UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: September 30, 2001

OR

[ ] 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 1-4471

XEROX CORPORATION
(Exact Name of Registrant as specified in its charter)

New York	16-0468020
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

P.O. Box 1600
Stamford, Connecticut 06904-1600
(Address of principal executive offices) (Zip Code)

(203) 968-3000
(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 ______ No X

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 31, 2001
Common Stock	719,988,021 shares

This document consists of 55 pages.

Forward-Looking Statements

From time to time Xerox Corporation (the Registrant or the Company) and its representatives may provide information, whether orally or in writing, including certain statements in this Form 10-Q, which are deemed to be "forward-looking" within the meaning of the Private Securities Litigation Reform Act of 1995 ("Litigation Reform Act"). These forward-looking statements and other information relating to the Company are based on the beliefs of management as well as assumptions made by and information currently available to management.

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

In accordance with the provisions of the Litigation Reform Act we are making investors aware that such "forward-looking" statements, because they relate to future events, are by their very nature subject to many important factors which

could cause actual results to differ materially from those contained in the "forward-looking" statements. Such factors include but are not limited to the following:

Competition - the Registrant operates in an environment of significant competition, driven by rapid technological advances and the demands of customers to become more efficient. There are a number of companies worldwide with significant financial resources which compete with the Registrant to provide document processing products and services in each of the markets served by the Registrant, some of whom operate on a global basis. The Registrant's success in its future performance is largely dependent upon its ability to compete successfully in its currently-served markets and to expand into additional market segments. If we are unable to compete successfully it could adversely affect our results of operations and financial condition.

Transition to Digital - presently black and white light-lens copiers represent approximately 25% of the Registrant's revenues. This segment of the market is mature with anticipated declining industry revenues as the market transitions to digital technology. Some of the Registrant's new digital products replace or compete with the Registrant's current light-lens equipment. Changes in the mix of products from light-lens to digital, and the pace of that change as well as competitive developments could cause actual results to vary from those expected.

Expansion of Color - color printing and copying represents an important and growing segment of the market. Printing from computers has both facilitated and increased the demand for color. A significant part of the Registrant's strategy and ultimate success in this changing market is its ability to develop and market machines that produce color prints and copies quickly and at reduced cost. The Registrant's continuing success in this strategy depends on its ability to make the investments and commit the necessary resources in this highly competitive market. If we are unable to develop and market alternative offerings in digital and color technologies, we may lose market share which could have a material adverse effect on our operating results.

Pricing - the Registrant's ability to succeed is dependent upon its ability to obtain adequate pricing for its products and services which provide a reasonable return to shareholders. Depending on competitive market factors, future prices the Registrant can obtain for its products and services may vary from historical levels. In addition, pricing actions to offset currency devaluations may not prove sufficient to offset further devaluations or may not hold in the face of customer resistance and/or competition.

Customer Financing Activities - On average, 75 - 80 percent of the Registrant's equipment sales are financed through the Registrant. To fund these arrangements, the Registrant must access the credit markets and the long-term viability and profitability of its customer financing activities is dependent on its ability to borrow and its cost of borrowing in these markets. This ability and cost, in turn, is dependent on the Registrant's credit ratings. Currently the Registrant's credit ratings effectively preclude its ready access to capital markets and the Registrant is currently funding its customer financing activity from available sources of liquidity including cash on hand. There is no assurance that the Registrant will be able to continue to fund its customer financing activity at present levels. The Registrant is actively seeking third parties to provide financing to its customers and recently announced a "framework agreement" for GE Capital's Vendor Financial Services to become the primary equipment financing for Xerox customers in the United States. This Agreement has not yet been completed and remains subject to the negotiation of definitive agreements and satisfaction of closing conditions, including completion of due diligence. We are in various stages of negotiations with third party vendors to offer financing to our customers in Canada and all of the major countries in Europe. There is no assurance if or when we will be able to successfully complete these negotiations. The Registrant's ability to continue to offer customer financing and be successful in the placement of its equipment with customers is largely dependent upon obtaining such third party financing. In addition, the Company does not expect to be able to access the capital markets in registered public offerings pending resolution of the review of the Company's accounting practices by the Securities and Exchange Commission referred to in Note 12 to the Consolidated Financial Statements. The Company cannot predict when the Securities and Exchange commission will conclude either its investigation or its review or the outcome or impact of either.

Manufacturing Outsourcing - In October 2001, the Registrant announced a manufacturing agreement with Flextronics, a $12 billion global electronics manufacturing services company. The agreement includes a five-year supply contract for Flextronics to manufacture certain office equipment and components and the payment of approximately $220 million to Registrant for inventory, property and equipment at a modest premium over book value, and the assumption of certain liabilities. The actual cash proceeds will vary, based upon the actual net asset levels at the time of the closings. As a result of these

actions, Registrant expects to incur restructuring charges in the fourth quarter of 2001. Approximately 50 percent of Registrant's manufacturing capacity has been sold to Flextronics. Registrant's ability to ensure continued product availability and achieve improved asset utilization, supply chain flexibilities and cost savings is dependent upon successfully completing the transition to Flextronics. The Registrant's future success in the market for office equipment will be significantly effected by the successful conclusion, implementation and operation of this manufacturing agreement.

Productivity - the Registrant's ability to sustain and improve its profit margins is largely dependent on its ability to maintain an efficient, cost-effective operation. Productivity improvements through process reengineering, design efficiency and supplier cost improvements, including manufacturing outsourcing discussed above, are required to offset labor cost inflation and potential materials cost changes and competitive price pressures. Registrant's productivity in the market for office equipment will be significantly effected by the successful conclusion, implementation and operation of the manufacturing agreement with Flextronics described above.

International Operations - Following the events of September 11, 2001, economic outlook in the United States and the other areas of the world has further weakened. The Registrant derives approximately half its revenue from operations outside of the United States. In addition, the Registrant manufactures or acquires many of its products and/or their components outside the United States. The Registrant's future revenue, cost and profit results could be affected by a number of factors, including global economic conditions, changes in foreign currency exchange rates, changes in economic conditions from country to country, changes in a country's political conditions, trade protection measures, licensing requirements and local tax issues. Our ability to enter into new foreign exchange contracts to manage foreign exchange risk is currently severely limited and, therefore, we anticipate increased volatility in our results of operations due to changes in foreign exchange rates.

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

Revenue - the Registrant's ability to attain a consistent trend of revenue over the intermediate to longer term is largely dependent upon stabilization and subsequent expansion of its equipment sales worldwide and usage growth (i.e., an increase in the number of images produced by customers). The ability to achieve equipment sales growth is subject to the successful implementation of our initiatives, including our vendor financing programs, to ensure the stability and increasing tenure of our direct sales force while continuing to expand indirect sales channels in the face of global competition and pricing pressures. The ability to grow usage may be adversely impacted by the movement towards distributed printing and electronic substitutes. Our inability to attain a consistent trend of revenue growth could materially affect the trend of our actual results.

Turnaround Program - In October 2000, the Registrant announced a turnaround program which includes a wide-ranging plan to generate cash, return to profitability and pay down debt. The success of the turnaround program is dependent upon successful and timely sales of assets, restructuring the cost base, placement of greater operational focus on the core business and the transfer of the financing of customer equipment purchases to third parties. Cost base restructuring is dependent upon effective and timely elimination of employees, closing and consolidation of facilities, outsourcing of certain manufacturing operations, reductions in operational expenses and the successful implementation of process and systems changes. See "Customer Financing Activities" and "Manufacturing Outsourcing" above for a description of two of the Turnaround initiatives.

Liquidity - the Registrant's liquidity is dependent on the timely implementation and execution of the various turnaround program initiatives as well as its ability to generate positive cash flow from operations, possible asset sales, and various financing strategies including securitizations and its ability to successfully refinance a portion of its $7 billion Revolving Credit Agreement and extend its maturity beyond October, 2002. Should the Registrant not be able to successfully complete the turnaround program, generate cash and refinance and extend the maturity of the Revolving Credit Agreement on a timely or satisfactory basis, the Registrant will need to obtain additional sources of funds through other operating improvements, financing from third parties, asset sales, or a combination thereof. There can be no assurance that we can obtain these additional sources of funds. We have initiated discussions with the agent banks under our $7 billion revolving credit agreement in order to refinance a portion and extend its maturity beyond October, 2002. This

agreement contains a consolidated tangible net worth ("CTNW") covenant and at September 30, 2001 we had a $182 million cushion over the minimum amount required under the covenant. Operating losses, restructuring costs and adverse currency translation adjustments would erode the cushion. Failure to successfully refinance and extend the maturity of the agreement or a breach of the CTNW covenant could have a serious adverse impact on our liquidity.

Xerox Corporation
Form 10-Q
September 30, 2001

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For additional information about The Document Company Xerox, please visit our World-Wide Web site at www.xerox.com/investor. Any information on or linked from the website is not incorporated by reference into the Form 10-Q.

PART I - FINANCIAL INFORMATION

Item 1

Xerox Corporation
Consolidated Statements of Operations (Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
(In millions, except per share data)	2001	2000*	2001	2000*
Revenues				
Sales	$1,842	$2,420	$5,878	$7,341
Service, outsourcing, financing and rentals	2,060	2,083	6,363	6,479
Total Revenues	3,902	4,503	12,241	13,820
Costs and Expenses				
Cost of sales	1,262	1,582	4,049	4,460
Cost of service, outsourcing, financing				

and rentals	1,226	1,344	3,860	3,986
Inventory charges	5		29	90
Research and development expenses	284	269	779	774
Selling, administrative and general expenses	1,215	1,428	3,629	4,074
Restructuring charge and asset impairments	39		431	504
Gain on sale of half of interest in Fuji Xerox	-	-	(769)	-
Gain on affiliate's sale of stock	-	-	-	(21)
Purchased in process research and development	-	-	-	27
Other, net	119	115	370	274
Total Costs and Expenses	4,150	4,738	12,378	14,168
Loss before Income Taxes (Benefits), Equity Income (Loss), Minorities' Interests, Extraordinary Gain, and Cumulative Effect of Change in Accounting Principle	(248)	(235)	(137)	(348)
Income taxes (benefits)	(56)	(44)	187	(84)
Loss after Income Taxes (Benefits) before Equity income and Minorities' Interests	(192)	(191)	(324)	(264)
Equity in net income (loss) of unconsolidated affiliates	(1)	10	32	60
Minorities' interests in earnings of subsidiaries	19	10	31	33
Loss before extraordinary gain and cumulative effect of change in accounting principle	(212)	(191)	(323)	(237)
Extraordinary gain on early extinguishment of debt (less income taxes of $1 and $23, respectively)	1		36	
Cumulative effect of change in accounting principle (less income tax benefit of $1)			(2)	
Net Loss	$ (211)	$ (191)	$ (289)	$ (237)
Basic loss per share:				
Loss before extraordinary gain and cumulative effect of change in accounting principle	$(0.29)	$(0.30)	$(0.48)	$(0.39)
Extraordinary gain, net	-	-	0.05	-
Cumulative effect of change in accounting principle, net	-	-	-	-
Basic Loss per Share	$(0.29)	$(0.30)	$(0.43)	$(0.39)
Diluted loss per share:				
Loss before extraordinary gain and cumulative effect of change in accounting principle	$(0.29)	$(0.30)	$(0.48)	$(0.39)
Extraordinary gain, net			0.05	
Cumulative effect of change in accounting principle, net				
Diluted Loss per Share	$(0.29)	$(0.30)	$(0.43)	$(0.39)

See accompanying notes

* As restated, see Note 2

Xerox Corporation
Consolidated Balance Sheets

(In millions, except share data in thousands)	September 30, 2001	December 31, 2000
Assets	(Unaudited)	
Cash and cash equivalents	$ 2,427	$ 1,741
Accounts receivable, net	1,994	2,281
Finance receivables, net	4,828	5,097
Inventories, net	1,541	1,932
Equipment on operating leases, net	573	724
Deferred taxes and other current assets	1,409	1,247
Total Current Assets	12,772	13,022
Finance receivables due after one year, net	6,498	7,957

Land, buildings and equipment, net	2,099	2,495
Investments in affiliates, at equity	659	1,362
Intangible and other assets, net	3,478	3,061
Goodwill, net	1,525	1,578
Total Assets	$ 27,031	$ 29,475
Liabilities and Equity		
Short-term debt and current portion of long-term debt	$ 2,696	$ 2,693
Accounts payable	710	1,033
Accrued compensation and benefit costs	720	662
Unearned income	269	250
Other current liabilities	1,982	1,630
Total Current Liabilities	6,377	6,268
Long-term debt	13,380	15,404
Postretirement medical benefits	1,224	1,197
Deferred taxes and other liabilities	1,822	1,876
Deferred ESOP benefits	(221)	(221)
Minorities' interests in equity of subsidiaries	76	95
Obligation for equity put options		32
Company-obligated, mandatorily redeemable preferred securities of subsidiary trusts holding solely subordinated debentures of the Company	686	684
Preferred stock	613	647
Common shareholders' equity	3,074	3,493
Total Liabilities and Equity	$ 27,031	$ 29,475
Shares of common stock issued and outstanding	717,518	668,576

See accompanying notes.

Xerox Corporation
Consolidated Statements of Cash Flows (Unaudited)

Nine Months ended September 30 (In millions)	2001	2000*
Cash Flows from Operating Activities		
Net Loss	$ (289)	$ (237)
Adjustments required to reconcile net loss to cash flows from operating activities, net of effects of acquisitions:		
Depreciation and amortization	794	794
Provisions for doubtful accounts	401	417
Restructuring and other charges	452	621
Gains on sales of businesses and assets	(745)	(84)
Gain on early extinguishment of debt	(59)	
Cash payments for restructurings	(368)	(222)
Minorities' interests in earnings of subsidiaries	31	33
Undistributed equity in income of affiliated companies		(20)
Decrease (increase) in inventories	279	(158)
Increase in on-lease equipment	(176)	(350)
Decrease (increase) in finance receivables	400	(776)
Securitization of finance receivables	480	
Decrease (increase) in accounts receivable	66	(188)
Securitization of accounts receivable		315
Decrease in accounts payable and accrued compensation and benefit costs	(237)	(126)
Net change in current and deferred income taxes	256	(481)
Change in other current and non-current liabilities	(131)	(219)
Other, net	(136)	(482)
Net cash provided by (used in) operating activities	1,018	(1,163)
Cash Flows from Investing Activities		
Additions to land, buildings and equipment	(159)	(324)
Proceeds from sales of land, buildings and equipment	64	80
Acquisitions, net of cash acquired	-	(856)
Proceeds from divestitures	1,635	90
Cash paid to fund Ridge Re Trust	(255)	
Other, net	-	(17)

Net cash provided by (used in) investing activities	1,285	(1,027)
Cash Flows from Financing Activities		
Net change in debt	(1,530)	2,619
Dividends on common and preferred stock	(93)	(441)
Proceeds from sales of common stock	28	22
(Settlements of) proceeds from equity put options, net	(28)	24
Dividends to minority shareholders	(2)	(5)
Net cash (used in) provided by financing activities	(1,625)	2,219
Effect of Exchange Rate Changes on Cash and Cash Equivalents	8	(1)
Increase in Cash and Cash Equivalents	686	28
Cash and Cash Equivalents at Beginning of Period	1,741	126
Cash and Cash Equivalents at End of Period	$ 2,427	$ 154

See accompanying notes.
* As restated, see Note

Xerox Corporation
Notes to Consolidated Financial Statements (Unaudited)
($ in millions except per share data)

1. Basis of Presentation:

The unaudited consolidated interim financial statements presented herein have been prepared by Xerox Corporation (the Company) in accordance with the accounting policies described in its 2000 Annual Report to Shareholders and should be read in conjunction with the notes thereto.

In the opinion of management, all adjustments (including normal recurring adjustments) which are necessary for a fair statement of operating results for the interim periods presented have been made.

We adopted Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities" as of January 1, 2001. See Note 9 for additional details.

Prior years' financial statements have been reclassified to reflect certain reclassifications to conform with the 2001 presentation. The impact of these changes is not material and did not affect net loss.

The term "pre-tax income (loss)" as used herein refers to the Consolidated Statement of Operations line item "Income (Loss) before Income Taxes (Benefits), Equity Income (Loss), Minorities' Interests, Extraordinary Gain and Cumulative Effect of Change in Accounting Principle".

References herein to "we" or "our" refer to Xerox Corporation and consolidated subsidiaries unless the context specifically requires otherwise.

2. Restatement:

We have restated our Consolidated Financial Statements for the three and nine month periods ended September 30, 2000 as a result of two separate investigations conducted by the Audit Committee of the Board of Directors. These investigations involved previously disclosed issues in our Mexico operations and a review of our accounting policies and procedures and the application thereof. This filing should be read in conjunction with Amendment No. 1 to our Annual Report on Form 10-K for the fiscal year ended December 31, 2000. The adjustments made to the Consolidated Financial Statements for the three months and nine months ended September 30, 2000 reflect the changes discussed in such amendment. All amounts included herein have been restated to reflect the changes as discussed in that report.

These adjustments relate primarily to imprudent and improper business practices in Mexico, acquisition contingencies associated with our acquisition of the remaining ownership interest in Xerox Limited from the Rank Group Plc, misapplications of GAAP under SFAS No. 13 "Accounting for Leases" and certain other items.

The following table presents the effects of the adjustments on pre-tax income (loss):

	Three months ended September 30, 2000	Nine months ended September 30, 2000
Mexico	$ 21	$ 69
Lease issues, net	22	72

Other, net	(82)	(104)
Total	$(39)	$ 37

The following tables present the impact of the adjustments and restatements on a condensed basis:

	Previously Reported	As Restated
Statement of Operations: Three months ended September 30, 2000		
Revenues	$ 4,462	$ 4,503
Costs and expenses	$ 4,658	$ 4,738
Net loss before extraordinary gain and cumulative effect of change in accounting principle	$ (167)	$ (191)
Basic loss per share	$ (0.26)	$ (0.30)
Diluted loss per share	$ (0.26)	$ (0.30)

	Previously Reported	As Restated
Statement of Operations: Nine months ended September 30, 2000		
Revenues	$ 13,581	$ 13,820
Costs and expenses	$ 13,966	$ 14,168
Net loss before extraordinary gain and cumulative effect of change in accounting principle	$ (265)	$ (237)
Basic loss per share	$ (0.44)	$ (0.39)
Diluted loss per share	$ (0.44)	$ (0.39)

3. Inventories:

Inventories consist of the following:

	September 30, 2001	December 31, 2000
Finished products	$ 1,038	$ 1,439
Work in process	112	147
Raw materials and supplies	391	346
Total	$ 1,541	$ 1,932

4. Restructurings and Turnaround Program:

March 2000 Restructuring. In March 2000, we announced details of a worldwide restructuring program. In connection with this program, we recorded a pre-tax provision of $596 ($423 after taxes, including our $18 share of a restructuring provision recorded by Fuji Xerox, an unconsolidated affiliate). The $596 pre-tax charge included severance costs related to the elimination of 5,200 positions worldwide. Approximately 65 percent of the positions eliminated were in the U.S., 20 percent were in Europe, and the remainder were predominantly in Latin America. The employment reductions primarily affected employees in manufacturing, logistics, customer service and back office support functions. For facility fixed assets classified as assets to be disposed of, the impairment loss recognized is based on the fair value less cost to sell, with fair value based on estimates of existing market prices for similar assets. The inventory charges relate primarily to the consolidation of distribution centers and warehouses and the exit from certain product lines.

Included in the original provision were reserves related to liabilities due to various third parties and several asset impairment charges. Liabilities recorded for lease cancellation and other costs originally aggregated $51 and included $32 for various contractual commitments, other than facility occupancy leases, that will be terminated early as a result of the restructuring. The commitments include cancellation of supply contracts and outsourced vendor contracts. Included in the asset impairment charge of $71 was: $44 for machinery and tooling for products that were discontinued or will be alternatively sourced; $7 for leasehold improvements at facilities that will be closed; and $20 of sundry surplus assets, individually insignificant, from various parts of our business. These impaired assets were primarily located in the U.S. and the related product lines generated an immaterial amount of revenue. Approximately $71 of the $90 of inventory charges related to excess inventory in many product lines created by the consolidation of distribution centers and warehouses. The remainder was primarily related to the transition

~~to inkjet technology in our wide format printing business.~~

~~Weakening business conditions and operating results during 2000 required a re-evaluation of the initiatives announced in March 2000. Accordingly, during the fourth quarter of 2000, and in connection with the Turnaround Program discussed below, $71 of the original $596 provision was reversed, $59 related to severance costs for 1,000 positions and $12 related to lease cancellation and other costs. The reversals primarily relate to delays in the consolidation and outsourcing of certain of our warehousing and logistics operations and the cancellation of certain European initiatives no longer necessary as a result of higher than expected attrition.~~

~~During the first nine months of 2001 we recorded a net reversal to the March 2000 restructuring reserve of $14. This included the reversal of approximately $53 of previously recorded charges and additional charges of approximately $39. These reversals relate to adjustments to the originally recorded reserves based on management's most recent estimate of the costs to fund previously announced actions. Cash charges against the reserve for the first nine months were $161. Other reductions to the reserve, including currency, were $19. The cash charges were primarily for severance and related costs. The March 2000 restructuring reserve balance at September 30, 2001 is $15. The remaining reserve is primarily related to committed severance costs for actions that are substantially complete.~~

~~During the third quarter of 2001, we also reversed $8 related to our April 1998 restructuring program based on management's most recent estimate of the costs to fund previously announced actions. Cash charges against the reserve for the first nine months were $49. Other reductions to the reserve, including currency, were $18. The April 1998 restructuring reserve balance at September 30, 2001 is $24. The remaining balance will be utilized as severance and remaining lease payments are made.~~

~~Turnaround Program. During 2000, the significant business challenges that we began to experience in the second half of 1999 continued to adversely affect our financial performance. These challenges included: the ineffective execution of a major sales force realignment, the ineffective consolidation of our U.S. customer administrative centers, increased competition and adverse economic conditions.~~

~~These operational challenges, exacerbated by significant technology and acquisition investments, led to a net loss in 2000, credit rating agency downgrades, limited access to capital markets and marketplace concerns regarding our liquidity. In response to these challenges, in October 2000, we announced a Turnaround Program that includes a wide-ranging plan to sell assets, cut costs and strengthen core operations. Additionally, we are in substantive negotiations to provide financing for customers using third parties.~~

~~In December 2000, we sold our operations in China to Fuji Xerox for $550 and in March 2001 we sold half of our ownership interest in Fuji Xerox Co., Ltd. (Fuji Xerox) to Fuji Photo Film Co, Ltd. (Fujifilm) for $1,283. In April 2001, we sold our leasing business in four Nordic countries to Resonia Leasing AB for cash proceeds of $352 (See Note 11). In July we completed the offering of floating rate asset backed notes supported by U.S. finance receivables for proceeds of $480 net of $3 paid in expenses and fees. As part of our plan to transition customer equipment financing to third parties, in September we announced a framework agreement with GE Capital under which, GE Capital's Vendor Financial Services Group will become the primary equipment financing provider for Xerox customers in the United States. We also agreed to the principal terms of a financing agreement under which we will receive approximately $1 billion from GE Capital, secured by portions of Xerox's U.S. finance receivables. Both agreements are subject to the completion of definitive agreements and the satisfactory completion of due diligence. (Refer to Note 14 - Subsequent Events for a discussion of our agreement with Flextronics.)~~

~~In 2000, we provided $105 for the Turnaround Program, $71 for severance and related costs and $34 for asset impairments associated with the disposition of a non core business. During the first nine months of 2001 we provided an additional $220, $192 for severance and related costs and $28 for asset impairments. The severance and related costs are related to the elimination of approximately 3,400 positions worldwide reflecting continued streamlining of existing work processes, elimination of redundant resources and the consolidation of activities into other existing operations. The asset impairments related primarily to manufacturing operations. Cash charges against the reserve for the first nine months were $126. Other reductions to the reserve, including currency, were $1. The cash charges were primarily for severance and related costs. The reserve balance at September 30, 2001 was $127.~~

~~SOHO Disengagement. In June 2001, the Company approved the disengagement from~~

our worldwide SOHO business. In connection with exiting this business, we recorded a second quarter pretax charge of $274 ($196 after taxes). The charge included provisions for the elimination of approximately 1,200 jobs worldwide by the end of 2001, the closing of facilities and the write down of certain assets to net realizable value. In the 2001 third quarter we reduced the original $274 provision by a net $12 as a result of changes in estimates for employee termination and de-commitment costs. This included the reversal of approximately $19 of previously recorded charges and additional charges of approximately $7. The year to date $262 pretax charge for the SOHO disengagement consists of $30 in employee termination costs, $144 of asset impairments, $29 in inventory charges, $24 in purchase commitments, $16 in decommitment costs and $19 in other miscellaneous charges. Charges against the SOHO disengagement reserve were $180 for asset impairments and $32 for severance and related costs. The reserve balance at September 30, 2001 was $49.

5. Common Shareholders' Equity:

Common shareholders' equity consists of:

	September 30, 2001	December 31, 2000
Common stock	$ 719	$ 670
Additional paid in capital	1,861	1,556
Retained earnings	3,105	3,441
Accumulated other comprehensive loss (1)	(2,611)	(2,174)
Total	$ 3,074	$ 3,493

(1) Accumulated other comprehensive loss at September 30, 2001 is comprised of cumulative translation of $2,550, minimum pension liability of $28, unrealized losses on marketable securities of $15, and mark to market losses on cash flow hedges of $18.

In January 2001, 0.8 million put options with a strike price of $40.56 per share were net cash settled for $28. Funds for this net cash settlement were obtained by selling 5.9 million unregistered shares of our common stock for proceeds of $28.

Comprehensive loss for the three months and nine months ended September 30, 2001 and 2000 is as follows:

	Three months ended September 30, 2001	Three months ended September 30, 2000	Nine months ended September 30, 2001	Nine months ended September 30, 2000
Net loss	$ (211)	$ (191)	$ (289)	$ (237)
Translation adjustments	(45)	(108)	(411)	(242)
Unrealized gains (losses)on marketable securities			(9)	14
Cash flow hedge adjustments	1		(18)	
Comprehensive loss	$ (255)	$ (299)	$ (727)	$ (465)

6. Interest expense and income:

Interest expense totaled $131 and $265 for the three months ended September 30, 2001 and 2000, respectively, and $683 and $739 for the nine months ended September 30, 2001 and 2000, respectively. Interest income totaled $211 and $236 for the three months ended September 30, 2001 and 2000, respectively, and $688 and $711 for the nine months ended September 30, 2001 and 2000, respectively.

7. Segment Reporting:

In the first quarter of 2001, we completed the realignment of our operations in order to more closely align our reportable segments with the markets that we serve. As a result of this realignment our reportable segments have been revised accordingly and are as follows: Production, Office, Small Office/Home Office, and Developing Markets Operations.

The Production segment includes DocuTech, production printing, color products for the production and graphic arts markets and light-lens copiers over 90 pages per minute sold to Fortune 1000, graphic arts and government, education and other public sector customers predominantly through direct sales channels in North America and Europe.

The Office segment includes our family of Document Centre digital multi-function products, light lens copiers under 90 pages per minute, color laser, solid ink and monochrome laser desktop printers, digital copiers and facsimile products sold through direct and indirect sales channels in North America and Europe. The Office market is comprised of global, national and mid-size commercial customers as well as government, education and other public sector customers.

The Small Office/Home Office (SOHO) segment includes inkjet printers and personal copiers sold through indirect channels in North America and Europe to small offices, home offices and personal users (consumers). As more fully discussed in Note 4, in June 2001 the Company approved the disengagement from the worldwide SOHO business.

The Developing Markets Operations segment (DMO) includes Latin America, Russia, India, the Middle East and Africa.

Other includes several units, none of which met the thresholds for separate segment reporting. This group primarily includes Xerox Engineering Systems and Xerox Supplies Group (predominantly paper). Other segment profit/(loss) includes certain corporate items such as non-financing interest expense which have not been allocated to the operating segments.

Operating segment profit/(loss) information for the three months ended September 30, 2001 and 2000 is as follows:

	Production	Office	SOHO	Developing Markets	Other	Total
2001						
Revenues from external customers	$ 1,377	$ 1,626	$ 109	$ 417	$ 373	$ 3,902
Intercompany revenues		(8)			8	
Total segment revenues	$ 1,377	$ 1,618	$ 109	$ 417	$ 381	$ 3,902
Segment profit/ (loss)	$ 45	$ 124	$ (49)	$ (76)	$ (249)	$ (205)
2000						
Revenues from external customers	$ 1,494	$ 1,713	$ 140	$ 635	$ 521	$ 4,503
Intercompany revenues	-	(4)	1	-	3	-
Total segment revenues	$ 1,494	$ 1,709	$ 141	$ 635	$ 524	$ 4,503
Segment profit/ (loss)	$ 29	$ (1)	$ (79)	$ (37)	$ (137)	$ (225)

Operating segment profit/(loss) information for the nine months ended September 30, 2001 and 2000 is as follows:

	Production	Office	SOHO	Developing Markets	Other	Total
2001						
Revenues from external customers	$ 4,277	$ 5,051	$ 326	$ 1,314	$ 1,273	$12,241
Intercompany revenues		(15)	(2)		17	
Total segment revenues	$ 4,277	$ 5,036	$ 324	$ 1,314	$ 1,290	$12,241
Segment profit/ (loss)(1)	$ 309	$ 354	$ (208)	$ (279)	$ (590)	$ (414)
2000						
Revenues from external customers	$ 4,622	$ 5,244	$ 439	$ 1,877	$ 1,638	$13,820
Intercompany revenues		(11)	1		10	
Total segment revenues	$ 4,622	$ 5,233	$ 440	$ 1,877	$ 1,648	$13,820
Segment profit/ (loss)(1)	$ 525	$ 183	$ (183)	$ 42	$ (216)	$ 351

(1) The following is a reconciliation of segment profit/(loss) to total Company Income (Loss) before Income Taxes (Benefits), Equity Income (Loss), Minorities' Interest, Extraordinary Gain and Cumulative Effect of Change in Accounting Principle:

Three months Nine months

	ended September 30,		ended September 30,	
	2001	2000	2001	2000
Total segment profit (loss)	$ (205)	$ (225)	$ (414)	$ 351
Restructuring:				
Inventory charges	(5)	-	(29)	(90)
Restructuring charge and asset impairments	(39)	-	(431)	(504)
Gain on sale of half of ownership interest in Fuji Xerox	-	-	769	-
Purchased in-process R&D	-	-	-	(27)
Equity in net income of unconsolidated affiliates	1	(10)	(32)	(78)*
Income (Loss) before Income Taxes (Benefits),Equity Income (Loss), Minorities' Interests, Extraordinary Gain and Cumulative Effect of Change in Accounting Principle	$ (248)	$ (235)	$ (137)	$ (348)

* Excludes $18 associated with our share of Fuji Xerox after tax restructuring expenses.

8. Receivables - Financing transactions:

In January 2001, we transferred $898 of finance receivables to a special purpose entity for cash proceeds of $435, received from an affiliate of General Electric Capital Corporation (GE Capital), and a retained interest of $463. The proceeds were accounted for as a secured borrowing. At September 30, 2001 the balance of receivables transferred was $624 and is included in Finance receivables, net in the Consolidated Balance Sheets. The remaining secured borrowing balance of $168 is included in Debt. The total proceeds of $435 are included in the Net Change in debt in the Consolidated Statements of Cash Flows. The borrowing will be repaid over 18 months and bears interest at the rate of 8.98 percent.

In July 2001, we completed the offering of $513 of floating rate asset backed notes and received cash proceeds of $480 million net of $3 million paid in expenses and fees. The remaining cash proceeds of approximately $30 will be held in reserve over the term of the asset backed notes. As part of the transaction we sold approximately $639 of domestic finance receivables to a qualified special purpose entity in which we have a retained interest of approximately $159, including the cash proceeds held in reserve. The transaction was accounted for as a sale of finance receivables at approximately book value.

In September 2001 Xerox and GE Capital announced a framework agreement for GE Capital's Vendor Financial Services Unit to become the primary equipment financing provider for Xerox customers in the United States. The two companies also agreed to the principal terms of a financing arrangement under which Xerox will receive from GE Capital approximately $1 billion secured by portions of Xerox's finance receivables in the United States. As part of this transaction, Xerox will transition nearly all of its U.S. customer administration operations into a co-managed joint venture with GE Capital Vendor Financial Services. It is anticipated that Xerox employees who work in Xerox customer financing and administration offices will join the new joint venture on January 2, 2002. Their work, which includes order processing, credit approval, financing programs, billing and collections, is expected to continue in the current locations. The arrangements are subject to the negotiation of definitive agreements and satisfaction of closing conditions, including completion of due diligence.

Refer to Note 11 - Divestitures for a discussion of the sale of certain of our European leasing businesses.

9. Accounting Changes - Accounting for Derivative Instruments:

We adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities", (SFAS No. 133) as of January 1, 2001. SFAS No. 133 requires companies to recognize all derivatives as assets or liabilities measured at their fair value. Gains or losses resulting from changes in the fair value of derivatives would be recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction.

Upon adoption of SFAS No. 133, we recorded a net cumulative after-tax loss of $2 in the first quarter statement of operations and a net cumulative after-tax loss of $19 in Accumulated Other Comprehensive Income. Further, as a result of recognizing all derivatives at fair value, including the differences between the carrying values and fair values of related hedged assets,

~~liabilities and firm commitments, we recognized a $403 increase in Total Assets and a $424 increase in Total Liabilities. Approximately $4 of the after tax loss of $19 recorded in Accumulated Other Comprehensive Income at transition has been reclassified to year to date earnings.~~

~~The adoption of SFAS 133 is expected to increase the future volatility of reported earnings and other comprehensive income. In general, the amount of volatility will vary with the level of derivative and hedging activities and the market volatility during any period. However, as more fully described in management's discussion of capital resources and liquidity, our ability to enter into new derivative contracts is severely constrained. The following is a summary of our FAS 133 activity during the first nine months of 2001:~~

~~Interest Rate/Cross Currency Swaps. We enter into several types of derivative agreements primarily to manage interest rate and currency exposures related to our indebtedness and to "match fund" our customer financing assets. We attempt to manage our exposures in total on an economic basis, considering our total portfolio of indebtedness, which includes fixed rate, variable rate and foreign currency borrowings with varying terms. Accordingly, while all of our derivative instruments are intended to economically hedge currency and interest rate risk, differences between the contract terms of our derivatives and the underlying related debt preclude hedge accounting in accordance with SFAS No. 133. This results in mark to market valuation of these derivatives directly through earnings which leads to increased earnings volatility.~~

~~During the third quarter we recorded a net gain of $46 from the mark to market valuation of our interest rate derivatives primarily as a result of lower interest rates during the period. Previous quarter mark to market valuations were not material, however, the mark to market valuation of certain cross currency interest rate swap agreements did result in a net gain of $14. This gain is net of the remeasurement of the underlying foreign currency debt and is included in Other, net.~~

~~Since May 2001, we designated certain cross currency interest rate swaps associated with 65 billion in Yen borrowings as fair value type hedges and accordingly accounted for them on a prospective basis. These borrowings have an underlying Yen fixed interest rate, which the swaps convert to a US dollar variable based rate. The net ineffective portion of these fair value hedges recorded in third quarter and year to date earnings was not material.~~

~~Currency Derivatives. We utilize forward exchange contracts and option contracts to hedge against the potentially adverse impacts of foreign currency fluctuations on foreign currency denominated assets and liabilities. Changes in the value of these currency derivatives are recorded in earnings together with the offsetting foreign exchange gains and losses on the underlying assets and liabilities.~~

~~We also utilize currency derivatives to hedge anticipated transactions, primarily forecasted purchases of foreign sourced inventory and lease payments. These contracts are accounted for as cash flow hedges, and changes in their value are deferred in Accumulated Other Comprehensive Income (AOCI) until the anticipated transaction is recognized through earnings. During the third quarter and first nine months of 2001, the impacts of our cash flow hedges recorded through AOCI were not material.~~

~~Net Investment Hedges. We also utilize currency derivatives to hedge against the potentially adverse impacts of foreign currency fluctuations on certain of our investments in foreign entities. During the third quarter and first nine months of 2001, $(5) and $12, respectively, of net after tax gains/(losses) related to hedges of our net investments in Xerox Brazil, Xerox Limited and Fuji Xerox were included in the cumulative translation adjustments account.~~

~~10. Debt for Equity Exchanges:~~

~~We retired $340 of long term debt through the exchange of 37.4 million shares of common stock valued at $283 in the first nine months of 2001. These retirements resulted in a pre tax extraordinary gain of $59 ($36 after taxes) for a net equity increase of $319.~~

~~11. Divestitures:~~

~~In March 2001, we completed the sale of half of our ownership interest in Fuji Xerox to Fujifilm for $1,283 in cash. The sale resulted in a pre-tax gain of $769 ($300 after taxes). Under the agreement, Fujifilm's ownership interest in Fuji Xerox increased from 50 percent to 75 percent. While Xerox's ownership interest decreased to 25 percent, we retain significant rights as a minority shareholder. All product and technology agreements between us and Fuji Xerox will continue, ensuring that the two companies retain uninterrupted access to each other's portfolio of patents.~~

~~In the second quarter of 2001, we sold our leasing businesses in four Nordic~~

~~countries to Resonia Leasing AB for $352 in cash and retained interests in certain finance receivables for total proceeds of approximately $370. The carrying value of the assets transferred was approximately $385. These sales are part of an agreement under which Resonia will provide on going, exclusive equipment financing to our customers in those countries.~~

~~12. Litigation:~~

~~On April 11, 1996, an action was commenced by Accuscan Corp. (Accuscan), in the United States District Court for the Southern District of New York, against the Company seeking unspecified damages for infringement of a patent of Accuscan which expired in 1993. The suit, as amended, was directed to facsimile and certain other products containing scanning functions and sought damages for sales between 1990 and 1993. On April 1, 1998, the jury entered verdict in favor of Accuscan for $40. However, on September 14, 1998, the court granted the Company's motion for a new trial on damages. The trial ended on October 25, 1999 with a jury verdict of $10. The Company's motion to set aside the verdict or, in the alternative, to grant a new trial was denied by the court. The Company appealed to the Court of Appeals for the Federal Circuit which found the patent not infringed, thereby terminating the lawsuit subject to an appeal which has been filed by Accuscan to the U.S. Supreme Court. The Company will file its opposition to the appeal.~~

~~On June 24, 1999, the Company was served with a summons and complaint filed in the Superior Court of the State of California for the County of Los Angeles. The complaint was filed on behalf of 681 individual plaintiffs claiming damages as a result of the Company's alleged disposal and/or release of hazardous substances into the soil, air and groundwater. On July 22, 1999, April 12, 2000, November 30, 2000, March 31, 2001 and May 24, 2001, respectively, five additional complaints were filed in the same court on behalf of an additional 79, 141, 76, 51, and 29 plaintiffs, respectively, with the same claims for damages as the June 1999 action. Four of the five additional cases have been served on the Company.~~

~~Plaintiffs in all six cases further allege that they have been exposed to such hazardous substances by inhalation, ingestion and dermal contact, including but not limited to hazardous substances contained within the municipal drinking water supplied by the City of Pomona and the Southern California Water Company. Plaintiffs' claims against Registrant include personal injury, wrongful death, property damage, negligence, trespass, nuisance, fraudulent concealment, absolute liability for ultra-hazardous activities, civil conspiracy, battery and violation of the California Unfair Trade Practices Act. Damages are unspecified.~~

~~The Company denies any liability for the plaintiffs' alleged damages and intends to vigorously defend these actions. The Company has not answered or appeared in any of the cases because of an agreement among the parties and the court to stay these cases pending resolution of several similar cases currently pending before the California Supreme Court. However, the court recently directed that the six cases against the Company be coordinated with a number of other unrelated groundwater cases pending in Southern California.~~

~~A consolidated securities law action entitled In re Xerox Corporation Securities Litigation is pending in the United States District Court for the District of Connecticut. Defendants are Registrant, Barry Romeril, Paul Allaire and G. Richard Thoman, former Chief Executive Officer, and purports to be a class action on behalf of the named plaintiffs and all other purchasers of Common Stock of the Company during the period between October 22, 1998 through October 7, 1999 (Class Period). The amended consolidated complaint in the action alleges that in violation of Section 10(b) and/or 20(a) of the Securities Exchange Act of 1934, as amended (34 Act), and Securities and Exchange Commission Rule 10b 5 thereunder, each of the defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of the Company's Common Stock during the Class Period by disseminating materially false and misleading statements and/or concealing material facts. The amended complaint further alleges that the alleged scheme: (i) deceived the investing public regarding the economic capabilities, sales proficiencies, growth, operations and the intrinsic value of the Company's Common Stock; (ii) allowed several corporate insiders, such as the named individual defendants, to sell shares of privately held Common Stock of the Company while in possession of materially adverse, non public information; and (iii) caused the individual plaintiffs and the other members of the purported class to purchase Common Stock of the Company at inflated prices. The amended consolidated complaint seeks unspecified compensatory damages in favor of the plaintiffs and the other members of the purported class against all defendants, jointly and severally, for all damages sustained as a result of defendants' alleged wrongdoing, including interest thereon, together with reasonable costs and expenses incurred in the action, including counsel fees and expert fees. On September 28, 2001, the court denied the defendants' motion for dismissal of the complaint. On November 5, 2001, the defendants answered the complaint. The named individual defendants and the Company deny~~

~~any wrongdoing and intend to vigorously defend the action.~~

~~A consolidated putative shareholder derivative action entitled In re Xerox Derivative Actions is pending in the Supreme Court of the State of New York, County of New York against several current and former members of the Board of Directors including William F. Buehler, B.R. Inman, Antonia Ax:son Johnson, Vernon E. Jordan, Jr., Yotaro Kobayashi, Hilmar Kopper, Ralph Larsen, George J. Mitchell, N.J. Nicholas, Jr., John E. Pepper, Patricia Russo, Martha Seger, Thomas C. Theobald, Paul Allaire, G. Richard Thoman, Anne Mulcahy and Barry Romeril, as well as the Company, as a nominal defendant. Previously, two separate derivative actions had been filed in that court and another had been pending in the United States District Court for the District of Connecticut. Defendants filed a motion to dismiss in one of the New York actions. Subsequently, the parties to the federal action in Connecticut agreed to dismiss that action without prejudice in favor of the earlier filed New York action. The parties also agreed, subject to court approval, to seek consolidation of the New York actions and a withdrawal, without prejudice, of the motion to dismiss. On May 10, 2001 the court entered an order which, among other things, approved that agreement. On or about October 16, 2001 the plaintiffs in the two prior New York actions and the federal action in Connecticut, along with one additional plaintiff filed an amended consolidated complaint. The amended complaint alleges that each of the individual defendants breached their fiduciary duties to the Company and its shareholders by, among other things, ignoring indications of a lack of oversight at the Company and the existence of flawed business and accounting practices within the Company's Mexican and other operations which allegedly caused serious harm to the Company; failing to have in place sufficient controls and procedures to monitor the Company's accounting practices; knowingly and recklessly disseminating and permitting to be disseminated, misleading information to shareholders and the investing public; and permitting the Company to engage in improper accounting practices. The amended complaint further alleges that each of the individual defendants breached their duties of due care and diligence in the management and administration of the Company's affairs and grossly mismanaged or aided and abetted the gross mismanagement of the Company and its assets. Further, the plaintiffs allege that the defendant members of the Audit Committee failed to adequately inform themselves about the Company's accounting practices and breached their fiduciary duties. On behalf of the Company, the plaintiffs seek a judgment that the individual defendants violated and/or aided and abetted the breach of their fiduciary duties to the Company and its shareholders, unspecified compensatory damages against the individual defendants, punitive damages, costs, and reasonable attorneys' and experts' fees. On August 2, 2001 the Commonwealth Court of Pennsylvania issued an order which, among other things, purported to stay, for a period of 180 days from August 2, 2001, certain actions pending against insured parties of Reliance Insurance Company, including this derivative litigation. On October 3, 2001 that court issued an order which, among other things, purports to supersede its previous order and stays, for a period of 90 days from October 3, 2001, all proceedings in which Reliance is obligated to defend a party. This litigation does not fall within that category. The individual defendants deny the wrongdoing alleged and intend to vigorously defend the litigation.~~

~~Twelve purported class actions had been pending in the United States District Court for the District of Connecticut against Registrant, KPMG LLP (KPMG), and Paul A. Allaire, G. Richard Thoman, Anne M. Mulcahy and Barry D. Romeril. A court order consolidated these twelve actions and established a procedure for consolidating any subsequently filed related actions. The consolidated action purports to be a class action on behalf of the named plaintiffs and all purchasers of securities of, and bonds issued by, Registrant during the period between February 15, 1998 through February 6, 2001 (Class). Among other things, the consolidated complaint generally alleges that each of the Company, KPMG, the individuals and additional defendants Philip Fishbach and Gregory Tayler violated Sections 10(b) and/or 20(a) of the 34 Act and Securities and Exchange Commission Rule 10b-5 thereunder, by participating in a fraudulent scheme that operated as a fraud and deceit on purchasers of the Company's Common Stock by disseminating materially false and misleading statements and/or concealing material adverse facts relating to the Company's Mexican operations and other matters relating to the Company's financial condition beyond the Company's Mexican operations. The amended complaint generally alleges that this scheme deceived the investing public regarding the true state of the Company's financial condition and caused the named plaintiff and other members of the alleged Class to purchase the Company's Common Stock and Bonds at artificially inflated prices. The amended complaint seeks unspecified compensatory damages in favor of the named plaintiff and the other members of the alleged Class against the Company, KPMG and the individual defendants, jointly and severally, including interest thereon, together with reasonable costs and expenses, including counsel fees and expert fees. Following the entry of the order of consolidation, several (nine) additional related class action complaints were filed in the same Court. In each of these cases, the plaintiffs defined a class consisting of persons who purchased the Common Stock of the Company during the period February 15, 1998 through and including February 6, 2001. Some of these plaintiffs filed objections to the consolidation order, challenging the~~

appointment of lead plaintiffs and lead and liaison counsel and have separately moved for the appointment of lead plaintiff and lead counsel. The court has not rendered a decision with regard to the objections or motion. On August 2, 2001 the Commonwealth Court of Pennsylvania issued an order which, among other things, purported to stay, for a period of 180 days from August 2, 2001, certain actions pending against insured parties of Reliance Insurance Company, including this consolidated securities law action. On October 3, 2001 that court issued an order which, among other things, purports to supersede its previous order and stays, for a period of 90 days from October 3, 2001, all proceedings in which Reliance is obligated to defend a party. This litigation does not fall within that category. The individual defendants and the Company deny any wrongdoing alleged in the complaints and intend to vigorously defend the actions.

A lawsuit has been instituted in the Superior Court, Judicial District of Stamford/Norwalk, Connecticut, by James F. Bingham, a former employee of the Company, against the Company, Barry D. Romeril, Eunice M. Filter and Paul Allaire. The complaint alleges that the plaintiff was wrongfully terminated in violation of public policy because he attempted to disclose to senior management and to remedy alleged accounting fraud and reporting irregularities. The plaintiff further claims that the Company and the individual defendants violated the Company's policies/commitments to refrain from retaliating against employees who report ethics issues. The plaintiff also asserts claims of defamation and tortious interference with a contract. He seeks: (a) unspecified compensatory damages in excess of $15 thousand, (b) punitive damages, and (c) the cost of bringing the action and other relief as deemed appropriate by the court. The individuals and the Company deny any wrongdoing and intend to vigorously defend the action.

A putative shareholder derivative action is pending in the Supreme Court of the State of New York, Monroe County against certain current and former members of the Board of Directors, namely G. Richard Thoman, Paul A. Allaire, B. R. Inman, Antonia Ax:son Johnson, Vernon E. Jordan Jr., Yotaro Kobayashi, Ralph S. Larsen, Hilmar Kopper, John D. Macomber, George J. Mitchell, N. J. Nicholas, Jr., John E. Pepper, Patricia L. Russo, Martha R. Seger and Thomas C. Theobald (collectively, the "Individual Defendants"), and the Company, as a nominal defendant. Plaintiff claims the Individual Defendants breached their fiduciary duties of care and loyalty to the Company and engaged in gross mismanagement by allegedly awarding former CEO, G. Richard Thoman, compensation including elements that were unrelated in any reasonable way to his tenure with the Company, his job performance, or the Company's financial performance. The complaint further specifically alleges that the Individual Defendants failed to exercise business judgment in granting Thoman lifetime compensation, a special bonus award, termination payments, early vesting of stock compensation, and certain transportation perquisites, all of which allegedly constituted gross, wanton and reckless waste of corporate assets of the Company and its shareholders. Plaintiff claims that the Company has suffered damages and seeks judgment against the Individual Defendants in an amount equal to the sum of the special bonus, the present value of the $800 thousand per year lifetime compensation, the valuation of all options unexercised upon termination, the cost of transportation to and from France, and/or an amount equal to costs already incurred under the various compensation programs, cancellation of unpaid balances of these obligations, and/or cancellation of unexercised options and other deferred compensation at the time of his resignation, plus the cost and expenses of the litigation, including reasonable attorneys', accountants' and experts' fees and other costs and disbursements. On May 31, 2001 defendants filed a motion to dismiss the complaint. The motion is pending. The Individual Defendants deny the wrongdoing alleged in the complaint and intend to vigorously defend the action.

A class was certified in an action originally filed in the United States District Court for the Southern District of Illinois last August against the Company's Retirement Income Guarantee Plan ("RIGP"). Plaintiffs bring this action on behalf of themselves and an alleged class of over 25,000 persons who received lump sum distributions from RIGP after January 1, 1990. Plaintiffs assert violations of the Employee Retirement Income Security Act ("ERISA"), claiming that the lump sum distributions were improperly calculated. The damages sought are not specified. On July 3, 2001 the court granted the Plaintiffs' motion for summary judgment, finding that the lump sum calculations violated ERISA. RIGP denies any wrongdoing and intends to appeal the District Court's ruling.

In 2000, the Company was advised that the Division of Enforcement of the Securities and Exchange Commission (SEC) had entered an order of a formal, non-public investigation into our accounting and financial reporting practices. The investigation initially focused on accounting and financial reporting practices in Mexico. Subsequent SEC inquiries have included certain of our accounting policies and procedures and the application thereof referred to in Note 2. We are cooperating fully with the SEC. Among ongoing SEC matters, the Company is also engaged in a review with the SEC's Division of Corporation Finance and its Office of the Chief Accountant concerning the Company's method

of accounting for sales type leases under the Financial Accounting Standard Board's Statement of Financial Accounting Standards No. 13 ("SFAS No. 13"). The review concerns whether the Company's method of applying SFAS No. 13 results in an appropriate allocation of revenue among the various elements of its sales type leases; equipment, financing, service and supplies. The Company believes both the methodology and the financial results it reports are in accordance with SFAS No. 13 and GAAP. The Company cannot predict when the SEC will conclude either its investigation or its review or the outcome or impact of either.

On June 19, 2001, an action was commenced by Pitney Bowes in the United States District Court for the District of Connecticut against the Company seeking unspecified damages for infringement of a patent of Pitney Bowes which expired on May 31, 2000. Plaintiff claims that two printers containing image enhancement functions infringe the patent and seeks damages in an unspecified amount for sales between June 1995 and May 2000. The Company filed their answer and counter claims on October 1, 2001. The Company denies any wrongdoing and intends to vigorously defend the action.

At this time we do not expect these matters to have a material adverse effect on our current financial position. However, these matters could have a material adverse effect on our future results of operations and cash flows.

13. New Accounting Pronouncements:

In June of 2001, the Financial Accounting Standards Board issued Statement No. 141, "Business Combinations" (SFAS No. 141). SFAS No. 141 requires the use of the purchase method of accounting for business combinations and prohibits the use of the pooling of interests method. The Company has not historically engaged in transactions that qualify for using the pooling of interest method and therefore, this aspect of the new rules will not have an impact on the Company's financial results. SFAS No. 141 also changes the definition of intangible assets acquired in a purchase business combination. As a result, the purchase price allocation of future business combinations may be different than the allocation that would have resulted under the old rules. Business combinations must be accounted for using SFAS No. 141 starting on July 1, 2001.

In June of 2001, the Financial Accounting Standards Board issued Statement No. 142 "Goodwill and Other Intangible Assets" (SFAS No. 142). The statement addresses financial accounting and reporting for acquired goodwill and other intangible assets. This statement recognizes that goodwill has an indefinite useful life and will no longer be subject to periodic amortization. However, goodwill will be tested at least annually for impairment in lieu of amortization. The Company recognized goodwill amortization expense of $14 and $44 in the third quarter and first nine months of 2001, respectively. The statement also requires the Company to perform transitional impairment tests on existing acquired goodwill and other intangible assets and evaluate those assets for proper classification. The Company is currently evaluating the impacts of this new standard on our financial statements. The Company will adopt this standard, as required, on January 1, 2002.

In June of 2001, The Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations". The Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long lived assets that result from the acquisition, construction, development and (or) the normal operation of a long lived asset, except for certain obligations of lessees. In August 2001, The Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long Lived Assets". The Statement primarily supercedes FASB Statement No. 121, Accounting for the Impairment of Long Lived Assets and for Long Lived Assets to Be Disposed of. This Statement addresses financial accounting and reporting for the impairment or disposal of long lived assets. Management believes that adoption of both Statements will not have a material effect on the financial position or results of operations of the Company. The Company will adopt the Statements, as required on January 1, 2003 and January 1, 2002, respectively.

14. Subsequent Events:

In October 2001, we announced a manufacturing agreement with Flextronics, a $12 billion global electronics manufacturing services company. The agreement includes a five year supply contract for Flextronics to manufacture certain office equipment and components, payment of approximately $220 million to Xerox for inventory, property and equipment at a modest premium over book value, and the assumption of certain liabilities. The premium will be amortized over the life of the five-year supply contract. The actual cash proceeds will vary, based upon the actual net asset levels at the time of the closings. As a result of these actions, we expect to incur restructuring charges in the fourth quarter of 2001. Additional information on the agreement with Flextronics is included in the accompanying Management's Discussion and Analysis on pages 30-31.

In October 2001, S&P reduced its rating of our senior debt to below investment grade. Additional information related to the downgrade is included in the accompanying Management's Discussion and Analysis on page 35.

As more fully discussed on page 36 in the accompanying Management's Discussion and Analysis, a European affiliate of Xerox Corporation repaid its 125 million GBP 8 3/4 percent Guaranteed Bonds on October 4, 2001 at 103% of par including accrued interest.

Item 2 Xerox Corporation
Management's Discussion and Analysis of
Results of Operations and Financial Condition

Results of Operations

Summary

As discussed in Note 2 to the Consolidated Financial Statements, we have restated our 1999 and 1998 financial statements. This restatement has also impacted the quarterly and year to date financial information previously presented for the period ended September 30, 2000. All dollar and per share amounts and financial ratios have been revised, as appropriate, for the effects of the restatement.

Total third quarter 2001 revenues of $3.9 billion declined 13 percent (12 percent pre currency) from $4.5 billion in the 2000 third quarter. This decline was driven by increased competitive pressure and continued weakness in the economy exacerbated by the events of September 11. While revenue in North America and Europe declined, both regions showed significant year over year profitability improvements led by North America. Developing Markets Operations third quarter 2001 revenues were 34 percent below the 2000 third quarter as we reconfigure our Latin American Operations to a new business approach prioritizing liquidity and profitable revenue rather than market share.

Total revenues in the first nine months of 2001 of $12.2 billion declined 11 percent (10 percent pre currency) from $13.8 billion in the first nine months of 2000. Year to date pre-currency revenue declines of 2 percent in North America and 5 percent in Europe were the result of a weak economic environment and competition partly offset by stabilization of the U.S. direct sales force.

Including additional net after-tax restructuring provisions of $37 million associated with the company's previously announced Turnaround Program and disengagement from our worldwide small office / home office (SOHO) business and a $1 million after tax gain on early retirement of debt, the third quarter 2001 net loss was $211 million. Excluding these items, the third quarter 2001 after tax loss was $175 million. In the 2001 third quarter, we incurred a $37 million loss in our worldwide SOHO operations. The 2001 third quarter loss reflected the revenue decline, but our operating margin stabilized together with an improvement in the gross margin.

The 2001 year to date net loss was $289 million compared to a net loss of $237 million in the first nine months 2000. 2001 special items included the following after tax charges - $190 million associated with the Company's disengagement from the SOHO business, $139 million related to the Company's previously announced Turnaround Program, and a $2 million loss from the implementation of SFAS 133. Special items also included the following after-tax gains - $300 million related to the March 2001 sale of half of our investment in Fuji Xerox Co., Ltd. (Fuji Xerox) to Fuji Photo Film Co. Ltd. (Fujifilm), and $36 million associated with the early retirement of debt. 2000 special items include a $423 million after tax restructuring provision and a $16 million after tax in process research and development charge associated with the January 1, 2000 acquisition of the Tektronix, Inc. Color Printing and Imaging Division (CPID).

Excluding all special items, the year to date 2001 net loss was $294 million compared with net income of $202 million in the first nine months of 2000.

Our loss per share was $0.29 in the 2001 third quarter. Excluding the $0.05 restructuring provision, the third quarter 2001 loss per share was $0.24 compared with $0.30 loss per share in the 2000 third quarter.

Including the $0.27 SOHO disengagement charge, $0.20 restructuring provision, $0.43 gain on the sale of Fuji Xerox, and $0.05 gain from the early retirement of debt, the year to date 2001 loss per share was $0.43. The year to date 2000 loss per share was $0.39 including charges of $0.66 for restructuring and acquired CPID in-process R&D. Excluding all special items, the 2001 year to date loss per share was $0.44 compared with $0.27 earnings per share in the first nine months of 2000.

In the ordinary course of business, management makes many estimates in the accounting for items that affect our reported results of operations and financial position. The following table summarizes the more significant of these estimates, and the changes therein, and their impacts on pre tax income (loss):

	Three months ended September 30,		Nine months ended September 30,	
	2001	2000	2001	2000
Impact on pre-tax income (loss):				
Provisions for doubtful accounts	$(186)	$(172)	$(401)	$(417)
Provisions for obsolete and excess inventory	(46)	(36)	(108)	(70)
Revenue allocations	(21)	18	(37)	50
Finance discount rates	(8)	-	(25)	22

The significant preceding items are analyzed as appropriate in succeeding sections of this Management's Discussion and Analysis of Operations and Financial Condition and/or the accompanying Notes to Consolidated Financial Statements.

Pre-Currency Growth

To understand the trends in the business, we believe that it is helpful to adjust revenue and expense growth (except for ratios) to exclude the impact of changes in the translation of European and Canadian currencies into U.S. dollars. We refer to this adjusted growth as "pre-currency growth." Latin American currencies are shown at actual exchange rates for both pre-currency and post-currency reporting, since these countries generally have volatile currency and inflationary environments.

A substantial portion of our consolidated revenues is derived from operations outside of the United States where the U.S. dollar is not the functional currency. When compared with the average of the major European and Canadian currencies on a revenue-weighted basis, the U.S. dollar was approximately 2 percent stronger in the 2001 third quarter than in the 2000 third quarter. As a result, currency translation had an unfavorable impact of approximately one percentage point on revenue growth.

Segment Analysis

Revenues and year-over-year revenue growth rates by segment are as follows (Dollars are in billions):

	2000 Full Year	Pre-Currency Revenue Growth								Q3 2001 Post Currency	
		2000					2001				
	Revenues	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	Revenues	Growth
Total Revenues	$18.7	8%	-%	(2)%	(9)%	(1)%	(5)%	(12)%	(12)%	$3.9	(13)%
Production	6.3	1	(2)	(8)	(12)	(6)	(2)	(8)	(7)	1.4	(8)
Office	7.1	4	5	4	(3)	2	3	(5)	(4)	1.6	(5)
SOHO	0.6	35	(3)	(2)	1	6	(24)	(30)	(22)	0.1	(23)
DMO	2.5	36	4	(3)	(21)		(21)	(31)	(33)	0.4	(34)
Other	2.2	7	(9)	(1)	(4)	(2)	(16)	(17)	(26)	0.4	(27)
Memo: Color	2.9	64	60	74	54	62	17	1	(4)	0.7	(6)

	YTD 2001		
		Revenue Growth	
	Revenues	Pre Currency	Post Currency
Total Revenues	$12.2	(10)%	(11)%
Production	4.3	(6)	(8)
Office	5.0	(2)	(4)
SOHO	0.3	(25)	(26)
DMO	1.3	(29)	(30)
Other	1.3	(20)	(22)
Memo: Color	2.1	4	2

2000 pre-currency revenue growth includes the beneficial impact of the January 1, 2000 acquisition of the Tektronix, Inc. Color Printing and Imaging Division.

Production revenues include DocuTech, Production Printing, color products for the production and graphic arts markets and light-lens copiers over 90 pages per minute sold predominantly through direct sales channels in North America and Europe. Third quarter 2001 revenues declined 8 percent (7 percent pre-currency). Third quarter 2001 pre-currency revenues declined 3 percent in North

~~America and 7 percent in Europe from the 2000 third quarter. Monochrome production revenue declines reflect the downturn in the economy, competitive product introductions and continued movement to distributed printing and electronic substitutes. In addition, revenue was adversely impacted by reduced DocuTech sales to Fuji Xerox and unfavorable product mix reflecting installations of the recently introduced DocuTech 75 and DocuPrint 75. Post equipment install revenues continue to be adversely affected by reduced equipment placements in earlier quarters and lower print volumes. Production color revenues declined as the weaker economic environment impacted sales of color equipment and competitive product introductions continued. Revenues from the successful DocuColor 2000 series, which began shipments in June 2000, continued to grow reflecting increased equipment sales and recurring revenues. Reduced DocuColor 30/40 and mid-range installs combined with more aggressive pricing resulted in revenue declines. Production revenues represented 35 percent of third quarter 2001 revenues compared with 33 percent in the 2000 third quarter. Third quarter 2001 gross margin for the production segment improved from the 2000 third quarter as significant improvement in document outsourcing margins and improved service productivity were only partially offset by unfavorable mix.~~

~~Production revenues declined 8 percent (6 percent pre-currency) in the first nine months of 2001 from the first nine months of 2000 due to a weaker economic environment and continued movement to distributed printing and electronic substitutes. Good growth in production color revenues are not yet sufficient to offset monochrome declines.~~

~~Office revenues include our family of Document Centre digital multi-function products; light lens copiers under 90 pages per minute; and our color laser, solid ink and monochrome laser desktop printers, digital copiers and facsimile products sold through direct and indirect sales channels in North America and Europe. Third quarter 2001 revenues declined 5 percent (4 percent pre-currency) from the third quarter 2000. Black and white revenues declined as equipment sales were impacted by the weaker economy, continued competitive pressures and light lens declines and our decision in Europe to reduce our participation in very aggressively priced competitive customer bids and tenders as we reorient our focus from market share to profitable revenue. Shipments of the Document Centre 490, the fastest in its class at 90 pages per minute began in North America in September. European launch is scheduled for the first quarter 2002. Strong office color revenue growth was driven by continued growth in the Document Centre ColorSeries 50 partially offset by office color printer equipment sales declines. The Document Centre ColorSeries 50 is the industry's first color-enabled digital multi-function product. Office revenues represented 41 percent of third quarter 2001 revenues compared with 38 percent in the 2000 third quarter. Third quarter 2001 gross margin for the office segment improved significantly from the 2000 third quarter primarily as a result of our reduced participation in very aggressively priced competitive bids and tenders, improving Document Centre margins facilitated by strong Document Centre 480 placements and initial Document Centre 490 placements, improved manufacturing and service productivity, favorable currency and significantly improved document outsourcing margins.~~

~~Office revenues declined 4 percent (2 percent pre-currency) in the first nine months of 2001 from the first nine months of 2000 as strong office color revenue growth was insufficient to offset black and white declines.~~

~~Small Office/Home Office (SOHO) revenues include inkjet printers and personal copiers sold through indirect channels in North America and Europe. On June 14, 2001 we announced our disengagement from the SOHO business. Third quarter and year-to-date 2001 SOHO revenues declined 23 percent (22 percent pre-currency) and 26 percent (25 percent pre-currency), respectively, from the 2000 periods and gross margin declined as we exit this business and reduce equipment inventory in a very difficult market environment. SOHO revenues represented 3 percent of third quarter and year to date revenues in both 2001 and 2000.~~

~~Developing Markets Operations (DMO) includes operations in Latin America, Russia, India, the Middle East and Africa. Third quarter 2001 revenue declined significantly in Brazil from the 2000 third quarter reflecting reduced equipment placements and the transition of its business model to maximize liquidity and profitable revenue rather than market share, compounded by an average 29 percent devaluation in the Brazilian Real. During the third quarter and first nine months of 2000 revenues in Brazil included structured transactions, as discussed below, of $30 million and $111 million, respectively; there were no similar arrangements in the 2001 third quarter and first nine months.~~

~~Revenue declined throughout the other Latin American countries due to weaker economies and our decision to focus on liquidity and profitable revenue rather than market share. DMO revenues represented 11 percent of third quarter 2001 revenues compared with 14 percent in the 2000 third quarter. DMO incurred a substantial pre-tax loss in the third quarter 2001. Gross margin declined in DMO as a result of lower equipment and service margins, currency devaluation~~

not offset by price increases, weak mix and the absence of any structured transactions in Brazil.

DMO revenues decreased 30 percent (29 percent pre-currency) in the first nine months of 2001 from the first nine months of 2000 reflecting reduced equipment placements, an increased competitive environment, the lack of structured transactions in 2001, and lower prices as we focused on reducing inventory, compounded by a 21 percent devaluation in the Real.

Since 1985 the company, primarily in North America, has sold pools of equipment subject to operating leases to third party finance companies (the counter-party) and recorded these transactions as sales at the time the equipment is accepted by the counter party. The various programs provided us with additional funding sources and/or enhanced credit positions. The counter party accepts the risks of ownership of the equipment. Remanufacturing and remarketing of off-lease equipment belonging to the counter party is performed by the company on a nondiscriminatory basis for a fee. North American transactions are structured to provide cash proceeds up front from the counter party versus collection over time from the underlying customer lessees. There were $22 of sales of equipment subject to operating leases in North America in the third quarter and first nine months of 2000, none in the first nine months of 2001. The reduction of operating lease revenues as a result of prior year sales of equipment on operating leases was $9 million and $15 million in the third quarter of 2001 and 2000, respectively, and $30 million and $52 million in the first nine months of 2001 and 2000, respectively.

Beginning in 1999 several Latin American affiliates entered into certain structured transactions involving contractual arrangements which transferred the risks of ownership of equipment subject to operating leases to third party financial companies who are obligated to pay the Company a fixed amount each month. The Company accounts for these transactions similar to its sales type leases. The counter party assumes the risks associated with the payments from the underlying customer lessees thus mitigating risk and variability from the cash flow stream. The following shows the effects of such sales of equipment under structured finance arrangements offset by the associated reductions of operating lease revenues from current and prior year transactions:

	Three months Ended September 30,		Nine months Ended September 30,	
	2001	2000	2001	2000
Sales of equipment	$ -	$ 30	$ -	$ 111
Reduced Operating Lease Revenue	(27)	(34)	(89)	(92)
Net revenue impact	$ (27)	$ (4)	$ (89)	$ 19

Over time the number and value of the contracts will vary depending on the number of operating leases entered into in any given period, the willingness of third party financing institutions to accept the risks of ownership, and our consideration as to the desirability of entering into such arrangements. At this time, the Company does not expect to enter into any structured transactions for the remainder of 2001.

Key Ratios and Expenses

The trend in key ratios was as follows:

	2000					2001			
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3	YTD
Gross Margin	39.1%*	40.4%	35.0%	35.1%	37.4%*	33.6%	35.8%**	36.1%**	35.2%**
SAG % Revenue	28.0	28.8	31.7	32.2	30.2	27.4	30.6	31.1	29.6

*Includes inventory charges associated with the 2000 restructuring. If excluded the gross margin would have been 41.1 percent and 37.9 percent, respectively.
**Includes inventory charges associated with the SOHO disengagement. If excluded the gross margin would have been 36.4 percent for second quarter, 36.2 percent for the third quarter and 35.4 percent for the first nine months of 2001.

The third quarter 2001 gross margin improved by 1.2 percentage points from the 2000 third quarter as improved manufacturing and service productivity and favorable currency were only partially offset by unfavorable mix. Weak performance in DMO reduced the gross margin by 0.7 percentage points. Excluding SOHO operations, the 2001 third quarter gross margin was 37.7 percent.

Including inventory charges associated with the SOHO disengagement, the gross

margin was 35.2 percent for the first nine months of 2001, a decline of 3.0 percentage points from the first nine months of 2000 gross margin which includes inventory charges associated with the 2000 restructuring program. Excluding the 2001 SOHO inventory charges and the 2000 restructuring inventory charges, the gross margin for the first nine months of 2001 was 35.4 percent compared to 38.9 percent in the first nine months of 2000. Approximately two percentage points of the decline was due to weak activity in Developing Markets, primarily in Brazil, as well as lower lease residual values being recognized in 2001 versus the prior year, and the absence of the previously described structured transactions. In addition, improved asset management practices, lower activity levels and unfavorable mix adversely impacted gross margin.

Selling, administrative and general expenses (SAG) declined 15 percent (14 percent pre-currency) in the 2001 third quarter from the third quarter 2000. SAG declined 11 percent (10 percent pre-currency) in the first nine months of 2001 from the first nine months of 2000. SAG declines in both the third quarter and first nine months reflect continued benefits from our Turnaround Program including significantly lower labor costs and advertising and marketing communications spending. These reductions were partially offset by increased professional costs related to our regulatory filings and related matters and higher costs incurred by Developing Markets Operations in the renegotiation of customer contracts associated with implementation of their new business approach. Third quarter 2001 bad debt provisions of $186 million were $14 million higher than the 2000 third quarter despite an improvement in Mexico. Increased provisions in North America primarily associated with higher risk smaller customers in this weakened economic environment more than offset the significant 2000 third quarter provisions in Mexico. Bad debt provisions were $401 million and $417 million for the first nine months of 2001 and 2000, respectively. In the 2001 third quarter, SAG represented 31.1 percent of revenue compared with 31.7 percent of revenue in the 2000 third quarter. SAG represented 29.6 percent of revenue in the first nine months of 2001 compared with 29.5 percent of revenue in the first nine months of 2000.

Research and development (R&D) expense was $15 million and $5 million higher in the 2001 third quarter and first nine months, respectively, compared to the 2000 third quarter and first nine months due to increased iGen3 expenses. R&D spending was 7 percent and 6 percent of revenue in the 2001 third quarter and first nine months, respectively, as we continue to invest in technological development, particularly color, to maintain our position in the rapidly changing document processing market. Xerox R&D remains technologically competitive and is strategically coordinated with Fuji Xerox.

Worldwide employment declined by 2,300 and 8,900 in the 2001 third quarter and first nine months, respectively, to 83,300 primarily as a result of employees leaving the company under our restructuring programs. Excluding divestitures, worldwide employment has declined by 10,900 since implementation of our Turnaround Program in October 2000.

Other, net was $119 million in the 2001 third quarter compared to $115 million in the third quarter 2000. In the third quarter 2001 we incurred $54 million of net currency losses resulting from the remeasurement of unhedged foreign currency denominated assets and liabilities. These currency exposures are unhedged in 2001 largely due to our restricted access to the derivatives markets. Also included in Other, net in the 2001 third quarter is $10 million of property losses related to the September 11 incident. In addition, the 2000 third quarter included approximately $30 million of non-recurring interest income related to an income tax refund receivable. Lower third quarter 2001 net non-financing interest expense of $94 million primarily reflects lower interest rates and lower debt levels as compared to the prior year, including net gains of $46 million from the mark to market of our remaining interest rate swaps required to be recorded as a result of applying SFAS 133 accounting rules. This was primarily driven by sharply lower variable rates in the quarter. Differences between the contract terms of our interest rate swaps and the underlying related debt preclude hedge accounting treatment in accordance with SFAS 133 which requires us to record the mark to market valuation of these derivatives directly through earnings. Due to the inherent volatility in the interest and foreign currency markets, the company is unable to predict the amount of the above noted remeasurement and mark to market gains or losses in future periods.

The year to date 2001 increase in Other, net of $96 million was primarily due to a $48 million increase in Brazilian indirect taxes, approximately $30 million of non-recurring interest income in 2000 related to an income tax refund receivable and gains in 2000 of $75 million associated with the sale of the North American commodity paper business and sales of other assets. These unfavorable items were offset by a decrease of $64 million in net non-financing interest expense reflecting our lower net debt levels and lower interest rates.

During the fourth quarter of 2000 we announced a Turnaround Program in which we outlined a wide-ranging plan to sell assets, cut costs and strengthen our

strategic core. We announced plans that were designed to reduce costs by at least $1.0 billion annually, the majority of which will affect 2001. As part of the cost cutting program, we continue to take additional charges for finalized initiatives under the Turnaround Program. As a result of these actions, in the third quarter of 2001 we provided an incremental $56 million to complete our open initiatives under the Turnaround plan. For the first nine months of 2001, we have provided a total of $220 million under this plan. We expect additional provisions will be required in 2001 as additional plans are finalized. The restructuring reserve balance at September 30, 2001 for both the Turnaround Program and the March 2000 program amounted to $142 million.

In connection with the disengagement from our SOHO business, we recorded a second quarter pretax charge of $274 million ($196 million after taxes). The charge includes provisions for the elimination of approximately 1,200 jobs worldwide by the end of 2001, the closing of facilities and the write down of certain assets to net realizable value. In the 2001 third quarter, changes in estimates for employee termination and decommitment costs reduced the original reserve by approximately $12 million. The year to date $262 million pretax charge for the SOHO disengagement consists of approximately $30 million in employee termination costs, $144 million of asset impairments, $29 million in inventory charges, $24 million in purchase commitments, $16 million in decommitment costs, and $19 million in other miscellaneous charges. The SOHO disengagement reserve balance at September 30, 2001 was $49 million.

Over the remainder of the fourth quarter we will discontinue our line of personal inkjet and xerographic printers, copiers, facsimile machines and multi function devices which are sold primarily through retail channels to small offices, home offices and personal users (consumers). We intend to sell the remaining inventory through current channels. We will continue to provide service, support and supplies, including the manufacturing of such supplies, for customers who currently own SOHO products during a phase down period to meet customer commitments.

Income Taxes, Equity in Net Income of Unconsolidated Affiliates and Minorities' Interests in Earnings of Subsidiaries

Our pre tax loss was $(248) million in the 2001 third quarter including the restructuring provisions. Excluding these items, the pre tax loss was $(204) million in the 2001 third quarter compared to a loss of $(235) million in the 2000 third quarter.

Including the effect of special items, pre-tax loss was $(137) million in the first nine months of 2001 compared to a $(348) million loss for the first nine months of 2000. Excluding special items, the pre-tax loss was $(455) million for the first nine months 2001 compared to pre-tax income of $273 million for the first nine months 2000. 2001 special items included a net charge of $262 million related to the SOHO disengagement, a $190 million net charge in connection with our existing restructuring programs and a gain of $769 million related to the sale of half our ownership in Fuji Xerox. In the first nine months of 2000, special items included a $594 million charge related to the 2000 restructuring program and a $27 million charge for acquired in-process research and development associated with the CPID acquisition.

The effective tax rate, including the net tax benefit related to additional restructuring provisions and an adjustment to the underlying tax rate on the 2001 first half loss was 22.6 percent in the 2001 third quarter. Excluding these items, the 2001 third quarter and year to date tax rates were 33.7 percent compared to 34.9 percent in the 2000 third quarter. This reduction in the tax rate is due primarily to continued losses in low tax rate jurisdictions where losses could not be tax effected, offset by a favorable tax audit.

The third quarter change in the tax rate from 42.0 percent to 33.7 percent required a catch up adjustment to the previously recorded first half tax benefits. This catch up adjustment reduced the tax benefit and increased the third quarter 2001 net loss by $21 million. A similar 2000 third quarter adjustment reduced that tax benefit and increased the 2000 net loss by $41 million.

Equity in net income of unconsolidated affiliates is principally our 25 percent share of Fuji Xerox income. Total equity in net income declined by $11 million and $29 million in the 2001 third quarter and first nine months, respectively, due primarily to our reduced ownership in Fuji Xerox. Our share of total Fuji Xerox net income of $4 million and $27 million in the 2001 third quarter and first nine months, respectively, decreased by $11 million and $39 million from the 2000 periods.

In the first nine months of 2001, we retired $340 million of debt through the exchange of 37.4 million shares of common stock valued at $283 million, resulting in pre-tax extraordinary gains of $59 million ($36 million after taxes) for a net equity increase of approximately $319 million.

~~In the 2001 second quarter, we sold our leasing businesses in four European countries to Resonia Leasing AB for proceeds of approximately $370 million. These sales are part of an agreement under which Resonia will provide on-going, exclusive equipment financing to our customers in those countries.~~

~~In July 2001, we completed the offering of $513 million of floating rate asset backed notes. In conjunction with this offering, we received cash proceeds of $480 million net of $3 million paid in expenses and fees. The remaining cash proceeds of approximately $30 million will be held in reserve over the term of the asset backed notes. As part of the transaction we sold approximately $639 million of domestic finance receivables to a qualified special purpose entity in which we have a retained interest of approximately $159 million, including the cash proceeds held in reserve. The transaction was accounted for as a sale of finance receivables at approximately book value.~~

~~In September 2001 Xerox and GE Capital announced a framework agreement for GE Capital's Vendor Financial Services Unit to become the primary equipment financing provider for Xerox customers in the United States. The two companies also agreed to the principal terms of a financing arrangement under which Xerox will receive from GE Capital approximately $1 billion secured by portions of Xerox's finance receivables in the United States.~~

~~As part of this transaction, Xerox will transition nearly all of its U.S. customer administration operations into a co-managed joint venture with GE Capital Vendor Financial Services. It is anticipated that Xerox employees who work in Xerox customer financing and administration offices will join the new joint venture on January 2, 2002. Their work, which includes order processing, credit approval, financing programs, billing and collections, is expected to continue in the current locations, ensuring further continuity for Xerox customers and employees. The arrangements are expected to close in the fourth quarter subject to the negotiation of definitive agreements and satisfaction of closing conditions, including completion of due diligence.~~

~~In October 2001, we announced a manufacturing agreement with Flextronics, a $12 billion global electronics manufacturing services company. The agreement includes a five year supply contract for Flextronics to manufacture certain office equipment and components, payment of approximately $220 million to Xerox for inventory, property and equipment at a modest premium over book value, and the assumption of certain liabilities. The premium will be amortized over the life of the five year supply contract. As a result of these actions, we expect to incur restructuring charges in the fourth quarter of 2001.~~

~~Flextronics will purchase four Xerox office products manufacturing operations including selected manufacturing assets and inventory. The approximately 3,650 current Xerox employees in these operations are expected to transfer to Flextronics. We will also stop production by the end of the second quarter 2002 at our printed circuit board factory in El Segundo, California, and our customer replaceable unit plant in Utica, New York. Flextronics will build this work into its global network of manufacturing plants. In addition, we have begun consultations with European works councils regarding the sale of our office manufacturing operations in Venray, The Netherlands, and the transfer to Flextronics of some production work currently performed at our site in Mitcheldean, England. In total, the agreement with Flextronics represents approximately 50 percent of our overall manufacturing operations. The first sales are expected to close in the fourth quarter, beginning a one year transition period for Flextronics to assume manufacturing of Xerox designed office products and related components. The actual cash proceeds will vary, based upon the actual net asset levels at the time of the closings.~~

~~We adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), as of January 1, 2001. Upon adoption of SFAS No. 133 we recorded a net cumulative after tax loss of $2 million in the first quarter Income Statement and a net cumulative after tax loss of $19 million in Accumulated Other Comprehensive Income. The adoption of SFAS No. 133 is expected to increase the future volatility of reported earnings and other comprehensive income. In general, the amount of volatility will vary with the level of derivative and hedging activities and the market volatility during any period.~~

~~Additional details regarding the effects of SFAS No. 133 on the quarter and year-to-date results are included in Note 9 of the "Notes to Consolidated Financial Statements".~~

~~The $21 million gain on affiliate's sale of stock in the first quarter 2000 reflected our proportionate share of the increase in equity of Scansoft Inc. (NASDAQ:SSFT) resulting from Scansoft's issuance of stock in connection with an acquisition. This gain was partially offset by a $5 million charge reflecting our share of Scansoft's write-off of in-process research and development associated with this acquisition, which is included in Equity in net income of~~

unconsolidated affiliates.

See footnote No. 13 in the Notes to Consolidated Financial Statements for a discussion of the impact of recently issued accounting standards.

Capital Resources and Liquidity

Xerox and its material subsidiaries and affiliates have cash management systems and internal policies and procedures for managing the availability of worldwide cash, cash equivalents and liquidity resources. They are subject to (i) statutes, regulations and practices of the local jurisdictions in which the companies operate, (ii) legal requirements of the agreements to which the companies are parties and (iii) the policies and continuing cooperation of the financial institutions utilized by the companies to maintain such cash management systems.

At September 30, 2001, cash on hand was $2,427 million versus $1,741 million at December 31, 2000, and total debt was $16,076 million versus $18,097 million at December 31, 2000. Total debt net of cash on hand (Net Debt) decreased by $2,707 million in the first nine months of 2001 versus an increase of $2,168 million in the first nine months of 2000. As of September 30, 2001, Net Debt has decreased by $3,394 million since our Turnaround Program was initiated on September 30, 2000. The consolidated ratio of total debt to common and preferred equity was 4.4:1 as of both September 30, 2001 and December 31, 2000. This ratio reflects our decision, beginning in the fourth quarter of 2000, to accumulate cash to maintain financial flexibility, rather than continue our historical practice of using available excess cash to pay down debt. Had our cash balance at September 30, 2001 and December 31, 2000 been reduced to historical levels by paying off debt, the debt to equity ratio would have been approximately 3.7:1 and 4.0:1, respectively.

We historically managed the capital structures of our non financing operations and our captive financing operations separately. We are in the process of exiting the customer equipment financing business, and we are no longer managing our liquidity on a financing / non financing basis. Accordingly, we believe that a review of operating cash flow and earnings before interest, income taxes, depreciation, amortization and special items (EBITDA) provides the most meaningful understanding of our changes in cash and debt balances.

The following is a summary of EBITDA, operating and other cash flows for the nine months ended September 30, 2001 and 2000:

	2001	2000
Net Loss	$ (289)	$ (237)
Income tax provision (benefit)	209	(84)
Depreciation and amortization	794	794
Restructuring charges	452	594
Interest expense	683	739
Gains on sales of businesses	(754)	(63)
Other items	26	(26)
EBITDA	1,121	1,717
Less financing and interest income	(689)	(711)
Adjusted EBITDA	432	1,006
Working capital and other changes	496	(669)
On Lease equipment spending	(176)	(350)
Capital spending	(159)	(324)
Restructuring payments	(368)	(222)
Interest Payments	(819)	(739)
Operating Cash Flow (Usage)*	(594)	(1,298)
Financing Cash Flow	1,568	(65)
Debt borrowings (repayments), net	(1,530)	2,619
Dividends and other non operating items	(393)	(462)
Proceeds from sales of businesses	1,635	90
Acquisitions		(856)
Net Change in Cash	$ 686	$ 28

* The primary difference between this amount and the Cash Flows from Operations reported in our Statements of Cash Flows, is the inclusion of Capital Spending in, and the exclusion of Financing Cash Flow from, the amount shown above.

Operating cash usage in the first nine months of 2001 decreased by approximately $700 million, to $(594) million, versus $(1,298) million usage in the prior year period. Excluding the effect of a $315 million accounts receivable securitization in the third quarter of 2000, operating cash flow improved by over $1 billion. The improvement was driven by significant reductions in working capital. Lower investments in on-lease equipment and

~~capital spending only partially offset higher restructuring payments and the negative cash flow impacts of weak operating results on EBITDA. The working capital improvements stem largely from a significant reduction in inventories and lower tax payments in the first nine months of 2001 compared to the same period in 2000. The significant inventory reduction reflects management actions to improve inventory turns, and changes in the supply/demand and logistics processes. The decline in 2001 capital spending versus 2000 is due primarily to substantial completion of our Ireland projects as well as significant spending constraints. We expect full-year 2001 capital spending to be approximately 50 percent below 2000 levels. Investments in on-lease equipment reflect the growth in our document outsourcing business, which we expect will continue to grow in the remainder of 2001.~~

~~Cash restructuring payments of $368 million reflect continued progress with respect to our Turnaround Program. The status of the restructuring reserves is discussed in Note 4 to the Consolidated Financial Statements.~~

~~The increase in financing cash flow in 2001 includes the sale of asset-backed securities in July 2001 for net proceeds of $480 million. The remaining cash flow improvement reflects the lower equipment sales in the first nine months of 2001 versus the year ago period, which resulted in a lower level of finance receivable originations.~~

~~Dividends and other non-operating items in the first nine months of 2001 totaled $(393) million, including a premium payment of $45 million to Ridge Reinsurance, a payment of $255 million related to our funding of trusts to replace Ridge Reinsurance letters of credit, and dividends of $93 million. The 2000 amount of $(462) million includes dividends of $441. The improvement in 2001 versus 2000 is due to our elimination of dividends which we announced in July 2001, offset by the Ridge Reinsurance trust funding requirement.~~

~~In the first nine months of 2001, we generated approximately $1.6 billion of cash from the sale of half our interest in Fuji Xerox and the sale of our leasing businesses in four European countries as discussed below. These asset sales, together with the significant improvements in operating and financing cash flows and the absence in 2001 of acquisitions, which used cash of $856 in the first nine months of 2000, funded debt repayments of $1.5 billion in 2001, versus incremental borrowings of $2.6 billion in 2000, and generated a net cash increase of $658 million.~~

~~Liquidity and Funding Plans for 2001~~

~~Historically, our primary sources of funding have been cash flows from operations, borrowings under our commercial paper and term funding programs, and securitizations of finance and trade receivables. Our overall funding requirements have been to finance customers' purchases of our equipment, to fund working capital and capital expenditure requirements, and to finance acquisitions.~~

~~During 2001 and 2000, the agencies that assign ratings to our debt downgraded the Company's debt several times. As of October 31, 2001, senior and short-term debt ratings by Moody's are Ba1 and Not Prime, respectively, and the outlook is negative; ratings by Fitch are BB and B, respectively, and the outlook is stable; and ratings by Standard and Poors (S&P) are BB and B, respectively, and the outlook is stable. Since October 2000, uncommitted bank lines of credit and the unsecured capital markets have been, and are expected to continue to be, largely unavailable to us. We expect this to result in higher borrowing costs going forward, and this may also result in Xerox Corporation having to increase its level of intercompany lending to affiliates. In addition, the Company does not expect to be able to access the capital markets in registered public offerings pending resolution of the review of the Company's accounting practices by the Securities and Exchange Commission referred to in Note 12 to the Consolidated Financial Statements.~~

~~As a result of the debt downgrades described above, in the fourth quarter 2000 we drew down the entire $7.0 billion available to us under our Revolving Credit Agreement (the "Revolver"), primarily to maintain financial flexibility and pay down debt obligations as they came due. We are in compliance with the covenants, terms and conditions in the Revolver, which matures on October 22, 2002. The only financial covenant in the Revolver requires us to maintain a minimum of $3.2 billion of Consolidated Tangible Net Worth, as defined ("CTNW").~~

~~At September 30, 2001, our CTNW was $182 million in excess of the minimum requirement, a decrease of approximately $330 million from the December 31, 2000 level. The decrease is due to operating and restructuring losses and unfavorable foreign currency translation during that period of time, offset partially by the favorable impacts of gains on asset sales and debt-for-equity exchanges described below. Further operating losses, restructuring costs and adverse currency translation adjustments would erode this excess, while operating income, gains on asset sales, favorable currency translation, and~~

exchanges of debt for equity would increase this excess. We expect to be in continued compliance with the covenant.

The Company has recently initiated discussions with its agent banks to refinance a portion of the Revolver and extend its maturity beyond October 2002. Failure to successfully refinance and extend the maturity of the Revolver or a breach of the CTNW covenant could have a serious adverse effect on our liquidity.

In the first nine months of 2001, we retired $340 million of long-term debt through the exchange of 37.4 million shares of common stock of the Company, which increased CTNW by approximately $319 million. Since September 30, 2001 we have retired an additional $35 million of debt through the exchange of 3.8 million additional shares, which increased our CTNW by an estimated $32 million.

As of September 30, 2001, we had approximately $1.3 billion of debt obligations expected to be repaid during the remainder of 2001, and $9.0 billion maturing in 2002, as summarized below (in billions):

	2001	2002
First Quarter		$0.3
Second Quarter		1.0
Third Quarter		0.1
Fourth Quarter	$1.3	7.6*
Full Year	$1.3	$9.0

* Includes $7.0 billion maturity under the Revolver

In 2000 we announced a global Turnaround Program which includes initiatives to sell certain assets, improve operations and liquidity, and reduce annual costs by at least $1 billion. As of September 30, 2001 we had made significant progress toward these objectives, which we believe will positively affect our capital resources and liquidity position when completed.

With respect to asset sale initiatives, in the fourth quarter of 2000 we sold our China operations to Fuji Xerox Co., Ltd. ("Fuji Xerox"), generating $550 million of cash and transferring $118 million of debt to Fuji Xerox. In March 2001, we sold half of our interest in Fuji Xerox to Fuji Photo Film Co., Ltd. for $1,283 million in cash. On October 2, 2001, we announced an agreement under which Flextronics, a Singapore company, will purchase certain assets and assume certain liabilities related to our office segment manufacturing facilities in several locations around the world. We expect to receive cash proceeds of approximately $220 million in phases over the next year, including a significant portion in the fourth quarter 2001, as each of the applicable locations is sold. Under this agreement, Flextronics will manufacture certain of our office segment equipment and components for a period of five years.

We have initiated discussions to implement third party vendor financing programs which will significantly reduce our debt and finance receivables levels going forward. In addition, we are in discussions to consider selling portions of our existing finance receivables portfolios, and we continue to actively pursue alternative forms of financing including securitizations and secured borrowings. In connection with these initiatives, in January 2001, we received $435 million in financing from an affiliate of GE Capital, secured by our portfolio of lease receivables in the United Kingdom. In the second quarter of 2001, we sold our leasing businesses in four Nordic countries to Resonia Leasing AB for $352 million in cash plus retained interests in certain finance receivables for total proceeds of approximately $370 million. These sales are part of an agreement under which Resonia will provide on going, exclusive equipment financing to our customers in those countries. In July 2001, we sold $513 million of floating rate asset backed notes for cash proceeds of $480 million net of $3 million of expenses and fees. An additional $30 million of proceeds will be held in reserve until the notes are repaid, which we currently estimate will occur in August 2003. As part of the transaction, we sold approximately $639 million of domestic finance receivables to a qualified special purpose entity in which we have a retained interest of $159 million, which includes the $30 million cash reserve. The transaction was accounted for as a sale of finance receivables.

On September 11, 2001, we announced a Framework Agreement with GE Capital's Vendor Financial Services group, under which GE Capital will become the primary equipment financing provider for our U.S. customers. We also announced an agreement under which we will receive a loan of approximately $1 billion from GE Capital, secured by certain of our lease receivables in the United States. We expect both of these agreements to be completed in the fourth quarter 2001.

~~On June 5, 2001, we had announced our receipt of a commitment letter from Bankers Trust Company, a subsidiary of Deutsche Bank, for a fully underwritten secured revolving borrowing facility of $500 million. As a result of the commencement of discussions to refinance the Revolver, as well as the progress we have made to date on the global initiatives discussed above, we have allowed the Bankers Trust loan commitment to expire unutilized.~~

~~With $2.4 billion of cash on hand at September 30, 2001, we believe our liquidity is presently sufficient to meet current and anticipated needs going forward, subject to timely implementation and execution of the various global initiatives discussed above and our ability to successfully refinance a portion of the Revolver and extend its maturity beyond October, 2002. Should we be unable to successfully complete these initiatives or refinance and extend the maturity of the Revolver on a timely or satisfactory basis, we will need to obtain additional sources of funds through further operating improvements, financing from third parties, additional asset sales including sales or securitizations of our receivables portfolios, or a combination thereof. The adequacy of our continuing liquidity depends on our ability to successfully generate positive cash flow from an appropriate combination of these sources.~~

~~On December 1, 2000, Moody's reduced its rating of our senior debt to below investment grade, significantly constraining our ability to enter into new foreign currency and interest rate derivative agreements, and requiring us to immediately repurchase certain of our then outstanding derivative agreements. On October 23, 2001, S&P reduced its rating of our senior debt to below investment grade, further constraining our ability to enter into new derivative agreements, and requiring us to immediately repurchase certain of our then outstanding out of the money interest rate and cross currency interest rate derivative agreements for a total of $148 million. To minimize the resulting interest and currency exposures, we replaced two of the terminated derivatives with a derivative contract involving a new counterparty. That contract will require us to collateralize any out of the money positions going forward. Our remaining consolidated derivative portfolio at October 31, 2001, included $15 million of out of the money contracts which are contractually subject to termination by the related counterparties. The fair market values of all of our derivative contracts change with fluctuations in interest rates and currency rates where applicable, as discussed in the Risk Management section below.~~

~~In the third quarter 2000, Xerox Credit Corporation (XCC) securitized certain finance receivables in the United States, generating gross proceeds of $411 million. This facility was accounted for as a secured borrowing. In the third quarter 2000, Xerox Corporation securitized certain accounts receivable in the United States, generating gross proceeds of $315 million. This revolving facility was accounted for as a sale of receivables. In December 2000, as a result of the senior debt downgrade by Moody's discussed above, Xerox Corporation renegotiated the $315 million accounts receivable securitization facility, reducing the facility size to $290 million. The facility size will remain at $290 million unless and until our senior debt is downgraded to or below a Ba2 rating by Moody's, at which time we would seek to renegotiate the terms of the facility.~~

~~In January 2001, we paid $28 million to settle 0.8 million outstanding equity put options at their strike price of approximately $41 per share, which we funded by issuing 5.9 million unregistered common shares.~~

~~On October 4, 2001, a European affiliate of Xerox Corporation convened a second meeting of holders of its 125 million GBP 8 3/4 percent Guaranteed Bonds, issued in 1993 and maturing in 2003 (the "Bonds"), in order to consider a proposal to repay the Bonds early at 103% of par plus accrued interest. At the meeting, Bondholders holding approximately 79% of the outstanding amount voted in favor of the proposal. On October 11, 2001, the Bonds were repaid for 129 million GBP (approximately $184 million) plus accrued interest. Repaying the Bonds early has reduced outstanding indebtedness and eliminated certain restrictive covenants in the Bonds and related documents, thereby providing additional flexibility to Xerox and its subsidiaries and affiliates in connection with their cash management systems and practices. Repaying the bonds will also reduce future interest costs.~~

~~Risk Management~~

~~We are typical of multinational corporations because we are exposed to market risk from changes in foreign currency exchange rates and interest rates that could affect our results of operations and financial condition.~~

~~We have historically entered into certain derivative contracts, including interest rate swap agreements, forward exchange contracts and foreign currency swap agreements, to manage interest rate and foreign currency exposures. These instruments are held solely to hedge economic exposures; we do not enter into derivative instrument transactions for trading purposes, and we employ long-standing policies prescribing that derivative instruments are only to be used to achieve a set of very limited objectives. As described above, our ability to~~

currently enter into new derivative contracts is severely constrained. Therefore, while the following paragraphs describe our overall risk management strategy, our current ability to employ that strategy effectively has been severely limited.

Currency derivatives are primarily arranged to manage the risk of exchange rate fluctuations associated with assets and liabilities that are denominated in foreign currencies. Our primary foreign currency market exposures include the Japanese Yen, Euro, Brazilian Real, British Pound Sterling and Canadian Dollar. For each of our legal entities, we have historically hedged a significant portion of all foreign-currency-denominated cash transactions. From time to time (when cost-effective) foreign-currency-denominated debt and foreign-currency derivatives have been used to hedge international equity investments.

Virtually all customer-financing assets earn fixed rates of interest. Therefore, we have historically sought to "lock in" an interest rate spread by arranging fixed-rate liabilities with similar maturities as the underlying assets, and we have funded the assets with liabilities in the same currency. As part of this overall strategy, pay fixed rate/receive variable rate interest rate swaps are often used in place of more expensive fixed rate debt. Additionally, pay variable rate/receive fixed rate interest rate swaps are used from time to time to transform longer term fixed rate debt into variable rate obligations. The transactions performed within each of these categories enable more cost-effective management of interest rate exposures by eliminating the risk of a major change in interest rates. We refer to the effect of these conservative practices as "match funding" customer financing assets.

Consistent with the nature of economic hedges, unrealized gains or losses from interest rate and foreign currency derivative contracts are designed to offset any corresponding changes in the value of the underlying assets, liabilities or debt. As described above, the downgrades of our debt during 2000 and 2001 and the ongoing SEC investigation have significantly reduced our access to capital markets. Furthermore, the specific downgrades of our debt on December 1, 2000, and October 23, 2001, required us to repurchase a number of derivative contracts which were then outstanding, and we could contractually be required to repurchase additional contracts which are currently outstanding. Therefore, we are largely precluded from utilizing derivative agreements to manage the risks associated with interest rate and foreign currency fluctuations, including our ability to continue effectively employing our match funding strategy, and we anticipate increased volatility in our results of operations due to market changes in interest rates and foreign currency rates.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

The information set forth under the caption "Risk Management" on pages 36-37 of this Quarterly Report on Form 10-Q is hereby incorporated by reference in answer to this Item.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth under Note 12 contained in the "Notes to Consolidated Financial Statements" on pages 17-21 of this Quarterly Report on Form 10-Q is incorporated by reference in answer to this item.

Item 2. Changes in Securities

(a) During the quarter ended September 30, 2001, registrant issued the following securities in transactions which were not registered under the Securities Act of 1933, as amended (the Act):

(1) Securities Sold: on July 1, 2001, Registrant issued 9,925 shares of Common stock, par value $1 per share.

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

(3) The shares were issued at a deemed purchase price of $9.57 per share (aggregate price $94,875), based upon the market value on the date of issuance, in payment of the quarterly Directors' fees pursuant to Registrant's Restricted Stock Plan for Directors.

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

(b) In addition, during the quarter ended September 30, 2001, Registrant issued an aggregate of 1,225,019 shares of Common Stock in the following transactions, all of which were not registered under the Act by reason of the exemption from registration under the Act provided by Section 3(a)(9) of the Act:

Date issued ...	July 27
Aggregate amount of consideration received by Registrant ...	$12,000,000
Aggregate number of shares of Common Stock issued by Registrant ...	1,225,019
Aggregate value of Common Stock delivered by Registrant ...	$10,245,000
Names of the principal underwriters ...	None

The "Aggregate amount of consideration received by Registrant" in Item 2(b) above represents the aggregate principal amount (or the aggregate accreted value, in the case of original issue discount securities) of the outstanding publicly issued debt securities of Registrant which the holders of such debt securities exchanged for the number of shares of Common Stock specified in "Aggregate number of shares of Common Stock issued by Registrant" in Item 2(b) above.

The "Aggregate value of Common Stock delivered by Registrant" in Item 2(b) above represents the multiple of the "Aggregate number of shares of Common Stock issued by Registrant", times either a fixed price per share of Common Stock or the average of the closing price, or the volume weighted average price, per share of Common Stock on the New York Stock Exchange over a certain number of days.

In each of the transactions described in Item 2(b) above, Registrant issued shares of Common Stock pursuant to the exemption from registration under the Act provided by Section 3(a)(9) of the Act. Registrant's reliance upon the Section 3(a)(9) exemption from registration is premised upon the facts that the shares of Common Stock were issued by Registrant to the then holders of outstanding publicly issued debt securities of Registrant solely in exchange for such debt securities, that each of the exchanges was effected pursuant to an unsolicited offer from such holder of debt securities, and that no commission or remuneration was paid or given directly or indirectly in connection with any such exchange.

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

The Annual Meeting of Shareholders of Xerox Corporation was duly called and held on August 28, 2001 at Sheraton Stamford, 2701 Summer Street, Stamford, Connecticut.

Proxies for the meeting were solicited on behalf of the Board of Directors of the Registrant pursuant to Regulation 14A of the General Rules and Regulations of the Commission. There was no solicitation in opposition to the Board of Directors' nominees for election as directors as listed in the Proxy Statement, and all nominees were elected.

At the meeting, votes were cast upon the election of directors as described in the Proxy Statement for the meeting (filed with the Commission pursuant to Regulation 14A and incorporated herein by reference)as follows:

Name	For	Withheld Vote
Paul A. Allaire	314,123,843	9,137,191
Antonia Ax:son Johnson	314,255,064	9,005,971
Vernon E. Jordan, Jr.	313,752,971	9,508,064
Yotaro Kobayashi	314,254,376	9,006,659

Hilmar Kopper	314,264,433	8,996,602
Ralph S. Larsen	314,252,811	9,008,223
Anne M. Mulcahy	314,254,119	9,006,915
George J. Mitchell	314,110,372	9,150,663
N. J. Nicholas, Jr.	314,270,426	8,990,608
John E. Pepper	314,268,329	8,992,705
Barry D. Romeril	314,141,449	9,119,586
Martha R. Seger	314,213,894	9,047,141
Thomas C. Theobald	314,225,849	9,035,186

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibit 3(a)(1) Restated Certificate of Incorporation of Registrant filed by the Department of State of the State of New York on October 29, 1996. Incorporated by reference to Exhibit 3(a)(1) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1996.

Exhibit 3 (b) By-Laws of Registrant, as amended through October 8, 2001.

Exhibit 11 Computation of Net Income (Loss) per Common Share.

Exhibit 12 Computation of Ratio of Earnings to Fixed Charges.

(b) Current reports on Form 8-K dated July 9, 2001, July 26, 2001 and September 11, 2001 reporting Item 5 "Other Events" were filed during the quarter for which this Quarterly Report is filed.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

XEROX CORPORATION
(Registrant)

/s/ Gary R. Kabureck

Date: November 13, 2001

By Gary R. Kabureck
Assistant Controller and
Chief Accounting Officer
(Principal Accounting Officer)

Exhibit 3(b)

BY LAWS AMENDED THROUGH October 8, 2001

BY LAWS

of

XEROX CORPORATION

October 8, 2001

ARTICLE I

MEETINGS OF STOCKHOLDERS

SECTION 1. Annual Meetings: A meeting of shareholders entitled to vote shall be held for the election of Directors and the transaction of other business each year in such month and on such day (except a Saturday, Sunday, or holiday) as determined by the Board of Directors.

SECTION 2. Special Meetings: Special Meetings of the shareholders may be called at any time by the Chairman of the Board, the President or the Board of Directors.

SECTION 3. Place of Meetings: Meetings of shareholders shall be held at the principal office of the Company or at such other place, within or without the State of New York, as may be fixed by the Board of Directors.

SECTION 4. Notice of Meetings:

(a) Notice of each meeting of shareholders shall be in writing and shall state the place, date and hour of the meeting. Notice of a Special Meeting shall state the purpose or purposes for which it is being called and shall also indicate that it is being issued by or at the direction of the person or persons calling the meeting. If, at any meeting, action is proposed to be taken which would, if taken, entitle shareholders, fulfilling the requirements of Section 623 of the Business Corporation Law to receive payment for their shares, the notice of such meeting shall include a statement of that purpose and to that effect.

(b) A copy of the notice of any meeting shall be given, personally or by mail, not less than ten nor more than sixty days before the date of the meeting, to each shareholder entitled to vote at such meeting. If mailed, such notice is given when deposited in the United States mail, with postage thereon prepaid, directed to the shareholder at his or her address as it appears on the record of shareholders, or, if he or she shall have filed with the Secretary a written request that notices to him or her be mailed to some other address, then directed to him or her at such other address.

(c) Notice of meeting need not be given to any shareholder who submits a signed waiver of notice, in person or by proxy, whether before or after the meeting. The attendance of any shareholder at a meeting, in person or by proxy, without protesting prior to the conclusion of the meeting the lack of notice of such meeting, shall constitute a waiver of notice by him or her.

SECTION 5. Quorum and Adjourned Meetings:

(a) At any Annual or Special Meeting the holders of a majority of the votes of shares entitled to vote thereat, present in person or by proxy, shall constitute a quorum for the transaction of any business, provided that when a specified item of business is required to be voted on by a class or series, voting as a class, the holders of a majority of the votes of shares of such class or series shall constitute a quorum for the transaction of such specified item of business. When a quorum is once present to organize a meeting, it is not broken by the subsequent withdrawal of any shareholders.

(b) Despite the absence of a quorum, the shareholders present may adjourn the meeting to another time and place, and it shall not be necessary to give any notice of the adjourned meeting if the time and place to which the meeting is adjourned are announced at the meeting at which the adjournment is taken. At the adjourned meeting any business may be transacted that might have been transacted on the original date of the meeting. If after the adjournment, however, the Board of Directors fixes a new record date for the adjourned meeting, a notice of the adjourned

~~meeting shall be given to each shareholder on the new record date entitled to notice under Section 4 of this Article I of the By Laws.~~

~~SECTION 6. Nominations and Business at Meetings:~~

~~At any annual meeting of shareholders, only persons who are nominated or business which is proposed in accordance with the procedures set forth in this Section 6 shall be eligible for election as Directors or considered for action by shareholders. Nominations of persons for election to the Board of Directors of the Company may be made or business proposed at a meeting of shareholders (i) by or at the direction of the Board of Directors or (ii) by any shareholder of the Company entitled to vote at the meeting who complies with the notice and other procedures set forth in this Section 6. Such nominations or business proposals, other than those made by or at the direction of the Board of Directors, shall be made pursuant to timely notice in writing to the Secretary of the Company and such business proposals must, under applicable law, be a proper matter for shareholder action. To be timely, a shareholder's notice shall be delivered to or mailed and received at the principal executive offices of the Company not less than 120 days nor more than 150 days in advance of the date which is the anniversary of the date the Company's proxy statement was released to security holders in connection with the previous year's annual meeting; provided, that, if the Company did not hold such previous year's annual meeting or if the anniversary date of the current year's annual meeting has been changed by more than 30 days from the date of the previous year's annual meeting, then such shareholder's notice shall be so delivered or mailed and received within a reasonable time before the Company begins to print and mail its proxy statement.~~

~~Such shareholder's notice shall set forth (a) as to each person whom such shareholder proposes to nominate for election or reelection as a Director, all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (including such person's written consent to being named in the proxy statement as a nominee and to serving as a Director if elected); (b) as to any other business that the shareholder proposes to bring before the meeting, a brief description of the business desired to be brought before the annual meeting, the reasons for conducting such business at the annual meeting and any material interest in such business of such person on whose behalf such proposal is made; and (c) as to the shareholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made, (i) the name and address of such shareholder, as they appear on the Company's books and (ii) the class and number of shares of the Company which are beneficially owned by such shareholder. No person shall be eligible for election as a Director of the Company and no business shall be conducted at the annual meeting of shareholders unless nominated or proposed in accordance with the procedures set forth in this Section 6. The Chairman of the meeting may, if the facts warrant, determine and declare to the meeting that a nomination or proposal was not made in accordance with the provisions of this Section 6 and, if he or she should so determine, he or she shall so declare to the meeting and the defective nomination or proposal shall be disregarded.~~

~~SECTION 7. Organization: At every meeting of the shareholders, the Chairman of the Board, or in his or her absence if the President is a Director, the President, or if the President is not a Director or is absent, a Vice Chairman, or in the absence of such officers, an Executive Vice President designated by the Chairman of the Board, or in the absence of such officers, a person selected by the meeting, shall act as chairman of the meeting. The Secretary or, in his or her absence, an Assistant Secretary shall act as secretary of the meeting, and in the absence of both the Secretary and an Assistant Secretary, a person selected by the meeting shall act as secretary of the meeting.~~

~~SECTION 8. Voting:~~

~~(a) Whenever any corporate action, other than the election of Directors, is to be taken by vote of the shareholders, it shall, except as otherwise required by law or by the Certificate of Incorporation be authorized by a majority of the votes cast in favor of or against such action at a meeting of shareholders by the holders of shares entitled to vote thereon. An abstention shall not constitute a vote cast.~~

~~(b) Directors shall, except as otherwise required by law, be elected by a plurality of the votes cast at a meeting of shareholders by holders of shares entitled to vote in the election.~~

~~SECTION 9. Qualification of Voters:~~

~~(a) Every shareholder of record of Common Stock and Series B Convertible Preferred Stock of the Company shall be entitled at every meeting of such shareholders to one vote for every share of Common Stock and Series B~~

~~Convertible Preferred Stock, respectively, standing in his or her name on the record of shareholders.~~

~~(b) Shares of stock belonging to the Company and shares held by another domestic or foreign corporation of any type or kind, if a majority of the shares entitled to vote in the election of directors of such other corporation is held by the Company, shall not be shares entitled to vote or to be counted in determining the total number of outstanding shares.~~

~~(c) Shares held by an administrator, executor, guardian, conservator, committee, or other fiduciary, except a trustee, may be voted by him or her, either in person or by proxy, without transfer of such shares into his or her name. Shares held by a trustee may be voted by him or her, either in person or by proxy, only after the shares have been transferred into his or her name as trustee or into the name of his or her nominee.~~

~~(d) Shares standing in the name of another domestic or foreign corporation of any type or kind may be voted by such officer, agent or proxy as the By Laws of such corporation may provide, or in the absence of such provision, as the Board of Directors of such corporation may provide.~~

~~SECTION 10. Proxies:~~

~~(a) Every shareholder entitled to vote at a meeting of shareholders or to express consent or dissent without a meeting may authorize another person or persons to act for him or her by proxy.~~

~~(b) No proxy shall be valid after the expiration of eleven months from the date thereof unless otherwise provided in the proxy. Every proxy shall be revocable at the pleasure of the shareholder executing it, except as otherwise provided by law.~~

~~(c) The authority of the holder of a proxy to act shall not be revoked by the incompetence or death of the shareholder who executed the proxy unless, before the authority is exercised, written notice of an adjudication of such incompetence or of such death is received by the Secretary or an Assistant Secretary.~~

~~(d) Without limiting the manner in which a shareholder may authorize another person or persons to act for him or her as proxy pursuant to paragraph (a) of this Section, the following shall constitute a valid means by which a shareholder may grant such authority:~~

~~(1) A shareholder may execute a writing authorizing another person or persons to act for him or her as proxy. Execution may be accomplished by the shareholder or the shareholder's authorized officer, director, employee or agent signing such writing or causing his or her signature to be affixed to such writing by any reasonable means including, but not limited to, by facsimile signature.~~

~~(2) A shareholder may authorize another person or persons to act for the shareholder as proxy by transmitting or authorizing the transmission of a telegram, cablegram or other means of electronic transmission to the person who will be the holder of the proxy or to a proxy solicitation firm, proxy support service organization or like agent duly authorized by the person who will be the holder of the proxy to receive such transmission, provided that such telegram, cablegram or other means of electronic transmission must either set forth or be submitted with information from which it can be reasonably determined that the telegram, cablegram or other electronic transmission was authorized by the shareholder. If it is determined that such telegrams, cablegrams or other electronic transmissions are valid, the inspectors shall specify the nature of the information upon which they relied.~~

~~(e) Any copy, facsimile telecommunication or other reliable reproduction of the writing or transmission created pursuant to paragraph (d) of this Section may be substituted or used in lieu of the original writing or transmission for any and all purposes for which the original writing or transmission could be used, provided that such copy, facsimile, telecommunication or other reproduction shall be a complete reproduction of the entire original writing or transmission.~~

~~SECTION 11. Inspectors of Election:~~

~~(a) The Board of Directors, in advance of any shareholders' meeting, shall appoint one or more inspectors to act at the meeting or any adjournment thereof. The Board of Directors may designate one or more persons as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate has been appointed, or if such persons are unable to act at a meeting of shareholders, the person presiding at a shareholders' meeting shall appoint one or more inspectors. Each inspector, before entering upon the~~

discharge of his or her duties, shall take and sign an oath faithfully to execute the duties of inspector at such meeting with strict impartiality and according to the best of his or her ability.

(b) The inspectors shall determine the number of shares outstanding and the voting power of each, the shares represented at the meeting, the existence of a quorum, the validity and effect of proxies, and shall receive votes, ballots or consents, hear and determine all challenges and questions arising in connection with the right to vote, count and tabulate all votes, ballots or consents, determine the result, and do such acts as are proper to conduct the election or vote with fairness to all shareholders. On request of the person presiding at the meeting or any shareholder entitled to vote thereat, the inspectors shall make a report in writing of any challenge, question or matter determined by them and execute a certificate of any fact found by them. Any report or certificate made by them shall be prima facie evidence of the facts stated and of the vote as certified by them.

SECTION 12. List of Shareholders at Meetings: A list of shareholders as of the record date, certified by the Secretary or by the transfer agent, shall be produced at any meeting of shareholders upon the request thereat or prior thereto of any shareholder. If the right to vote at any meeting is challenged, the inspectors of election, or person presiding thereat shall require such list of shareholders to be produced as evidence of the right of the persons challenged to vote at such meeting, and all persons who appear from such list to be shareholders entitled to vote thereat may vote at such meeting.

ARTICLE II

BOARD OF DIRECTORS

SECTION 1. Power of Board and Qualification of Directors: The business of the Company shall be managed under the direction of the Board of Directors, each of whom shall be at least eighteen years of age.

SECTION 2. Number, Term of Office and Classification:

(a) The Board of Directors shall consist of not less than five nor more than twenty-one members. The number of Directors shall be determined from time to time by resolution of a majority of the entire Board of Directors then in office, provided that no decrease in the number of Directors shall shorten the term of any incumbent Director. At each Annual Meeting of shareholders Directors shall be elected to hold office until the next annual meeting.

(b) If and whenever six full quarter-yearly dividends (whether or not consecutive) payable on the Cumulative Preferred Stock of any series shall be in arrears, in whole or in part, the number of Directors then constituting the Board of Directors shall be increased by two and the holders of the Cumulative Preferred Stock, voting separately as a class, regardless of series, shall be entitled to elect the two additional Directors at any annual meeting of shareholders or special meeting held in place thereof, or at a special meeting of the holders of the Cumulative Preferred Stock called as hereinafter provided. Whenever all arrears in dividends on the Cumulative Preferred Stock then outstanding shall have been paid and dividends thereon for the current quarter-yearly dividend period shall have been paid or declared and set apart for payment, then the right of the holders of the Cumulative Preferred Stock to elect such additional two Directors shall cease (but subject always to the same provisions for the vesting of such voting rights in the case of any similar future arrearages in dividends), and the terms of office of all persons elected as Directors by the holders of the Cumulative Preferred Stock shall forthwith terminate and the number of the Board of Directors shall be reduced accordingly. At any time after such voting power shall have been so vested in the Cumulative Preferred Stock, the Secretary of the Company may, and upon the written request of any holder of the Cumulative Preferred Stock (addressed to the Secretary at the principal office of the Company) shall, call a special meeting of the holders of the Cumulative Preferred Stock for the election of the two Directors to be elected by them as herein provided, such call to be made by notice similar to that provided in the By-Laws for a special meeting of the shareholders or as required by law. If any such special meeting required to be called as above provided shall not be called by the Secretary within twenty days after receipt of any such request, then any holder of Cumulative Preferred Stock may call such meeting, upon the notice above provided, and for that purpose shall have access to the stock books of the Company. The Directors elected at any such special meeting shall hold office until the next annual meeting of the shareholders or special meeting held in place thereof. In case any vacancy shall occur among the Directors elected by the holders of the Cumulative Preferred Stock, a successor shall be elected to serve until the next annual meeting of the shareholders or special meeting held in place thereof by the then remaining Director elected by the holders of the Cumulative Preferred Stock or the successor of such remaining Director.

~~(c) All Directors shall have equal voting power.~~

~~SECTION 3. Organization: At each meeting of the Board of Directors, the Chairman of the Board, or in his or her absence, the President, or in his or her absence, a chairman chosen by a majority of the Directors present shall preside. The Secretary shall act as secretary of the Board of Directors. In the event the Secretary shall be absent from any meeting of the Board of Directors, the meeting shall select its secretary.~~

~~SECTION 4. Resignations: Any Director of the Company may resign at any time by giving written notice to the Chairman of the Board, the President or to the Secretary of the Company. Such resignation shall take effect at the time specified therein or, if no time be specified, then on delivery.~~

~~SECTION 5. Vacancies: Newly created directorships resulting from an increase in the number of Directors and vacancies occurring in the Board of Directors for any reason except the removal of Directors without cause may be filled by a vote of a majority of the Directors then in office, although less than a quorum exists. A Director elected to fill a vacancy shall hold office until the next annual meeting.~~

~~SECTION 6. Place of Meeting: The Board of Directors may hold its meetings at such place or places within or without the State of New York as the Board of Directors may from time to time by resolution determine.~~

~~SECTION 7. First Meeting: On the day of each annual election of Directors, the Board of Directors shall meet for the purpose of organization and the transaction of other business. Notice of such meeting need not be given. Such first meeting may be held at any other time which shall be specified in a notice given as hereinafter provided for special meetings of the Board of Directors.~~

~~SECTION 8. Regular Meetings: Regular meetings of the Board of Directors may be held at such times as may be fixed from time to time by resolution of the Board of Directors without notice.~~

~~SECTION 9. Special Meetings: Special meetings of the Board of Directors shall be held whenever called by the Chairman of the Board, the President, or by any two of the Directors. Oral, telegraphic or written notice shall be given, sent or mailed not less than one day before the meeting and shall state, in addition to the purposes, the date, place and hour of such meeting.~~

~~SECTION 10. Waivers of Notice: Notice of a meeting need not be given to any Director who submits a signed waiver of notice whether before or after the meeting, or who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to him or her.~~

~~SECTION 11. Quorum and Manner of Acting:~~

~~(a) If the number of Directors is twelve or more, seven Directors shall constitute a quorum for the transaction of business or any specified item of business. If the number of Directors is less than twelve, a majority of the entire Board of Directors shall constitute a quorum.~~

~~(b) A majority of the Directors present, whether or not a quorum is present, may adjourn any meeting to another time and place without notice to any Director.~~

~~SECTION 12. Written Consents: Any action required or permitted to be taken by the Board of Directors or any committee thereof may be taken without a meeting if all members of the Board or the committee consent in writing to the adoption of a resolution authorizing the action. The resolution and the written consents thereto by the members of the Board or committee shall be filed with the minutes of the proceedings of the Board or committee.~~

~~SECTION 13. Participation At Meetings By Telephone: Any one or more members of the Board of Directors or any committee thereof may participate in a meeting of such Board or committee by means of a conference telephone or similar communications equipment allowing all persons participating in the meeting to hear each other at the same time. Participation by such means shall constitute presence in person at a meeting.~~

~~SECTION 14. Compensation: The Board of Directors shall have authority to fix the compensation of Directors for services in any capacity.~~

~~SECTION 15. Interested Directors:~~

~~(a) No contract or other transaction between the Company and one or more of its Directors, or between the Company and any other corporation, firm, association or other entity in which one or more of its Directors are~~

~~directors or officers, or are financially interested, shall be either void or voidable for this reason alone or by reason alone that such Director or Directors are present at the meeting of the Board of Directors, or of a committee thereof, which approves such contract or transaction, or that his or her or their votes are counted for such purpose, provided that the parties to the contract or transaction establish affirmatively that it was fair and reasonable as to the Company at the time it was approved by the Board, a committee, or the shareholders.~~

~~(b) Any such contract or transaction may not be avoided by the Company for the reasons set forth in (a) if~~

~~(1) the material facts as to such Director's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the Board or committee, and the Board or committee approves such contract or transaction by a vote sufficient for such purpose without counting the vote of such interested Director or, if the votes of the disinterested Directors are insufficient for such purpose, by unanimous vote of the disinterested Directors (although common or interested Directors may be counted in determining the presence of a quorum at a meeting of the Board or of a committee which approves such contract or transactions), or~~

~~(2) the material facts as to such Director's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the shareholders entitled to vote thereon, and such contract or transaction is approved by vote of such shareholders.~~

~~SECTION 16. Loans to Directors: The Company may not lend money to or guarantee the obligation of a Director of the Company unless the particular loan or guarantee is approved by the shareholders, with the holders of a majority of the shares entitled to vote thereon constituting a quorum, but shares held of record or beneficially by Directors who are benefited by such loan or guarantee shall not be entitled to vote or to be included in the determination of a quorum.~~

~~ARTICLE III~~

~~EXECUTIVE COMMITTEE~~

~~SECTION 1. How Constituted and Powers: There shall be an Executive Committee, consisting of not less than three nor more than nine Directors, including the Chairman of the Board, the Chairman of the Executive Committee and the President, if the President is a Director, elected by a majority of the entire Board of Directors, who shall serve at the pleasure of the Board. The Executive Committee shall have all the authority of the Board, except it shall have no authority as to the following matters:~~

~~(a) The submission to shareholders of any action that needs shareholders' authorization.~~

~~(b) The filling of vacancies in the Board or in any committee.~~

~~(c) The fixing of compensation of the Directors for serving on the Board or on any committee.~~

~~(d) The amendment or repeal of the By Laws, or the adoption of new By Laws.~~

~~(e) The amendment or repeal of any resolution of the Board which, by its terms, shall not be so amendable or repealable.~~

~~(f) The declaration of dividends.~~

~~SECTION 2. Meetings: Meetings of the Executive Committee, of which no notice shall be necessary, shall be held on such days and at such place as shall be fixed, either by the Chairman of the Board, the Chairman of the Executive Committee, or by a vote of the majority of the whole Committee.~~

~~SECTION 3. Quorum and Manner of Acting: Unless otherwise provided by resolution of the Board of Directors, a majority of the Executive Committee shall constitute a quorum for the transaction of business and the act of a majority of all of the members of the Committee, whether present or not, shall be the act of the Executive Committee. The members of the Executive Committee shall act only as a Committee. The procedure of the Committee and its manner of acting shall be subject at all times to the directions of the Board of Directors.~~

~~SECTION 4. Additional Committees: The Board of Directors by resolution~~

~~adopted by a majority of the entire Board may designate from among its members additional committees, each of which shall consist of one or more Directors and shall have such authority as provided in the resolution designating the committee, except such authority shall not exceed the authority conferred on the Executive Committee by Section 1 of this Article.~~

~~SECTION 5. Alternate Members: The Board of Directors may designate one or more eligible Directors as alternate members of the Executive Committee, or of any other committee of the Board, who may replace any absent or disqualified member or members at any meeting of any such committee.~~

~~ARTICLE IV~~

~~OFFICERS~~

~~SECTION 1. Number: The officers of the Company shall be a Chairman of the Board, a President, a Chairman of the Executive Committee, one or more Vice Chairman of the Board, one or more Vice Presidents, a Treasurer, a Secretary, a Controller, and such other officers as the Board of Directors may in its discretion elect. Any two or more offices may be held by the same person.~~

~~SECTION 2. Term of Offices and Qualifications: Those officers whose titles are specifically mentioned in Section 1 of this Article IV shall be chosen by the Board of Directors on the day of the Annual Meeting. Unless a shorter term is provided in the resolution of the Board electing such officer, the term of office of such officer shall extend to and expire at the meeting of the Board held on the day of the next Annual Meeting. The Chairman of the Board, the Chairman of the Executive Committee and the Vice Chairmen shall be chosen from among the Directors.~~

~~SECTION 3. Additional Officers: Additional officers other than those whose titles are specifically mentioned in Section 1 of this Article IV shall be elected for such period, have such authority and perform such duties, either in an administrative or subordinate capacity, as the Board of Directors may from time to time determine.~~

~~SECTION 4. Removal of Officers: Any officer may be removed by the Board of Directors with or without cause, at any time. Removal of an officer without cause shall be without prejudice to his or her contract rights, if any, but his or her election as an officer shall not of itself create contract rights.~~

~~SECTION 5. Resignation: Any officer may resign at any time by giving written notice to the Board of Directors, or to the Chairman of the Board, or the President, or to the Secretary. Any such resignation shall take effect at the time specified therein, or if no time be specified, then upon delivery.~~

~~SECTION 6. Vacancies: A vacancy in any office shall be filled by the Board of Directors.~~

~~SECTION 7. Chairman of the Board: The Chairman of the Board shall preside at all meetings of the shareholders at which he or she is present, unless at such meetings the shareholders shall appoint a chairman other than the Chairman of the Board. The Chairman of the Board shall preside at all meetings of the Directors at which he or she is present. In the absence or inability to act of the President, or if the office of the President be vacant, the Chairman of the Board, subject to the right of the Board from time to time to extend or confine such powers and duties or to assign them to others, shall perform all the duties and may exercise all the powers of the President. The Chairman of the Board shall have such powers and perform such other duties as may be assigned to him or her by the Board.~~

~~SECTION 8. President: The President shall, if he or she is also a Director, in the absence of the Chairman of the Board, preside at all meetings of the shareholders, Directors or the Executive Committee at which he or she is present. The President shall act as the Chief Executive Officer of the Company and it shall be his or her duty to supervise generally the management of the business of the Company with responsibility direct to the Board and subject to the control of the Board. The President shall have such powers and perform such other duties as may be assigned to him or her by the Board.~~

~~SECTION 9. Chairman of the Executive Committee: The Chairman of the Executive Committee shall have such powers and perform such duties as may be assigned to him or her by the Board. The Chairman of the Executive Committee shall preside at meetings of the Executive Committee of the Board of Directors.~~

~~SECTION 10. The Vice Chairmen: Each Vice Chairman of the Board shall have such power and shall perform such duties as may be assigned to him or her by the Board of Directors, the Chairman of the Board or the President.~~

~~SECTION 11. The Vice Presidents: Each Vice President shall have such powers and shall perform such duties as may be assigned to him or her by the Board of Directors, the Chairman of the Board or the President.~~

~~SECTION 12. The Treasurer: The Treasurer shall, if required by the Board of Directors, give a bond for the faithful discharge of his or her duties, in such sum and with such sureties as the Board of Directors shall require. He or she shall have charge and custody of, and be responsible for, all funds and securities of the Company, and deposit all such funds in the name of and to the credit of the Company in such banks, trust companies, or other depositories as shall be selected by the Board of Directors. The Treasurer may sign certificates for stock of the Company authorized by the Board of Directors. He or she shall also perform all other duties customarily incident to the office of Treasurer and such other duties as from time to time may be assigned to him or her by the Board of Directors.~~

~~SECTION 13. The Controller: The Controller shall keep and maintain the books of account for internal and external reporting purposes. He or she shall also perform all other duties customarily incident to the office of Controller and such other duties as may be assigned to him or her from time to time by the Board of Directors. If no Controller shall then be serving, or in the absence or inability to act of the Controller, an Assistant Controller shall perform all of the duties and exercise all of the powers of the Controller. If there is more than one Assistant Controller serving at such time, the Chief Executive Officer of the Company shall select the Assistant Controller to perform such duties and exercise such powers.~~

~~SECTION 14. The Secretary: It shall be the duty of the Secretary to act as secretary of all meetings of the Board of Directors, and of the shareholders, and to keep the minutes of all such meetings at which he or she shall so act in a proper book or books to be provided for that purpose; he or she shall see that all notices required to be given by the Company are duly given and served; he or she may sign and execute in the name of the Company certificates for the stock of the Company, deeds, mortgages, bonds, contracts or other instruments authorized by the Board of Directors; he or she shall prepare, or cause to be prepared, for use at meetings of shareholders the list of shareholders as of the record date referred to in Article I, Section 12 of these By Laws and shall certify, or cause the transfer agent to certify, such list; he or she shall keep a current list of the Company's Directors and officers and their residence addresses; he or she shall be custodian of the seal of the Company and shall affix the seal, or cause it to be affixed, to all agreements, documents and other papers requiring the same. The Secretary shall have custody of the Minute Book containing the minutes of all meetings of shareholders, Directors, the Executive Committee, and any other committees which may keep minutes, and of all other contracts and documents which are not in the custody of the Treasurer or the Controller of the Company, or in the custody of some other person authorized by the Board of Directors to have such custody.~~

~~SECTION 15. Appointed Officers: The Board of Directors may delegate to any officer or committee the power to appoint and to remove any subordinate officer, agent or employee.~~

~~SECTION 16. Assignment and Transfer of Stocks, Bonds, and Other Securities: The Chairman of the Board, the President, the Treasurer, the Secretary, any Assistant Secretary, any Assistant Treasurer, and each of them, shall have power to assign, or to endorse for transfer, under the corporate seal, and to deliver, any stock, bonds, subscription rights, or other securities, or any beneficial interest therein, held or owned by the Company.~~

~~ARTICLE V~~

~~CONTRACTS, CHECKS, DRAFTS AND BANK ACCOUNTS~~

~~SECTION 1. Execution of Contracts: The Board of Directors, except as in these By Laws otherwise provided, may authorize any officer or officers, agent, or agents, in the name of and on behalf of the Company to enter into any contract or execute and deliver any instrument, and such authority may be general or confined to specific instances; but, unless so authorized by the Board of Directors, or expressly authorized by these By Laws, no officer, agent or employee shall have any power or authority to bind the Company by any contract or engagement or to pledge its credit or to render it liable pecuniarily in any amount for any purpose.~~

~~SECTION 2. Loans: No loans shall be contracted on behalf of the Company, and no negotiable paper shall be issued in its name unless specifically authorized by the Board of Directors.~~

~~SECTION 3. Checks, Drafts, etc.: All checks, drafts, and other orders for the payment of money out of the funds of the Company, and all notes or~~

~~other evidences of indebtedness of the Company, shall be signed on behalf of the Company in such manner as shall from time to time be determined by resolution of the Board of Directors.~~

~~SECTION 4. Deposits: All funds of the Company not otherwise employed shall be deposited from time to time to the credit of the Company in such banks, trust companies or other depositories as the Board of Directors may select.~~

~~ARTICLE VI~~

~~STOCKS AND DIVIDENDS~~

~~SECTION 1. Shares of Stock: Shares of stock of the Company shall be represented by certificates except to the extent that the Board of Directors of the Company shall provide by resolution that some or all of any or all classes and series of the Company's shares shall be uncertificated shares, provided that such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the Company. Except as otherwise expressly provided by law, the rights and obligations of holders of uncertificated shares and the rights and obligations of the holders of certificates representing shares of the same class and series shall be identical.~~

~~SECTION 2. Certificates For Shares. To the extent that shares of stock of the Company are to be represented by certificates, the certificates therefor shall be in such form as shall be approved by the Board of Directors. The certificates of stock shall be numbered in order of their issue, shall be signed by the Chairman of the Board, the President, a Vice Chairman or a Vice President, and the Secretary or an Assistant Secretary, or the Treasurer or an Assistant Treasurer. The signature of the officers upon a certificate may be facsimiles if the certificate is countersigned by a transfer agent or registered by a registrar other than the Company itself or its employee. In case any officer who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer before such certificate is issued, it may be issued by the Company with the same effect as if he or she were an officer at the date of issue.~~

~~SECTION 3. Transfer of Stock: Transfers of stock of the Company shall be made only on the books of the Company by the holder thereof, or by his or her duly authorized attorney, on surrender of the certificate or certificates for stock represented by certificates, properly endorsed, or in the case of shares of stock not represented by certificates, on delivery to the Company of proper transfer instructions. Within a reasonable time after the issuance or transfer of uncertificated stock, the Company shall send to the registered owner thereof a written notice containing the information required to be set forth or stated on certificates pursuant to the Business Corporation Law of the State of New York. Every certificate surrendered to the Company shall be marked "Canceled", with the date of cancellation, and no new certificate shall be issued in exchange therefor until the old certificate has been surrendered and canceled. A person in whose name stock of the Company stands on the books of the Company shall be deemed the owner thereof as regards the Company; provided that, whenever any transfer of stock shall be made for collateral security, and not absolutely, such fact, if known to the Secretary of the Company, or to its transfer agent shall be so expressed in the entry of the transfer. No transfer of stock shall be valid as against the Company, or its shareholders for any purpose, until it shall have been entered in the stock records of the Company as specified in these By Laws by an entry showing from and to whom transferred.~~

~~SECTION 4. Transfer and Registry Agents: The Company may, from time to time, maintain one or more transfer offices or agencies and/or registry offices at such place or places as may be determined from time to time by the Board of Directors; and the Board of Directors may, from time to time, define the duties of such transfer agents and registrars and make such rules and regulations as it may deem expedient, not inconsistent with these By Laws, concerning the issue, transfer and registration of certificates for stock or uncertificated stock of the Company.~~

~~SECTION 5. Lost, Destroyed and Mutilated Certificates: The holder of any certificated stock of the Company shall immediately notify the Company of any loss, destruction or mutilation of the certificate therefor. The Company may issue a new certificate or uncertificated stock in place of the lost or destroyed certificate, but as a condition to such issue, the holder of such certificate must make satisfactory proof of the loss or destruction thereof, and must give to the Company a bond of indemnity in form and amount and with one or more sureties satisfactory to the Treasurer, the Secretary or any Assistant Treasurer or Assistant Secretary. Such bond of indemnity shall also name as obligee each of the transfer agents and registrars for the stock the certificate for which has been lost or destroyed.~~

~~SECTION 6. Record Dates for Certain Purposes: The Board of Directors of the Company shall fix a day and hour not more than sixty days preceding the date of any meeting of shareholders, or the date for payment of any cash or stock dividend, or the date for the allotment of any rights of subscription, or the date when any change or conversion or exchange of capital stock shall go into effect, as a record date for the determination of the shareholders entitled to notice of, and to vote at, any such meeting and any adjournment thereof, or entitled to receive payment of any such dividend, or entitled to receive any such allotment of rights of subscription, or entitled to exercise rights in respect of any such change, conversion or exchange of capital stock, and in such case, such shareholders and only such shareholders as shall be shareholders of record on the day and hour so fixed shall be entitled to such notice of, and to vote at, such meeting or any adjournment thereof, or to receive payment of such dividend, or to receive such allotment of rights of subscription, or to exercise rights in connection with such change or conversion or exchange of capital stock, as the case may be, notwithstanding any transfer of any stock on the books of the Company after such day and hour fixed as aforesaid.~~

~~SECTION 7. Dividends and Surplus: Subject to the limitations prescribed by law, the Board of Directors (1) may declare dividends on the stock of the Company whenever and in such amounts as, in its opinion, the condition of the affairs of the Company shall render it advisable, (2) may use and apply, in its discretion, any part or all of the surplus of the Company in purchasing or acquiring any of the shares of stock of the Company, and (3) may set aside from time to time out of such surplus or net profits such sum or sums as it in its absolute discretion, may think proper as a reserve fund to meet contingencies or for equalizing dividends, or for the purpose of maintaining or increasing the property or business of the Company, or for any other purpose it may think conducive to the best interest of the Company.~~

~~ARTICLE VII~~

~~OFFICES AND BOOKS~~

~~SECTION 1. Offices: The Company shall maintain an office at such place in the County of Monroe, State of New York, as the Board of Directors may determine. The Board of Directors may from time to time and at any time establish other offices of the Company or branches of its business at whatever place or places seem to it expedient.~~

~~SECTION 2. Books and Records:~~

~~(a) There shall be kept at one or more offices of the Company (1) correct and complete books and records of account, (2) minutes of the proceedings of the shareholders, Board of Directors and the Executive Committee, (3) a current list of the Directors and officers of the Company and their residence addresses, and (4) a copy of these By-Laws.~~

~~(b) The stock records may be kept either at the office of the Company or at the office of its transfer agent or registrar in the State of New York, if any, and shall contain the names and addresses of all shareholders, the number and class of shares held by each and the dates when they respectively became the owners of record thereof.~~

~~ARTICLE VIII~~

~~GENERAL~~

~~SECTION 1. Seal: The corporate seal shall be in the form of a circle and shall bear the full name of the Company and the words and figures "Incorporated 1906, Rochester, N. Y.".~~

~~SECTION 2. Indemnification of Directors and Officers: Except to the extent expressly prohibited by law, the Company shall indemnify any person, made or threatened to be made, a party in any civil or criminal action or proceeding, including an action or proceeding by or in the right of the Company to procure a judgment in its favor or by or in the right of any other corporation of any type or kind, domestic or foreign, or any partnership, joint venture, trust, employee benefit plan or other enterprise, which any Director or officer of the Company served in any capacity at the request of the Company, by reason of the fact that he or she, his or her testator or intestate is or was a Director or officer of the Company or serves or served such other corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, in any capacity, against judgments, fines, penalties, amounts paid in settlement and reasonable expenses, including attorneys' fees, incurred in connection with such action or proceeding, or any appeal therein, provided that no such indemnification shall be required with respect to any settlement unless the Company shall have given its prior approval thereto. Such indemnification shall include the right to be paid advances of any expenses incurred by such person in connection with such action, suit or proceeding, consistent with the provisions of applicable law.~~

In addition to the foregoing, the Company is authorized to extend rights to indemnification and advancement of expenses to such persons by i) resolution of the shareholders, ii) resolution of the Directors or iii) an agreement, to the extent not expressly prohibited by law.

ARTICLE IX

FISCAL YEAR

SECTION 1. Fiscal Year: The fiscal year of the Company shall end on the 31st day of December in each year.

ARTICLE X

AMENDMENTS

SECTION 1. Amendments: By Laws of the Company may be amended, repealed or adopted by a majority of the votes of the shares at the time entitled to vote in the election of any Directors. If, at any meeting of shareholders, action is proposed to be taken to amend, repeal or adopt By Laws, the notice of such meeting shall include a brief statement or summary of the proposed action. The By Laws may also be amended, repealed or adopted by the Board of Directors, but any By Law adopted by the Board may be amended or repealed by shareholders entitled to vote thereon as hereinabove provided. If any By Law regulating an impending election of Directors is adopted, amended or repealed by the Board of Directors, there shall be set forth in the notice of the next meeting of shareholders for the election of Directors the By Law so adopted, amended or repealed, together with a concise statement of the changes made.

Exhibit 11

Xerox Corporation
Computation of Net Loss Per Common Share
(Dollars in millions, except per share data; shares in thousands)

	Three months ended September 30, 2001	Three months ended September 30, 2000	Nine months ended September 30, 2001	Nine months ended September 30, 2000
I. Basic Net Loss Per Common Share				
Net Loss	$(211)	$(191)	$(289)	$(237)
Accrued dividends on ESOP preferred stock, net	-	(8)	(12)	(26)
Adjusted net loss	$(211)	$(199)	$(301)	$(263)
Average common shares outstanding during the period	716,791	666,802	697,114	666,284
Common shares issuable with respect to exchangeable shares	759	919	834	920
Adjusted average shares outstanding for the period	717,550	667,721	697,948	667,204
Basic loss per share	$(0.29)	$(0.30)	$(0.43)	$(0.39)
II. Diluted Net Loss Per Common Share				
Net Loss	$(211)	$(191)	$(289)	$(237)
Accrued dividends on ESOP preferred stock, net		(8)	(12)	(26)
Adjusted net loss	$(211)	$(199)	$(301)	$(263)
Average common shares outstanding during the period	716,791	666,802	697,114	666,284
Common shares issuable with respect to exchangeable shares	759	919	834	920
Adjusted average shares outstanding for the period	717,550	667,721	697,948	667,204
Diluted loss per share	$(0.29)	$(0.30)	$(0.43)	$(0.39)

Exhibit 12

Xerox Corporation

Computation of Ratio of Earnings to Fixed Charges

(In millions)	Nine months ended September 30,		Year ended December 31,				
	2001	2000	2000	1999	1998	1997	1996
Fixed charges:							
Interest expense	$ 683	$ 739	$ 1,031	$ 803	$ 749	$ 617	$ 592
Rental expense	80	92	115	132	145	140	140
Total fixed charges before capitalized interest and preferred stock dividends of subsidiaries	763	831	1,146	935	894	757	732
Preferred stock dividends of subsidiaries	40	41	55	55	55	50	-
Capitalized interest		9	3	8			
Total fixed charges	$ 803	$ 881	$ 1,204	$ 998	$ 949	$ 807	$ 732
Earnings available for fixed charges:							
Earnings(3)	$ (106)	$ (315)	$ (323)	$1,976	$ 653	$2,132	$2,045
Adjustment to reflect undistributed income from minority owned companies		(20)	(20)	(68)	(27)	(84)	(84)
Add fixed charges before capitalized interest and preferred stock dividends of subsidiaries	763	831	1,146	935	894	757	732
Total earnings available for fixed charges	$ 657	$ 496	$ 803	$2,843	$1,520	$2,805	$2,693
Ratio of earnings to fixed charges (1)(2)	*	**	***	2.85	1.60	3.48	3.68

(1) The ratio of earnings to fixed charges has been computed based on the Company's continuing operations by dividing total earnings available for fixed charges, excluding capitalized interest and preferred stock dividends of subsidiaries, by total fixed charges. Fixed charges consist of interest, including capitalized interest and preferred stock dividends of subsidiaries, and one-third of rent expense as representative of the interest portion of rentals.

(2) The Company's ratio of earnings to fixed charges includes the effect of the Company's finance subsidiaries, which primarily finance Xerox equipment. Financing businesses are more highly leveraged and, therefore, tend to operate at lower earnings to fixed charges ratio levels than do non financial businesses.

(3) Sum of "Income (Loss) before Income Taxes (Benefits), Equity Income (Loss), Minorities' Interests, Extraordinary Gain and Cumulative Effect of Change in Accounting Principle" and "Equity in Net Income of Unconsolidated Affiliates."

* Earnings for the nine months ended September 30, 2001 were inadequate to cover fixed charges. The coverage deficiency was $146 million.

** Earnings for the nine months ended September 30, 2000 were inadequate to cover fixed charges. The coverage deficiency was $385 million.

*** Earnings for the year ended December 31, 2000 were inadequate to cover fixed charges. The coverage deficiency was $401 million.