition, certain expenses, such as corporate general administrative expenses, and depreciation and amortization on corporate assets, are not included in segment ATOI. Segment assets exclude cash, cash equivalents, short-term investments and all deferred taxes. Segment assets also exclude items such as corporate fixed assets, LIFO reserves, goodwill allocated to corporate and other amounts.

The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies (Note A). Transactions among segments are established based on negotiation among the parties. Differences between segment totals and Alcoa's consolidated totals for line items not reconciled are primarily due to corporate allocations.

Alcoa's products are used primarily by packaging, consumer products, transportation (including aerospace, automotive, truck trailer, rail and shipping), building and construction and industrial customers worldwide. Total exports from the U.S. were $2,066 in 2001, compared with $1,687 in 2000 and $1,309 in 1999. Alcoa's reportable segments follow.

Segment information	Alumina and Chemicals	Primary Metals	Flat-Rolled Products	Engineered Products	Packaging and Consumer	Other	Total
2001							
Sales:							
Third-party sales	$1,908	$3,432	$4,999	$6,098	$2,720	$3,702	$22,859
Intersegment sales	1,021	3,300	64	35	—	—	4,420
Total sales	$2,929	$6,732	$5,063	$6,133	$2,720	$3,702	$27,279
Profit and loss:							
Equity income (loss)	$ 1	$ 52	$ (2)	$ —	$ 28	$ 16	$ 95
Depreciation, depletion and amortization	144	327	191	268	137	113	1,180
Income taxes	184	434	94	111	79	—	902
After-tax operating income	471	905	262	173	185	47	2,043
Assets:							
Capital expenditures	$ 129	$ 209	$ 221	$ 259	$ 94	$ 84	$ 996
Equity investments	170	319	47	—	128	317	981
Total assets	2,797	7,122	3,453	6,231	2,498	1,883	23,984
2000							
Sales:							
Third-party sales	$2,108	$3,756	$5,446	$5,471	$2,084	$4,071	$22,936
Intersegment sales	1,104	3,504	97	62	—	—	4,767
Total sales	$3,212	$7,260	$5,543	$5,533	$2,084	$4,071	$27,703
Profit and loss:							
Equity income	$ 3	$ 50	$ 6	$ 1	$ —	$ 32	$ 92
Depreciation, depletion and amortization	163	311	188	221	105	127	1,115
Income taxes	279	505	126	124	70	93	1,197
After-tax operating income	585	1,000	299	210	131	164	2,389
Assets:							
Capital expenditures	$ 154	$ 232	$ 185	$ 234	$ 112	$ 100	$ 1,017
Equity investments	176	274	90	6	1	139	686
Total assets	2,924	7,700	3,657	6,455	2,457	3,376	26,569
1999							
Sales:							
Third-party sales	$1,842	$2,241	$5,113	$3,728	$ 801	$2,592	$16,317
Intersegment sales	925	2,793	51	26	—	—	3,795
Total sales	$2,767	$5,034	$5,164	$3,754	$ 801	$2,592	$20,112
Profit and loss:							
Equity income (loss)	$ —	$ 42	$ (9)	$ —	$ —	$ 10	$ 43
Depreciation, depletion and amortization	161	216	184	116	60	89	826
Income taxes	159	214	131	88	32	71	695
After-tax operating income	307	535	281	180	68	118	1,489
Assets:							
Capital expenditures	$ 183	$ 207	$ 166	$ 144	$ 96	$ 62	$ 858
Equity investments	54	153	66	—	1	138	412
Total assets	3,046	4,532	3,385	2,320	646	1,647	15,576

Alumina and Chemicals. This segment consists of Alcoa's worldwide alumina and chemicals system, that includes the mining of bauxite, which is then refined into alumina. Alumina is sold directly to internal and external smelter customers worldwide or is processed into industrial chemical products. Alcoa's alumina operations in Australia are a significant component of this segment. Approximately two-thirds of the third-party sales from this segment are derived from alumina.

Primary Metals. This segment consists of Alcoa's worldwide smelter system. Primary Metals receives alumina primarily from the Alumina and Chemicals segment and produces aluminum ingot to be used by Alcoa's fabricating businesses, as well as sold to external customers, aluminum traders and commodity markets. Results from the sale of aluminum powder, scrap and excess power are also included in this segment, as well as the results from aluminum derivative contracts. The sale of ingot represents approximately 80% of this segment's third-party sales.

Flat-Rolled Products. This segment's principal business is the production and sale of aluminum plate, sheet and foil. This segment includes rigid container sheet (RCS), which is used to produce aluminum beverage cans, and sheet and plate used in the transportation and distributor markets. Approximately 60% of the third-party sales in this segment are derived from sheet and plate, and foil used in industrial markets, while the remaining 40% of third-party sales consists of RCS.

Engineered Products. This segment includes hard- and soft-alloy extrusions, including architectural extrusions, super-alloy castings, steel and aluminum fasteners, aluminum forgings and wheels. These products serve the transportation, building and construction and distributor markets.

Packaging and Consumer. This segment includes foodservice, flexible packaging, consumer products and packaging graphics design, as well as closures, PET bottles and packaging machinery. The principal products in this segment include aluminum foil; plastic wraps and bags; metal and plastic beverage and food closures; prepress services and plastic shrink film and wraps. Consumer products are marketed under brands including Reynolds Wrap, Diamond, Baco and Cut-Rite wax paper.

Other. This group includes other Alcoa businesses that are not included in the segments previously mentioned. This group includes Alcoa Fujikura Ltd., which produces electrical components for the automotive industry along with fiber-optic cable and provides services to the telecommunications industry; residential building products operations, Alcoa Building Products (ABP); automotive parts businesses; Thiokol, a producer of solid rocket propulsion systems (Thiokol was sold in April 2001); and Reynolds' metal distribution business, RASCO (in November 2001, the net assets of RASCO were contributed to a joint venture, in which Alcoa retains a 50% equity interest).

The following reconciles segment information to consolidated totals.

	2001	2000	1999
Sales:			
Total sales	$27,279	$27,703	$20,112
Elimination of intersegment sales	(4,420)	(4,767)	(3,795)
Other revenues	—	—	6
Consolidated sales	$22,859	$22,936	$16,323
Net income:			
Total after-tax operating income	$ 2,043	$ 2,389	$ 1,489
Impact of intersegment profit eliminations	(20)	24	(24)
Unallocated amounts (net of tax):			
Interest income	40	40	26
Interest expense	(242)	(278)	(126)
Minority interests	(208)	(381)	(242)
Special items	(397)	—	—
Corporate expense	(261)	(227)	(171)
Other	(47)	(83)	102
Consolidated net income	$ 908	$ 1,484	$ 1,054
Assets:			
Total assets	$23,984	$26,569	$15,576
Elimination of intersegment receivables	(309)	(530)	(362)
Unallocated amounts:			
Cash, cash equivalents and short-term investments	527	371	314
Deferred tax assets	855	745	657
Corporate goodwill	1,710	1,570	558
Corporate fixed assets	513	414	278
LIFO reserve	(605)	(658)	(645)
Operations to be divested	—	1,473	—
Other	1,680	1,737	690
Consolidated assets	$28,355	$31,691	$17,066

Geographic information for revenues, based on country of origin, and long-lived assets follows.

	2001	2000	1999
Revenues:			
U.S.	$15,000	$15,487	$10,392
Australia	1,350	1,690	1,398
Spain	1,011	1,146	1,059
United Kingdom	899	379	253
Brazil	736	885	730
Germany	720	713	521
Other	3,143	2,636	1,970
	$22,859	$22,936	$16,323
Long-lived assets:			
U.S.	$12,495	$14,276	$ 6,650
Canada	2,787	2,844	948
Australia	1,345	1,458	1,585
United Kingdom	682	378	72
Brazil	600	698	712
Germany	194	213	165
Other	1,164	1,322	1,050
	$19,267	$21,189	$11,182

M. Preferred and Common Stock

Preferred Stock. Alcoa has two classes of preferred stock. Serial preferred stock has 557,740 shares authorized and outstanding, with a par value of $100 per share and an annual $3.75 cumulative dividend preference per share. Class B serial preferred stock has 10 million shares authorized (none issued) and a par value of $1 per share.

Common Stock. There are 1.8 billion shares authorized at a par value of $1 per share. As of December 31, 2001, 94.5 million shares of common stock were reserved for issuance under the long-term stock incentive plans.

In July 2001, the Alcoa Board of Directors authorized the repurchase of 50 million shares of Alcoa common stock. As of December 31, 2001, there were 37.5 million shares remaining on the stock repurchase authorization.

Stock options under the company's stock incentive plans have been and may be granted, generally at not less than market prices on the dates of grant. The stock option program includes a reload or stock continuation ownership feature. Stock options granted have a maximum term of 10 years. Vesting periods are one year from the date of grant and six months for options granted under the reload feature.

Alcoa's net income and earnings per share would have been reduced to the pro forma amounts shown below if compensation cost had been determined based on the fair value at the grant dates.

	2001	2000	1999
Net income:			
As reported	$908	$1,484	$1,054
Pro forma	730	1,277	912
Basic earnings per share:			
As reported	1.06	1.82	1.43
Pro forma	0.85	1.57	1.24
Diluted earnings per share:			
As reported	1.05	1.80	1.41
Pro forma	0.84	1.55	1.22

The weighted average fair value per option granted was $9.54 in 2001, $10.13 in 2000 and $5.35 in 1999.

The fair value of each option is estimated on the date of grant or subsequent reload using the Black-Scholes pricing model with the following assumptions:

	2001	2000	1999
Average risk-free interest rate	3.8%	6.1%	5.0%
Expected dividend yield	1.6	1.6	1.4
Expected volatility	43.0	40.0	37.0
Expected life (years):			
New option grants	2.5	2.5	2.5
Reload option grants	2.0	2.0	1.5

The transactions for shares under options were: (shares in millions)

	2001	2000	1999
Outstanding, beginning of year:			
Number of options	74.8	53.0	53.2
Weighted average exercise price	$29.29	$22.15	$16.50
Options assumed from acquisitions:			
Number of options	—	15.2	—
Weighted average exercise price	—	$25.09	—
Granted:			
Number of options	28.9	31.3	43.6
Weighted average exercise price	$36.19	$37.87	$24.47
Exercised:			
Number of options	(29.0)	(24.3)	(43.2)
Weighted average exercise price	$29.03	$22.03	$17.22
Expired or forfeited:			
Number of options	(1.2)	(.4)	(.6)
Weighted average exercise price	$32.50	$34.90	$18.59
Outstanding, end of year:			
Number of options	73.5	74.8	53.0
Weighted average exercise price	$32.02	$29.29	$22.15
Exercisable, end of year:			
Number of options	58.6	44.6	26.4
Weighted average exercise price	$31.88	$23.42	$19.21
Shares reserved for future options	21.0	15.8	28.6

The following tables summarize certain stock option information at December 31, 2001: (shares in millions)

Options Outstanding

Range of exercise price	Number	Weighted average remaining life	Weighted average exercise price
$ 0.125	0.2	employment career	$0.125
$ 4.38–$12.15	2.0	3.24	10.11
$12.16–$19.93	5.8	3.85	17.08
$19.94–$27.71	12.0	5.39	23.16
$27.72–$35.49	27.0	7.14	32.56
$35.50–$43.25	26.5	6.67	40.63
Total	73.5	6.31	$32.02

Options Exercisable

Range of exercise price	Number	Weighted average exercisable price
$ 0.125	0.2	$0.125
$ 4.38–$12.15	2.0	10.11
$12.16–$19.93	5.8	17.08
$19.94–$27.71	12.1	23.16
$27.72–$35.49	14.0	33.52
$35.50–$43.25	24.5	40.74
Total	58.6	$31.88

N. Earnings Per Share

Basic earnings per common share (EPS) amounts are computed by dividing earnings after the deduction of preferred stock dividends by the average number of common shares outstanding. Diluted EPS amounts assume the issuance of common stock for all potentially dilutive equivalents outstanding.

The details of basic and diluted EPS follow. (shares in millions)

	2001	2000	1999
Income before cumulative effect	$908	$1,489	$1,054
Less: preferred stock dividends	2	2	2
Income available to common stockholders before cumulative effect	$906	$1,487	$1,052
Cumulative effect of accounting change	—	(5)	—
Income available to common stockholders after cumulative effect	$906	$1,482	$1,052
Average shares outstanding—basic	858.0	814.2	733.8
Effect of dilutive securities:			
Shares issuable upon exercise of dilutive stock options	8.6	9.0	13.4
Average shares outstanding—diluted	866.6	823.2	747.2
Basic EPS (before cumulative effect)	$1.06	$1.83	$1.43
Basic EPS (after cumulative effect)	1.06	1.82	1.43
Diluted EPS (before cumulative effect)	1.05	1.81	1.41
Diluted EPS (after cumulative effect)	1.05	1.80	1.41

Options to purchase 32 million shares of common stock at an average exercise price of $40 per share were outstanding as of December 31, 2001 but were not included in the computation of diluted EPS because the option exercise price was greater than the average market price of the common shares.

In April 2000, Alcoa entered into a forward share repurchase agreement to partially hedge the equity exposure related to its stock option program. As of June 30, 2001, Alcoa had repurchased all 10 million shares under the agreement.

O. Income Taxes

The components of income before taxes on income were:

	2001	2000	1999
U.S.	$ (84)	$ 756	$ 631
Foreign	1,725	2,056	1,218
	$1,641	$2,812	$1,849

The provision for taxes on income consisted of:

	2001	2000	1999
Current:			
U.S. federal*	$ (17)	$217	$175
Foreign	521	568	306
State and local	45	22	18
	549	807	499
Deferred:			
U.S. federal*	(32)	90	74
Foreign	3	42	(25)
State and local	5	3	5
	(24)	135	54
Total	$525	$942	$553

*Includes U.S. taxes related to foreign income

In the 1999 fourth quarter, Australia reduced its corporate income tax rate from 36% to 34% for 2000 and 30% for 2001.

The exercise of employee stock options generated a tax benefit of $90 in 2001, $108 in 2000 and $145 in 1999. This amount was credited to additional capital and reduced current taxes payable.

Reconciliation of the U.S. federal statutory rate to Alcoa's effective tax rate follows.

	2001	2000	1999
U.S. federal statutory rate	35.0%	35.0%	35.0%
Taxes on foreign income	(8.4)	(3.5)	(2.4)
State taxes net of federal benefit	1.1	.5	.5
Tax rate changes	—	—	(2.4)
Minority interests	1.8	.1	.3
Permanent differences on sold and disposed assets	(1.4)	—	—
Goodwill amortization	2.4	1.2	0.5
Other	1.5	.2	(1.6)
Effective tax rate	32.0%	33.5%	29.9%

The components of net deferred tax assets and liabilities follow.

	2001		2000	
December 31	Deferred tax assets	Deferred tax liabilities	Deferred tax assets	Deferred tax liabilities
Depreciation	$ —	$1,744	$ —	$2,263
Employee benefits	1,071	—	1,127	—
Loss provisions	406	—	588	—
Deferred income/expense	279	132	237	166
Tax loss carryforwards	329	—	272	—
Tax credit carryforwards	219	—	144	—
Other	293	252	262	304
	2,597	2,128	2,630	2,733
Valuation allowance	(201)	—	(165)	—
	$2,396	$2,128	$2,465	$2,733

Of the total deferred tax assets associated with the tax loss carryforwards, $65 expires over the next 10 years, $104 over the next 20 years and $160 is unlimited. Of the tax credit carryforwards, $142 is unlimited with the balance expiring over the next 10 years. A substantial portion of the valuation allowance relates to the loss carryforwards because the ability to generate sufficient foreign taxable income in future years is uncertain. Approximately $52 of the valuation allowance relates to acquired companies for which subsequently recognized benefits will reduce goodwill.

The cumulative amount of Alcoa's share of undistributed earnings for which no deferred taxes have been provided was $4,399 at December 31, 2001. Management has no plans to distribute such earnings in the foreseeable future. It is not practical to determine the deferred tax liability on these earnings.

P. Pension Plans and Other Postretirement Benefits

Alcoa maintains pension plans covering most U.S. employees and certain other employees. Pension benefits generally depend on length of service, job grade and remuneration. Substantially all benefits are paid through pension trusts that are sufficiently funded to ensure that all plans can pay benefits to retirees as they become due.

Alcoa maintains health care and life insurance benefit plans covering most eligible U.S. retired employees and certain other retirees. Generally, the medical plans pay a stated percentage of medical expenses, reduced by deductibles and other coverages. These plans are generally unfunded, except for certain benefits funded through a trust. Life benefits are generally provided by insurance contracts. Alcoa retains the right, subject to existing agreements, to change or eliminate these benefits. All U.S. salaried and certain hourly employees hired after January 1, 2002 will not have postretirement health care benefits.

The table below reflects the status of Alcoa's pension and postretirement benefit plans.

	Pension benefits		Postretirement benefits	
December 31	2001	2000	2001	2000
Change in benefit obligation				
Benefit obligation at beginning of year	$8,270	$ 5,366	$ 2,924	$ 1,687
Service cost	162	162	25	25
Interest cost	578	502	220	177
Amendments	136	9	76	(17)
Actuarial losses (gains)	634	(309)	369	85
Acquisitions (principally Reynolds and Cordant)	—	3,124	—	1,182
Divestitures (principally Thiokol)	(664)	—	(159)	—
Benefits paid	(585)	(514)	(278)	(215)
Exchange rate	(43)	(70)	—	—
Benefit obligation at end of year	$8,488	$ 8,270	$ 3,177	$ 2,924
Change in plan assets				
Fair value of plan assets at beginning of year	$9,790	$ 6,103	$ 155	$ 112
Actual return on plan assets	65	586	1	12
Acquisitions (principally Reynolds and Cordant)	—	3,597	—	31
Employer contributions	37	61	—	5
Participants' contributions	11	13	—	—
Divestitures (principally Thiokol)	(783)	—	(33)	—
Transfer to defined contribution pension plan	(49)	—	—	—
Benefits paid	(574)	(487)	—	(5)
Administrative expenses	(17)	(12)	—	—
Exchange rate	(46)	(71)	—	—
Fair value of plan assets at end of year	$8,434	$ 9,790	$ 123	$ 155
Funded status	$ (54)	$ 1,520	$(3,054)	$(2,769)
Unrecognized net actuarial (gain) loss	(8)	(1,385)	221	(137)
Unrecognized net prior service cost (credit)	138	40	11	(97)
Net amount recognized	$ 76	$ 175	$(2,822)	$(3,003)
Amount recognized in the balance sheet consists of:				
Prepaid benefit	$ 502	$ 661	$ —	$ —
Accrued benefit liability	(568)	(509)	(2,822)	(3,003)
Intangible asset	50	9	—	—
Accumulated other comprehensive loss	92	14	—	—
Net amount recognized	$ 76	$ 175	$(2,822)	$(3,003)

The components of net periodic benefit costs are reflected below.

	Pension benefits			Postretirement benefits		
December 31	2001	2000	1999	2001	2000	1999
Components of net periodic benefit (income) costs						
Service cost	$ 162	$ 162	$ 141	$ 25	$ 25	$ 19
Interest cost	578	502	342	220	177	109
Expected return on plan assets	(781)	(666)	(427)	(11)	(11)	(9)
Amortization of prior service cost (benefit)	34	35	39	(33)	(34)	(34)
Recognized actuarial gain	(26)	(18)	(4)	(2)	(2)	(4)
Amortization of transition obligation	—	2	2	—	—	—
Net periodic benefit (income) costs	$ (33)	$ 17	$ 93	$199	$155	$ 81

The aggregate benefit obligation and fair value of plan assets for the pension plans with benefit obligations in excess of plan assets were $1,921 and $1,362, respectively, as of December 31, 2001, and $804 and $508, respectively, as of December 31, 2000. The aggregate pension accumulated benefit obligation and fair value of plan assets with accumulated benefit obligations in excess of plan assets were $1,708 and $1,284, respectively, as of December 31, 2001, and $594 and $338, respectively, at December 31, 2000.

Weighted average assumptions used in the accounting for Alcoa's plans follow.

December 31	2001	2000	1999
Discount rate	7.25%	7.75%	7.00%
Expected long-term return on plan assets	9.50	9.00	9.00
Rate of compensation increase	5.00	5.00	5.00

For measurement purposes, a 9.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2002. The rate was assumed to decrease gradually to 5% in 2006 and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. A one-percentage-point change in these assumed rates would have the following effects:

	1% increase	1% decrease
Effect on total of service and interest cost components	$ 16	$ (14)
Effect on postretirement benefit obligations	196	(172)

Alcoa also sponsors a number of defined contribution pension plans. Expenses were $103 in 2001, $80 in 2000 and $64 in 1999.

Q. Lease Expense

Certain equipment, warehousing and office space and oceangoing vessels are under operating lease agreements. Total expense for all leases was $199 in 2001, $152 in 2000 and $145 in 1999. Under long-term operating leases, minimum annual rentals are $128 in 2002, $98 in 2003, $77 in 2004, $64 in 2005, $60 in 2006 and a total of $223 for 2007 and thereafter.

R. Interest Cost Components

	2001	2000	1999
Amount charged to expense	$371	$427	$195
Amount capitalized	22	20	21
	$393	$447	$216

S. Other Financial Instruments and Derivatives

Other Financial Instruments. The carrying values and fair values of Alcoa's financial instruments at December 31 follow.

	2001		2000	
	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	$ 512	$ 512	$ 315	$ 315
Short-term investments	15	15	56	56
Noncurrent receivables	44	44	118	118
Short-term debt	245	245	3,146	3,146
Long-term debt	6,388	6,535	4,987	5,053

The methods used to estimate the fair values of certain financial instruments follow.

Cash and Cash Equivalents, Short-Term Investments and Short-Term Debt. The carrying amounts approximate fair value because of the short maturity of the instruments.

Noncurrent Receivables. The fair value of noncurrent receivables is based on anticipated cash flows and approximates carrying value.

Long-Term Debt. The fair value is based on interest rates that are currently available to Alcoa for issuance of debt with similar terms and remaining maturities.

Derivatives. Alcoa holds or purchases derivative financial instruments for purposes other than trading. Details of the fair values of the significant instruments follow.

	2001	2000
Aluminum	$ (65)	$ 29
Interest rates	34	(1)
Foreign currency	(132)	(166)
Other commodities	(30)	74

Fair Value Hedges

Aluminum. Customers often require Alcoa to enter into long-term fixed-price commitments. These commitments expose Alcoa to the risk of fluctuating aluminum prices between the time the order is committed and the time that the order is shipped. Alcoa's commodity risk management policy is to hedge, through the use of futures and option contracts, the aluminum price risk for a portion of its firm commitments. These contracts cover known exposures, generally within three years.

Interest Rates. Alcoa attempts to maintain a reasonable balance between fixed- and floating-rate debt and uses interest rate swaps to help manage this balance. The company has entered into pay floating, receive fixed interest rate swaps to effectively convert the interest rate from fixed to floating on $2,250 of debt, through 2011.

Hedges of these existing assets, liabilities and firm commitments qualify as "fair value" hedges. As a result, the fair values of derivatives and changes in the fair values of the underlying hedged items are reported in the balance sheet. Changes in the fair values of these derivatives and underlying hedged items generally offset and are recorded each period in sales, cost of goods sold or interest expense, consistent with the underlying hedged item. There were no transactions that ceased to qualify as a fair value hedge in 2001.

Cash Flow Hedges

Currencies. Alcoa is subject to exposure from fluctuations in foreign currencies. Foreign currency exchange contracts are used to hedge the variability in cash flows from the forecasted payment or receipt of currencies other than the functional currency. Alcoa's foreign currency contracts were principally used to purchase Australian dollars and Canadian dollars. The U.S. dollar notional amount of all foreign currency contracts was $1,409 and $2,342 as of December 31, 2001 and 2000, respectively.

Commodities. Alcoa may elect to sell forward a portion of its anticipated primary aluminum and alumina production. In addition, Alcoa anticipates the continued requirement to purchase aluminum and other commodities such as natural gas, fuel oil and electricity for its operations. Alcoa enters into futures and options contracts to reduce volatility in the price of these commodities.

Interest Rates. From time to time, Alcoa enters into pay floating, receive fixed interest rate swaps to hedge the interest rate risk exposure of forecasted interest payments on a portion of its outstanding variable rate debt. As of December 31, 2001, there were no outstanding contracts of this nature.

For these cash flow hedge transactions, the fair values of the derivatives are recorded on the balance sheet. The effective portions of the changes in the fair values of these derivatives are recorded in other comprehensive income and are reclassified to sales, cost of goods sold or interest expense in the period in which earnings are impacted by the hedged items or in the period that the transaction no longer qualifies as a cash flow hedge. There were no material transactions that ceased to qualify as a cash flow hedge in 2001. These contracts cover periods commensurate with known or expected exposures, generally within three years. Assuming market rates remain constant with the rates at December 31, 2001, $71 of the $104 loss included in other comprehensive income is expected to be recognized in earnings over the next 12 months.

Other

Alcoa also enters into foreign currency contracts that do not qualify as a fair value, cash flow or net investment hedge. These contracts hedge the variability in cash flows from the payment or receipt of currencies other than the functional currency for certain foreign currency denominated assets and liabilities or for certain forecasted transactions that do not qualify as hedged items. These contracts were not material at December 31, 2001 or 2000.

Alcoa is exposed to credit loss in the event of nonperformance by counterparties on the above instruments, as well as credit or performance risk with respect to its hedged customers' commitments. Although nonperformance is possible, Alcoa does not anticipate nonperformance by any of these parties. Futures and options contracts are with creditworthy counterparties and are further supported by cash, treasury bills or irrevocable letters of credit issued by carefully chosen banks. In addition, various master netting arrangements are in place with counterparties to facilitate settlement of gains and losses on these contracts.

For further information on Alcoa's hedging and derivatives activities, see Note A.

T. Environmental Matters

Alcoa participates in environmental assessments and cleanups at a number of locations. These include approximately 31 owned or operating facilities and adjoining properties, approximately 28 previously owned or operated facilities and adjoining properties and approximately 91 Superfund and other waste sites. A liability is recorded for environmental remediation costs or damages when a cleanup program becomes probable and the costs or damages can be reasonably estimated. See Note A for additional information.

As assessments and cleanups proceed, the liability is adjusted based on progress in determining the extent of remedial actions and related costs and damages. The liability can change substantially due to factors such as the nature and extent of contamination, changes in remedial requirements and technological changes. Therefore, it is not possible to determine the outcomes or to estimate with any degree of accuracy the potential costs for certain of these matters. For example, there are issues related to the Massena, New York and Point Comfort, Texas sites where investigations are ongoing and where natural resource damage or off-site contaminated sediments have been alleged. The following discussion provides additional details regarding the current status of certain sites.

Massena. Since 1989, Alcoa has been conducting investigations and studies of the Grasse River, adjacent to Alcoa's Massena, New York plant site, under order from the U.S. Environmental Protection Agency (EPA) issued under the Comprehensive Environmental Response, Compensation and Liability Act, also known as Superfund. Sediments and fish in the river contain varying levels of polychlorinated biphenyl (PCB).

In the fourth quarter of 1999, Alcoa submitted an Analysis of Alternatives Report to the EPA. This report identified potential courses of remedial action related to the PCB contamination of the river. The EPA indicated to Alcoa that it believed additional remedial alternatives needed to be included in the Analysis of Alternatives Report. During 2000 and 2001, Alcoa completed certain studies and investigations on the river, including pilot tests of sediment-capping techniques and other remediation technologies. In February 2002, Alcoa submitted a revised draft Analysis of Alternatives Report based on these additional evaluations and included additional remedial alternatives required by the EPA. The additional alternatives required by the EPA involve removal of more sediment than was included in the 1999 Analysis of Alternatives Report. The range of costs associated with the remedial alternatives evaluated in the 2002 report is between $2 and $525. Alcoa believes that several of those alternatives, involving the largest amounts of sediment removal, should not be selected for the Grasse River remedy. Alcoa believes the alternatives that should be selected are those ranging from monitored natural recovery ($2) to a combination of moderate dredging and capping ($90). A reserve of $2 has been recorded for any probable losses, as no one of the alternatives is more likely to be selected than any other.

Portions of the St. Lawrence River system adjacent to the former Reynolds plant were also contaminated with PCB, and during 2001, Alcoa substantially completed a dredging remedy for the St. Lawrence River. Further analysis of the condition of the sediments is being performed. Any required additional dredging or capping of residual contamination is likely to be completed during the 2003 construction season. The most probable cost of any such additional remediation is fully reserved.

Alcoa is aware of natural resource damage claims that may be asserted by certain federal, state and tribal natural resource trustees at these locations.

Point Comfort/Lavaca Bay. Since 1990, Alcoa has undertaken investigations and evaluations concerning alleged releases of mercury from its Point Comfort, Texas facility into the adjacent Lavaca Bay pursuant to a Superfund order from the EPA. In March 1994, the EPA listed the "Alcoa (Point Comfort)/Lavaca Bay Site" on the National Priorities List. In December 2001, the EPA issued its Record of Decision (ROD) for the site. That ROD selected the final remedial approach for the site, which is fully reserved. The company is negotiating a Consent Order with the EPA under which it will undertake to implement the remedy. The company and certain federal and state natural resource trustees, who previously served Alcoa with notice of their intent to file suit to recover damages for alleged loss or injury of natural resources in Lavaca Bay, have cooperatively identified restoration alternatives and approaches for Lavaca Bay. The cost of such restoration is reserved and Alcoa anticipates negotiating a Consent Decree with the trustees under which it will implement the restoration.

Troutdale. In 1994, the EPA added Reynolds' Troutdale, Oregon primary aluminum production plant to the National Priorities List of Superfund sites. Alcoa is cooperating with the EPA and, under a September 1995 Consent Order, is working with the EPA to identify cleanup solutions for the site. Following curtailment of active production operations and based on further evaluation of remedial options, the company has determined the most probable cost of cleanup. This amount has been fully reserved. The company anticipates a final ROD to be issued by the EPA in 2002.

Sherwin. In connection with the sale of the Sherwin alumina refinery in Texas, which was required to be divested as part of the Reynolds merger in 2000 (see Note C), Alcoa has agreed to retain responsibility for the remediation of certain properties, including former waste disposal areas, and a share of the ultimate closure costs of other active waste disposal areas. The most probable cost of such remediation has been evaluated and is fully reserved.

Based on the above, it is possible that Alcoa's results of operations, in a particular period, could be materially affected by matters relating to these sites. However, based on facts currently available, management believes that adequate reserves have been provided and that the disposition of these matters will not have a materially adverse effect on the financial position or liquidity of the company.

Alcoa's remediation reserve balance at the end of 2001 and 2000 was $431 and $447 (of which $74 and $78 were classified as a current liability), respectively, and reflects the most probable costs to remediate identified environmental conditions for which costs can be reasonably estimated. Of the 2001 reserve balance, approximately 8% relates to the Massena, New York plant sites, 6% relates to the Troutdale, Oregon plant site, and 23% relates to the Sherwin, Texas site. Remediation costs charged to the reserve were $72 in 2001, $77 in 2000 and $47 in 1999. They include expenditures currently mandated, as well as those not required by any regulatory authority or third party. In 2001, the reserve balance was increased by $56 primarily as a result of acquisitions and the shutdown of the company's magnesium plant in Addy, Washington. In 2000, the reserve balance was increased by $350 as a result of acquisitions.

Included in annual operating expenses are the recurring costs of managing hazardous substances and environmental programs. These costs are estimated to be about 2% of cost of goods sold.

Supplemental Financial Information

Quarterly Data (unaudited)

(dollars in millions, except per-share amounts)

2001	First	Second	Third	Fourth	Year
Sales	$6,176	$5,991	$5,511	$5,181	$22,859
Income (loss) from operations	500	339	391	(114)	1,116
Net income (loss)*	404	307	339	(142)†	908
Earnings per share:					
Basic	0.47	0.36	0.40	(0.17)	1.06
Diluted	0.46	0.35	0.39	(0.17)	1.05

* After special charges of $114, or 13 cents per share, in the second quarter and $241, or 28 cents per share, in the fourth quarter (See Note B)

† The 2001 fourth quarter includes an after-tax credit of $22, or three cents per share, related to changes in the LIFO index.

2000	First	Second	Third	Fourth	Year
Sales	$4,509	$5,569	$6,298	$6,560	$22,936
Income from operations	457	462	459	492	1,870
Net income	347	377	368	392*	1,484
Earnings per share:					
Basic	.47	.47	.42	.45	1.82
Diluted	.47	.47	.42	.45	1.80

* The 2000 fourth quarter includes an after-tax credit of $18, or two cents per share, related to changes in the LIFO index and LIFO liquidations.

Number of Employees (unaudited)

	2001	2000	1999
Other Americas	38,700	46,500	45,100
U.S.	56,500	61,600	38,400
Europe	27,700	27,400	18,800
Pacific	6,100	6,500	5,400
	129,000	142,000	107,700