DELL INC
Form 10-Q
October 30, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended August 4, 2006
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .

Commission File Number: 0-17017

Dell Inc.
(Exact name of registrant as specified in its charter)

Delaware	**74-2487834**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Dell Way
Round Rock, Texas 78682
(Address of Principal Executive Offices) (Zip Code)

(512) 338-4400
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes o No þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check One)
Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of the close of business on October 19, 2007, 2,235,866,516 shares of common stock, par value $.01 per share, were outstanding.

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Certification of Chairman and CEO Pursuant to Section 302
Certification of Vice Chairman and CFO Pursuant to Section 302
Certifications Pursuant to Section 906

Special Note

The Audit Committee of our Board of Directors recently completed an independent investigation into certain accounting and financial reporting matters. As a result of issues identified in that investigation, as well as issues identified in additional reviews and procedures conducted by management, the Audit Committee, in consultation with management and PricewaterhouseCoopers LLP, our independent registered public accounting firm, concluded on August 13, 2007 that our previously issued financial statements for Fiscal 2003, 2004, 2005, and 2006 (including the interim periods within those years), and the first quarter of Fiscal 2007, should no longer be relied upon because of certain accounting errors and irregularities in those financial statements. Accordingly, we have restated our previously issued financial statements for those periods. Restated financial information is presented in this report, as well as in our Annual Report on Form 10-K for Fiscal 2007. For a discussion of the investigation, the accounting errors and irregularities identified, and the adjustments made as a result of the restatement, see Note 2 of Notes to Condensed Consolidated Financial Statements included in Part I Item 1 Financial Statements.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DELL INC.

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(in millions)

	August 4, 2006 (unaudited)	February 3, 2006 As Restated
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,795	$ 7,054
Short-term investments	1,331	2,016
Accounts receivable, net	4,723	4,082
Financing receivables, net	1,459	1,366
Inventories	669	588
Other	2,606	2,688
Total current assets	17,583	17,794
Property, plant, and equipment, net	2,150	1,993
Investments	2,631	2,686
Long-term financing receivables, net	271	325
Other non-current assets	667	454
Total assets	$ 23,302	$ 23,252
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term borrowings	$ 55	$ 65
Accounts payable	10,330	9,868
Accrued and other	6,658	6,240
Total current liabilities	17,043	16,173
Long-term debt	600	625
Other non-current liabilities	2,619	2,407
Total liabilities	20,262	19,205
Commitments and contingencies (Note 9)		

Redeemable common stock and capital in excess of $.01 par value; 3 shares issued and outstanding (Note 12)		
Stockholders equity:		
Preferred stock and capital in excess of $.01 par value; shares issued and outstanding: none		
Common stock and capital in excess of $.01 par value; shares authorized: 7,000; shares issued: 2,828 and 2,818, respectively; shares outstanding: 2,238 and 2,330, respectively	9,857	9,503
Treasury stock at cost: 590 and 488 shares, respectively	(20,698)	(18,007)
Retained earnings	13,955	12,699
Accumulated other comprehensive loss	(144)	(101)
Other		(47)
Total stockholders equity	2,970	4,047
Total liabilities and equity	$ 23,302	$ 23,252

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DELL INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in millions, except per share amounts; unaudited)

	Three Months Ended		Six Months Ended	
	August 4, 2006	July 29, 2005 As Restated	August 4, 2006	July 29, 2005 As Restated
Net revenue	$ 14,211	$ 13,382	$ 28,531	$ 26,682
Cost of net revenue[1]	12,073	10,951	23,885	21,799
Gross margin	2,138	2,431	4,646	4,883
Operating expenses:				
Selling, general, and administrative[1]	1,469	1,196	2,883	2,402
Research, development, and engineering[1]	125	122	254	231
Total operating expenses	1,594	1,318	3,137	2,633
Operating income	544	1,113	1,509	2,250
Investment and other income, net	50	74	104	125
Income before income taxes	594	1,187	1,613	2,375
Income tax provision	114	205	357	485
Net income	$ 480	$ 982	$ 1,256	$ 1,890
Earnings per common share:				
Basic	$ 0.21	$ 0.41	$ 0.55	$ 0.78
Diluted	$ 0.21	$ 0.40	$ 0.55	$ 0.76
Weighted-average shares outstanding:				
Basic	2,264	2,418	2,280	2,437
Diluted	2,278	2,478	2,298	2,497

(1) Cost of revenue and operating expenses for the three and six-month periods ended August 4, 2006 include stock-based compensation expense pursuant to Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment.* See Note 6 of Notes to Condensed Consolidated Financial Statements for additional information.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DELL INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions, unaudited)

	Six Months Ended	
	August 4, 2006	July 29, 2005 As Restated
Cash flows from operating activities:		
Net income	$ 1,256	$ 1,890
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	225	186
Stock-based compensation	217	9
Excess tax benefits from stock-based compensation	(53)	
Tax benefits from employee stock plans		123
Effects of exchange rate changes on monetary assets and liabilities denominated in foreign currencies	19	(24)
Other	58	65
Changes in:		
Operating working capital	3	(338)
Non-current assets and liabilities	87	224
Net cash provided by operating activities	1,812	2,135
Cash flows from investing activities:		
Investments:		
Purchases	(5,917)	(2,280)
Maturities and sales	6,745	5,593
Capital expenditures	(386)	(347)
Acquisition of business, net of cash received	(97)	
Net cash provided by investing activities	345	2,966
Cash flows from financing activities:		
Repurchase of common stock	(2,691)	(3,800)
Issuance of common stock under benefit plans	188	643
Excess tax benefits from stock-based compensation	53	
Other	(20)	(30)
Net cash used in financing activities	(2,470)	(3,187)
Effect of exchange rate changes on cash and cash equivalents	54	(49)
Net (decrease) increase in cash and cash equivalents	(259)	1,865
Cash and cash equivalents at beginning of period	7,054	4,479

Cash and cash equivalents at end of period	$ 6,795	$ 6,344

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1 Basis of Presentation

Basis of Presentation The accompanying condensed consolidated financial statements of Dell Inc. (Dell) should be read in conjunction with the consolidated financial statements and accompanying notes filed with the U.S. Securities and Exchange Commission (SEC) in Dell s Annual Report on Form 10-K for the fiscal year ended February 3, 2006. The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments of a normal recurring nature, as well as all adjustments discussed in Note 2, Audit Committee Independent Investigation and Restatement, considered necessary to fairly state the financial position of Dell and its consolidated subsidiaries at August 4, 2006 and February 3, 2006; the results of its operations for the three and six month periods ended August 4, 2006 and July 29, 2005; and its cash flows for the six month periods ended August 4, 2006 and July 29, 2005.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in Dell s condensed consolidated financial statements and the accompanying notes. Actual results could differ materially from those estimates.

Dell is currently a partner in Dell Financial Services L.P. (DFS), a joint venture with CIT Group, Inc. (CIT). The joint venture allows Dell to provide its customers with various financing alternatives. Dell consolidates DFS financial results in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46R (FIN 46R) as Dell is the primary beneficiary. See Note 7 of Notes to Condensed Consolidated Financial Statements.

Acquisitions On May 8, 2006, Dell acquired Alienware Corporation (Alienware). Consequently, Alienware s financial position, results of operations, and cash flows subsequent to acquisition are included in the accompanying condensed consolidated financial statements. Pro forma effects of the acquisition are not material.

Stock-Based Compensation Effective February 4, 2006, Dell adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)) using the modified prospective transition method which does not require revising the presentation in prior periods for stock-based compensation. Under this transition method, stock-based compensation expense for the second quarter and first six-month period of Fiscal 2007 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested at, February 4, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, *Accounting for Stock-Based Compensation* (SFAS 123). Stock-based compensation expense for all stock-based compensation awards granted after February 3, 2006 is based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). Dell recognizes this compensation expense net of an estimated forfeiture rate over the requisite service period of the award, which is generally the vesting term of five years for stock options and five-to-seven years for restricted stock awards. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC s interpretation of SFAS 123(R) and the valuation of share-based payments for public companies. Dell has applied the provisions of SAB 107 in its adoption of SFAS 123(R). See Note 6 of Notes to Condensed Consolidated Financial Statements for further discussion on stock-based compensation.

Prior to the adoption of SFAS 123(R), Dell measured compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25,

Accounting for Stock Issued to Employees (APB 25). Dell applied the disclosure provisions of SFAS 123 such that the fair value of employee stock-based compensation was disclosed in the notes to its

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

financial statements. Under APB 25, when the exercise price of Dell s employee stock options equaled the market price of the underlying stock at the date of the grant, no compensation expense was recognized.

Recently Issued Accounting Pronouncements In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Instruments* (SFAS 155), which is an amendment of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125* (SFAS 140). SFAS 155 allows Dell to elect to account for financial instruments with embedded derivatives as a whole on a fair value basis, instead of bifurcating the derivative from the host financial instrument. This statement also requires Dell to evaluate its interest in securitized financial assets to identify any freestanding derivatives and embedded derivatives, and clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS 155 is effective for all financial instruments acquired, issued, or subject to a remeasurement event after the beginning of Dell s Fiscal 2008. Dell determined that its retained interest in securitized assets contains embedded derivatives and elected to account for the entire asset on a fair value basis. The fair value basis did not have a material effect on Dell s results of operations, financial position, or cash flows.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140* (SFAS 156). SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in specific situations. Additionally, the servicing asset or servicing liability is initially measured at fair value; however, an entity may elect the amortization method or fair value method for subsequent reporting periods. SFAS 156 is effective beginning Dell s Fiscal 2008. Adoption of SFAS 156 did not have a material effect on Dell s results of operations, financial position, or cash flows.

In June 2006, the Emerging Issues Task Force reached a consensus on Issue No. 06-3, *Disclosure Requirements for Taxes Assessed by a Governmental Authority on Revenue-Producing Transactions* (EITF 06-3). The consensus allows an entity to choose between two acceptable alternatives based on their accounting policies for transactions in which the entity collects taxes on behalf of a governmental authority, such as sales taxes. Under the gross method, taxes collected are accounted for as a component of revenue with an offsetting expense. Conversely, the net method excludes such taxes from revenue. Companies are required to disclose the method selected pursuant to APB Opinion No. 22, *Disclosure of Accounting Policies*. If such taxes are reported gross and are significant, companies are required to disclose the amount of those taxes. The guidance should be applied to financial reports through retrospective application for all periods presented, if amounts are significant, for interim and annual reporting periods beginning after December 15, 2006, which is Dell s Fiscal 2008. Dell records revenue net of such taxes.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No 109* (FIN 48). FIN 48 clarifies the accounting and reporting for uncertainties in income tax law. This Interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation, and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. Dell adopted this Interpretation in the first quarter of Fiscal 2008, and this adoption resulted in a decrease to stockholders equity of approximately $62 million. In addition, consistent with the provisions of FIN 48, Dell changed the classification of $1.1 billion of income tax liabilities from current to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 addresses the process of quantifying financial statement misstatements; however, it does not

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

address how to assess materiality in interim financial statements. SAB 108 establishes the dual approach for the evaluation of the impact of financial statement misstatements. SAB 108 was effective for Dell s Fiscal 2007. There was no impact on Dell s results of operations, financial position, or cash flows due to the adoption of SAB 108. However, this guidance was considered in the determination by Dell to restate its previously issued financial statements as discussed in Note 2 of Notes to Condensed Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for assets and liabilities measured at fair value. SFAS 157 applies to existing accounting pronouncements that require fair value measurements; it does not require any new fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by Dell beginning in the first quarter of Fiscal 2009. Management is currently evaluating the impact that SFAS 157 may have on Dell s results of operations, financial position, and cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159), which provides companies with an option to report selected financial assets and liabilities at fair value with the changes in fair value recognized in earnings at each subsequent reporting date. SFAS 159 provides an opportunity to mitigate potential volatility in earnings caused by measuring related assets and liabilities differently, and it may reduce the need for applying complex hedge accounting provisions. If elected, SFAS 159 is effective for fiscal years beginning after November 15, 2007, which is Dell s Fiscal 2009. Management is currently evaluating the impact that this statement may have on Dell s results of operations and financial position, and has yet to make a decision on the elective adoption of SFAS 159.

Reclassifications To maintain comparability among the periods presented, Dell has revised the presentation of certain prior period amounts reported within the Notes to Condensed Consolidated Financial Statements. For further discussion regarding the presentation of service obligations honored, see Note 8 of Notes to Condensed Consolidated Financial Statements.

NOTE 2 Audit Committee Independent Investigation and Restatement

Background and Scope of the Investigation

In August 2005, the Division of Enforcement of the SEC initiated an inquiry into certain of Dell s accounting and financial reporting matters and requested that Dell provide certain documents. Over the course of several months, Dell produced documents and provided information in response to the SEC s initial request and subsequent requests.

In June 2006, the SEC sent Dell an additional request for documents and information that appeared to expand the scope of the inquiry, with respect to both issues and periods. As documents and information were collected in response to this additional request, Dell s management was made aware of information that raised significant accounting and financial reporting concerns, including whether accruals, reserves, and other balance sheet items had been recorded and reported properly. After evaluating this information and in consultation with PricewaterhouseCoopers LLP, Dell s independent registered public accounting firm, management determined that the identified issues warranted an independent investigation and recommended such to the Audit Committee of Dell s Board of Directors.

On August 16, 2006, the Audit Committee, acting on management s recommendation, approved the initiation of an independent investigation. The Audit Committee engaged Willkie Farr & Gallagher LLP (Willkie Farr) to lead the investigation as the independent legal counsel to the Audit Committee. Willkie Farr in turn engaged KPMG LLP (KPMG) to serve as its independent forensic accountants.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The scope of the investigation was determined by Willkie Farr, in consultation with the Audit Committee and KPMG. The investigation involved a program of forensic analysis and inquiry directed to aspects of Dell s accounting and financial reporting practices throughout the world, and evaluated aspects of its historical accounting and financial reporting practices since Fiscal 2002 and, with respect to certain issues, prior fiscal years.

Summary of Investigation Findings

The investigation raised questions relating to numerous accounting issues, most of which involved adjustments to various reserve and accrued liability accounts, and identified evidence that certain adjustments appear to have been motivated by the objective of attaining financial targets. According to the investigation, these activities typically occurred in the days immediately following the end of a quarter, when the accounting books were being closed and the results of the quarter were being compiled. The investigation found evidence that, in that timeframe, account balances were reviewed, sometimes at the request or with the knowledge of senior executives, with the goal of seeking adjustments so that quarterly performance objectives could be met. The investigation concluded that a number of these adjustments were improper, including the creation and release of accruals and reserves that appear to have been made for the purpose of enhancing internal performance measures or reported results, as well as the transfer of excess accruals from one liability account to another and the use of the excess balances to offset unrelated expenses in later periods. The investigation found that sometimes business unit personnel did not provide complete information to corporate headquarters and, in a number of instances, purposefully incorrect or incomplete information about these activities was provided to internal or external auditors.

The investigation identified evidence that accounting adjustments were viewed at times as an acceptable device to compensate for earnings shortfalls that could not be closed through operational means. Often, these adjustments ranged from several hundred thousand to several million dollars, in the context of a company with annual revenues ranging from $35.3 billion to $55.8 billion and annual net income ranging from $2.0 billion to $3.6 billion for the periods in question. The errors and irregularities identified in the course of the investigation revealed deficiencies in Dell s accounting and financial control environment, some of which were determined to be material weaknesses, that require corrective and remedial actions. For a description of the control deficiencies identified by management as a result of the investigation and Dell s internal reviews described below, as well as management s plan to remediate those deficiencies, see Part I Item 4 Controls and Procedures.

Other Company Identified Adjustments

Concurrently with the investigation, Dell also conducted extensive internal reviews for the purpose of the preparation and certification of Dell s Fiscal 2007 financial statements and its assessment of internal controls over financial reporting. Dell s procedures included expanded account reviews and expanded balance sheet reconciliations to ensure all accounts were fully reconciled, supported, and appropriately documented. Dell also implemented improvements to its quarterly and annual accounting close process to provide for more complete review of the various business unit financial results.

Restatement Adjustments

As a result of the issues identified in the Audit Committee independent investigation, as well as issues identified in additional reviews and procedures conducted by management, the Audit Committee, in consultation with management

and PricewaterhouseCoopers LLP, concluded on August 13, 2007 that Dell s previously issued financial statements for Fiscal 2003, 2004, 2005, and 2006 (including the interim periods within those years), and the first quarter of Fiscal 2007, should no longer be relied upon because of

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

certain accounting errors and irregularities in those financial statements. Accordingly, Dell has restated its previously issued financial statements for those periods. Restated financial information is presented in this report, as well as in Dell s Annual Report on Form 10-K for Fiscal 2007.

The nature of the restatement adjustments and the impact of the adjustments for the three-month period ended July 29, 2005 are shown in the following table:

	Three Month Period Ended July 29, 2005						
		Adjustments					
	As Reported	Revenue recognition: Software sales	Revenue recognition: Other	Warranty liabilities	Other reserves and accruals	Provision for income tax[a]	As Restated
	(in millions, except per share data)						
Net revenue	$ 13,428	$ (67)	$ 21	$	$	$	$ 13,382
Cost of net revenue	10,929	(64)	32	51	3		10,951
Gross margin	2,499	(3)	(11)	(51)	(3)		2,431
Operating expenses:							
Selling, general, and administrative	1,204				(8)		1,196
Research, development, and engineering	122						122
Total operating expenses	1,326				(8)		1,318
Operating income	1,173	(3)	(11)	(51)	5		1,113
Investment and other income, net	61		8	(1)	6		74
Income before income taxes	1,234	(3)	(3)	(52)	11		1,187
Income tax provision	214					(9)	205
Net income	$ 1,020						$ 982
Earnings per common share:							
Basic	$ 0.42						$ 0.41
Diluted	$ 0.41						$ 0.40

Weighted-average shares outstanding:		
Basic	2,418	2,418
Diluted	2,478	2,478

(a) Primarily represents the aggregate tax impact of the adjustments.

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DELL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

The nature of the restatement adjustments and the impact of the adjustments for the six-month period ended July 29, 2005 are shown in the following table:

	Six Month Period Ended July 29, 2005						
		Adjustments					
		Revenue recognition					
	As Reported	Software sales	Other	Warranty liabilities	Other reserves and accruals	Provision for income tax[a]	As Restated
	(in millions, except per share data)						
Net revenue	$ 26,814	$ (121)	$ (11)	$	$	$	$ 26,682
Cost of net revenue	21,824	(115)	18	65	7		21,799
Gross margin	4,990	(6)	(29)	(65)	(7)		4,883
Operating expenses:							
Selling, general, and administrative	2,411		2		(11)		2,402
Research, development, and engineering	232			(1)			231
Total operating expenses	2,643		2	(1)	(11)		2,633
Operating income	2,347	(6)	(31)	(64)	4		2,250
Investment and other income, net	120		8	(2)	(1)		125
Income before income taxes	2,467	(6)	(23)	(66)	3		2,375
Income tax provision	513					(28)	485
Net income	$ 1,954						$ 1,890
Earnings per common share:							
Basic	$ 0.80						$ 0.78
Diluted	$ 0.78						$ 0.76
Weighted-average shares outstanding:							
Basic	2,437						2,437
Diluted	2,497						2,497

(a) Primarily represents the aggregate tax impact of the adjustments.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

Revenue Recognition Adjustments

Software Sales The largest revenue recognition adjustment relates to correcting the timing and amount of revenue recognized on the sale of certain software products. Dell is a reseller of a broad array of third-party developed software. Individually significant categories of software are analyzed for application of the appropriate accounting under American Institute of Certified Public Accountants (AICPA) Statement of Position No. 97-2, *Software Revenue Recognition* (SOP 97-2). However, the allocation of software sales revenue between the software license (recognized at point of sale) and post-contract support (deferred and recognized over time) for other high volume, lower dollar value software products has historically been assessed as a group and the post-contract support revenue was deferred based on an estimate of average Vendor Specific Objective Evidence (VSOE). During the course of its internal reviews, Dell determined that its application of SOP 97-2 for these high volume software products was not correct. Dell has determined that the most appropriate application of SOP 97-2 is to defer all of the revenue from these other software offerings and amortize the revenue over the post-contract support period as VSOE has not been appropriately established. Additionally, during the course of its reviews, Dell identified certain software offerings where it had previously recognized the gross amount of revenue from the sale but where it functions more as a selling agent as opposed to the principal in the sale to the customer. In those cases Dell should have recognized the revenue net of the related cost pursuant to EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal vs. Net as an Agent.*

Other The other revenue recognition adjustments include cases where Dell recognized revenue in the incorrect periods or recognized the incorrect amount of revenue on certain transactions, and cases where the allocation of revenue among the individual elements of the sale was not correct. The primary categories of other revenue recognition adjustments include the following:

SAB 104 Deferrals Instances were identified where Dell prematurely recognized revenue prior to finalization of the terms of sale with the customer, or prior to title and/or risk of loss having been passed to the customer. Sometimes these situations involved warehousing arrangements. Additionally, there were situations where revenue was incorrectly deferred to later periods despite title and/or risk of loss having passed to the end customer. Under SAB 104, there were also cases where the in-transit deferral calculation for the period end was not appropriately calculated or was based on incorrect assumptions.

Deferred Warranty Revenue Pursuant to FASB Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts,* Dell defers and amortizes the revenue from the sale of extended warranties and enhanced service level agreements over the service period of the associated agreement. In some instances Dell s accounting estimates of the agreement durations were not correct, resulting in revenue being recognized over a shorter time period than the actual contract durations. Additionally, an error was identified in the amount of deferred revenue recognized and amortized during the restatement period.

Customer Rebate Accruals Dell s U.S. Consumer segment and small business group historically offered various forms of rebates to stimulate sales, including mail-in rebates. The rebate redemption liability is estimated at the time of sale based on historical redemption rates for the various types of promotions. Dell has determined that this liability was overstated due to a number of factors, including failure to update redemption rates when appropriate, additional amounts accrued for expected customer satisfaction costs, and unsupported incremental accruals recorded in addition to the calculated redemption liability estimate.

Japan Services Transactions In late January 2007, a Japanese systems integrator with whom Dell s Japanese services division did business, filed for bankruptcy. The bankruptcy trustee publicly indicated that the systems integrator had engaged in fictitious transactions. Dell promptly commenced an internal

DELL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
(unaudited)

investigation led by Dell s Ethics Office to determine whether its Japanese business unit had engaged in any fictitious transactions with the systems integrator. Dell hired independent outside counsel who retained independent accountants to lead the investigation. The investigation determined that almost all of the transactions of the Japan services business involving the systems integrator likely were fabricated, as were certain additional smaller transactions involving two other Japanese systems integrators. The impact of the adjustments reduced net revenue and cost of revenue to eliminate the effect of the fictitious transactions.

Sales Reflected in Cost of Sales There were transactions identified involving the sale of certain computer component commodities and parts where the net proceeds were presented as a reduction of cost of sales rather than as revenue.

Warranty Liabilities

The issues related to Dell s warranty liabilities include situations where certain vendor reimbursement agreements were incorrectly accounted for as a reduction in the estimate of the outstanding warranty liabilities. There were also instances where warranty reserves in excess of the estimated warranty liability as calculated by the warranty liability estimation process were retained and not released to the income statement as appropriate. Additionally, certain adjustments in the warranty liability estimation process were identified where expected future costs or estimated failure rates were not accurate.

Other Reserves and Accruals

Many of the restatement adjustments relate to the estimates and reconciliation of various reserves and accrued liabilities, including employee benefits, accounts payable, litigation, sales commissions, payroll, employee bonuses, and supplier rebates. Dell extensively reviewed its accruals and underlying estimates, giving consideration to subsequent developments after the date of the financial statements, to assess whether any of the previously recorded amounts required adjustment. Dell conducted expanded account reviews and expanded balance sheet reconciliations to ensure that all accounts were fully reconciled, supported, and appropriately documented. As a result of this review, Dell determined that a number of its accruals required adjustment across various accounting periods. The largest of these adjustments are described in more detail below:

Employee Bonuses Certain employee bonuses were not accrued correctly, including the timing of the recording of the accrual for the employee bonuses. Additionally, in certain cases when excess accruals resulted from differences in the actual bonus payments, the excess accruals were not adjusted as appropriate.

Vendor Funding Arrangements In some instances vendor funding arrangements were not accounted for appropriately under EITF Issue No. 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor.* Certain amounts received from vendors were recorded as a reduction in operating expenses instead of being correctly recorded as a reduction of cost of goods sold. Additionally, certain amounts received were retained on the balance sheet and released in future periods despite the earnings process having been complete in the earlier period. Finally, there were instances where the benefit of certain vendor funding was recorded prior to the completion of the earnings process.

Unsubstantiated Accruals and Inadequately Reconciled Accounts In some instances accrual and reserve accounts lacked justification or supporting documentation. In certain cases these accounts were used to accumulate excess

amounts from other reserve and accrual accounts. However, these excess reserves were not released to the income statement in the appropriate reporting period or were released

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for other purposes. In some instances accounts had incorrect balances because they had not been properly reconciled or because reconciling items had not been adjusted timely.

The table below summarizes the effects of the restatement adjustments on the Consolidated Statement of Financial Position at February 3, 2006.

	February 3, 2006		
	As Reported	Adjustments (in millions)	As Restated
ASSETS			
Current assets:			
Cash and cash equivalents	$ 7,042	$ 12	$ 7,054
Short-term investments	2,016		2,016
Accounts receivable, net	4,089	(7)	4,082
Financing receivables, net	1,363	3	1,366
Inventories	576	12	588
Other	2,620	68	2,688
Total current assets	17,706	88	17,794
Property, plant, and equipment, net	2,005	(12)	1,993
Investments	2,691	(5)	2,686
Long-term financing receivables, net	325		325
Other non-current assets	382	72	454
Total assets	$ 23,109	$ 143	$ 23,252
LIABILITIES AND STOCKHOLDERS EQUITY			
Current liabilities:			
Short-term borrowings	$	$ 65	$ 65
Accounts payable	9,840	28	9,868
Accrued and other	6,087	153	6,240
Total current liabilities	15,927	246	16,173
Long-term debt	504	121	625
Other non-current liabilities	2,549	(142)	2,407
Total liabilities	18,980	225	19,205
Redeemable common stock and capital in excess of par value			

Stockholders equity:			
Common stock and capital in excess of par	9,540	(37)	9,503
Treasury stock	(18,007)		(18,007)
Retained earnings	12,746	(47)	12,699
Accumulated other comprehensive loss	(103)	2	(101)
Other	(47)		(47)
Total stockholders equity	4,129	(82)	4,047
Total liabilities and equity	$ 23,109	$ 143	$ 23,252

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Statement of Financial Position Adjustments

In addition to the income statement adjustments described above, certain Statement of Financial Position classification adjustments were also identified. These include (i) correcting the classification of advances under credit facilities by DFS from other current and non-current liabilities to short-term borrowings and long-term debt as appropriate; (ii) correcting the presentation of liabilities for estimated litigation settlements by presenting estimated insurance recoveries as a receivable from the insurance carriers rather than as a reduction of the estimated settlement liability; (iii) correcting an error in the calculation and recording of the tax benefit of employee stock options which had an offsetting impact on accrued and other liabilities and stockholders equity; (iv) adjusting the fair value of long-term debt, where the interest rate is hedged with interest rate swap agreements; and (v) adjusting deferred revenue to record professional and deployment services impacting accounts receivable and accrued and other liabilities. These balance sheet corrections in classification are included in the adjustments column above.

Statement of Cash Flows

The following table presents the major subtotals for Dell s Statement of Cash Flows and the related impact of the restatement adjustments discussed above for the six-month period ended July 29, 2005:

	Six Months Ended July 29, 2005	
	As Reported	As Restated
	(in millions)	
Net cash provided by (used in):		
Net income	$ 1,954	$ 1,890
Non-cash adjustments	386	359
Changes in working capital	(447)	(338)
Changes in noncurrent assets and liabilities	216	224
Operating activities	2,109	2,135
Investing activities	2,710	2,966
Financing activities	(3,173)	(3,187)
Effect of exchange rate changes on cash and cash equivalents[(a)]	(56)	(49)
Net increase in cash and cash equivalents	1,590	1,865
Cash and cash equivalents at beginning of period	4,747	4,479
Cash and cash equivalents at end of period	$ 6,337	$ 6,344

(a)

The cash flows have been revised to reflect a closer approximation of the weighted-average exchange rates during the reporting periods. For most periods, this revision reduced the previously reported effect of exchange rate changes on cash and cash equivalents and with an offsetting change in effects of exchange rate changes on monetary assets and liabilities denominated in foreign currencies and changes in operating working capital included in cash flows from operating activities.

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NOTE 3 Inventories

	August 4, 2006	February 3, 2006 As Restated
	(in millions)	
Inventories:		
Production materials	$ 374	$ 325
Work-in-process	61	43
Finished goods	234	220
Inventories	$ 669	$ 588

NOTE 4 Earnings Per Common Share

Basic earnings per share is based on the weighted-average effect of all common shares issued and outstanding, and is calculated by dividing net income by the weighted-average shares outstanding during the period. Diluted earnings per share is calculated by dividing net income by the weighted-average number of common shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming exercise or conversion of all potentially dilutive common shares outstanding. Dell excludes equity instruments from the calculation of diluted earnings per share if the effect of including such instruments is antidilutive. Accordingly, certain employee stock options have been excluded from the calculation of diluted earnings per share totaling 305 million and 74 million shares during the second quarter of Fiscal 2007 and Fiscal 2006, respectively, and 257 million and 73 million during the six month periods ended August 4, 2006 and July 29, 2005, respectively.

The following table sets forth the computation of basic and diluted earnings per share for the three and six month periods ended August 4, 2006 and July 29, 2005:

	Three Months Ended		Six Months Ended	
	August 4, 2006	July 29, 2005 As Restated	August 4, 2006	July 29, 2005 As Restated
	(in millions, except per share amounts)			
Numerator:				
Net income	$ 480	$ 982	$ 1,256	$ 1,890
Denominator:				

Weighted-average shares outstanding:				
Basic	2,264	2,418	2,280	2,437
Effect of dilutive options, restricted stock units, restricted stock, and other	14	60	18	60
Diluted	2,278	2,478	2,298	2,497
Earnings per common share:				
Basic	$ 0.21	$ 0.41	$ 0.55	$ 0.78
Diluted	$ 0.21	$ 0.40	$ 0.55	$ 0.76

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NOTE 5 Comprehensive Income

Dell s comprehensive income is comprised of net income, unrealized gains and losses on derivative financial instruments related to foreign currency hedging, unrealized gains and losses on marketable securities classified as available-for-sale, unrealized gains and losses related to the change in valuation of retained interests in securitized assets, and foreign currency translation adjustments.

The following table summarizes comprehensive income for the three and six month periods ended August 4, 2006 and July 29, 2005:

	Three Months Ended		Six Months Ended	
	August 4, 2006	July 29, 2005 As Restated	August 4, 2006	July 29, 2005 As Restated
	(in millions)			
Comprehensive income:				
Net income	$ 480	$ 982	$ 1,256	$ 1,890
Unrealized gains (losses) on foreign currency hedging instruments, net	64	92	(44)	99
Unrealized gains (losses) on marketable securities, net	16	(8)	1	(20)
Valuation of retained interests in securitized assets	4		6	
Foreign currency translation adjustments	(2)	(4)	(6)	(2)
Comprehensive income	$ 562	$ 1,062	$ 1,213	$ 1,967

NOTE 6 Benefit Plans

Description of the Plans

Employee Stock Purchase Plan Dell has a shareholder approved employee stock purchase plan (ESPP) that permits substantially all employees to purchase shares of Dell s common stock. Effective July 1, 2005, participating employees were permitted to purchase common stock through payroll deductions at the end of each three-month participation period at a purchase price equal to 85% of the fair market value of the common stock at the end of the participation period. Upon adoption of SFAS 123(R) in Fiscal 2007, Dell began recognizing compensation expense for the 15% discount received by the participating employees. Common stock reserved for future employee purchases under the plan aggregated 13 million shares at August 4, 2006 and 16 million shares at February 3, 2006. The weighted-average fair value of the purchase rights under the ESPP during the three and six month periods ended August 4, 2006 was $3.68 and $4.12, respectively.

Employee Stock Plans Dell has the following four employee stock plans (collectively referred to as the Stock Plans) under which options, restricted stock, and restricted stock units were outstanding at August 4, 2006:

The Dell Computer Corporation 1989 Stock Option Plan (the 1989 Option Plan)

The Dell Computer Corporation Incentive Plan (the 1994 Incentive Plan)

The Dell Computer Corporation 1998 Broad-Based Stock Option Plan (the 1998 Broad-Based Plan)

The Dell Computer Corporation 2002 Long-Term Incentive Plan (the 2002 Incentive Plan)

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The Stock Plans are administered by the Leadership Development and Compensation Committee of Dell s Board of Directors. The 1989 Option Plan, the 1994 Incentive Plan, and the 1998 Broad-Based Plan have been terminated (except for options previously granted under those plans that are still outstanding). Consequently, awards are currently only being granted under the 2002 Incentive Plan.

The 2002 Incentive Plan provides for the granting of stock-based incentive awards to Dell s employees, non-employee directors, and certain consultants and advisors to Dell. Awards may be incentive stock options within the meaning of Section 422 of the Internal Revenue Code, nonqualified stock options, restricted stock, or restricted stock units. There were approximately 262 million and 272 million shares of Dell s common stock available for future grants under the Stock Plans at August 4, 2006 and February 3, 2006, respectively. To satisfy stock option exercises, Dell has a policy of issuing new shares as opposed to repurchasing shares on the open market.

Stock Option Agreements The right to purchase shares pursuant to existing stock option agreements typically vests pro-rata at each option anniversary date over a five-year period. The options, which are granted with option exercise prices equal to the fair market value of Dell s common stock on the date of grant, generally expire within ten to twelve years from the date of grant. Dell has not issued any options to consultants or advisors to Dell since Fiscal 1999. In conjunction with the adoption of SFAS 123(R) in the first quarter of Fiscal 2007, Dell changed its method of attributing the value of stock-based compensation expense from an accelerated approach to a straight-line method. Compensation expense for all stock option awards granted on or prior to February 3, 2006 is recognized using an accelerated approach with the exception of stock options granted in Fiscal 2002 and Fiscal 2003, for which compensation expense is recognized using a straight-line method.

Restricted Stock Awards Awards of restricted stock may be either grants of restricted stock, restricted stock units, or performance-based stock units that are issued at no cost to the recipient. For restricted stock grants, at the date of grant, the recipient has all rights of a stockholder, subject to certain restrictions on transferability and a risk of forfeiture. Restricted stock grants typically vest over a five-to-seven-year period beginning on the date of grant. For restricted stock units, legal ownership of the shares is not transferred to the employee until the unit vests, which is generally over a five-year period. Dell also grants performance-based restricted stock units as a long-term incentive in which an award recipient receives shares contingent upon Dell achieving performance objectives and the employees continuing employment through the vesting period, which is generally over a five-year period. Compensation expense recorded in connection with these performance-based restricted stock units is based on Dell s best estimate of the number of shares that will eventually be issued upon achievement of the specified performance criteria and when it becomes probable that certain performance goals will be achieved. The cost of these awards is determined using the fair market value of Dell s common stock on the date of the grant. Compensation expense for restricted stock awards with a service condition is recognized on a straight-line basis over the vesting term. Compensation expense for performance-based restricted stock awards is recognized on an accelerated multiple-award approach based on the most probable outcome of the performance condition. In accordance with SFAS 123(R), deferred compensation related to restricted stock awards issued prior to Fiscal 2007, which was previously classified as other in stockholders equity, was classified as capital in excess of par value upon adoption.

Temporary Suspension of Option Exercises, Vesting of Restricted Stock Units, and ESPP Purchases As a result of Dell s inability to timely file its Annual Report on Form 10-K for Fiscal 2007, Dell suspended the exercise of employee stock options, the vesting of restricted stock units, and the purchase of shares under the ESPP. Dell expects

to resume the exercise of employee stock options by employees, the vesting of restricted stock units, and the purchase of shares under the ESPP when it is again current in its reporting obligations under the Securities Exchange Act of 1934.

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Dell agreed to pay cash to certain current and former employees who held in-the-money stock options (options that have an exercise price less than the current stock market price) that expired during the period of unexercisability. Within 45 days after Dell files its Annual Report on Form 10-K for Fiscal 2007, Dell will make payments relating to in-the-money stock options that expired in the second and third quarters of Fiscal 2008, which are expected to total approximately $113 million. Dell will not continue to pay cash for expired in-the-money stock options once the options again become exercisable.

General Information

Stock Option Activity The following table summarizes stock option activity for the Stock Plans during the six-month period ended August 4, 2006:

	Number of Options (in millions)	Weighted-Average Exercise Price (per share)	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Options outstanding February 3, 2006	343	$ 31.86		
Granted	5	28.00		
Exercised	(9)	12.62		
Forfeited	(2)	25.83		
Cancelled/expired	(9)	37.18		
Options outstanding August 4, 2006	328	$ 32.22		
Vested and expected to vest (net of estimated forfeitures) August 4, 2006[(a)]	326	$ 31.52	5.6	$ 191
Exercisable August 4, 2006[(a)]	290	$ 33.00	5.5	$ 121

(a) For options vested and expected to vest and options exercisable, the aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between Dell s closing stock price on August 4, 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had the holders exercised their options on August 4, 2006. The intrinsic value changes based on changes in the fair market value of Dell s common stock.

Other information pertaining to stock options for the three and six month periods ended August 4, 2006 is as follows:

	Three Months Ended August 4, 2006	Six Months Ended August 4, 2006
	(in millions, except per option data)	
Weighted-average grant date fair value of stock options granted per option	$ 6.46	$ 7.24
Total intrinsic value of options exercised[(a)]	$ 61	$ 134

(a) The total intrinsic value of options exercised represents the total pre-tax intrinsic value (the difference between the stock price at exercise and the exercise price, multiplied by the number of options exercised) that was received by the option holders who exercised their options during the three and six month periods ended August 4, 2006.

At August 4, 2006, $227 million of total unrecognized stock-based compensation expense, net of estimated forfeitures, related to stock options is expected to be recognized over a weighted-average period of approximately 1.3 years.

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Non-vested Restricted Stock Activity Non-vested restricted stock awards at August 4, 2006 and activities during the six-month period ended August 4, 2006 were as follows:

		Number of Shares (in millions)	Weighted-Average Grant Date Fair Value (per share)
Non-vested restricted stock	February 3, 2006	2	$ 34.66
Granted		18	29.12
Vested		(1)	27.75
Forfeited		(1)	30.21
Non-vested restricted stock	August 4, 2006	18	$ 29.66

For the three and six month periods ended August 4, 2006, the weighted-average fair value of restricted stock awards granted during the period was $25.91 and $29.12 per share, respectively. At August 4, 2006, $422 million of unrecognized stock-based compensation expense, net of estimated forfeitures, related to non-vested restricted stock awards cost is expected to be recognized over a weighted-average period of approximately 2.6 years.

Expense Information under SFAS 123(R)

For the three and six month periods ended August 4, 2006, stock-based compensation expense, net of income taxes, was allocated as follows:

	Three Months Ended August 4, 2006	Six Months Ended August 4, 2006
	(in millions)	
Stock-based compensation expense:		
Cost of net revenue	$ 18	$ 36
Operating expenses	86	181
Stock-based compensation expense before taxes	104	217
Income tax benefit	(31)	(65)
Stock-based compensation expense	$ 73	$ 152

Prior to the adoption of SFAS 123(R), net income included compensation expense related to restricted stock awards but did not include stock-based compensation expense for employee stock options or the purchase discount under Dell s ESPP. Total stock-based compensation expense was $104 million and $217 million for the three and six month periods ended August 4, 2006, respectively. As a result of adopting SFAS 123(R), income before income taxes and net income were lower by $75 million and $53 million, respectively, for the three-month period ended August 4, 2006, and $165 million and $116 million, respectively, for the six-month period ended August 4, 2006, than if Dell had not adopted SFAS 123(R). The impact on both basic and diluted earnings per share for the three- and six-month periods ended August 4, 2006 was $.02 and $.05 per share, respectively. The remaining $29 million and $52 million of pre-tax stock compensation expense for the three and six month periods ended August 4, 2006, respectively, is associated with restricted stock awards that, consistent with APB 25, are expensed over the associated vesting period. Stock-based compensation expense recognized for the first three and six month periods ended August 4, 2006 is based on awards expected to vest, reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if

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actual forfeitures differ from those estimates. In the pro forma information required under SFAS 123, forfeitures were accounted for as they occurred.

Prior to the adoption of SFAS 123(R), tax benefits resulting from tax deductions in excess of the stock-based compensation expense recognized for those options were classified as operating cash flows. These excess tax benefits are now classified as financing cash flows with an offsetting amount classified as a use of operating cash flows. This amount was $53 million for the six-month period ended August 4, 2006. In addition, there was no material stock-based compensation expense capitalized as part of the cost of an asset.

Pro Forma Information under SFAS 123 for Periods Prior to Fiscal 2007

Prior to the adoption of SFAS 123(R), Dell measured compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by APB 25. Under APB 25, when the exercise price of Dell s employee stock options equaled or exceeded the market price of the underlying stock on the date of the grant, no compensation expense was recognized. Dell applied the disclosure provisions of SFAS 123 as amended by SFAS 148, as if the fair-value-based method had been applied in measuring compensation expense.

The following table illustrates the effect on net income and earnings per share for the three and six month periods ended July 29, 2005, as if Dell had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation:

	July 29, 2005	
	Three Months Ended As Restated	Six Months Ended As Restated
	(in millions, except per share data)	
Net income	$ 982	$ 1,890
Deduct: Total stock-based employee compensation determined under fair value method for all awards, net of related tax effects	(201)	(414)
Net income pro forma	$ 781	$ 1,476
Earnings per common share:		
Basic as restated	$ 0.41	$ 0.78
Basic pro forma	$ 0.32	$ 0.61
Diluted as restated	$ 0.40	$ 0.76

Diluted pro forma	$	0.32	$	0.59

On January 5, 2006, Dell s Board of Directors approved the acceleration of vesting of certain unvested and out-of-the-money stock options with exercise prices equal to or greater than $30.75 per share previously awarded under equity compensation plans. Options to purchase approximately 101 million shares of common stock, or 29% of the outstanding unvested options, were subject to the acceleration. The weighted-average exercise price of the options that were accelerated was $36.37. The purpose of the acceleration was to enable Dell to reduce future compensation expense associated with these options upon the adoption of SFAS 123(R).

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Valuation Information

SFAS 123(R) requires the use of a valuation model to calculate the fair value of stock option awards. Dell has elected to use the Black-Scholes option pricing model, which incorporates various assumptions, including volatility, expected term, and risk-free interest rates. The volatility is based on a blend of implied and historical volatility of Dell s common stock over the most recent period commensurate with the estimated expected term of Dell s stock options. Dell uses this blend of implied and historical volatility, as well as other economic data, because management believes such volatility is more representative of prospective trends. The expected term of an award is based on historical experience and on the terms and conditions of the stock awards granted to employees. The dividend yield of zero is based on the fact that Dell has never paid cash dividends and has no present intention to pay cash dividends.

The weighted-average fair value of stock options and purchase rights under the employee stock purchase plan was determined based on the Black-Scholes option pricing model weighted for all grants during the period, utilizing the assumptions in the following table:

	Three Months Ended		Six Months Ended	
	August 4, 2006	July 29, 2005	August 4, 2006	July 29, 2005
Expected term:				
Stock options	3.2 years	3.8 years	3.2 years	3.8 years
Employee stock purchase plan	3 months	3 months	3 months	3 months
Risk-free interest rate (U.S. Government Treasury Note)	5.0%	3.8%	4.8%	3.9%
Volatility	27%	24%	27%	24%
Dividends	0%	0%	0%	0%

NOTE 7 Financial Services

Joint Venture Agreement

Dell offers various customer financial services for its business and consumer customers in the U.S. through DFS, a joint venture with CIT. Loan and lease financing through DFS is one of many sources of financing that Dell s customers may select. Dell recognized revenue from the sale of products financed through DFS of $1.5 billion and $1.4 billion during the three month periods ended August 4, 2006 and July 29, 2005, respectively, and $3.0 billion for both six month periods ended August 4, 2006 and July 29, 2005.

On September 8, 2004, Dell and CIT executed an agreement that extended the term of the joint venture to January 29, 2010, and modified certain terms of the relationship. In accordance with the extension agreement, net income and losses generated by DFS are currently allocated 70% to Dell and 30% to CIT. At August 4, 2006 and February 3, 2006, CIT s equity ownership in the net assets of DFS was $21 million and $14 million, respectively, which is recorded as minority interest and included in other non-current liabilities.

The extension agreement provides Dell with the option to purchase CIT s 30% interest in DFS in February 2008, for a purchase price ranging from approximately $100 million to $345 million. Dell currently expects that the purchase price will likely be towards the upper end of that range. If Dell does not exercise this purchase option, Dell is obligated to purchase CIT s 30% interest upon the occurrence of certain termination events, or upon the expiration of the joint venture on January 29, 2010.

Dell is dependent upon DFS to facilitate financing for a significant number of customers who elect to finance products sold by Dell. Dell also purchases loan and lease receivables facilitated by DFS on substantially the same terms and conditions as CIT. Dell s purchase of these assets allows Dell to retain a

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greater portion of the assets future earnings. During the three and six month periods ended August 4, 2006, Dell funded approximately 35% of these financing transactions. The percentage of transactions that Dell will purchase under the extension agreement is expected to be approximately 50% in Fiscal 2008.

DFS is a full service financial services entity; key activities include the origination, collection, and servicing of financing receivables related to the purchase of Dell products. While DFS services CIT funded receivables, Dell s obligation related to the performance of these receivables is limited to the cash funded reserves established at the time of funding.

Financing Receivables

The following table summarizes the components of Dell s financing receivables, net of the allowance for estimated uncollectible amounts:

	August 4, 2006	February 3, 2006 As Restated
	(in millions)	
Financing receivables, net:		
Customer receivables:		
Revolving loans, net	$ 769	$ 1,025
Leases and loans, net	567	302
Customer receivables, net	1,336	1,327
Residual interests	291	274
Retained interest	103	90
Financing receivables, net	$ 1,730	$ 1,691
Short-term	$ 1,459	$ 1,366
Long-term	271	325
Financing receivables, net	$ 1,730	$ 1,691

Financing receivables primarily consist of revolving loans and fixed-term leases and loans resulting from the sale of Dell products. If customers desire revolving or term loan financing, Dell sells equipment directly to customers who, in turn, enter into agreements to finance their purchases. For customers who desire lease financing, Dell sells the equipment to DFS, and DFS enters into direct financing lease arrangements with the customers.

Customer receivables are presented net of an allowance for uncollectible accounts. The allowance is based on factors including historical trends and the composition and credit quality of the customer receivables. The composition and credit quality varies from investment grade commercial customers to subprime consumers. Customer receivables are charged to the allowance at the earlier of when an account is deemed to be uncollectible or when the account is 180 days delinquent. Recoveries on customer receivables previously charged off as uncollectible are adjusted to the allowance for uncollectible accounts. The following is a description of the components of financing receivables:

- Revolving loans offered under private label credit financing programs provide qualified customers with a revolving credit line for the purchase of products and services offered by Dell. From time to time, account holders may have the opportunity to finance their Dell purchases with special programs during which, if the outstanding balance is paid in full, no interest is charged. These special programs generally range from 3 to 18 months and have an average original term of approximately 13 months. Revolving loans bear interest at a variable annual percentage rate that is tied to the prime rate.

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- Leases with business customers generally have fixed-terms of two to three years. Future maturities of minimum lease payments at August 4, 2006 are as follows: 2007: $37 million; 2008: $36 million; 2009: $16 million; and 2010: $3 million. Fixed-term loans are also offered to qualified small businesses for the purchase of products sold by Dell.

Dell retains a residual interest in the leased equipment. The amount of the residual interest is established at the inception of the lease based upon estimates of the value of the equipment at the end of the lease term using historical studies, industry data, and future value-at-risk demand valuation methods. On a periodic basis, Dell assesses the carrying amount of its recorded residual values for impairment. Anticipated declines in specific future residual values that are considered to be other-than-temporary are recorded in current earnings.

Retained interests represent the residual beneficial interest Dell retains in certain pools of securitized finance receivables. Retained interests are stated at the present value of the estimated net beneficial cash flows after payment of all senior interests. In estimating the value of retained interests, Dell makes a variety of financial assumptions, including pool credit losses, payment rates, and discount rates. These assumptions are supported by both Dell s historical experience and anticipated trends relative to the particular receivable pool. Dell reviews its investments in retained interests periodically for impairment, based on estimated fair value. Any resulting losses representing the excess of carrying value over estimated fair value that are other-than-temporary are recorded in earnings. However, unrealized gains are reflected in stockholders equity as part of accumulated other comprehensive income. In the first quarter of Fiscal 2008, Dell adopted SFAS 155, and as a result, all gains and losses are recognized in income immediately and are no longer included in accumulated other comprehensive income.

Asset Securitization

During the first six months of Fiscal 2007 and Fiscal 2006, Dell sold $514 million and $197 million, respectively, of fixed-term leases and loans and revolving loans to unconsolidated qualifying special purpose entities. The qualifying special purpose entities are bankruptcy remote legal entities with assets and liabilities separate from those of Dell. The sole purpose of the qualifying special purpose entities is to facilitate the funding of finance receivables in the capital markets. Dell determines the amount of receivables to securitize based on its funding requirements in conjunction with specific selection criteria designed for the transaction. The qualifying special purpose entities have entered into financing arrangements with three multi-seller conduits that, in turn, issue asset-backed debt securities in the capital markets. Transfers of financing receivables are recorded in accordance with the provisions of SFAS 140.

Dell retains the right to receive collections on securitized receivables in excess of amounts needed to pay interest and principal as well as other required fees. Upon the sale of the financing receivables, Dell records the present value of the excess cash flows as a retained interest, which typically results in a gain that ranges from 2% to 4% of the customer receivables sold. Dell services the securitized contracts and earns a servicing fee. Dell s securitization transactions generally do not result in servicing assets and liabilities, as the contractual fees are adequate compensation in relation to the associated servicing cost.

Dell s securitization program contains structural features that could prevent further funding if the credit losses or delinquencies on the pool of sold receivables exceed specified levels. These structural features are within normal industry practice and are similar to comparable securitization programs in the marketplace. Dell does not currently expect that any of these features will have a material adverse impact on its ability to securitize financing receivables.

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NOTE 8 Warranty Liability and Related Deferred Revenue

Revenue from extended warranty and service contracts, for which Dell is obligated to perform, is recorded as deferred revenue and subsequently recognized over the term of the contract or when the service is completed. Dell records warranty liabilities at the time of sale for the estimated costs that may be incurred under its limited warranty. Changes in Dell s deferred revenue for extended warranties and warranty liability for standard warranties, which are included in other current and non-current liabilities on Dell s Condensed Consolidated Statements of Financial Position, are presented in the following tables:

	Three Months Ended		Six Months Ended	
	August 4, 2006	July 29, 2005 As Restated	August 4, 2006	July 29, 2005 As Restated
	(in millions)			
Deferred revenue:				
Deferred revenue at beginning of period	$ 3,907	$ 3,097	$ 3,707	$ 2,904
Revenue deferred for new extended warranty and service contracts sold[(a)]	814	709	1,573	1,329
Revenue recognized[(a)]	(697)	(522)	(1,256)	(949)
Deferred revenue at end of period	$ 4,024	$ 3,284	$ 4,024	$ 3,284
Current portion	$ 2,055	$ 1,671	$ 2,055	$ 1,671
Non-current portion	1,969	1,613	1,969	1,613
Deferred revenue at end of period	$ 4,024	$ 3,284	$ 4,024	$ 3,284

	Three Months Ended		Six Months Ended	
	August 4, 2006	July 29, 2005 As Restated	August 4, 2006	July 29, 2005 As Restated
	(in millions)			
Warranty liability:				
Warranty liability at beginning of period	$ 909	$ 708	$ 951	$ 722
Costs accrued for new warranty contracts and changes in estimates for pre-existing warranties[(b)]	330	298	575	511
Service obligations honored[(a)]	(310)	(294)	(597)	(521)

Warranty liability at end of period	$	929	$	712	$	929	$	712
Current portion	$	665	$	515	$	665	$	515
Non-current portion		264		197		264		197
Warranty liability at end of period	$	929	$	712	$	929	$	712

(a) Prior period amounts have been changed to reflect the current year presentation of service obligations honored. There is no impact to the Condensed Consolidated Statements of Financial Position or Condensed Consolidated Statements of Income as a result of this change.

(b) Changes in cost estimates related to pre-existing warranties are aggregated with accruals for new warranty contracts. Dell s warranty liability process does not differentiate between estimates made for pre-existing warranties and new warranty obligations.

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NOTE 9 Commitments and Contingencies

DFS Purchase Commitment Pursuant to the joint venture agreement between Dell and CIT, Dell has an obligation to purchase CIT s 30% interest in DFS at the expiration of the joint venture on January 29, 2010, for a purchase price ranging from approximately $100 million to $345 million. Dell currently expects that the purchase price will likely be towards the upper end of the range. See Note 7 of Notes to Condensed Consolidated Financial Statements.

Restricted Cash Pursuant to an agreement between DFS and CIT, Dell is required to maintain escrow cash accounts that are held as recourse reserves for credit losses, performance fee deposits related to Dell s private label credit card, and deferred servicing revenue. Restricted cash specific to the consolidation of DFS in the amount of $410 million and $453 million is included in other current assets on Dell s Consolidated Statements of Financial Position as of August 4, 2006 and February 3, 2006, respectively.

Legal Matters Dell is involved in various claims, suits, investigations, and legal proceedings that arise from time to time in the ordinary course of its business. As required by SFAS No. 5, *Accounting for Contingencies* (SFAS 5), Dell accrues a liability when it believes that it is both probable that a liability has been incurred and that it can reasonably estimate the amount of the loss. The following is a discussion of Dell s significant legal matters.

Investigations and Related Litigation In August 2005, the SEC initiated an inquiry into certain of Dell s accounting and financial reporting matters and requested that Dell provide certain documents. The SEC expanded that inquiry in June 2006 and entered a formal order of investigation in October 2006. The SEC s requests for information were joined by a similar request from the United States Attorney for the Southern District of New York (SDNY), who subpoenaed documents related to Dell s financial reporting from and after Fiscal 2002. In August 2006, because of potential issues identified in the course of responding to the SEC s requests for information, Dell s Audit Committee, on the recommendation of management and in consultation with PricewaterhouseCoopers LLP, Dell s independent registered public accounting firm, initiated an independent investigation, which was recently completed. For information regarding the Audit Committee s investigation, the accounting errors and irregularities identified, and the restatement adjustments, see Note 2 of Notes to Condensed Consolidated Financial Statements. Although the Audit Committee investigation has been completed, the investigations being conducted by the SEC and the SDNY are ongoing. Dell continues to cooperate with the SEC and the SDNY.

Dell and several of its current and former directors and officers are parties to securities, Employee Retirement Income Security Act of 1974 (ERISA), and shareholder derivative lawsuits all arising out of the same events and facts. Four putative securities class actions that were filed in the Western District of Texas, Austin Division, against Dell and certain of its current and former officers have been consolidated as *In re Dell Inc. Securities Litigation*, and a lead plaintiff has been appointed by the court. The lead plaintiff has asserted claims under sections 10(b), 20(a), and 20A of the Securities Exchange Act of 1934 based on alleged false and misleading disclosures or omissions regarding Dell s financial statements, governmental investigations, known battery problems, business model, and insiders sales of its securities. This action also includes Dell s independent registered public accounting firm, PricewaterhouseCoopers LLP, as a defendant. Four other putative class actions that were also filed in the Western District by purported participants in the Dell Inc. 401(k) Plan have been consolidated as *In re Dell Inc. ERISA Litigation*, and lead plaintiffs have been appointed by the court. The lead plaintiffs have asserted claims under ERISA based on allegations that Dell, certain current officers, and certain current and former directors imprudently invested

and managed participants funds and failed to disclose information regarding its stock held in the 401(k) Plan. In addition, seven shareholder derivative lawsuits that were filed in three separate jurisdictions (the Western District of Texas, Austin Division; the Delaware

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Chancery Court; and the state district court in Travis County, Texas) have been consolidated into three actions, one in each of the respective jurisdictions, as *In re Dell Inc. Derivative Litigation,* and name various current and former officers and directors as defendants and Dell as a nominal defendant. On October 8, 2007, the shareholder derivative lawsuit filed in the Western District of Texas was dismissed without prejudice by the court. The Travis County, Texas action has been transferred to the state district court in Williamson County, Texas. The shareholder derivative lawsuits assert claims derivatively on behalf of Dell under state law, including breaches of fiduciary duties. Finally, one purported shareholder has filed an action against Dell in Delaware Chancery Court under Section 220 of the Delaware General Corporation Law, *Baltimore County Employees Retirement System v. Dell Inc.,* seeking inspection of certain of Dell s books and records related to the internal investigation and government investigations. Dell intends to defend all of these lawsuits vigorously.

Copyright Levies Proceedings against the IT industry in Germany seek to impose levies on equipment, such as personal computers, multifunction devices, and printers that facilitate making private copies of copyrighted materials. The total levies due, if imposed, would be based on the number of products sold and the per-product amounts of the levies, which vary. Dell, along with other companies and various industry associations are opposing these levies and instead are advocating compensation to rights holders through digital rights management systems.

There are currently three levy cases involving other equipment manufacturers pending before the German Federal Supreme Court. Adverse decisions in these cases could ultimately impact Dell. The cases involve personal computers, printers, and multifunctional devices. The equipment manufacturers in these cases recently lost in the lower courts and have appealed. The amount allowed by the lower courts with respect to PCs is 12 per personal computer sold for reprographic copying capabilities. The amounts claimed with respect to printers and multifunctional devices depend on speed and color and vary between 10 and 300 for printers and between 38 and 600 for multifunctional devices. On December 29, 2005, Zentralstelle Für private Überspielungrechte (ZPÜ), a joint association of various German collection societies, instituted arbitration proceedings against Dell s German subsidiary before the Arbitration Body in Munich. ZPÜ claims a levy of 18.4 per PC that Dell sold in Germany from January 1, 2002 through December 31, 2005. On July 31, 2007, the Arbitration Body recommended a levy of 15 on each PC sold during that period, for audio and visual copying capabilities. Dell and ZPÜ rejected the recommendation and Dell expects that the matter will proceed to court. Dell will continue to defend this claim vigorously.

Lucent v. Dell In February 2003, Lucent Technologies, Inc. filed a lawsuit against Dell in the United States District Court for Delaware, and the lawsuit was subsequently transferred to the United States District Court for the Southern District of California. The lawsuit alleges that Dell infringed 12 patents owned by Lucent and seeks monetary damages and injunctive relief. In April 2003, Microsoft Corporation filed a declaratory judgment action against Lucent in the United States District Court for the Southern District of California, asserting that Microsoft products do not infringe patents held by Lucent, including 10 of the 12 patents at issue in the lawsuit involving Dell and Microsoft. These actions were consolidated for discovery purposes with a previous suit that Lucent filed against Gateway, Inc. In September 2005, the court granted a summary judgment of invalidity with respect to one of the Lucent patents asserted against Dell. In addition, in decisions made through May 2007, the court granted summary judgment of non-infringement with respect to five more of the Lucent patents asserted against Dell. The court has ordered invalidity briefing with regard to other patents at issue in view of the April 30, 2007, U.S. Supreme Court decision in *KSR v. Teleflex*. Fact and expert discovery has closed, and the three actions have been consolidated. Trial is scheduled to begin in February 2008. Dell is defending these claims vigorously. Separately, Dell has filed a lawsuit against Lucent in the United States District

DELL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
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Court for the Eastern District of Texas, alleging that Lucent infringes two patents owned by Dell and seeking monetary damages and injunctive relief. That litigation is pending and discovery is proceeding.

Sales Tax Claims Several state and local taxing jurisdictions have asserted claims against Dell Catalog Sales L.P. (DCSLP), an indirect wholly-owned subsidiary of Dell, alleging that DCSLP had an obligation to collect tax on sales made into those jurisdictions because of its alleged nexus, or physical presence, in those jurisdictions. During the first and second quarter of Fiscal 2008, Dell settled suits filed by the State of Louisiana and the Secretary of the Louisiana Department of Revenue and Taxation in the 19th Judicial District Court of the State of Louisiana, and by two Louisiana parishes, Orleans Parish and Jefferson Parish, in the State of Louisiana 24th Judicial District Court. Dell also settled similar claims made by a number of other Louisiana parishes and by the State of Massachusetts. These settlement amounts did not have a material adverse effect on Dell s financial condition, results of operations, or cash flows. While there are ongoing claims by certain other state and local taxing authorities, DCSLP disputes the allegation that it had nexus in any of these other jurisdictions during the periods in issue, and is defending the claims vigorously. Dell does not expect that the outcome of these other claims, individually or collectively, will have a material adverse effect on its financial condition, results of operations, or cash flows.

Income Tax Dell is currently under audit in various jurisdictions, including the United States. The tax periods open to examination by the major taxing jurisdictions to which Dell is subject include Fiscal 1999 through Fiscal 2007. Dell does not anticipate a significant change to the total amount of unrecognized benefits within the next 12 months.

Dell is involved in various other claims, suits, investigations, and legal proceedings that arise from time to time in the ordinary course of its business. Although Dell does not expect that the outcome in any of these other legal proceedings, individually or collectively, will have a material adverse effect on its financial condition or results of operations, litigation is inherently unpredictable. Therefore, Dell could incur judgments or enter into settlements of claims that could adversely affect its operating results or cash flows in a particular period.

NOTE 10 Segment Information

Dell conducts operations worldwide and is managed in three geographic regions: the Americas; Europe, Middle East, and Africa (EMEA); and Asia Pacific-Japan (APJ). The Americas region, which is based in Round Rock, Texas, covers the U.S., Canada, and Latin America. Within the Americas, Dell is further segmented into Business and U.S. Consumer. The Americas Business (Business) segment includes sales to corporate, government, healthcare, education, and small and medium business customers, while the U.S. Consumer segment includes sales primarily to individual consumers. The EMEA segment, based in Bracknell, England, covers Europe, the Middle East, and Africa. The APJ region, based in Singapore, covers the Asian countries of the Pacific Rim as well as Australia, New Zealand, and India.

Corporate expenses are included in Dell s measure of segment operating income for management reporting purposes; however, with the adoption of SFAS 123(R), beginning in Fiscal 2007 stock-based compensation expense is not allocated to Dell s reportable segments. The following table presents net revenue by Dell s reportable segments as well as a reconciliation of consolidated segment operating

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income to Dell s consolidated operating income for the three and six month periods ended August 4, 2006 and July 29, 2005:

	Three Months Ended		Six Months Ended	
	August 4, 2006	July 29, 2005 As Restated	August 4, 2006	July 29, 2005 As Restated
	(in millions)			
Net revenue:				
Americas:				
Business	$ 7,502	$ 7,154	$ 14,612	$ 13,726
U.S. Consumer	1,787	1,686	3,698	3,621
Americas	9,289	8,840	18,310	17,347
EMEA	3,049	2,920	6,451	6,074
APJ	1,873	1,622	3,770	3,261
Net revenue	$ 14,211	$ 13,382	$ 28,531	$ 26,682

Consolidated operating income: