From time to time the Company has entered into arrangements with investors in which certain films are sold and leased back. The sale-leaseback of the films allows the investors to claim certain international tax benefits of ownership of the film master negatives while the Company maintains control over all exploitation rights and privileges to the films. Such entities are capitalized with the investors' capital and debt and the investors participate in all of the profits or losses of the entities. The present value to these entities of the future revenue streams attributable to these transactions is $1.3 billion as of December 31, 2002. The Company does not consolidate nor participate in the operating results of the entities. The Company retains certain proceeds of the transactions as consideration for entering into the sale-leaseback transactions, and records the consideration received as a reduction of corresponding film costs. The benefit to the Company from these transactions that was recognized as a reduction to film cost amortization in 2002 totaled $47 million.

Rating Triggers and Financial Covenants

Each of the Company's bank credit agreements and financing arrangements with SPEs, contain customary covenants. A breach of such covenants in the bank credit agreements that continues beyond any grace period can constitute a default, which can limit the ability to borrow and can give rise to a right of the lenders to terminate the facility and/or require immediate payment of any outstanding debt. A breach of such covenants in the financing arrangements with SPEs that continues beyond any grace period can constitute a termination event which can limit the facility as a future source of liquidity; however, there would be no claims on the Company for the receivables or backlog contracts previously sold. Additionally, in the event that the Company's credit ratings decrease, the cost of maintaining the bank credit agreements and facilities and of borrowing increases and, conversely, if the ratings improve, such costs decrease.

As of December 31, 2002 and through the date of this filing, the Company was in compliance with all covenants. Management does not foresee that the Company will have any difficulty complying with the covenants currently in place in the foreseeable future. As discussed in more detail in Note 1 to the accompanying consolidated financial statements, the Company took a one-time, non-cash charge of $21.763 billion upon adoption FAS 142. In addition, TWE took a non-cash charge of $2.355 billion in the fourth quarter of 2002 to reduce the carrying value of goodwill and other intangible assets. This charge did not result in a violation of any of the Company's covenants.

During 2003, the Company received unanimous consent from its bank group to amend its 2002 Credit Facilities. The amendment will, among other changes, replace the Company's covenant to maintain at least $50 billion of GAAP net worth with an interest coverage covenant of 2.0 times cash interest expense. The amendment will be effective upon the closing of the TWE restructuring.

Contractual and Other Obligations

Firm Commitments

In addition to the above financing arrangements, the Company has commitments under certain firm contractual arrangements ("firm commitments") to make future payments for goods and services. These firm commitments secure the future rights to various assets and services to be used in the normal course of operations. For example, the Company is contractually committed to make certain minimum lease payments for the use of property under operating lease agreements. In accordance with current accounting rules, the future rights and obligations pertaining to firm commitments contracts are not reflected as assets or liabilities on the accompanying consolidated balance sheet.

The following table summarizes separately the Company's material firm commitments at December 31, 2002 and the timing and effect that such obligations are expected to have on the Company's liquidity and cash flow in future periods. In addition, the table reflects the timing of principal payments on outstanding debt, which has been previously discussed under "Outstanding Debt and Available Financial Capacity." The Company expects to fund the firm commitments with operating cash flow generated in the normal course of business.

Firm Commitments and Outstanding Debt	2003	2004-2006	2007 and thereafter	Total
		(millions)		
Programming and production deals	$2,178	$5,076	$ 5,455	$12,709
Operating leases	144	388	947	1,479
Other firm commitments	163	57	10	230
Total firm commitments	$2,485	$5,521	$ 6,412	$14,418
Total principal outstanding on long-term debt	—	2,370	4,367	6,737
Total firm commitments and outstanding debt	$2,485	$7,891	$10,779	$21,155

Following is a description of TWE's firm commitments at December 31, 2002:

- The Networks segment (HBO and The WB Network) enters into agreements with movie studios to air movies they produce. In addition, the Cable segment enters into commitments to purchase programming from cable network providers to provide service to its subscribers (e.g. programming deals). The commitments represent an estimate of future programming costs based on per subscriber rates contained in contracts existing as of December 31, 2002 applied to the number of consolidated subscribers on that date. Such amounts are subject to variability based on changes in the number of future subscribers, the extension of existing contracts, and the entering into of new contracts. These arrangements are collectively referred to as programming and production deals.

- Operating lease obligations primarily relate to the minimum lease rental obligations for the Company's real estate and operating equipment in various locations around the world.

- Other firm commitments include obligations to actors and directors. In addition, other firm commitments includes a payment of $128 million made in January 2003 to acquire an additional 11% interest in The WB Network.

Contingent Commitments

The Company also has certain contractual arrangements that would require the Company to make payments or provide funding if certain circumstances occur ("contingent commitments"). For example, the Company has guaranteed certain lease obligations of joint venture investees. In this circumstance, the Company would be required to make payments due under the lease to the lessor in the event of default by the joint venture investee. The Company does not expect that these contingent commitments will result in any material amounts being paid by the Company in the foreseeable future.

The following table summarizes separately the Company's contingent commitments at December 31, 2002. The timing of amounts presented in the table represents when the maximum contingent commitment

will expire and does not necessarily mean that the Company expects to incur an obligation to make any payments during that timeframe.

Nature of Contingent Commitments	Total Commitments	Expiration of Commitments 2003	2004-2006	2007 and thereafter
		(millions)		
Guarantees	$2,637	$62	$444	$2,131
Letters of credit and other contingent commitments	170	8	1	161
Total contingent commitments	$2,807	$70	$445	$2,292

Following is a description of the Company's contingent commitments at December 31, 2002:

- Guarantees include guarantees the Company has provided on certain lease and operating commitments entered into by formerly owned entities and joint ventures in which TWE is a venture partner.
- The Cable segment provides letters of credit for several of its joint ventures. Should these joint ventures default on their debts, TWE would be obligated to cover these costs to the extent of the letters of credit. In addition, the Company provides for letters of credit and surety bonds related to insurance premiums and the Cable segment provides for letters of credit and surety bonds that are required by certain local governments when cable is being installed.

Guarantees

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a reconciliation of changes in the entity's product warranty liabilities. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The initial recognition and initial measurement provisions of FIN 45 are not expected to have a material impact on the Company's consolidated financial statements. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002; therefore, the Company has modified its disclosures herein as required.

Equity Method Investments

Except as otherwise discussed above, TWE does not guarantee the debt of any of its investments accounted for using the equity method of accounting. However, for certain of these investments, TWE may continue to provide funding in excess of amounts currently invested.

Filmed Entertainment Backlog

Backlog represents the amount of future revenue not yet recorded from cash contracts for the licensing of theatrical and television product for pay cable, basic cable, network and syndicated television exhibition. Backlog for Warner Bros. was approximately $3.2 billion at December 31, 2002, compared to approximately $3.5 billion at December 31, 2001 (including amounts relating to the licensing of film product to TWE's Networks segment of approximately $405 million at December 31, 2002 and approximately $433 million at December 31, 2001).

Because backlog generally relates to contracts for the licensing of theatrical and television product which have already been produced, the recognition of revenue for such completed product is principally only

dependent upon the commencement of the availability period for telecast under the terms of the related licensing agreement. Cash licensing fees are collected periodically over the term of the related licensing agreements or, as referenced above and discussed in more detail in Note 7 to the accompanying consolidated financial statements, on an accelerated basis using a $500 million securitization facility. The portion of backlog for which cash has not already been received has significant off-balance sheet asset value as a source of future funding. Of the approximately $3.2 billion of backlog relating to Warner Bros. as of December 31, 2002, TWE has recorded $694 million of deferred revenue on the accompanying consolidated balance sheet, representing cash received through the utilization of the securitization facility and other advanced payments. The backlog excludes filmed entertainment advertising barter contracts, which are also expected to result in the future realization of revenues and cash through the sale of advertising spots received under such contracts.

MARKET RISK MANAGEMENT

Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates, foreign currency exchange rates and changes in the market value of investments.

Interest Rate Risk

TWE has entered into variable-rate debt that, at December 31, 2002, had an outstanding balance of approximately $1.458 billion. Based on TWE's variable-rate obligations outstanding at December 31, 2001, each 25 basis point increase or decrease in the level of interest rates would, respectively, increase or decrease TWE's annual interest expense and related cash payments by approximately $4 million. Such potential increases or decreases are based on certain simplifying assumptions, including a constant level of variable-rate debt for all maturities and an immediate, across-the-board increase or decrease in the level of interest rates with no other subsequent changes for the remainder of the period.

TWE has entered into fixed-rate public debt that, at December 31, 2002, had an outstanding balance of approximately $3.394 billion and a fair value of $3.610 billion. Based on TWE's fixed-rate debt obligations outstanding at December 31, 2001, a 25 basis point increase or decrease in the level of interest rates would decrease or increase the fair value of the fixed-rate debt by approximately $8 million. Such potential increases or decreases are based on certain simplifying assumptions, including a constant level and rate of fixed-rate debt for all securities and an immediate across-the-board increase or decrease in the level of interest rates with no other subsequent changes for the remainder of the period.

Foreign Currency Risk

AOL Time Warner uses foreign exchange contracts primarily to hedge the risk that unremitted or future license fees owed to TWE domestic companies for the sale or anticipated sale of U.S. copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. Similarly, the Company enters into foreign exchange contracts to hedge film production costs abroad. As part of its overall strategy to manage the level of exposure to the risk of foreign currency exchange rate fluctuations, AOL Time Warner hedges a portion of its foreign currency exposures anticipated over the ensuing fifteen-month period, including those related to TWE. At December 31, 2002, AOL Time Warner had effectively hedged approximately 75% of TWE's estimated net foreign currency exposures that principally relate to anticipated cash flows to be remitted to the U.S. over the ensuing fifteen-month period (the "hedging period"). The hedging period covers revenues expected to be recognized over the ensuing twelve-month period, however, there is often a lag between the time that revenue is recognized and the transfer of foreign-denominated revenues back into U.S. dollars, therefore, the hedging period covers fifteen months. To hedge this exposure, AOL Time Warner uses foreign exchange contracts that generally have maturities of three months to fifteen months providing continuous coverage throughout the hedging period. TWE is reimbursed by or reimburses AOL Time Warner for AOL Time Warner contract gains and losses related to TWE's foreign currency exposure. At Decem-

ber 31, 2002, AOL Time Warner had contracts for the sale of $1.588 billion and the purchase of $1.341 billion of foreign currencies at fixed rates. Of AOL Time Warner's $247 million net sale contract position, $811 million of foreign currency exchange sale contracts and $732 million of the foreign exchange purchase contracts related to TWE's foreign currency exposure, including net contracts for the sale of $73 million Canadian dollars, $65 million of Japanese yen and $176 million of European currency and for the purchase of $203 million of the British pound. At December 31, 2001, TWE had contracts for the sale of $320 million and the purchase of $130 million of foreign currencies at fixed rates at December 31, 2001.

Based on AOL Time Warner's outstanding foreign exchange contracts related to TWE's exposure at December 31, 2002, each 5% devaluation of the U.S. dollar as compared to the level of foreign exchange rates for currencies under contract at December 31, 2002 would result in approximately $4 million of net unrealized losses on foreign exchange contracts. Conversely, a 5% appreciation of the U.S. dollar as compared to the level of foreign exchange rates for currencies under contract at December 31, 2002 would result in $4 million of net unrealized gains on contracts. Consistent with the nature of the economic hedge provided by such foreign exchange contracts, such unrealized gains or losses largely would be offset by corresponding decreases or increases, respectively, in the dollar value of future foreign currency license fee payments that would be received in cash within the hedging period from the sale of U.S. copyrighted products abroad.

Equity Risk

The Company is exposed to market risk as it relates to changes in market value of its investments. The Company invests in equity instruments of public and private companies for operational and strategic business purposes, many of which are Internet and technology companies. These securities are subject to significant fluctuations in fair market value due to volatility of the stock market and the industries in which the companies operate. These securities, which are classified in "Investments, including available-for-sale securities" on the accompanying consolidated balance sheet, include equity-method investments, investments in private securities, available-for-sale securities, restricted securities and equity derivative instruments. As of December 31, 2002, the Company had $16 million of cost-method investments, primarily relating to private equity securities, $142 million of fair value investments, including $141 million of investments in public equity securities held for purposes other than trading and $1 million of equity derivative instruments, and $2.345 billion of investments accounted for using the equity method of accounting.

CRITICAL ACCOUNTING POLICIES

The Securities and Exchange Commission ("SEC") has recently issued Financial Reporting Release No. 60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies" ("FRR 60"), suggests companies provide additional disclosure and commentary on those accounting policies considered most critical. FRR 60 considers an accounting policy to be critical if it is important to the Company's financial condition and results, and requires significant judgment and estimates on the part of management in its application. TWE believes the following represent the critical accounting policies of the Company as contemplated by FRR 60. For a summary of all of the Company's significant accounting policies, are included in see Note 1 to the accompanying consolidated financial statements.

Accounting for Goodwill and Other Intangible Assets

During 2001, the FASB issued FAS 142, which requires that, effective January 1, 2002, goodwill, including the goodwill included in the carrying value of investments accounted for using the equity method of accounting, and certain other intangible assets deemed to have an indefinite useful life, cease amortizing. FAS 142 requires that goodwill and certain intangible assets be assessed for impairment using fair value measurement techniques. Specifically, goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a

reporting unit (generally, the Company's operating segment) with its net book value (or carrying amount), including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The impairment test for other intangible assets consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

Determining the fair value of a reporting unit under first step of the goodwill impairment test and determining the fair value of individual assets and liabilities of a reporting unit (including unrecognized intangible assets) under the second step of the goodwill impairment test is judgmental in nature and often involves the use of significant estimates and assumptions. Similarly, estimates and assumptions are used in determining the fair value of other intangible assets. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. To assist in the process of determining goodwill impairment, the Company obtains appraisals from independent valuation firms. In addition to the use of independent valuation firms, the Company performs internal analyses and considers other market information that is publicly available. Estimates of fair value are primarily determined using discounted cash flows and market comparisons and recent transactions. These approaches use significant estimates and assumptions including projected future cash flows (including timing), discount rate reflecting the risk inherent in future cash flows, perpetual growth rate, determination of appropriate market comparables and the determination of whether a premium or discount should be applied to comparables.

During the first quarter of 2002, upon adoption of FAS 142, the Company completed its initial impairment review and recorded a $21.763 billion non-cash pre-tax charge for the impairment of goodwill, substantially all of which was generated in the Merger. During the fourth quarter of 2002, the Company performed its annual impairment review and recorded an additional $2.355 billion charge to reduce the carrying value of goodwill. The $21.763 billion charge is reflected as a cumulative effect of an accounting change and the $2.355 billion charge is reflected as a component of operating income in the accompanying consolidated statement of operations.

As previously discussed, the TWE's $2.355 billion goodwill impairment charge recognized in the fourth quarter of 2002, reflected the fair value of the Company's operating divisions as of December 31, 2002. As

encouraged by FRR 60, the following table illustrates the hypothetical goodwill impairment charge assuming both an increase and decrease in the fair value of each of the Company's operating divisions by 10%.

	Assuming 10% Increase in Fair Value	Actual 4th Quarter Impairment Charge	Assuming 10% Decrease in Fair Value
		(millions)	
Cable[(a)]	$2,355	$2,355	$2,355
Filmed Entertainment	—	—	—
Networks	—	—	369
Total	$2,355	$2,355	$2,724

(a) Assuming a decline in fair value of 10% would not impact the amount of goodwill impairment because the carrying amount of goodwill was reduced to zero as a result of the actual fourth quarter impairment charge. The analysis does not consider any potential impairments relating to indefinite lived intangibles.

Investments

The Company's investments comprise of fair value investments, including available-for-sale investments, investments accounted for using the cost method of accounting and investments accounted for using the equity method of accounting. A judgmental aspect of accounting for investments involves determining whether an other-than-temporary decline in value of the investment has been sustained. If it has been determined that an investment has sustained an other-than-temporary decline in value, the investment is written down to its fair value, by a charge to earnings. Such evaluation is dependent on the specific facts and circumstances. Factors that are considered by the Company in determining whether an other-than-temporary decline in value has occurred include: the market value of the security in relation to its cost basis; the financial condition of the investee; and the intent and ability to retain the investment for a sufficient period of time to allow for recovery in the market value of the investment.

In evaluating the factors above for available-for-sale securities, management presumes a decline in value to be other-than-temporary if the quoted market price of the security is 20% or more below the investment's cost basis for a period of six months or more (the "20% criteria") or the quoted market price of the security is 50% or more below the security's cost basis at any quarter end (the "50% criteria"). However, the presumption of an other-than-temporary decline in these instances may be overcome if there is persuasive evidence indicating that the decline is temporary in nature (e.g., strong operating performance of investee, historical volatility of investee, etc.). Additionally, there may be instances where impairment losses are recognized even if the 20% and 50% criteria are not satisfied (e.g., plan to sell the security in the near term and the fair value is below the Company's cost basis).

For investments accounted for using the cost or equity method of accounting, management evaluates information (e.g., budgets, business plans, financial statements, etc.) in addition to quoted market price, if any, in determining whether an other-than-temporary decline in value exists. Factors indicative of an other-than-temporary decline include recurring operating losses, credit defaults and subsequent rounds of financings at an amount below the cost basis of the investment. This list is not all inclusive and management weighs all quantitative and qualitative factors in determining if an other-than-temporary decline in value of an investment has occurred.

While TWE has recognized all declines that are believed to be other-than-temporary, which were not material in 2002, it is reasonably possible that individual investments in the Company's portfolio may experience an other-than-temporary decline in value in the future if the underlying investee experiences poor operating results or the U.S. equity markets experience future broad declines in value.

Revenue and Cost Recognition

There are two areas related to revenue and cost recognition which incorporate significant judgment and estimates by management — the accounting for multiple-element arrangements and the amortization of film costs resulting from the determination of revenue ultimates under the film accounting rules.

Multiple-Element Transactions

Multiple-Element transactions within TWE fall broadly into two categories:

1. Contemporaneous purchases and sales. In these transactions, TWE is selling a product or service to a customer and at the same time purchasing goods or services from that customer or making an investment in the customer;

2. Sales of multiple products or services. In these transactions, TWE is selling multiple products or services to a counterparty.

Contemporaneous Purchases and Sales

In the normal course of business, TWE enters into transactions where it is purchasing a product, service or making an investment in a vendor and at the same time it is negotiating a contract for the sale of advertising to the vendor. For example, when negotiating programming arrangements with cable networks, TWE will, at times, simultaneously negotiate for the sale of advertising to the cable network. This arrangement may be documented in one contract or may be documented in two separate contracts; whether there are one or two contracts, these arrangements are negotiated simultaneously. In accounting for these arrangements, TWE looks to the guidance contained in the following authoritative literature:

- APB Opinion No. 29, "Accounting for Nonmonetary Transactions" (APB 29); and
- EITF 01-09, "Accounting for Consideration Given by a Vendor to a Customer" (EITF 01-09).

TWE measures these transactions based on the respective fair values of the goods or services purchased and the goods or services sold. If TWE is unable to determine the fair value of one or more of the element(s) being purchased, then revenue recognition is limited to the total consideration received for the products or services sold less the amounts paid that can be supported. For example, if TWE sells advertising to a customer for $10 million in cash and contemporaneously enters into an arrangement to acquire software for $2 million from the same customer, but fair value for the software cannot be reliably determined, TWE would limit the amount of revenue recognized related to the advertising sold to $8 million. As another example, if TWE sells advertising to a customer for $10 million in cash and contemporaneously invests $2 million in the equity of that same customer, but fair value for the equity investment is only determined to be $1 million, TWE would limit the amount of revenue recognized related to the advertising sold to $9 million. Accordingly, the judgments made in accounting for these arrangements impact the period revenues, expenses and net income over the term of the contract.

In applying the above guidance, one of the key judgments is determining the fair value of the respective elements. In determining the fair value of the respective elements, the TWE refer to quoted market prices, historical transactions or comparable cash transactions. For example, in determining the fair value of a non-publicly traded equity security purchased at the same time TWE sells a good or a service to an investee, TWE would look to what other investors, which do not have other contemporaneous transactions, have paid in the most recent round of financings with the investee. If the investment is publicly traded, fair value would be determined by reference to quoted market prices. In addition, the stated terms of a transaction are considered to be at fair value to the extent that price protection in the form of most favored nation clauses or similar provisions has been received.

Finally, in a contemporaneous purchase and sale transaction, evidence of fair value for one element of a transaction will provide support for the fair value of the other element of a transaction. For example, if TWE sells advertising to a customer and contemporaneously invests in the equity of that same customer, evidence of the fair value of the investment would implicitly support the fair value of the advertising sold since there are only two elements in the arrangement.

Sales of Multiple Products or Services

TWE's policy for revenue recognition in instances where there are multiple elements being sold at the same time to the same counterparty is in accordance with the Frequently Asked Question Guide on SAB 110 and is similar to the principles underlying the recently finalized EITF Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." Specifically, if TWE enters into sales contracts for the sale of multiple products or services, then they evaluate whether or not they have objective fair value evidence for each element of the transaction. If objective fair value evidence for each element of the transaction exists, then each element of the transaction is accounted for independently as it is being delivered based on the relevant revenue recognition accounting policies. However, if the objective fair value for one or more elements of the transaction are unable to be determined, TWE generally recognizes advertising revenue on a straight line-basis over the term of the agreement.

Filmed Entertainment Revenues and Costs

An aspect of film accounting that requires the exercise of judgment relates to the process of estimating the total revenues to be received throughout a film's life cycle. Such estimate of a film's "ultimate revenue" is important for two reasons. First, while a film is being produced, and the related costs are being capitalized, it is necessary for management to estimate the ultimate revenues, less additional costs to be incurred including exploitation costs, in order to determine whether the value of a film has been impaired and thus requires an immediate write off of unrecoverable film costs. Second, the amount of capitalized film costs recognized as cost of revenues for a given film as it is exhibited in various markets, throughout its life cycle, is based upon the proportion of the film's revenues recognized for such period to the film's estimated ultimate total revenues. Similarly, the recognition of participants and residuals is recognized based upon the proportion of the film's revenues recognized for such period to the film's estimated ultimate total revenues.

Management bases its estimates of ultimate revenue for each film on the historical performance of similar films, incorporating factors such as the star power of the lead actors and actresses, the genre of the film and the expected number of theatres at which the film will be released. Management updates such estimates based on the actual results of each film. For example, a film which has resulted in lower-than-expected theatrical revenues in its initial weeks of release would generally have its theatrical, home video and distribution ultimate revenues adjusted downward; a failure to do so would result in the understatement of amortized film costs for the period. Since the total film cost to be amortized for a given film is fixed, the estimate of ultimate revenues impacts only the timing of film cost amortization.

Gross Versus Net Revenue Recognition

In the normal course of business, the Company acts an intermediary or agent with respect to certain payments received from third parties. For example, the Filmed Entertainment segment distributes films on behalf of independent film producers and our Cable segment collects taxes on behalf of franchising authorities.

The accounting issue encountered in these arrangements is whether the Company should report revenue based on the "gross" amount billed to the ultimate customer or on the "net" amount received from the customer after commissions and other payments to third parties. To the extent revenues are recorded gross, any commissions or other payments to third parties are recorded as expenses so that the net amount (gross

revenues, less expenses) flows through operating income. Accordingly, the impact on operating income is the same, whether the Company records the revenue on a gross or net basis. For example, the Company's Cable segment includes franchise taxes in a cable subscriber's monthly cable bill and remits these amounts to the local franchising authorities. Should the Cable segment record gross revenues received from the customer (e.g. including the franchise taxes) or should they record the net revenues they keep excluding franchise taxes submitted to the local authorities? In either case, the impact on operating income is the same.

Determining whether revenue should be reported gross or net is based on an assessment of whether the Company is acting as the "principal" in a transaction or acting as an "agent" in the transaction. To the extent the Company is acting as a principal in a transaction the Company reports as revenue the payments received on a gross basis. To the extent the Company is acting as an agent in a transaction the Company reports as revenue, the payments received less commissions and other payments to third parties, i.e., on a net basis. The determination of whether the Company is serving as principal or agent in a transaction is judgmental in nature and based on an evaluation of the terms of an arrangement.

In determining whether the Company serves as principal or agent in these arrangements the Company follows the guidance in EITF 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent" ("EITF 99-19"). Pursuant to such guidance, the Company serves as the principal in transactions in which it has substantial risks and rewards of ownership. The indicators that the Company has substantial risks and rewards of ownership are as follows:

- The Company is the supplier of the products or services to the customer;
- The Company has inventory risk for a product before it is sold;
- The Company has latitude in establishing prices;
- The Company has the contractual relationship with the ultimate customer;
- The Company modifies the product purchased to meet the ultimate customer specifications;
- The Company has discretion in supplier selection; and
- The Company has credit risk.

Conversely, pursuant to EITF 99-19 the Company serves as agent in arrangements where the Company does not have substantial risks and rewards of ownership. The indicators that the Company does not have substantial risks and rewards of ownership are as follows:

- The supplier (not TWE) is responsible for providing the product or service to the customer;
- The supplier (not TWE) has latitude in establishing prices;
- The amount the Company earns is fixed; and
- The supplier (not TWE) has credit risk.

Based on the above criteria and for our more significant transactions that we evaluated, the Filmed Entertainment segment records revenue from the distribution of films on behalf of independent film producers on a gross basis and the Cable segment records revenue from the collection of franchise fees on a gross basis.

Sales Returns and Uncollectible Accounts

One area of judgment affecting reported revenue and net income is management's estimate of product sales that will be returned and management's estimate of the amount of the receivables that will ultimately be collected. In determining the estimate of product sales that will be returned, management analyzes historical returns, current economic trends and changes in customer demand and acceptance of TWE's products. Based on this information, management reserves a percentage of each dollar of product sales that provide the customer with the right of return.

Similarly, management evaluates accounts receivables to determine if they will ultimately be collected. In performing this evaluation, significant judgments and estimates are involved, including an analysis of

specific risks on a customer-by-customer basis for larger accounts and customers, and an analysis of receivables aging that determines the percent that has historically been uncollected by aged category. Based on this information, management reserves an amount that is believed to be uncollectible.

RISK FACTORS AND CAUTION CONCERNING FORWARD-LOOKING STATEMENTS

Risk Factors

If the events discussed in these risk factors occur, the Company's business, financial condition, results of operations or cash flows could be materially adversely affected. In such case, the market price of the Company's common stock could decline.

Technological developments may adversely affect the Company's competitive position and limit its ability to protect its valuable intellectual property rights. TWE's businesses operate in the highly competitive, consumer-driven and rapidly changing media and entertainment industries. These businesses, as well as the industries generally, are to a large extent dependent on technological developments, including access to and selection and viability of new technologies, and are subject to potential pressure from competitors as a result of their technological developments. For example:

- The Company's cable business may be adversely affected by more aggressive than expected competition from alternate technologies such as satellite and DSL; by the failure to choose technologies appropriately; by the failure of new equipment, such as digital set-top boxes or digital video recorders, or services, such as digital cable, high-speed data services and video-on-demand, to appeal to enough consumers or to be available at prices consumers are willing to pay, to function as expected and to be delivered in a timely fashion;
- The Company's filmed entertainment and television network businesses may be adversely affected by the fragmentation of consumer leisure and entertainment time caused by a greater number of choices resulting from technological developments, the impact of personal video recorder or other technologies that have "ad-stripping" functions, and technological developments that facilitate the piracy of its copyrighted works; and

Caution Regarding Forward-Looking Statements

The SEC encourages companies to disclose forward-looking information so that investors can better understand a company's future prospects and make informed investment decisions. This document contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, particularly statements anticipating future growth in revenues, EBITDA and cash flow. Words such as "anticipates," "estimates," "expects," "projects," "intends," "plans," "believes" and words and terms of similar substance used in connection with any discussion of future operating or financial performance identify forward-looking statements. These forward-looking statements are based on management's present expectations and beliefs about future events. As with any projection or forecast, they are inherently susceptible to uncertainty and changes in circumstances, and the Company is under no obligation to, and expressly disclaim any obligation to, update or alter its forward-looking statements whether as a result of such changes, new information, future events or otherwise.

TWE operates in highly competitive, consumer-driven and rapidly changing media and entertainment businesses. These businesses are affected by government regulation, economic, strategic, political and social conditions, consumer response to new and existing products and services, technological developments and, particularly in view of new technologies, the continued ability to protect intellectual property rights. TWE's actual results could differ materially from management's expectations because of changes in such factors. Other factors and risks could adversely affect the operations, business or financial results of TWE or its

business segments in the future and could also cause actual results to differ from those contained in the forward-looking statements, including those identified in TWE's other filings with the SEC and the following:

For TWE's cable business:

- more aggressive than expected competition from new technologies and other types of video programming distributors, including satellite and DSL;
- increases in government regulation of basic cable or equipment rates or other terms of service, such as "digital must-carry," open access or common carrier requirements; government regulation of other services, such as broadband cable modem service;
- increased difficulty in obtaining franchise renewals;
- the failure of new equipment, such as digital set-top boxes or digital video recorders, or services, such as digital cable, high-speed data services or video-on-demand, to appeal to enough consumers or to be available at prices consumers are willing to pay, to function as expected and to be delivered in a timely fashion;
- theft of service from interception of cable transmissions;
- fluctuations in spending levels by advertisers and consumers; and
- greater than expected increases in programming or other costs.

For TWE's filmed entertainment businesses:

- the ability to continue to attract and select desirable talent and scripts at manageable costs;
- general increases in production costs;
- fragmentation of consumer leisure and entertainment time and its possible negative effects on the broadcast and cable networks, which are significant customers of these businesses;
- continued popularity of merchandising;
- the uncertain impact of technological developments that may facilitate piracy of its copyrighted works;
- the ability to develop a successful business model for delivery of feature films in a digital online environment;
- risks associated with foreign currency exchange rates;
- with respect to feature films, the increasing marketing costs associated with theatrical film releases in a highly competitive marketplace;
- with respect to television programming, a decrease in demand for television programming provided by non-affiliated producers; and
- with respect to home video, the ability to maintain relationships with significant customers in the rental and sell-through markets.

For TWE's network businesses:

- greater than expected programming or production costs;
- public or cable operator resistance to price increases and the negative impact on premium programmers of increases in basic cable rates;
- increased regulation of distribution agreements;
- the sensitivity of network advertising to economic cyclicality and to new media technologies;
- the negative impact of consolidation among cable and satellite distributors;
- piracy of content by means of interception of cable and satellite transmissions or Internet peer-to-peer file sharing;
- the impact of personal video recorder "ad-stripping" functions on advertising sales and network branding;
- the development of new technologies that alter the role of programming networks and services; and
- greater than expected fragmentation of consumer viewership due to an increased number of programming services or the increased popularity of alternatives to television.

For TWE generally, the overall financial strategy, including growth in operations, maintaining financial ratios and a strong balance sheet, could be adversely affected by decreased liquidity in the capital markets, including any reduction in the ability to access either the capital markets for debt securities or bank financings, significant acquisitions or other transactions, economic slowdowns, the risk of war, and changes in the Company's plans, strategies and intentions. In addition, lower than expected valuations associated with the cash flows and revenues at its segments may result in its inability to realize the value of recorded intangibles and goodwill at those segments.

TIME WARNER ENTERTAINMENT COMPANY, L.P.
CONSOLIDATED BALANCE SHEET
December 31,
(millions)

	2002	2001
ASSETS		
Current assets		
Cash and equivalents	$ 1,012	$ 250
Receivables, including $657 and $501 million due from AOL Time Warner, less allowances of $1.177 billion and $910 million	3,778	3,480
Inventories	871	852
Prepaid expenses	442	326
Total current assets	6,103	4,908
Noncurrent inventories and film costs	2,189	2,187
Investments, including available-for-sale securities	2,503	2,308
Property, plant and equipment	7,641	8,573
Intangible assets subject to amortization	2,341	2,464
Intangible assets not subject to amortization	22,518	22,356
Goodwill	10,129	41,004
Other assets	931	1,258
Total assets	$ 54,355	$85,058
LIABILITIES AND PARTNERS' CAPITAL		
Current liabilities		
Accounts payable	$ 2,354	$ 2,218
Participations payable	1,343	1,014
Programming costs payable	439	455
Debt due within one year	8	2
Other current liabilities, including $1.187 and $1.022 billion due to AOL Time Warner	2,713	2,616
Total current liabilities	6,857	6,305
Long-term debt, including $2.084 and $1.734 billion due to AOL Time Warner	6,947	8,049
Other long-term liabilities, including $8 and $446 million due to AOL Time Warner	2,546	3,108
Minority interests	888	2,191
Partners' capital		
Contributed capital	59,936	66,793
Accumulated other comprehensive income (loss), net	(166)	(6)
Partnership deficit	(22,653)	(1,382)
Total partners' capital	37,117	65,405
Total liabilities and partners' capital	$ 54,355	$85,058

See accompanying notes.

TIME WARNER ENTERTAINMENT COMPANY, L.P.
CONSOLIDATED STATEMENT OF OPERATIONS
Years Ended December 31,
(millions)

	2002	2001	2000
Revenues:			
Subscriptions	$ 7,554	$ 6,591	$ 5,869
Advertising and commerce	1,195	1,188	1,147
Content and other	7,676	6,563	6,162
Total revenues[(a)]	16,425	14,342	13,178
Cost of revenues[(a)]	(11,204)	(9,327)	(8,499)
Selling, general and administrative[(a)]	(2,408)	(2,378)	(2,454)
Amortization of goodwill and other intangible assets	(150)	(2,668)	(503)
Impairment of goodwill	(2,355)	—	—
Operating income (expense)	308	(31)	1,722
Interest expense, net	(401)	(530)	(612)
Other expense, net[(a)]	(357)	(346)	(228)
Minority interest income (expense)	(28)	36	82
Income (loss) before income tax expense, discontinued operations and cumulative effect of accounting change	(478)	(871)	964
Income tax expense	(157)	(127)	(157)
Income (loss) before discontinued operations and cumulative effect of accounting change	(635)	(998)	807
Discontinued operations, net of tax	1,179	(34)	(54)
Income (loss) before cumulative effect of accounting change	544	(1,032)	753
Cumulative effect of accounting change	(21,763)	—	(524)
Net income (loss)	$(21,219)	$(1,032)	$ 229

(a) Includes the following income (expenses) resulting from transactions with related companies:

	2002	2001	2000
Revenue	$ 935	$ 934	$ 677
Cost of revenues	(322)	(445)	(276)
Selling, general and administrative	(287)	(221)	(210)
Interest income (expense), net	12	31	(7)
Other income (expense), net	6	8	19

TIME WARNER ENTERTAINMENT COMPANY, L.P.
CONSOLIDATED STATEMENT OF CASH FLOWS
Years Ended December 31,
(millions)

	2002	2001	2000
OPERATIONS			
Net income (loss)[a]	$(21,219)	$(1,032)	$ 229
Adjustments for noncash and nonoperating items:			
Cumulative effect of accounting change	21,763	—	524
Impairment of goodwill	2,355	—	—
Depreciation and amortization	1,279	3,538	1,260
Amortization of film costs	1,917	1,916	1,676
Gain on sale of investments	(38)	(4)	1
Equity in losses of investee companies after distributions	22	334	275
Changes in operating assets and liabilities:			
Receivables	(432)	(414)	(310)
Inventories	(1,937)	(2,074)	(1,829)
Accounts payable and other liabilities	659	(140)	394
Other balance sheet changes	444	(139)	(122)
Adjustments for noncash and nonoperating items, and changes in operating assets and liabilities for discontinued operations	(801)	600	478
Cash provided by operations	4,012	2,585	2,576
INVESTING ACTIVITIES			
Investments and acquisitions	(297)	(913)	(421)
Investments in available-for-sale securities	—	(18)	—
Capital expenditures from continuing operations	(1,689)	(1,604)	(1,512)
Capital expenditures from discontinued operations	(206)	(408)	(414)
Investment proceeds from available-for-sale securities	—	3	—
Other investment proceeds	85	32	209
Cash used by investing activities	(2,107)	(2,908)	(2,138)
FINANCING ACTIVITIES			
Borrowings	3,524	3,226	2,850
Debt repayments	(4,113)	(2,541)	(2,399)
Capital and other distributions from discontinued operations, net	(11)	(59)	(52)
Capital and other distributions from continuing operations	(527)	(359)	(1,048)
Other	(16)	—	—
Cash provided (used) by financing activities	(1,143)	267	(649)
INCREASE (DECREASE) IN CASH AND EQUIVALENTS	762	(56)	(211)
CASH AND EQUIVALENTS AT BEGINNING OF PERIOD	250	306	517
CASH AND EQUIVALENTS AT END OF PERIOD	$ 1,012	$ 250	$ 306

[a] Includes net income (loss) from discontinued operations of $1.179 billion in 2002, $(34) million in 2001 and $(54) million in 2000.

See accompanying notes.

TIME WARNER ENTERTAINMENT COMPANY, L.P.
CONSOLIDATED STATEMENT OF PARTNERSHIP CAPITAL

	Contributed Capital	Partnership Earnings (Deficit)	Total Partners' Capital
		(Millions)	
BALANCE AT DECEMBER 31, 1999	$ 7,338	$ (189)	$ 7,149
Net income	—	229	229
Foreign currency translation adjustments	—	(44)	(44)
Unrealized losses on securities	—	(44)	(44)
Realized and unrealized gains on derivative financial instruments	—	8	8
Comprehensive income	—	149	149
Stock option and tax-related distributions	—	(392)	(392)
Other	11	9	20
BALANCE AT DECEMBER 31, 2000	7,349	(423)	6,926
Allocation of a portion of the purchase price in connection with America Online-Time Warner merger to TWE	59,444	74	59,518
Balance at December 31, 2000, adjusted to give effect of America Online-Time Warner merger	66,793	(349)	66,444
Net loss	—	(1,032)	(1,032)
Foreign currency translation adjustments	—	1	1
Unrealized losses on securities	—	(7)	(7)
Comprehensive loss	—	(1,038)	(1,038)
Stock option and tax-related distributions	—	(82)	(82)
Other	—	81	81
BALANCE AT DECEMBER 31, 2001	66,793	(1,388)	65,405
Reallocation of TWE goodwill to other segments of AOL Time Warner upon adoption of FAS 142	(6,857)	—	(6,857)
Net loss	—	(21,219)	(21,219)
Unfunded Accumulated Benefit Obligation	—	(183)	(183)
Derivatives FX Gain/Loss	—	(21)	(21)
Foreign currency translation adjustments	—	35	35
Unrealized gain on securities	—	9	9
Comprehensive loss	—	(21,379)	(21,379)
Distributions	—	(60)	(60)
Other	—	8	8
BALANCE AT DECEMBER 31, 2002	$59,936	$(22,819)	$ 37,117

See accompanying notes.

TIME WARNER ENTERTAINMENT COMPANY, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business and Basis of Presentation

Description of Business

AOL Time Warner Inc. ("AOL Time Warner") is the world's leading media and entertainment company. AOL Time Warner was formed in connection with the merger of America Online, Inc. ("America Online") and Time Warner Inc. ("Time Warner") which was consummated on January 11, 2001 (the "Merger"). As a result of the Merger, America Online and Time Warner each became a wholly-owned subsidiary of AOL Time Warner.

A majority of AOL Time Warner's interests in the Filmed Entertainment and Cable segments, and a portion of its interests in the Networks segment, are held through Time Warner Entertainment Company, L.P. ("TWE" or the "Company"). Prior to the change in ownership relating to the exercise of an option held by AT&T Corp. ("AT&T") which is discussed below, AOL Time Warner owned general and limited partnership interests in TWE consisting of 74.49% of the pro rata priority capital ("Series A Capital") and residual equity capital ("Residual Capital"), and 100% of the junior priority capital ("Series B Capital"). The remaining 25.51% limited partnership interests in the Series A Capital and Residual Capital of TWE were held by subsidiaries of AT&T. AT&T's interest in TWE was recently acquired by Comcast Corp. ("Comcast") upon consummation of the merger of Comcast and AT&T's broadband business in November 2002.

During the second quarter of 2002, AT&T exercised a one-time option to increase its ownership in the Series A Capital and Residual Capital of TWE. As a result, on May 31, 2002, AT&T's interest in the Series A Capital and Residual Capital of TWE increased by approximately 2.13% to approximately 27.64% and AOL Time Warner's corresponding interest in the Series A and Residual Capital of TWE decreased by approximately 2.13% to approximately 72.36%. In accordance with Staff Accounting Bulletin No. 51, "Accounting for Sales of Stock of a Subsidiary," AOL Time Warner has reflected the pretax impact of the dilution of its interest in TWE of approximately $690 million as an adjustment to paid-in-capital.

In August 2002, AOL Time Warner and AT&T announced that they had agreed to restructure TWE. The restructuring is expected to be completed on March 31, 2003. The TWE restructuring will result in the following: (i) AOL Time Warner will acquire complete ownership of TWE's content assets (including Warner Bros. and Home Box Office, which will become separate, wholly owned subsidiaries of the Company); (ii) all of AOL Time Warner's directly-owned cable television system interests will be contributed to a separate company which will become a majority-owned subsidiary of AOL Time Warner and will be renamed Time Warner Cable Inc. ("TWC Inc."); (iii) TWE will become a subsidiary of TWC Inc. and will continue to own the cable television system interests it previously owned; (iv) Comcast will receive $2.1 billion in cash, which the Company anticipates will be funded through a new credit facility at TWC Inc. that has not yet been established and AOL Time Warner equity securities valued at $1.5 billion; (v) a Comcast Trust will also retain a 21% economic interest in the Company's cable business, through a 17.9% direct ownership interest in TWC Inc. (representing a 10.7% voting interest) and a limited partnership interest in TWE representing a 4.7% residual equity interest; and (vi) AOL Time Warner will retain an overall 79% economic interest in the cable business, through an 82.1% ownership interest in TWC Inc. (representing an 89.3% voting interest) and a partnership interest in TWE representing a 1% residual equity interest and a $2.4 billion preferred component.

Based upon its controlling voting interest in Time Warner Cable Inc., AOL Time Warner will consolidate the results of Time Warner Cable Inc. for accounting purposes. At the closing of the restructuring, it is anticipated that Time Warner Cable Inc. will have approximately $8.1 billion in consolidated net debt and preferred equity. Subject to market conditions, AOL Time Warner plans to conduct an initial public offering of Time Warner Cable Inc. soon after the restructuring. It is anticipated that the first $2.1 billion raised in any such offering would be used to repay Time Warner Cable Inc.'s debt incurred to fund the $2.1 billion cash

payment to Comcast. Thereafter, Comcast will have certain priority registration rights with respect to its stake in Time Warner Cable Inc.

TWE, a Delaware limited partnership, classifies its business interests into three fundamental areas: *Cable,* consisting principally of interests in cable television systems; *Filmed Entertainment,* consisting principally of interests in filmed entertainment and television production; and *Networks,* consisting principally of interests in cable television and broadcast network programming. TWE also manages the cable properties wholly-owned by AOL Time Warner and the combined cable television operations are conducted under the name of Time Warner Cable.

Each of the business interests within Cable, Filmed Entertainment and Networks is important to TWE's objective of increasing partner value through the creation, extension and distribution of recognizable brands and copyrights throughout the world. Such brands and copyrights include (1) Time Warner Cable, currently the second largest operator of cable television systems in the U.S., (2) the unique and extensive film, television and animation libraries of Warner Bros. and trademarks such as the Looney Tunes characters and Batman, (3) HBO and Cinemax, the leading pay-television services and (4) The WB Network, a national broadcasting network launched in 1995 as an extension of the Warner Bros. brand and as an additional distribution outlet for Warner Bros.'s collection of children's cartoons and television programming.

Basis of Presentation

Restructuring of TWE-Advance/Newhouse and Road Runner Partnerships

Prior to August 1, 2002, the TWE-Advance/Newhouse Partnership ("TWE-A/N") was owned approximately 64.8% by TWE, the managing partner, 33.3% by the Advance/Newhouse Partnership ("Advance/Newhouse") and 1.9% indirectly by AOL Time Warner. The financial position and operating results of TWE-A/N were consolidated by AOL Time Warner and TWE, and the partnership interest owned by Advance/Newhouse was reflected in the consolidated financial statements of AOL Time Warner and TWE as minority interest. In addition, prior to August 1, 2002, Road Runner, a high-speed cable modem Internet service provider, was owned by TWI Cable Inc. (a wholly-owned subsidiary of AOL Time Warner), TWE and TWE-A/N, with AOL Time Warner owning approximately 65% on a fully attributed basis (i.e., after considering the portion attributable to the minority partners of TWE and TWE-A/N). TWE's interest in Road Runner was accounted for using the equity method of accounting because of certain approval rights held by Advance/Newhouse.

On June 24, 2002, TWE and Advance/Newhouse agreed to restructure TWE-A/N, which, on August 1, 2002 (the "Debt Closing Date"), resulted in Advance/Newhouse assuming responsibility for the day-to-day operations of certain TWE-A/N cable systems serving approximately 2.1 million subscribers located primarily in Florida (the "Advance/Newhouse Systems"). The restructuring is anticipated to be completed by the end of 2002, upon the receipt of certain regulatory approvals. On the Debt Closing Date, Advance/Newhouse and its affiliates arranged for a new credit facility to support the Advance/Newhouse Systems and assumed and repaid approximately $780 million of TWE-A/N's senior indebtedness. As of the Debt Closing Date, Advance/Newhouse assumed responsibility for the day-to-day operations of the Advance/Newhouse Systems. As a result, TWE has deconsolidated the financial position and operating results of these systems. Additionally, all prior period results associated with the Advance/Newhouse Systems, including the historical minority interest allocated to Advance/Newhouse's interest in TWE-A/N, have been reflected as a discontinued operation for all periods presented. Under the new TWE-A/N Partnership Agreement, effective as of the Debt Closing Date, Advance/Newhouse's partnership interest tracks only the economic performance of the Advance/Newhouse Systems, including associated liabilities, while AOL Time Warner retains all of the economic interests in the other TWE-A/N assets and liabilities. The restructuring was completed in December 2002.

As part of the restructuring of TWE-A/N, on the Debt Closing Date, AOL Time Warner acquired Advance/Newhouse's interest in Road Runner, thereby increasing TWE's ownership to approximately 82% on a fully attributed basis. As a result of the termination of Advance/Newhouse's minority rights in Road Runner, TWE has consolidated the financial position and results of operations of Road Runner with the financial position and results of operations of TWE's Cable segment. As permitted under generally accepted accounting principles, the Company has consolidated the results of Road Runner retroactive to the beginning of 2002.

In connection with the TWE-A/N restructuring, TWE recognized a non-cash pretax gain of approximately $1.2 billion, which related to the difference between the carrying value of TWE's interest in the Advance/Newhouse Systems and the fair value of TWE's acquired interest in the non-Advance/Newhouse Systems. The gain was mitigated because a portion of TWE's investment in TWE-A/N, relating to AOL Time Warner, was recently adjusted to fair value as part of purchase accounting for the Merger. The gain is included as part of discontinued operations in the accompanying consolidated statement of operations for year ended December 31, 2002.

America Online-Time Warner Merger

The Merger has been accounted for by AOL Time Warner as an acquisition of Time Warner under the purchase method of accounting for business combinations. Under the purchase method of accounting, the cost of approximately $147 billion to acquire Time Warner, including transaction costs, was allocated to its underlying net assets, including the net assets of TWE to the extent acquired, based on their respective estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired was recorded as goodwill. This allocation includes intangible assets, such as film and television libraries, cable television franchises and brands and trademarks.

Discontinued Operations

The Company's results of operations have been adjusted to reflect the results of the Advance/Newhouse Systems as a discontinued operation for all periods presented herein. For 2002, for the six months ended June 30, 2002 (e.g., the most recent reported period prior to the deconsolidation), the net impact of the deconsolidation of these systems was a reduction of Cable's previously reported revenues, EBITDA and operating income of $715 million, $333 million and $206 million, respectively. For the year ended December 31, 2001, the net impact of the deconsolidation of these systems was a reduction of Cable's revenues, EBITDA and operating income of $1.247 billion, $571 million and $313 million, respectively. For the year ended December 31, 2000, the net impact of the deconsolidation of these systems was a reduction of the Cable segment's previously reported revenues, EBITDA and operating income of $1.058 billion, $484 million and $256 million, respectively. In addition, during 2002, the Company recognized a non-cash pretax gain of $1.2 billion relating to the restructuring. As of December 31, 2001, the Advance/Newhouse Systems had current assets and total assets of approximately $64 million and $2.7 billion, respectively, and current liabilities and total liabilities of approximately $210 million and $963 million, respectively, including debt assumed on the Debt Closing Date.

New Accounting Principles

Cumulative Effect of Change in Film Accounting Principle

In June 2000, TWE adopted American Institute of Certified Public Accountants ("AICPA") Statement of Position ("SOP") 00-2, "Accounting by Producers and Distributors of Films" ("SOP 00-2"). SOP 00-2 established new film accounting standards, including changes in revenue recognition and accounting for advertising, development and overhead costs. Specifically, SOP 00-2 requires advertising costs for theatrical and television product to be expensed as incurred. This compares to TWE's previous policy of first capitalizing

and then expensing advertising costs for theatrical product over the related revenue streams. In addition, SOP 00-2 requires development costs for abandoned projects and certain indirect overhead costs to be charged directly to expense, instead of those costs being capitalized to film costs, which was required under the previous accounting model. SOP 00-2 also requires all film costs to be classified in the balance sheet as noncurrent assets.

TWE adopted the provisions of SOP 00-2, retroactively to the beginning of 2000. As a result, TWE's net income includes a one-time, non-cash charge of $524 million, primarily to reduce the carrying value of its film inventory. This charge has been reflected as a cumulative effect of an accounting change in the accompanying consolidated statement of operations.

Revenue Classification Changes

Reimbursement of "Out-of-Pocket" Expenses

In January 2002, the Financial Accounting Standards Board ("FASB") Staff reached a consensus on Emerging Issues Task Force ("EITF") Issue No. 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred" ("EITF 01-14"). EITF 01-14 requires that reimbursements received for out-of-pocket expenses be classified as revenue on the income statement and EITF 01-14 was effective for TWE in the first quarter of 2002 and required retroactive restatement of all periods presented to reflect the new accounting provisions. This change in revenue classification impacts TWE's Cable segment. As a result of applying the guidance of EITF 01-14, TWE's revenues and costs presented herein were retroactively increased by an equal amount of $196 million in 2001 and $171 million in 2000.

Accounting for Goodwill and Other Intangible Assets

During 2001, FASB issued Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" ("FAS 142"), which requires that, effective January 1, 2002, goodwill, including the goodwill included in the carrying value of investments accounted for using the equity method of accounting, and certain other intangible assets deemed to have an indefinite useful life, cease amortizing. The new rules also require that goodwill and certain intangible assets be assessed for impairment using fair value measurement techniques. During the first quarter of 2002, the Company completed its initial impairment review and recorded a $21.763 billion non-cash pretax charge for the impairment of goodwill, substantially all of which was generated in the Merger. The charge reflects overall market declines since the Merger was announced in January 2000, is non-operational in nature and is reflected as a cumulative effect of an accounting change in the accompanying consolidated financial statements (Note 2).

During the fourth quarter of 2002, the Company performed its annual impairment review for goodwill and other intangible assets and recorded an additional non-cash charge of $2.355 billion, which is recorded as a component of operating income in the accompanying consolidated statement of operations. The $2.355 billion charge reflects a reduction in the carrying value of goodwill at the Cable segment and reflects current market conditions in the cable television industry, as evidenced by the decline in the stock prices of comparable cable television companies.

The impairment charges are non-cash in nature and do not affect the Company's liquidity or result in the non-compliance with respect to any debt covenants.

Variable Interest Entities

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), which requires variable interest entities (commonly referred to as SPE's) to be consolidated by the primary beneficiary of the entity if certain criteria are met. FIN 46 is effective

immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 become effective for the Company during the third quarter of 2003. The Company anticipates that the adoption of FIN 46 will not result in a material impact to TWE.

Stock-Based Compensation

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure" ("FAS 148"). FAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. FAS 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, FAS 148 requires disclosure of the pro forma effect in interim financial statements. The transition and annual disclosure requirements of FAS 148 are effective for fiscal years ended beginning December 15, 2002. The interim disclosure requirements of FAS 148 are effective for interim periods beginning after December 15, 2002. The adoption of the provisions of FAS 148 did not have an impact on the Company's consolidated financial statements, however, the Company has modified its disclosures herein as provided for in the new standard.

Exit and Disposal Activities

In July 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("FAS 146"). FAS 146 nullifies the accounting for restructuring costs provided in EITF Issue No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." FAS 146 requires that a liability associated with an exit or disposal activity be recognized and measured at fair value only when incurred. In addition, one-time termination benefits should be recognized over the period employees will render service, if the service period required is beyond a minimum retention period. FAS 146 is effective for exit or disposal activities initiated after December 31, 2002. Management does not expect that the application of the provisions of FAS 146 will have a material impact on the Company's consolidated financial statements.

Multiple Element Arrangements

In November 2002, the EITF reached a consensus on EITF No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"). EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company believes that its current accounting is consistent with the provisions of EITF 00-21 and therefore does not expect that the application of the provisions of EITF 00-21 will have a material impact on the Company's consolidated financial statements.

Consideration Received from a Vendor by a Customer

In November 2002, the EITF reached a consensus on EITF No. 02-16, "Accounting for Consideration Received from a Vendor by a Customer" ("EITF 02-16"). EITF 02-16 provides guidance as to how customers should account for cash consideration received from a vendor. EITF 02-16 presumes that cash received from a vendor represents a reduction of the prices of the vendor's products or services, unless the cash received represents a payment for assets or services provided to the vendor or a reimbursement of costs incurred by the customer to sell the vendor's products. The provisions of EITF 02-16 will apply to all agreements entered into or modified after December 31, 2002. Management does not expect the provisions of EITF 02-16 to have a material impact on the Company's consolidated financial statements.

Guarantees

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a reconciliation of changes in the entity's product warranty liabilities. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The initial recognition and initial measurement provisions of FIN 45 are not expected to have a material impact on the Company's consolidated financial statements. The disclosure requirements of FIN 45 are effective for financial statements of interim or annual periods ending after December 15, 2002; therefore, the Company has modified its disclosures herein as required.

Asset Retirement Obligations

In July 2001, the FASB issued Statement No. 143, "Accounting for Asset Retirement Obligations" ("FAS 143"). FAS 143 addresses the accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. FAS 143 became effective for TWE in the first quarter of 2002. The provisions of FAS 143 did not have a material impact on TWE's consolidated financial statements.

Impairment or Disposal of Long-Lived Assets

In August 2001, the FASB issued Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FAS 144"). FAS 144 clarifies the accounting for the impairment of long-lived assets and for long-lived assets to be disposed of, including the disposal of business segments and major lines of business. FAS 144 became effective for TWE in the first quarter of 2002. The provisions of FAS 144 did not have a material impact on TWE's consolidated financial statements.

Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

In September 2000, FASB issued Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities — a Replacement of FASB Statement No. 125" ("FAS 140"). FAS 140 revises the criteria for accounting for securitizations and other transfers of financial assets and collateral. In addition, FAS 140 requires certain additional disclosures. Except for the new disclosure provisions, which were effective for the year ended December 31, 2000, FAS 140 was effective for the transfer of financial assets occurring after March 31, 2001. The provisions of FAS 140 did not have a significant effect on TWE's consolidated financial statements.

Summary of Significant Accounting Policies

Basis of Consolidation and Accounting for Investments

The consolidated financial statements include 100% of the assets, liabilities, revenues, expenses, income, loss and cash flows of TWE and all companies in which TWE has a controlling voting interest ("subsidiaries"), as if TWE and its subsidiaries were a single company. Intercompany accounts and transactions between the consolidated companies have been eliminated. Significant accounts and transactions between TWE and its partners and affiliates are disclosed as related party transactions (Note 15).

Investments in companies in which TWE has significant influence, but less than a controlling voting interest, are accounted for using the equity method. This is generally presumed to exist when TWE owns between 20% and 50% of the investee. However, in certain circumstances, TWE's ownership percentage exceeds 50% but TWE accounts for the investment using the equity method because the minority

shareholders hold certain rights which allow them to participate in the day-to-day operations of the business. Under the equity method, only TWE's investment in and amounts due to and from the equity investee are included in the consolidated balance sheet; only TWE's share of the investee's earnings is included in the consolidated operating results; and only the dividends, cash distributions, loans or other cash received from the investee, additional cash investments, loan repayments or other cash paid to the investee, are included in the consolidated cash flows. In circumstances where the Company's ownership in an investee is in the form of a preferred security or otherwise senior security, TWE's share in the investee's income or loss is determined by applying the equity method of accounting using the "hypothetical-liquidation-at-book-value" method. Under the hypothetical-liquidation-at-book-value method, the investor's share of earnings or losses is determined based on changes in the investor's claim in the net book value of the investee. Additionally, the carrying value of investments accounted for using the equity method of accounting are adjusted downward to reflect any other-than-temporary declines in value.

Investments in companies in which TWE does not have a controlling interest, or an ownership and voting interest so large as to exert significant influence, are accounted for as available-for-sale securities at market value if the investments are publicly traded and there are no resale restrictions greater than one year. If there are resale restrictions greater than one year, or if the investment is not publicly traded, then the investment is accounted for at cost. Unrealized gains and losses on investments accounted for at market value are reported in the accompanying consolidated statement of partnership capital as a component of accumulated other comprehensive income (loss) until the investment is sold, at which time the realized gain or loss is included in income. Dividends and other distributions of earnings from both market-value and investments accounted for at cost are included in income when declared.

The effect of any changes in TWE's ownership interests resulting from the issuance of capital by consolidated subsidiaries or equity investees to unaffiliated parties is included in income.

TWE has certain accounts receivable facilities that provide for the accelerated receipt of cash on available accounts receivables and licensing contracts. These securitization transactions are accounted for as a sale in accordance with FAS 140 because the Company relinquished control of the receivables. Since the Company has relinquished control over these receivables and does not control the Qualifying SPE that holds the receivables, the amounts held in these securitization facilities are not included in the consolidated financial statements of the Company.

Investment Impairments

The Company's investments are comprised of fair value investments, including available-for-sale investments, investments accounted for using the cost method of accounting and investments accounted for using the equity method of accounting. A judgmental aspect of accounting for investments involves determining whether an other-than-temporary decline in value of the investment has been sustained. If it has been determined that an investment has sustained an other-than-temporary decline in its value, the investment is written down to its fair value, by a charge to earnings. Such evaluation is dependent on the specific facts and circumstances. Factors that are considered by the Company in determining whether an other-than-temporary decline in value has occurred include: the market value of the security in relation to its cost basis; the financial condition of the investee; and the intent and ability to retain the investment for a sufficient period of time to allow for recovery in the market value of the investment.

In evaluating the factors above for available-for-sale securities, management presumes a decline in value to be other-than-temporary if the quoted market price of the security is 20% or more below the investment's cost basis for a period of six months or more (the "20% criteria") or the quoted market price of the security is 50% or more below the security's cost basis at any quarter end (the "50% criteria"). However, the presumption of an other-than-temporary decline in these instances may be overcome if there is persuasive evidence indicating that the decline is temporary in nature (e.g., strong operating performance of investee,

historical volatility of investee, etc.). Additionally, there may be instances where impairment losses are recognized even if the 20% and 50% criteria are not satisfied (e.g., plan to sell the security in the near term and the fair value is below the Company's cost basis).

For investments accounted for using the cost or equity method of accounting, management evaluates information (e.g., budgets, business plans, financial statements, etc.) in addition to quoted market price, if any, in determining whether an other-than-temporary decline in value exists. Factors indicative of an other-than- temporary decline include recurring operating losses, credit defaults and subsequent rounds of financings at an amount below the cost basis of the investment. This list is not all inclusive and management weighs all quantitative and qualitative factors in determining if an other-than-temporary decline in value of an investment has occurred.

Foreign Currency Translation

The financial position and operating results of substantially all foreign operations are consolidated using the local currency as the functional currency. Local currency assets and liabilities are translated at the rates of exchange on the balance sheet date, and local currency revenues and expenses are translated at average rates of exchange during the period. Resulting translation gains or losses, are included in the accompanying statement of partnership capital as a component of accumulated other comprehensive income (loss).

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and footnotes thereto. Actual results could differ from those estimates.

Significant estimates inherent in the preparation of the accompanying consolidated financial statements include management's forecast of anticipated revenues and cash flows from investments and the distribution of theatrical and television product in order to evaluate the ultimate recoverability of accounts receivable, film inventory and investments recorded as assets in the consolidated balance sheet. Accounts receivable and sales of home video product in the filmed entertainment industry are subject to customers' rights to return unsold items. In addition, significant estimates have been used in accounting for business combinations accounted for using the purchase method of accounting. Management periodically reviews such estimates and it is reasonably possible that management's assessment of recoverability of accounts receivable, individual films and television product, and investments may change based on actual results and other factors.

Revenues and Costs

Cable

Cable revenues are principally derived from video and high speed data subscriber fees and advertising. Subscriber fees are recorded as revenue in the period the service is provided and advertising revenues, including advertising purchased by programmers, are recognized in the period that the advertisements are exhibited. Video programming costs are recorded as the services are provided. Launch fees received by the Company from programming vendors are recognized as a reduction of expense over the life of the related programming arrangement. Fees received from programming vendors representing the reimbursement of marketing costs are recognized as a reduction of marketing expenses in the period such reimbursement are received.

Networks

Network revenues are primarily derived from subscriber fees and advertising. Subscriber fees are recorded as revenue in the period the service is provided and advertising revenues are recognized in the period that the advertisements are exhibited. The costs of rights to exhibit feature films and other programming on

pay cable services during one or more availability periods ("programming costs") generally are recorded as inventory when the programming is initially available for exhibition, and are allocated to the appropriate availability periods and amortized as the programming is exhibited.

Filmed Entertainment

Feature films are produced or acquired for initial exhibition in theaters followed by distribution in the home video, pay cable, basic cable, broadcast network and syndicated television markets. Generally, distribution to the theatrical, home video and pay cable markets (the primary markets) is completed within eighteen months of initial release. Thereafter, feature films are distributed to the basic cable, broadcast network and syndicated television markets (the secondary markets). Theatrical revenues are recognized as the films are exhibited. Home video revenues, less a provision for returns, are recognized when the home videos are sold. Revenues from the distribution of theatrical product to cable, broadcast network and syndicated television markets are recognized when the films are available to telecast.

Television films and series are initially produced for the broadcast networks, cable networks or first-run television syndication (the primary markets) and may be subsequently licensed to foreign or domestic cable and syndicated television markets (the secondary markets). Revenues from the distribution of television product are recognized when the films or series are available to telecast, except for barter agreements where the recognition of revenue is deferred until the related advertisements are exhibited.

License agreements for the telecast of theatrical and television product in the cable, broadcast network and syndicated television markets are routinely entered into well in advance of their available date for telecast, which is generally determined by the telecast privileges granted under previous license agreements. Accordingly, there are significant contractual rights to receive cash and barter under these licensing agreements. For cash contracts, the related revenues will not be recognized until such product is available for telecast under the contractual terms of the related license agreement. For barter contracts, the related revenues will not be recognized until the product is available for telecast and the advertising spots received under such contracts are either used or sold to third parties. All of these contractual rights for which revenue is not yet recognizable is referred to as "backlog."

Inventories of theatrical and television product are stated at the lower of unamortized cost or net realizable value. Cost principally consists of direct production costs and production overhead. A portion of the cost to acquire Time Warner in 2001, including Time Warner's interest in TWE, was allocated to its theatrical and television product, including an allocation to purchased program rights and product that had been exhibited at least once in all markets ("Library"). Library product is amortized on a straight-line basis over twenty years, which approximated the use of the film-forecast method. Individual films and series are amortized, and the related participations and residuals are accrued, based on the proportion that current revenues from the film or series bear to an estimate of total revenues anticipated from all markets. These estimates are revised periodically and losses, if any, are provided in full. Film inventories generally include the unamortized cost of completed theatrical and television films, theatrical films and television series in production pursuant to a contract of sale, film rights acquired for the home video market, advances pursuant to agreements to distribute third-party films and the Library.

Barter Transactions

TWE enters into transactions that exchange advertising for advertising. Such transactions are recorded at the estimated fair value of the advertising received or given in accordance with the provisions of the EITF Issue No. 99-17, "Accounting for Advertising Barter Transactions." In addition, TWE enters into transactions that exchange advertising for products and services, which are accounted for similarly. Revenue from barter transactions is recognized when advertising is provided, and services received are charged to expense when

used. Barter transactions are not material to the Company's consolidated statement of operations for all periods.

Multiple-Element Arrangements

TWE enters into transactions where it is purchasing a product, service or making an investment in a vendor and at the same time it is negotiating a contract for the sale of advertising to the vendor. For example, when negotiating programming arrangements with cable networks, TWE will, at times, simultaneously negotiate for the sale of advertising to the cable network. This arrangement may be documented in one contract or may be documented in two separate contracts; whether there are one or two contracts, these arrangements are negotiated simultaneously. In accounting for these arrangements, TWE looks to the guidance contained in the following authoritative literature.

- APB Opinion No. 29, "Accounting for Nonmonetary Transactions" (APB 29); and
- EITF 01-09, "Accounting for Consideration Given by a Vendor to a Customer" (EITF 01-09).

TWE measures these transactions based on the respective fair values of the goods or services purchased and the goods or services sold. If TWE is unable to determine the fair value of one or more of the element(s) being purchased, then revenue recognition is limited to the total consideration received for the products or services sold less amounts paid. The accounting for these transactions requires significant judgments and estimates, which are further discussed in Critical Accounting Policies.

Advertising Costs

TWE expenses advertising costs for theatrical and television product as incurred in accordance with AICPA SOP 00-2. In accordance with AICPA SOP 93-7, "Reporting on Advertising Costs," other advertising costs, including advertising associated with the launch of new cable channels and products, are expensed upon the first exhibition of the advertisement. Advertising expense was $1.8 billion in 2002, $1.5 billion on historical basis in 2001 and $1.3 billion in 2000.

Cash and Equivalents

Cash equivalents consist of commercial paper and other investments that are readily convertible into cash and have original maturities of three months or less. Cash equivalents are carried at cost, which approximates fair value.

Derivative and Financial Instruments

Effective July 1, 1998, TWE adopted FASB Statement No. 133, as amended by FASB Statement No. 138, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"). FAS 133 requires that all derivative instruments be recognized on the balance sheet at fair value. In addition, FAS 133 provides that for derivative instruments that qualify for hedge accounting, changes in the fair value will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in the accompanying consolidated statement of partnership capital as a component of accumulated other comprehensive income (loss) until the hedged item is recognized in earnings, depending on whether the derivative is being used to hedge changes in fair value or cash flows. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The adoption of FAS 133 did not have a material effect on TWE's consolidated financial statements (Note 12).

The carrying value of TWE's financial instruments approximates fair value, except for differences with respect to long-term, fixed-rate debt (Note 7) and certain differences relating to investments accounted for at cost and other financial instruments that are not significant (Note 5). The fair value of financial instruments is generally determined by reference to market values resulting from trading on a national securities exchange or

in an over-the-counter market. In cases where quoted market prices are not available, fair value is based on estimates using present value or other valuation techniques.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Additions to cable property, plant and equipment generally include material, labor, overhead and interest. Depreciation is provided generally on the straight-line method over useful lives ranging up to thirty years for buildings and improvements and up to sixteen years for furniture, fixtures and other equipment. For cable television plant upgrades and cable converters and modems, depreciation is provided generally over useful lives of 16 and 3-5 years, respectively. Property, plant and equipment consists of:

	December 31, 2002	December 31, 2001
	(millions)	
Land and buildings	$ 895	$ 923
Cable television equipment	7,695	8,769
Furniture, fixtures and other equipment	1,356	1,252
Less accumulated depreciation	(2,305)	(2,371)
Total	$ 7,641	$ 8,573

The Company periodically reviews the carrying value of its long-lived assets, including property, plant and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. To the extent fair value of a long-lived asset, determined based upon the estimated future cash inflows attributable to the asset, less estimated future cash outflows, are less than the carrying amount, an impairment loss is recognized.

Goodwill and Other Intangible Assets

As a creator and distributor of branded information and entertainment copyrights, TWE has a significant and growing number of intangible assets, including goodwill, cable television franchises, film and television libraries and other copyrighted products and trademarks. In accordance with generally accepted accounting principles, TWE does not recognize the fair value of internally generated intangible assets. Costs incurred to create and produce copyrighted product, such as feature films and television series, generally are either expensed as incurred, or capitalized as tangible assets, as in the case of cash advances and inventoriable product costs. However, accounting recognition is not given to any increasing asset value that may be associated with the collection of the underlying copyrighted material. Additionally, costs incurred to create or extend brands generally result in losses over an extended development period and are recognized as a reduction of income as incurred, while any corresponding brand value created is not recognized as an intangible asset in the consolidated balance sheet. On the other hand, intangible assets acquired in business combinations accounted for by the purchase method of accounting are capitalized and amortized over their expected useful life as a non-cash charge against future results of operations. As of January 1, 2001, in connection with the Merger, the intangible assets of Time Warner, including the significant value of internally generated intangible assets of TWE to the extent acquired, were recorded at fair value on AOL Time Warner's and TWE's consolidated balance sheets. However, increases in the fair value of TWE's intangible assets to the extent they weren't acquired in the Merger or increases in the fair value or creation of intangible assets related to TWE businesses subsequent to the consummation of the Merger, are not reflected on AOL Time Warner's or TWE's consolidated balance sheet.

As discussed previously, FAS 142, which became effective on January 1, 2002, required that goodwill and certain other intangible assets deemed to have an indefinite useful life cease amortization. As a result, a

substantial portion of the Company's goodwill and intangible assets, including cable and television franchises and brands and trademarks cease amortizing. However, TWE continues to amortize intangible assets that are deemed to have a finite useful life, including film and television libraries and customer lists which are amortized over weighted average useful lives of 17 and 5 years, respectively. Amortization of goodwill and intangible assets was $150 million in 2002, $2.668 billion in 2001 and $503 million in 2000. Accumulated amortization of goodwill and intangible assets at December 31, 2002 was $2.175 billion, $3.859 billion in 2001 and $4.445 billion in 2000.

TWE periodically reviews the carrying value of acquired intangible assets, including goodwill, to determine whether impairment may exist. FAS 142 requires that goodwill and certain intangible assets be assessed for impairment using fair value measurement techniques. Specifically, goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The impairment test for other intangible assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. For intangible assets subject to amortization, to the extent the fair value of the intangible asset, determined based upon the estimated future cash flows attributable to the asset less estimated future cash outflows, are less than the carrying amount, an impairment loss is recognized. The determination of impairment of goodwill and other intangible assets requires significant judgments and estimates, which is further discussed under Critical Accounting Policies.

Income Taxes

As a Delaware limited partnership, TWE is generally not subject to U.S. federal and state income taxation. However, certain of TWE's operations are conducted by subsidiary corporations that are subject to domestic or foreign taxation. Income taxes are provided on the income of such corporations using the liability method prescribed by FASB Statement No. 109, "Accounting for Income Taxes." Under the liability method, deferred income taxes reflect the tax effect of net operating loss and investment carryforwards and the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial statement and income tax purposes, as determined under enacted tax laws and rates. The financial effect of changes in tax laws or rates is accounted for in the period of enactment. The subsequent realization of net operating loss and investment tax credit carryforwards acquired in acquisitions accounted for using the purchase method of accounting is recorded as a reduction of goodwill.

Stock-Based Compensation

AOL Time Warner has various stock option plans under which it may grant options to purchase AOL Time Warner common stock to employees of AOL Time Warner and TWE. The Company follows the provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("FAS 123"). The provisions of FAS 123 allow companies to either expense the estimated fair value of stock options or to

continue to follow the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") but disclose the pro forma effects on net income (loss) had the fair value of the options been expensed. AOL Time Warner has elected to continue to apply APB 25 in accounting for its stock option incentive plans (Note 11).

In accordance with APB 25 and related interpretations, compensation expense for stock options is recognized in income based on the excess, if any, of the quoted market price of the stock at the grant date of the award or other measurement date over the amount an employee must pay to acquire the stock. Generally, the exercise price for stock options granted to employees of TWE equals or exceeds the fair market value of AOL Time Warner common stock at the date of grant, thereby resulting in no recognition of compensation expense by AOL Time Warner, nor charged to TWE. For awards that generate compensation expense as defined under APB 25, the Company calculates the amount of compensation expense and recognizes the expense over the vesting period of the award.

As previously discussed, in 2002 the FASB issued FAS 148. FAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. FAS 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, FAS 148 requires disclosure of the pro forma effect in interim financial statements. The transition and annual disclosure requirements of FAS 148 are effective for fiscal years ended after December 15, 2002. The interim disclosure requirements of FAS 148 are effective for interim periods beginning after December 15, 2002.

Had compensation cost for AOL Time Warner's stock option plans been determined based on the fair value method set forth in FAS 123, TWE's allocable share of compensation cost would have decreased its net income to the pro forma amounts indicated below:

	Years Ended December 31,		
	2002	2001	2000
		(millions)	
Net income, as reported	$(21,219)	$(1,032)	$ 229
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(297)	(69)	(146)
Pro forma net income	$(21,516)	$(1,101)	$ 83

Comprehensive Income (Loss)

Comprehensive income (loss), which is reported on the accompanying consolidated statement of partnership capital as a component of accumulated other comprehensive income (loss), consists of net income (loss) and other gains and losses affecting partners' capital that, under accounting principles generally accepted in the United States are excluded from net income (loss). For TWE, such items consist primarily of unrealized gains and losses on marketable equity investments and foreign currency translation gains and losses.

The following summary sets forth the components of other comprehensive income (loss) accumulated in partners' capital:

	Foreign Currency Translation Losses	Net Unrealized Gains (Losses) on Securities	Derivative Financial Instrument Losses	Unfunded Accumulated Benefit Obligation	Accumulated Other Comprehensive Income (Loss)
			(In millions)		
Balance at December 31, 2000...	$—	$—	$ —	$ —	$ —
2001 activity...	1	(7)	—	—	(6)
Balance at December 31, 2001...	1	(7)	—	—	(6)
2002 activity...	35	9	(21)	(183)	(160)
Balance at December 31, 2002...	$36	$ 2	$(21)	$(183)	$(166)

Reclassifications

Certain reclassifications have been made to the prior years' consolidated financial statements to conform to the 2002 presentation.

2. GOODWILL AND INTANGIBLE ASSETS

As discussed in Note 1, in January 2002, TWE adopted FAS 142, which requires companies to stop amortizing goodwill and certain intangible assets with an indefinite useful life. Instead, FAS 142 requires that goodwill and intangible assets deemed to have an indefinite useful life be reviewed for impairment upon adoption of FAS 142 (January 1, 2002) and annually thereafter.

Under FAS 142, goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value. The Company's reporting units are generally consistent with the operating segments underlying the segments identified in Note 13 — Segment Information. This methodology differs from TWE's previous policy, as permitted under accounting standards existing at that time, of using undiscounted cash flows on an enterprisewide basis to determine if goodwill is recoverable.

Upon adoption of FAS 142 in the first quarter of 2002, TWE recorded a one-time, noncash charge of $21.763 billion to reduce the carrying value of its goodwill. Such charge is nonoperational in nature and is reflected as a cumulative effect of an accounting change in the accompanying consolidated statement of operations. In calculating the impairment charge, the fair value of the impaired reporting units underlying the segments were estimated using either a discounted cash flow methodology, market comparisons or recent comparable transactions or a combination thereof.

The $21.763 billion goodwill impairment is associated solely with goodwill resulting from the Merger. The amount of the impairment primarily reflects the decline in AOL Time Warner's stock price since the Merger was announced and valued for accounting purposes in January of 2000. Prior to performing the review for impairment, FAS 142 required that all goodwill deemed to be related to the entity as a whole be assigned to all of the Company's reporting units, including the reporting units of the acquirer. This differs from the previous accounting rules where goodwill was assigned only to the businesses of the company acquired. As a result, effective January 1, 2002, $6.857 billion of the goodwill generated in the Merger, which was previously allocated to the TWE segments, has been reallocated on a relative fair value basis to other segments of AOL Time Warner.

During the fourth quarter of 2002, the Company performed its annual impairment review for goodwill and other intangible assets and recorded an additional charge of approximately $2.355 billion, which is recorded as a component of operating income in the accompanying consolidated statement of operations. The $2.355 billion is reflective of the overall decline in market values and includes charges to reduce the carrying value of goodwill at the Cable segment.

The approximate $2.355 billion charge at the Cable segment reflects current market conditions in the cable television industry, as evidenced by the decline in the stock prices of comparable cable television companies.

A summary of changes in the Company's goodwill during the year ended 2002, and total assets at December 31, 2002, by business segment is as follows (millions):

	Goodwill					
	January 1, 2002[a][b]	Acquisitions & Adjustments[d]	Cumulative Effect of Accounting Change	4th Quarter Impairment	December 31, 2002	Total Assets December 31, 2002
Cable	$19,048	$ 75	$(16,768)	$(2,355)	$ —	$29,990
Filmed Entertainment	6,165	6	(2,851)	—	3,320	13,276
Networks[c]	8,934	20	(2,144)	—	6,809	10,240
Corporate	—	—	—	—	—	849
Total	$34,147	$101	$(21,763)	$(2,355)	$10,129	$54,355

(a) Reflects the reallocation of goodwill of $6.857 billion to other segments of AOL Time Warner under FAS 142.
(b) In addition to the goodwill identified above, AOL Time Warner has recognized goodwill associated with deferred tax liabilities related to TWE's assets and liabilities. Neither the deferred tax liabilities nor the corresponding goodwill are recorded in TWE's standalone financial statements because TWE is generally not subject to U.S. Federal income taxation.
(c) Includes impairments at HBO ($1.933 billion) and The WB Network ($211 million).
(d) Includes goodwill created in acquisitions consummated in 2002 as well as adjustments to TWE's preliminary purchase price allocation for several acquisitions consummated in 2001.

The impairment charges are non-cash in nature and do not affect the Company's liquidity or result in the non-compliance of any debt covenants.

The Company's intangible assets and related accumulated amortization consisted of the following (in millions):

	As of December 31, 2002			As of December 31, 2001		
	Gross	Accumulated Amortization[a]	Net	Gross	Accumulated Amortization[a]	Net
Intangible assets subject to amortization:						
Film library	$ 2,529	$ (276)	$ 2,253	$ 2,529	$ (138)	$ 2,391
Customer lists and other intangible assets	193	(105)	88	204	(131)	73
Total	$ 2,722	$ (381)	$ 2,341	$ 2,733	$ (269)	$ 2,464
Intangible assets not subject to amortization:						
Cable television franchises[b]	$21,685	$(1,256)	$20,429	$21,911	$(1,644)	$20,267
Brands, trademarks and other intangible assets	2,150	(61)	2,089	2,150	(61)	2,089
Total	$23,835	$(1,317)	$22,518	$24,061	$(1,705)	$22,356

(a) Accumulated amortization for intangible assets not subject to amortization relates to amortization expense recognized prior to the adoption of FAS 142.

(b) The change in cable television franchises primarily relates to the restructuring of TWE-A/N, which resulted in the deconsolidation of the gross and accumulated amortization balances relating to the cable television franchise intangible assets of the Advance/Newhouse Systems. The decline in the gross balance was offset in part by the increase in the carrying value of Comcast's indirect interest in TWE-A/N as part of the restructuring.

The Company recorded amortization expense of $150 million for the year ended 2002 compared to $2.668 billion for the year ended of 2001. Based on the current amount of intangible assets subject to amortization, the estimated amortization expense for each of the succeeding 5 years are as follows: 2003: $149 million; 2004: $144 million; 2005: $183 million; 2006: $183 million; and 2007: $144 million. As acquisitions and dispositions occur in the future and as purchase price allocations are finalized, these amounts may vary.

During the year ended of 2002, the Company acquired the following intangible assets (in millions):

		Weighted Average Amortization Period
Other intangible assets subject to amortization	$ 27	10-15 years
Cable television franchises not subject to amortization[a]	890	Indefinite
Total	$917	

(a) The increase in cable television franchises primarily relates to the increase in the carrying value of Comcast's interest in TWE-A/N as part of a restructuring of that partnership.

The 2001 and 2000 results on a historical basis do not reflect the provisions of FAS 142. Had TWE adopted FAS 142 on January 1, 2000, the historical net income (loss) would have been changed to the adjusted amounts indicated below:

	Year Ended	
	December 31, 2001	December 31, 2000
	(millions)	
	Net income (loss)	Net income (loss)
As reported — historical basis	$(1,032)	$229
Add: Goodwill amortization	1,673	119
Add: Intangible amortization	853	324
Add: Equity investee goodwill amortization	133	44
Discontinued operations	41	62
Adjusted	$ 1,668	$778

3. MERGER-RELATED COSTS

America Online-Time Warner Merger

In connection with the Merger, TWE has reviewed its operations and implemented several plans to restructure its operations ("restructuring plans"). As part of the restructuring plans, TWE recorded a restructuring liability of $301 million during 2001. The restructuring accruals relate to costs to exit and consolidate certain activities at TWE, as well as costs to terminate employees across various business units. Such amounts were recognized as liabilities assumed in the purchase business combination and included in the allocation of the cost to acquire Time Warner. Accordingly, such amounts resulted in additional goodwill being recorded in connection with the Merger.

Of the total restructuring costs, $107 million related to work force reductions and represented employee termination benefits. Employee termination costs occurred across most TWE business units and ranged from senior executives to line personnel. The number of employees initially identified to be involuntarily terminated or relocated approximated 1,600. As of December 31, 2002, approximately 800 of the terminations had occurred. The remaining 800 terminations are no longer expected to occur. Because certain employees can defer receipt of termination benefits, cash payments may continue after the employee has been terminated

(generally for periods up to 24 months). Employee termination payments of $19 million were made in 2001 and $29 million were made in 2002. In addition during 2002, there were non-cash reductions in the restructuring accrual of $36 million, as actual employee termination payments were less than amounts originally estimated. As of December 31, 2002, the remaining liability of approximately $23 million was classified as a current liability in the accompanying consolidated balance sheet.

The restructuring charge also includes approximately $194 million associated with exiting certain activities. Specifically, TWE has exited certain under-performing operations, including the Studio Stores operations included in the Filmed Entertainment segment. The restructuring accrual associated with exit activities specifically includes incremental costs and contractual termination obligations for items such as leasehold termination payments and other facility exit costs incurred as a direct result of these plans, which will not have future benefits. Payments related to exit activities were approximately $88 million in 2001 and $80 million were paid in 2002. In addition, there were non-cash reductions in the restructuring accrual of approximately $11 million, as actual termination payments were more than amounts originally estimated. As of December 31, 2002, the remaining liability of $37 million was primarily classified as a current liability in the accompanying consolidated balance sheet.

Selected information relating to the restructuring plans follows (in millions):

	Employee Termination	Exit Costs	Total
Initial accruals	$107	$194	$301
Cash paid — 2001	(19)	(88)	(107)
Restructuring liability as of December 31, 2001	$ 88	$106	$194
Cash paid — 2002	(29)	(80)	(109)
Noncash reductions[a] — 2002	(23)	(2)	(25)
Restructuring liability as of December 31, 2002	$ 36	$ 24	$ 60

[a] Noncash reductions represent adjustments to the restructuring accrual, and a corresponding reduction in goodwill, as actual costs related to employee terminations and other exit costs were less than originally estimated.

Restructuring Costs

During the year ended December 31, 2002, TWE incurred and accrued other restructuring costs of $13 million that related to work force reductions and represented employee termination benefits. The number of employees expected to be terminated was approximately 210. As of December 31, 2002, substantially all the terminations had occurred. The severed employees spanned the major departments and divisions of TWE and ranged from senior executives to line personnel. As of December 31, 2002, $2 million has been paid against these accruals. The remaining $11 million is primarily classified as a current liability in the accompanying consolidated statement of operations.

4. CABLE-RELATED TRANSACTIONS AND INVESTMENTS

Restructuring of TWE-Advance/Newhouse and Road Runner Partnership

Prior to August 1, 2002, the TWE-A/N was owned approximately 64.8% by TWE, the managing partner, 33.3% by the Advance/Newhouse Partnership ("Advance/Newhouse") and 1.9% indirectly by AOL Time Warner. The financial position and operating results of TWE-A/N were consolidated by TWE, and the partnership interest owned by Advance/Newhouse was reflected in the consolidated financial statements of TWE as minority interest. In addition, prior to August 1, 2002, Road Runner, a high-speed cable modem Internet service provider, was owned by TWI Cable Inc. (a wholly owned subsidiary of AOL Time Warner), TWE and TWE-A/N, with AOL Time Warner owning approximately 65% on a fully attributed basis (i.e.,

after considering the portion attributable to the minority partners of TWE and TWE-A/N). AOL Time Warner's interest in Road Runner was accounted for using the equity method of accounting because of certain approval rights held by Advance/Newhouse.

On June 24, 2002, TWE and Advance/Newhouse agreed to restructure TWE-A/N, which, on August 1, 2002, (the "Debt Closing Date") resulted in Advance/Newhouse assuming responsibility for the day-to-day operations of certain TWE-A/N cable systems serving approximately 2.1 million subscribers located primarily in Florida (the "Advance/Newhouse Systems"). On the Debt Closing Date, Advance/Newhouse and its affiliates arranged for a new credit facility, which is independent of and not guaranteed by AOL Time Warner, to support the Advance/Newhouse Systems and assumed and repaid approximately $780 million of TWE-A/N's senior indebtedness. As of the Debt Closing Date, Advance/Newhouse assumed responsibility for the day-to-day operations of the Advance/Newhouse Systems. As a result, TWE has deconsolidated the financial position and operating results of these systems. Additionally, all prior period results associated with the Advance/Newhouse Systems, including the historical minority interest allocated to Advance/Newhouse's interest in TWE-A/N, have been reflected as a discontinued operation for all periods presented. Under the new TWE-A/N Partnership Agreement, effective as of the Debt Closing Date, Advance/Newhouse's partnership interest tracks only the economic performance of the Advance/Newhouse Systems, including associated liabilities, while TWE retains all of the economic interests in the other TWE-A/N assets and liabilities. The restructuring was completed on December 31, 2002.

Road Runner Restructuring

The high-speed online businesses of Time Warner Cable and AT&T were managed in a separate venture ("Road Runner") in which the common equity interests were collectively owned 68.6% by TWI Cable Inc., TWE and TWE-A/N and 31.4% by AT&T. In addition, Microsoft Corp. and Compaq Computer Corp. each owned a preferred equity interest in Road Runner that was convertible into a 10% common equity interest (the "Preferred Equity Interests"). In December 2000, Time Warner announced that the ownership of Road Runner would be restructured. As a result of the restructuring, TWE recognized a one-time restructuring charge of $35 million in 2000 related to employee severance and payments to terminate contracts. This charge is included in other expense, net, in the accompanying consolidated statement of operations. Subsequent to the restructuring, Road Runner was owned by TWI Cable Inc., TWE and TWE-A/N, with TWE owning approximately 68% on a fully attributed basis (i.e., after considering the portion attributable to the minority partners of TWE-A/N). As of December 31, 2001, TWE's interest in Road Runner continued to be accounted for using the equity method of accounting because of certain approval rights held by Advance/Newhouse, a partner in TWE-A/N.

As previously discussed, as part of the restructuring of TWE-A/N, on the Debt Closing Date, AOL Time Warner effectively acquired Advance/Newhouse's attributable interest in Road Runner, thereby increasing its ownership to approximately 82% on a fully attributed basis. As a result of the termination of Advance/Newhouse's minority rights in Road Runner, TWE has consolidated the financial position and results of operations of Road Runner with the financial position and results of operations of TWE's Cable segment. As permitted under generally accepted accounting principles, the Company has consolidated the results of Road Runner retroactive to the beginning of 2002.

In connection with the TWE-A/N restructuring, TWE recognized a non-cash pretax gain of approximately $1.2 billion. The gain was calculated as the difference between the fair value received in the restructuring (e.g., TWE's increased economic interest in the TWE-A/N cable systems remaining under the management of TWE) and the carrying value surrendered (e.g. the carrying value of TWE's interest in the Advance/Newhouse Systems). In order to determine fair value, in addition to internal analysis, the Company obtained an appraisal from an independent valuation firm. The gain was mitigated because a portion of TWE's investment in TWE-A/N that related to AOL Time Warner's interests was recently adjusted to fair value as

part of purchase accounting for the Merger. The gain is included as part of discontinued operations in the accompanying consolidated statement of operations for year ended December 31, 2002.

Cable Television System Joint Ventures

Time Warner Cable has a 50% interest in a number of unconsolidated cable television systems that served an aggregate 1.6 million subscribers and had combined debt of approximately $2.1 billion as of December 31, 2002. Unconsolidated cable television joint ventures include AOL Time Warner's investment in Texas Cable Partners, L.P., ("Texas Cable") which as of December 31, 2002 served approximately 1.2 million subscribers, and Kansas City Cable Partners ("Kansas City Cable"), which as of December 31, 2002 served approximately 306,000 subscribers. As of December 31, 2002, Texas Cable and Kansas City Cable had outstanding debt of approximately $1.764 billion (including $268 million due to TWE) and $399 million, respectively.

5. INVESTMENTS, INCLUDING AVAILABLE-FOR-SALE SECURITIES

TWE's investments, including available-for-sale securities consist of:

	December 31, 2002	December 31, 2001
	(millions)	
Equity method investments	$2,345	$2,084
Cost-method investments	16	13
Fair-value method investments, including derivative instruments	142	211
Total	$2,503	$2,308

[a] The fair value of TWE's cost-method and fair-value investments, including equity derivative instruments, was approximately $158 million at December 31, 2002, and $224 million at December 31, 2001.

Investment Writedowns

The carrying value of the Company's investments in its unconsolidated cable television system joint ventures was adjusted upward in the Merger by over $1 billion. During 2002, the value of these investments experienced a decline in value and during the fourth quarter, management determined that the decline in value was other-than-temporary and recorded an impairment charge of $363 million to reduce the carrying value of certain investments to fair value. In determining fair value, the Company considered the per subscriber valuation of consolidated cable television systems that was used to determine the goodwill impairment charge at the Cable segment in the fourth quarter of 2002, as well as per subscriber valuations of unrelated cable television companies.

Equity-Method Investments

At December 31, 2002, investments accounted for using the equity method and the voting ownership percentage held by TWE on a fully attributed basis included: Comedy Partners, L.P. (50% owned), certain cable system joint ventures and certain international cable and programming joint ventures (generally 25-50% owned) and Courtroom Television Network LLC (50% owned). In 2001 and 2000, equity investee information was additionally provided for Road Runner, which is no longer accounted for under the equity

method of accounting as of December 31, 2002. A summary of combined financial information as reported by the equity investees of TWE is set forth below:

	Years Ended December 31,		
	2002	2001	2000
		(millions)	
Operating Results:			
Revenues	$2,143	$1,701	$1,589
Operating income (loss)	322	(58)	33
Net income (loss)	149	(183)	(260)
Balance Sheet:			
Current assets	415	356	352
Total assets	3,570	3,464	3,103
Current liabilities	632	599	1,067
Long-term debt	2,065	2,108	2,018
Total liabilities	2,886	2,904	3,170
Total shareholders' equity or partners' capital	684	560	(67)

The above table represents the combined financial information of entities in which TWE has an investment accounted for using the equity method of accounting. These amounts are not the amounts reflected on the Company's accompanying consolidated financial statements. Consistent with TWE's accounting policy for investments accounted for using the equity method of accounting, as described in Note 1, TWE has included approximately $2.345 billion in "Investments, including available-for-sale securities" on the accompanying consolidated balance sheet, representing TWE's investment in and amounts due to and from the equity investee. Similarly, the Company has recorded $24 million of income in other expense, net, in the accompanying consolidated statement of operations, representing the Company's share in the pretax income (loss) of the investees.

As discussed in Note 1, under the purchase method of accounting, the cost to acquire Time Warner was allocated to its underlying net assets, including investments accounted for using the equity method of accounting, based on their estimated fair values. As a result, TWE's investments accounted for using the equity method of accounting were adjusted upward by approximately $1.6 billion, including over $1 billion relating to investments in certain cable television joint ventures. These adjustments, which approximate the difference between TWE's carrying value in the investees and the Company's underlying equity in the net assets of the investees, were amortized on a straight-line basis over a weighted-average useful life of 17 years. However, as discussed in Note 1, upon adoption of FAS 142 in the first quarter of 2002, AOL Time Warner ceased amortizing goodwill included in the carrying value of investments accounted for under the equity method of accounting.

Gains on Sale of Interest in CanalSatellite

During 2000, Warner Bros. recognized a net pretax, investment-related gain of approximately $65 million, principally relating to additional proceeds received in 2000 in connection with the 1999 sale of an interest in CanalSatellite. This gain has been included in other expense, net, in the accompanying consolidated statement of operations in 2000.

6. INVENTORIES AND FILM COSTS

Inventories and film costs consist of:

	December 31,	
	2002	2001
	(millions)	
Programming costs, less amortization	$1,314	$1,285
Merchandise	154	158
Film costs — Theatrical:		
Released, less amortization	602	650
Completed and not released	94	285
In production	458	346
Development and pre-production	39	36
Film costs — Television:		
Released, less amortization	160	123
Completed and not released	165	95
In production	69	59
Development and pre-production	5	2
Total inventories and film costs[(a)]	3,060	3,039
Less current portion of inventory[(b)]	871	852
Total noncurrent inventories and film costs	$2,189	$2,187

[(a)] Does not include $2.253 billion and $2.391 billion of net film library costs as of December 31, 2002 and December 31, 2001, respectively, which are included in intangible assets subject to amortization on the accompanying consolidated balance sheet. See Note 2.

[(b)] Current inventory as of December 31, 2002 and December 31, 2001 is comprised of programming inventory at the Networks segment ($717 million and $694 million, respectively) and videocassettes and DVDs at the Filmed Entertainment segment ($154 million and $158 million, respectively).

Excluding the Library, approximately 93% of unamortized film costs for released films is expected to be amortized within three years. Approximately $786 million of released and completed and not released film costs are expected to be amortized during the next twelve months.

7. LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS

Long-Term Debt

Long-term debt consists of:

	Weighted Average Interest Rate at December 31, 2002	Maturities	2002 Committed Capacity	2002 Unused Capacity	Outstanding Debt at December 31,	
					2002	2001
					(millions)	
Bank credit agreement debt and commercial paper programs[a][b]	1.92%	2004-2007	$10,801	$6,645	$1,458	$2,290
Fixed-rate public debt	7.49%	2008-2033	3,394	—	3,394	4,011
Due to AOL Time Warner	1.53%	2004	2,084	—	2,084	1,734
Other fixed-rate obligations[c]	—	—	19	—	19	16
Total			16,298	6,645	6,955	8,051
Debt due within one year[d]			(8)	—	(8)	(2)
Total long-term debt			$16,290	$6,645	$6,947	$8,049

[a] Committed capacity and unused capacity includes approximately $1.0 billion of cash and short-term investments less $211 million of outstanding letters of credit.

[b] Portion of bank credit agreement and commercial paper program's committed capacity can be used by non-TWE, AOL Time Warner segments. At December 31, 2002, approximately $2.7 billion of committed capacity was used by non-TWE segments.

[c] Includes obligations under capital leases.

[d] Debt due within one year relates to other fixed-rate obligations.

Bank Credit Agreements and Commercial Paper Programs

$10 Billion Revolving Credit Facilities

In July 2002, AOL Time Warner, together with certain of its consolidated subsidiaries, entered into two new senior unsecured long-term revolving bank credit agreements with an aggregate borrowing capacity of $10 billion (the "2002 Credit Agreements") and terminated two existing bank credit facilities with an aggregate borrowing capacity of $12.5 billion (the "Old Credit Agreements"), which were scheduled to expire during 2002. The 2002 Credit Agreements are comprised of a $6 billion five-year revolving credit facility and a $4 billion 364-day revolving credit facility, borrowings under which may be extended for a period up to two years following the initial term. The borrowers under the 2002 Credit Agreements are AOL Time Warner, TWE, TWE-A/N and AOL Time Warner Finance Ireland. The obligations of each of AOL Time Warner and AOL Time Warner Finance Ireland are guaranteed by America Online, Time Warner, Turner Broadcasting System, Inc. ("TBS") and Time Warner Companies, Inc. ("TW Companies"), directly or indirectly. The obligation of AOL Time Warner Finance Ireland is guaranteed by AOL Time Warner. Borrowings bear interest at specific rates, generally based on the credit rating for each of the borrowers, which is currently equal to LIBOR plus .625%, including facility fees of .10% and .125% on the total commitments of the 364-day and five-year facilities, respectively. In addition, the Company is required to pay an additional usage fee of .0625% if the two facilities in the aggregate have more than 33% outstanding and .125% if the facilities have more than 66% outstanding. The 2002 Credit Agreements provide same-day funding, multi-currency capability and letter of credit availability. They contain a maximum leverage ratio covenant of 5.0 times for each of TWE and TWE-A/N, but do not contain any credit ratings-based defaults or covenants, nor an ongoing covenant or representation specifically relating to a material adverse change in the Company's financial condition or results of operations. Borrowings may be used for general business purposes and unused credit is available to support commercial paper borrowings. As of December 31, 2002, $1.458 billion was

outstanding under these facilities. As of December 31, 2001, $2.290 billion was outstanding under the Old Credit Agreements.

In January 2003, the Company received unanimous approval to amend its 2002 Credit Agreements, effective upon closing of the TWE restructuring. The amendments will (i) replace the $50 billion net worth covenant in each of the credit facilities within the 2002 Credit Agreements with an interest coverage covenant of 2.0 times cash interest expense, (ii) remove TWE-A/N as a borrower under all the credit facilities and TWE as a borrower under the five-year revolving credit facility and (iii) divide the $4 billion 364-day revolving credit facility into a separate $2.5 billion revolving credit facility for AOL Time Warner and AOL Time Warner Finance Ireland and a $1.5 billion revolving credit facility for TWE (and TWC Inc. following any initial public offering of its stock or registered public issuance of its debt). Other terms of the 364-day credit facility were amended to reflect this bifurcation and the stand-alone nature of the $1.5 billion TWE credit facility. As part of the same consent, the maturity of the $1.5 billion TWE credit facility was extended from July 7, 2003 to January 7, 2004, while the length of the optional extension period was reduced from two years to one year.

Fixed-Rate Public Borrowings

From 1992 through 1993, TWE had various public debt offerings. The maturities of these outstanding offerings ranged from 10 to 40 years and the interest rates range from 7.25% to 10.15%. At December 31, 2002 and 2001, the total debt outstanding from these offerings was approximately $3.394 billion and $4.011, respectively.

Debt Guarantees

Each AOL Time Warner General Partner has guaranteed a pro rata portion of approximately $3.3 billion of TWE's debt and accrued interest at December 31, 2002, based on the relative fair value of the net assets each AOL Time Warner General Partner (or its predecessor) contributed to TWE (the "AOL Time Warner General Partner Guarantees"). Such indebtedness is recourse to each AOL Time Warner General Partner only to the extent of its guarantee. The indenture pursuant to which TWE's notes and debentures have been issued (the "Indenture") requires the majority consent of the holders of the notes and debentures to terminate the AOL Time Warner General Partner Guarantees. There are generally no restrictions on the ability of the AOL Time Warner General Partner guarantors to transfer material assets, other than TWE assets, to parties that are not guarantors. In addition approximately $1.168 billion of TWE-A/N's debt and accrued interest at December 31, 2002 has been guaranteed by TWI Cable Inc. and certain of its subsidiaries.

Interest Expense and Maturities

Interest expense amounted to $426 million in 2002, $554 million in 2001 and $634 million in 2000. The weighted average interest rate on TWE's total debt was 4.54% and 3.74% at December 31, 2002 and 2001, respectively. The Company recognized interest income of $25 million in 2002, $24 million in 2001 and $22 million in 2000.

Annual repayments of long-term debt for the five years subsequent to December 31, 2002 consist of $2.370 billion due in 2004 and $1.167 billion due in 2007, all of which is bank debt. This includes all borrowings under the Bank Credit Agreement, as well as any commercial paper borrowings supported thereby. After 2007, no more than $1 billion matures in any one year. TWE has the intent and ability to continue to refinance its borrowings on a long-term basis through arrangements with AOL Time Warner.

Fair Value of Debt

Based on the level of interest rates prevailing at December 31, 2002 and 2001, the fair value of TWE's fixed-rate debt exceeded its carrying value by approximately $216 million in 2002 and $241 million in 2001.

Unrealized gains or losses on debt do not result in the realization or expenditure of cash and generally are not recognized for financial reporting purposes unless the debt is retired prior to its maturity.

Other Financing Arrangements

From time to time, the Company enters into various other financing arrangements with special purpose entities ("SPEs"). These arrangements include facilities which provide for the accelerated receipt of cash on certain accounts receivable and backlog licensing contracts. TWE employs these arrangements because they provide a cost-efficient form of financing, including certain tax benefits, as well as an added level of diversification of funding sources. TWE is able to realize cost efficiencies under these arrangements since the assets securing the financing are held by a legally separate, bankruptcy-remote SPE and provides direct security for the funding being provided. These facilities generally have relatively short-term maturities (1 to 5 years), which is taken into account in determining the maximum efficiency for the Company's overall capital structure. The Company's maturity profile of its outstanding debt and other financing arrangements is relatively long-term, with a weighted average maturity of approximately 10 years. The assets and financing associated with these arrangements, which are discussed in more detail in the following paragraphs, generally qualify for off-balance sheet treatment.

Accounts Receivable Securitization Facilities

During 2002, TWE participated in two of AOL Time Warner's accounts receivable securitization facilities that provided for the accelerated receipt of $800 million of cash on available accounts receivables, including a $350 million accounts receivable securitization facility that matured during the fourth quarter of 2002 and was not renewed. As of December 31, 2002, TWE had no unused capacity under its remaining facility. In connection with each of these securitization facilities, TWE sells, on a revolving and nonrecourse basis, certain of its accounts receivables ("Pooled Receivables") to a qualifying SPE, which in turn sells a percentage ownership interest in the Pooled Receivables to third-party commercial paper conduits sponsored by financial institutions. These securitization transactions are accounted for as a sale in accordance FAS 140, because the Company relinquished control of the receivables. Accordingly, accounts receivable sold under these facilities are excluded from receivables in the accompanying consolidated balance sheet.

As proceeds for the accounts receivable sold to the qualifying SPE, TWE receives cash, for which there is no obligation to repay, and an interest-bearing retained beneficial interest, which is included in receivables on the accompanying consolidated balance sheet. In addition, TWE services the Pooled Receivables on behalf of the qualifying SPE. Income received by AOL Time Warner in exchange for this service is equal to the prevailing market rate for such services and has not been material in any period. The retained beneficial interest, which has been adjusted to reflect the portion that is not expected to be collectible, bear an interest rate that varies with the prevailing market interest rates. For this reason, and because the accounts receivables underlying the retained ownership interest that are sold to the qualifying SPE are generally short term in nature, the fair value of the notes receivable approximated its carrying value at December 31, 2002 and at December 31, 2001. The retained beneficial interest related to the sale of Pooled Receivables to a qualifying SPE is reflected in account receivables, net on the Company's consolidated balance sheet and was $481 million at December 31, 2002 and $416 million at December 31, 2001. In 2002, additional net proceeds received from TWE's accounts receivable by utilizing its accounts receivable securitization programs were not material. In 2001 and 2000, additional net proceeds received from TWE's accounts receivable by utilizing its accounts receivable securitization programs were $116 million and $174 million, respectively.

Backlog Securitization Facility

TWE also has a backlog securitization facility, which effectively provides for the accelerated receipt of up to $500 million of cash on available licensing contracts. Assets securitized under this facility consist of cash contracts for the licensing of theatrical and television product for broadcast network and syndicated television

exhibition, under which revenues have not been recognized because such product is not available for telecast until a later date ("Backlog Contracts"). In connection with this securitization facility, TWE sells, on a revolving and nonrecourse basis, certain of its Backlog Contracts ("Pooled Backlog Contracts") to a qualifying SPE, which in turn sells a percentage ownership interest in the Pooled Backlog Contracts to a third-party commercial paper conduit sponsored by a financial institution. As of December 31, 2002, TWE did not have any unused capacity under this facility.

Because the Backlog Contracts securitized under this facility consist of cash contracts for the licensing of theatrical and television product that have already been produced, the recognition of revenue for such completed product is dependent only upon the commencement of the availability period for telecast under the terms of the licensing agreements. Accordingly, the proceeds received under the program are classified as deferred revenues in long-term liabilities in the accompanying consolidated balance sheet. The amount of related deferred revenue reflected on TWE's accompanying consolidated balance sheet, related to the backlog securitization facility, was $500 million at December 31, 2002 and $442 million at December 31, 2001. Total filmed entertainment backlog contracts outstanding were approximately $3.2 billion at December 31, 2002 and approximately $3.8 billion at December 31, 2001.

Rating Triggers and Financial Covenants

Each of the Company's borrowing facilities discussed above, including financing arrangements with SPEs, contain customary covenants. A breach of such covenants in the bank credit agreement that continues beyond any grace period can constitute a default, which can limit the ability to borrow and can give rise to a right of the lenders to terminate the facility and/or require immediate payment of outstanding debt. A breach of such covenants in the financing arrangements with SPEs that continues beyond any grace period can constitute a termination event which can limit the facility as a future source of liquidity; however, there would be no claims on the Company for the receivables or backlog contracts previously sold. Additionally, in the event that the Company's credit ratings decrease, the cost of maintaining the facilities and of borrowing increases and, conversely, if the ratings improve, such costs decrease.

As of December 31, 2002 and through the date of this filing, the Company was in compliance with all covenants. Management does not foresee that the Company will have any difficulty complying with the covenants currently in place in the foreseeable future. As discussed in more detail in Note 1 to the accompanying consolidated financial statements, the Company recorded a non-cash charge of $21.763 billion upon adoption of FAS 142. In addition, TWE recorded a charge of $2.355 billion in the fourth quarter of 2002 to reduce the carrying value of goodwill. These charges did not result in a violation of any of the Company's covenants.

During 2003, the Company received unanimous consent from its bank group to amend its 2002 Credit Facilities. The amendment will, among other changes, replace the Company's covenant to maintain at least $50 billion of GAAP net worth with an interest coverage covenant of 2.0 times cash interest expense. The amendment will be effective upon the closing of the TWE restructuring.

Film Sale-Leaseback Transactions

From time to time the Company has entered into arrangements with investors in which certain films are sold and leased back. The sale-leaseback of the films allows the investors to claim certain international tax benefits of ownership of the film master negatives while the Company maintains control over all exploitation rights and privileges to the films. Such entities are capitalized with the investors' capital and debt and the investors participate in all of the profits or losses of the entities. The present value to these entities of the future revenue streams attributable to these transactions is $1.3 billion as of December 31, 2002. The Company does not consolidate nor participate in the operating results of the entities. The Company retains certain proceeds of the transactions as consideration for entering into the sale-leaseback transactions, and records the considera-

tion received as a reduction of corresponding film costs. The benefit to the Company from these transactions that was recognized as a reduction to film cost amortization in 2002 totaled $47 million.

8. INCOME TAXES

Domestic and foreign pretax income (loss) are as follows:

	Years Ended December 31,		
	2002	2001	2000
		(millions)	
Domestic	$(610)	$(951)	$811
Foreign	132	80	153
Total	$(478)	$(871)	$964

As a partnership, TWE is generally not subject to U.S. federal, state or local income taxation. However, certain of TWE's operations are conducted by subsidiary corporations that are subject to domestic or foreign taxation. Income taxes (benefits) of TWE and subsidiary corporations are as set forth below:

	Years Ended December 31,		
	2002	2001	2000
		(millions)	
Federal:			
Current	$ 3	$ 3	$ 13
Deferred	8	3	(6)
Foreign:			
Current[a]	138	106	139
Deferred	(9)	11	(11)
State and local:			
Current	17	4	13
Deferred	—	—	9
Total income taxes	$157	$127	$157

[a] Includes foreign withholding taxes of $81 million in 2002, $69 million in 2001 and $78 million in 2000.

The financial statement basis of TWE's assets exceeds the corresponding tax basis by approximately $37 billion at December 31, 2002, principally as a result of differences in goodwill and accounting for depreciable and amortizable assets for financial statement and income tax purposes.

9. PARTNERS' CAPITAL

Partnership Capital and Allocation of Income

Each partner's interest in TWE generally consists of the undistributed priority capital and residual equity amounts that were initially assigned to that partner, or its predecessor, based on the estimated fair value of the net assets each contributed to TWE ("Undistributed Contributed Capital"), plus, with respect to the priority capital interests only, any undistributed priority capital return. The priority capital return consists of net partnership income allocated to date in accordance with the provisions of the TWE partnership agreement and the right to be allocated additional partnership income which, together, provides for the various priority capital rates of return as specified in the following table. The sum of Undistributed Contributed Capital and the undistributed priority capital return is referred to herein as "Cumulative Priority Capital." Cumulative Priority

Capital is not necessarily indicative of the fair value of the underlying priority capital interests, principally due to above-market rates of return on certain priority capital interests as compared to securities of comparable credit risk and maturity, such as the 13.25% rate of return on the Series B Capital interest owned 100% by the AOL Time Warner General Partners. Furthermore, the ultimate realization of Cumulative Priority Capital could be affected by the fair value of TWE, which is subject to fluctuation.

A summary of the priority of Undistributed Contributed Capital, AOL Time Warner's ownership of Undistributed Contributed Capital and Cumulative Priority Capital at December 31, 2002 and priority capital rates of return thereon is as set forth below:

Priority of Undistributed Contributed Capital	Undistributed Contributed Capital(a)	Cumulative Priority Capital	Priority Capital Rates of Return(b)	% Owned by AOL Time Warner	Comcast
	(billions)			(ownership%)	
Series A Capital	$5.6	$22.0	13.00%	72.36%	27.64%
Series B Capital	2.9[c]	11.4	13.25%	100.00%	—
Residual Capital	3.3[c]	3.3[d]	—[d]	72.36%	27.64%

[a] Excludes partnership income or loss allocated thereto.

[b] To the extent income allocations are concurrently distributed, the priority capital rates of return on the Series A Capital and Series B Capital are 11.00% and 11.25%, respectively.

[c] The Undistributed Contributed Capital relating to the Series B Capital has priority over the priority returns on the Series A Capital. The Undistributed Contributed Capital relating to the Residual Capital has priority over the priority returns on the Series B Capital and the Series A Capital.

[d] Residual Capital is not entitled to stated priority rates of return and, as such, its Cumulative Priority Capital is equal to its Undistributed Contributed Capital. However, in the case of certain events such as the liquidation or dissolution of TWE, Residual Capital is entitled to any excess of the then fair value of the net assets of TWE over the aggregate amount of Cumulative Priority Capital and special tax allocations.

The Undistributed Contributed Capital generally is based on the fair value of the net assets that each partner initially contributed to the partnership. For purposes of allocating partnership income or loss to the partners, partnership income or loss is based on the fair value of the net assets contributed to the partnership and results in significantly less partnership income, or results in partnership losses, in contrast to the net income reported by TWE for financial statement purposes, which also is based on the historical cost of contributed net assets.

Under the TWE partnership agreement, partnership income, to the extent earned, is first allocated to the partners' capital accounts so that the economic burden of the income tax consequences of partnership operations is borne as though the partnership were taxed as a corporation ("special tax allocations"). After any special tax allocations, partnership income is allocated to the Series A Capital and Series B Capital, in order of priority, at rates of 13.00% and 13.25% per annum, respectively, and finally to the Residual Capital. Partnership losses generally are allocated first to eliminate prior allocations of partnership income to, and then to reduce the Undistributed Contributed Capital of, the Residual Capital, Series B Capital and Series A Capital, in that order, and then to reduce any special tax allocations. To the extent partnership income is insufficient to satisfy all special allocations in a particular accounting period, the right to receive additional partnership income necessary to provide for the various priority capital rates of return is carried forward until satisfied out of future partnership income, including any partnership income that may result from any liquidation, sale or dissolution of TWE.

TWE reported a net loss of $21.219 billion and $1.032 billion for the year ended December 31, 2002 and 2001, respectively. In 2002, this loss included a $21.763 billion non-cash charge related to the cumulative effect of an accounting change and a $2.355 billion impairment charge for goodwill, each of which was allocated from AOL Time Warner. In addition, in 2002 there was a $1.182 billion gain attributed to the minority partners of TWE in connection with the restructuring of TWE-A/N (Note 4). Because of the priority rights over allocations of income/loss and distributions of TWE held by the AOL Time Warner

General Partners, of the remaining $1.717 billion of TWE's income, $1.488 billion was allocated to AOL Time Warner and $229 million was allocated to the minority partners of TWE, including $6 million of pretax gains attributable to Comcast that were recognized in connection with the sale or exchange of various cable television systems at TWE. For 2001, $1.015 billion of TWE's net loss was allocated to AOL Time Warner and $17 million was allocated to the minority partners of TWE, net of $28 million of pretax gains attributable to Comcast that were recognized in connection with the sale or exchange of various cable television systems at TWE.

Capital Distributions

The assets and cash flows of TWE are restricted by the TWE partnership and credit agreements. As such, they are unavailable for use by the partners except through the payment of certain fees, reimbursements, cash distributions and loans, which are subject to limitations. Under the 2002 Credit Agreements, TWE is permitted to incur additional indebtedness to make loans, advances, distributions and other cash payments to its partners, subject to its individual compliance with the leverage ratio covenant contained therein.

At December 31, 2002 and 2001, the AOL Time Warner General Partners had recorded $8 million and $446 million respectively, of stock option related distributions due from TWE, based on closing prices of AOL Time Warner common stock of $13.10 and $32.10, respectively. AOL Time Warner is paid when the options are exercised. The AOL Time Warner General Partners also receive tax-related distributions from TWE on a current basis. During 2002, the AOL Time Warner General Partners received distributions from TWE in the amount of $497 million, consisting of $473 million of tax-related distributions and $24 million of stock option related distributions. During 2001, the AOL Time Warner General Partners received distributions from TWE in the amount of $317 million, consisting of $53 million of tax-related distributions and $264 million of stock option related distributions. In addition to the tax and stock option distributions, TWE may make other capital distributions to its partners that are also subject to certain limitations contained in the TWE partnership and credit agreements.

10. STOCK-BASED COMPENSATION PLANS

Effect of America Online-Time Warner Merger on Stock-Based Compensation Plans

In connection with Time Warner's agreement to merge with America Online entered into in January 2000, all Time Warner stock options and restricted stock outstanding at that time became fully vested, pursuant to the terms of Time Warner's stock option and restricted stock plans. In addition, on January 11, 2001, the date the Merger was consummated, each outstanding equity security of Time Warner was converted into 1.5 units of an equivalent equity security of AOL Time Warner. See Note 1 for a summary of the terms of the Merger.

Stock Option Plans

AOL Time Warner has various stock option plans under which AOL Time Warner may grant options to purchase AOL Time Warner common stock to employees of AOL Time Warner and TWE. Such options have been granted to employees of TWE with exercise prices equal to, or in excess of, fair market value at the date of grant. Accordingly, in accordance with APB 25 and related interpretations, compensation cost generally has not been recognized by AOL Time Warner, nor charged to TWE, related to such stock option plans. Generally, the options become exercisable over a four-year vesting period and expire ten years from the date of grant. Had compensation cost for Time Warner's stock option plans been determined based on the fair

value method set forth in FAS 123, TWE's allocable share of compensation cost would have decreased its net income to the pro forma amounts indicated below:

	Years Ended December 31,		
	2002	2001	2000
		(millions)	
Net income, as reported	$(21,219)	$(1,032)	$229
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(297)	(69)	(146)
Pro forma net income	$(21,516)	$(1,101)	$ 83

For purposes of applying FAS 123, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions (which, for 2000 reflect the impact of the announced Merger) used for grants to TWE employees in 2002, 2001 and 2000: dividend yields of 0% in all years; expected volatility of 52.9%, 59.3% and 46.3%, respectively; risk-free interest rates of 4.12%, 4.8% and 6.4%, respectively; and expected terms to exercise of .47 years after vesting for 2002 and 1.0 years after vesting for 2001 and 2000.

The weighted average fair value of an option granted to TWE employees during the year was $9.62 in 2002, $25.38 in 2001 and $28.05 in 2000.

A summary of stock option activity with respect to employees of TWE is as follows:

	Thousands of Shares	Weighted-Average Exercise Price
Balance at December 31, 1999	67,209	$17.11
Granted	7,251	57.23
Exercised	(6,522)	13.53
Cancelled[a]	1,502	16.99
Balance at December 31, 2000	69,440	21.63
Granted[b]	37,200	46.13
Exercised	(10,800)	13.06
Cancelled[a]	(394)	40.19
Balance at December 31, 2001	95,446	31.98
Granted	21,790	25.19
Exercised	(2,185)	9.95
Cancelled[a]	(10,329)	35.56
Balance at December 31, 2002	104,722	$30.67

[a] Includes all options cancelled and forfeited during the year, as well as options related to employees who have been transferred out of and into TWE to and from non-TWE AOL Time Warner segments.

[b] In 2001, a special Founder's Grant was issued to most individuals who were employees of TWE during the year the Merger was consummated, only a portion of which is expected to be recurring in the future.

	December 31,		
	2002	2001	2000
		(thousands)	
Exercisable	59,476	54,442	62,415

The following table summarizes information about stock options outstanding with respect to employees of TWE at December 31, 2002:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 12/31/02 (thousands)	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at 12/31/02 (thousands)	Weighted-Average Exercise Price
Under $10	559	1.18	$ 8.58	559	$ 8.58
$10.01 to $15.00	29,389	2.76	$13.28	28,494	$13.29
$15.01 to $20.00	6,484	5.40	$16.74	4,412	$16.17
$20.01 to $30.00	22,979	8.08	$25.65	6,139	$23.03
$30.01 to $45.00	10,883	7.57	$37.96	6,292	$38.49
$45.01 to $50.00	26,806	7.91	$47.62	9,062	$47.36
$50.01 to $60.00	7,438	7.51	$56.18	4,384	$56.85
$60.01 to $90.00	184	7.25	$64.00	134	$64.00
Total	104,722	6.25 years	$30.67	59,476	$25.64

TWE reimburses AOL Time Warner for the use of AOL Time Warner stock options on the basis described in Note 9.

11. BENEFIT PLANS

TWE and its subsidiaries have defined benefit pension plans covering most domestic employees. Pension benefits are based on formulas that reflect the employees' years of service and compensation levels during their employment period. AOL Time Warner's common stock whose value represents approximately 5% and 10% of fair value of plan assets at December 31, 2002 and 2001, respectively. After consummation of the Merger, participation in TWE's defined benefit pension plans was limited to employees who previously participated in these plans. A summary of activity for TWE's defined benefit pension plans is as follows:

	Years Ended December 31,		
	2002	2001	2000
	(millions)		
Components of Pension Expense			
Service cost	$39	$36	$39
Interest cost	48	45	41
Expected return on plan assets	(50)	(46)	(48)
Net amortization and deferral	7	—	(12)
Total pension expense	$44	$35	$20

	December 31, 2002	December 31, 2001
	(millions)	
Change in Projected Benefit Obligation		
Projected benefit obligation at beginning of year	$ 636	$538
Service cost	39	36
Interest cost	48	45
Actuarial loss	73	45
Benefits paid	(17)	(19)
Amendments to plan provisions	27	(9)
Impact of TWE-AN restructuring	(19)	—
Projected benefit obligation at end of year	$ 787	$636
Change in Plan Assets		
Fair value of plan assets at beginning of year	$ 587	$506
Actual return on plan assets	(82)	(41)
Employer contribution	27	137
Benefits paid	(15)	(15)
Impact of TWE-AN restructuring	(21)	—
Fair value of plan assets at end of year[(a)]	496	587
Underfunded projected benefit obligation	(291)	(49)
Additional minimum liability[(b)]	(214)	(5)
Unrecognized actuarial (gain) loss[(c)]	333	130
Effects of settlement accounting	(7)	—
Unrecognized prior service cost	30	3
Prepaid (accrued) pension expense	$(149)	$ 79

(a) Includes AOL Time Warner common stock of approximately 4 million in 2002 and 2001, respectively.
(b) The additional minimum liability is primarily offset by a $183 million reduction of other comprehensive income and a $31 million intangible asset in the consolidated balance sheet.
(c) Reflects primarily an actual loss on plan assets that significantly exceeded the assumed rate of return in 2002.

	December 31, 2002	2001	2000
Weighted-Average Pension Assumptions			
Discount rate	6.75%	7.50%	7.75%
Expected return on plan assets	9%	9%	9%
Rate of compensation increase	4.5%	4.5%	5%

Included above are projected benefit obligations and accumulated benefit obligations for unfunded defined benefit pension plans of $67 million and $60 million as of December 31, 2002, respectively; and $34 million and $41 million as of December 31, 2001, respectively. As of December 31, 2002, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets were $786 million, $644 million, and $494 million, respectively, for plans where the accumulated benefit obligation exceeded the fair value of plan assets.

Certain domestic employees of TWE participate in multi-employer pension plans as to which the expense amounted to $43 million in 2002, $36 million in 2001 and $36 million in 2000. Employees of TWE's operations in foreign countries participate to varying degrees in local pension plans, which in the aggregate are not significant.

TWE employees also generally participate in certain defined contribution plans, including savings and profit sharing plans, as to which the expense amounted to $38 million in 2002, $35 million in 2001 and $38 million in 2000. Contributions to the savings plans are based upon a percentage of the employees' elected contributions.

Pension Funding Liability

During the fourth quarter of 2002, the Company recorded a liability for the unfunded accumulated benefit obligation of approximately $90 million. This liability represents the excess of the accumulated benefit obligation under the Company's qualified defined benefit pension plans over the fair value of the plans' assets. In accordance with GAAP, this liability was established by a charge to shareholders' equity, resulting in no effect to the accompanying consolidated statement of operations. In early 2003, the Company made cash contributions to plan assets of approximately $42 million, which resulted in a funded status of approximately 75% relative to the projected benefit obligation.

12. DERIVATIVE INSTRUMENTS

TWE participates in AOL Time Warner's hedging program and uses derivative financial instruments principally to manage the risk that changes in foreign currency exchange rates will affect the amount of unremitted or future license fees to be received from the sale of U.S. copyrighted products abroad and to manage equity price risk in the Company's investment holdings. The following is a summary of TWE's foreign currency risk management strategy and the effect of this strategy on TWE's consolidated financial statements.

Foreign Currency Risk Management

Foreign exchange contracts are used primarily by TWE to hedge the risk that unremitted or future license fees owed to TWE domestic companies for the sale or anticipated sale of U.S. copyrighted products abroad may be adversely affected by changes in foreign currency exchange rates. Similarly, the Company enters into foreign exchange contracts to hedge film production costs abroad. As part of its overall strategy to manage the level of exposure to the risk of foreign currency exchange rate fluctuations, primarily exposure to changes in the value of the British pound, Japanese yen, and European currency, TWE hedges a portion of its foreign currency exposures anticipated over the ensuing fifteen-month period (the "hedging period"). The hedging period covers revenues expected to be recognized over the ensuing twelve-month period; however there is often a lag between the time that revenue is recognized and the transfer of foreign-denominated revenues back into U.S. dollars. Therefore, the hedging period covers a fifteen-month period. To hedge this exposure, TWE uses foreign exchange contracts that generally have maturities of three months to fifteen months to provide continuing coverage throughout the hedging period. AOL Time Warner reimburses or is reimbursed by TWE for contract gains and losses related to TWE's foreign currency exposure. At December 31, 2002, TWE had effectively hedged approximately 75% of the estimated net foreign currency exposures that principally relate to anticipated cash flows to be remitted to the U.S. over the hedging period.

TWE records these foreign exchange contracts at fair value in its consolidated balance sheet and the related gains or losses on these contracts are deferred in partners' capital (as a component of comprehensive income). These deferred gains and losses are recognized in income in the period in which the related license fees being hedged are received and recognized in income. However, to the extent that any of these contracts are not considered to be perfectly effective in offsetting the change in the value of the license fees being hedged, any changes in fair value relating to the ineffective portion of these contracts are immediately recognized in income. Gains and losses on foreign exchange contracts are generally included as a component of other expense, net, in TWE's consolidated statement of operations.

At December 31, 2002, AOL Time Warner had contracts for the sale of $1.588 billion and the purchase of $1.341 billion of foreign currencies at fixed rates. Of AOL Time Warner's $247 million net sale contract

position, $811 million of the foreign exchange sale contracts and $732 million of the foreign exchange purchase contracts related to TWE's foreign currency exposure. Included in TWE's foreign currency exposure were net contracts for the sale of $73 million of Canadian dollars, $65 million of Japanese yen, $176 million of European currency and net contracts for the purchase of $203 million of the British pound. Of AOL Time Warner's net sale contract position of $239 million of foreign currencies at December 31, 2001, $320 million of the foreign exchange sale contracts and $130 million of the foreign exchange purchase contracts related to TWE's foreign currency exposure. Included in TWE's foreign currency exposure were net contracts for the sale of $139 million of European currency, $51 million of Japanese yen, and net contracts for the purchase of $11 million of the British pound. TWE had deferred approximately $21 million of net losses on foreign exchange contracts at December 31, 2002, which is expected to be substantially recognized in income over the next twelve months. For the years ended December 31, 2002, 2001 and 2000, TWE recognized $9 million, $9 million and $12 million in gains, respectively, on foreign exchange contracts, which were or are expected to be largely offset by corresponding decreases and increases, respectively, in the dollar value of foreign currency license fee payments that have been or are anticipated to be received in cash from the sale of U.S. copyrighted products abroad. AOL Time Warner places foreign currency contracts with a number of major financial institutions in order to minimize counterparty credit risk.

13. SEGMENT INFORMATION

TWE classifies its business interests into three fundamental areas: *Cable,* consisting principally of interests in cable television systems; *Filmed Entertainment,* consisting principally of interests in filmed entertainment and television production; and *Networks,* consisting principally of interests in cable television and broadcast network programming.

Information as to the operations of TWE in different business segments is set forth below based on the nature of the products and services offered. TWE evaluates performance based on several factors, of which the primary financial measure is operating income (loss) before non-cash depreciation of tangible assets and amortization of goodwill and intangible assets ("EBITDA"). Additionally, the Company has provided a summary of operating income (loss) by segment.

The accounting policies of the business segments are the same as those described in the summary of significant accounting policies (Note 1). Intersegment sales are accounted for at fair value as if the sales were to third parties. While intercompany transactions are treated like third-party transactions to determine segment performance, the revenues (and corresponding expenses recognized by the segment that is counterparty to the transaction) are eliminated in consolidation and therefore, do not themselves impact consolidated results.

	Year Ended December 31,		
	2002	2001	2000
		(millions)	
Revenues[(a)]			
Cable[(b)]	$ 5,907	$ 4,983	$ 4,314
Filmed Entertainment	7,682	6,889	6,609
Networks	3,413	3,024	2,723
Intersegment elimination	(577)	(554)	(468)
Total Revenues	$16,425	$14,342	$13,178

(a) Revenues reflect the provisions of EITF 01-14 that were adopted by the Company in 2002, which require retroactive restatement of 2001 and 2000 results to reflect the new accounting provisions. As a result, the net impact of EITF 01-14 was to increase revenues and costs by equal amounts of $196 million for 2001 and reduce revenues and costs by an equal amount of $171 million in 2000.

(b) As a result of Advance/Newhouse assuming responsibility for the day-to-day operations of the Advance/Newhouse Systems in 2002, the Cable segment's results reflect the deconsolidation of the operating results of the Advance/Newhouse Systems for all periods presented. For 2002, 2001, and 2000 the net impact of the deconsolidation of these systems is a reduction of the Cable segment's previously reported revenues of $715 million, $1.247 billion and $1.058 billion, respectively.

Intersegment Revenues

In the normal course of business, the TWE segments enter into transactions with one another. The most common types of intercompany transactions include:

- The Filmed Entertainment segment generating content revenue by licensing television and theatrical programming to the Networks segment;
- The Networks segment generating subscription revenues by selling cable network programming to the Cable segment;
- The Cable and Networks segments generating advertising and commerce revenue by cross-promoting the products and services of all TWE segments.

These intercompany transactions are recorded by each segment at fair value as if the transactions were with third parties and, therefore, impact segment performance. While intercompany transactions are treated like third-party transactions to determine segment performance, the revenues (and corresponding expenses recognized by the segment that is counterparty to the transaction) are eliminated in consolidation and, therefore, do not themselves impact consolidated results. Revenues recognized by TWE's segments on intercompany transactions are as follows:

	Year Ended December 31,		
	2002	2001	2000
	(millions)		
Intersegment Revenues:			
Cable	$ 7	$ 2	$ —
Filmed Entertainment	323	326	148
Networks	247	226	320
Total intersegment revenues	$577	$554	$468

	Year Ended December 31,		
	2002	2001	2000
	(millions)		
EBITDA[a]			
Cable[b]	$2,333	$2,191	$1,960
Filmed Entertainment	844	691	585
Networks	849	703	512
Corporate	(84)	(78)	(75)
Total EBITDA	$3,942	$3,507	$2,982

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[a] EBITDA represents business segment operating income before non-cash depreciation of tangible assets and amortization of intangible assets. The impairment writedowns relating to goodwill and intangible assets were $2.355 billion for Cable. After deducting depreciation, amortization of intangible assets and impairment writedowns related to goodwill and intangible assets.. TWE's operating income (loss) was $308 million in 2002, $(31) million on a in 2001 and $1.722 billion in 2000.

[b] As a result of Advance/Newhouse assuming responsibility for the day-to-day operations of the Advance/Newhouse Systems in 2002, the Cable segment's results reflect the deconsolidation of the operating results of the Advance/Newhouse Systems for all periods presented. For 2002, 2001 and 2000 the net impact of the deconsolidation of these systems is a reduction of the Cable segment's previously reported EBITDA of $333 million, $571 million and $484, respectively.

	Year Ended December 31,		
	2002	2001	2000
		(millions)	
Depreciation of Property, Plant and Equipment			
Cable[(a)]	$1,018	$747	$633
Filmed Entertainment	74	83	85
Networks	27	33	33
Corporate	10	7	6
Total depreciation	$1,129	$870	$757

(a) The Cable segment's results reflect the deconsolidation of the operating results of the Advance/Newhouse systems for all periods presented. For 2002, 2001 and 2000, the net impact of the deconsolidation of these systems are a reduction of the Cable segment's depreciation of $125 million, $218 million and $166 million, respectively.

	Year Ended December 31,		
	2002	2001	2000
		(millions)	
Amortization of Intangible Assets[(a)]			
Cable[(b)]	$ 6	$1,900	$376
Filmed Entertainment	133	389	122
Networks	11	379	5
Total amortization	$150	$2,668	$503

(a) Includes amortization relating to business combinations accounted for by the purchase method, substantially all of which arose in the merger of America Online and Time Warner in 2001.
(b) The Cable segment's results reflect the deconsolidation of the operating results of the Advance/Newhouse systems for all periods presented. For 2002, 2001 and 2000, the net impact of the deconsolidation of these systems are a reduction of the Cable segment's amortization of $2 million, $40 million and $62 million, respectively.

	Year Ended December 31,		
	2002[(a)]	2001	2000
		(millions)	
Operating Income (Loss)			
Cable[(b)]	$(1,046)	$(456)	$ 951
Filmed Entertainment	637	219	378
Networks	811	291	474
Corporate	(94)	(85)	(81)
Total operating income (loss)	$ 308	$ (31)	$1,722

(a) Operating income (loss) in 2002 includes impairment write-downs related to goodwill of $2.355 billion for Cable.
(b) As a result of Advance/Newhouse assuming responsibility for the day-to-day operations of the Advance/Newhouse Systems in 2002, the Cable segment's results reflect the deconsolidation of the operating results of the Advance/Newhouse Systems for all periods presented. For 2002, 2001 and 2000, the net impact of the deconsolidation of these systems is a reduction of the Cable segment's previously reported operating income (loss) of $206 million, $313 million and $256 million, respectively.

As discussed in Notes 2, when FAS 142 was initially applied, all goodwill recognized on the Company's consolidated balance sheet on that date was reviewed for impairment using the new guidance. Before performing the review for impairment, the new guidance required that all goodwill deemed to relate to the entity as a whole be assigned to all of the Company's reporting units (generally, the AOL Time Warner operating segments), including the reporting units of the acquirer. This differs from the previous accounting rules, which required goodwill to be assigned only to the businesses of the company acquired. As a result,

$6.857 billion of the goodwill generated in the Merger originally allocated to the TWE segments was reallocated on January 1, 2002, to other segments of AOL Time Warner resulting in a change in segment assets. Following are TWE's assets by business segment, reflecting the January 1, 2002 reallocation of goodwill in accordance with FAS 142:

TWE's assets have significantly increased since December 31, 2000 due to the consummation of the Merger and the allocation of the $147 billion cost to acquire Time Warner to the underlying net assets of Time Warner, including the net assets of TWE to the extent acquired, based on their respective estimated fair values. Any excess of the purchase price over estimated fair value of the net assets acquired was recorded as goodwill and allocated among AOL Time Warner's business segments, including the business segments of TWE. As such, TWE's assets by business segment are as follows:

	Year Ended December 31,	
	2002	2001
	(millions)	
Assets		
Cable	$29,990	$56,694
Filmed Entertainment	13,276	16,375
Networks	10,240	11,212
Corporate[a]	849	777
Total Assets	$54,355	$85,058

[a] Consists principally of cash, cash equivalents and other investments.

Information as to TWE's capital expenditures is as follows:

	Year Ended December 31,		
	2002	2001	2000
		(millions)	
Capital Expenditures			
Cable[a]	$1,555	$1,467	$1,379
Filmed Entertainment	112	93	96
Networks	19	17	21
Corporate	3	27	16
Total Assets	$1,689	$1,604	$1,512

[a] As a result of Advance/Newhouse assuming responsibility for the day-to-day operations of the Advance/Newhouse Systems in 2002, the Cable segment's results reflect the deconsolidation of the operating results of the Advance/Newhouse Systems for all periods presented. For 2002, 2001 and 2000, the net impact of the deconsolidation of these systems is a reduction of the Cable segment's capital expenditures of $206 million, $408 million and $414 million, respectively.

Because a substantial portion of TWE's international revenues is derived from the sale of U.S. copyrighted products abroad, assets located outside the United States are not material. Information as to operations in different geographical areas is as follows:

	Years Ended December 31,		
	2002	2001	2000
		(millions)	
Revenues			
United States	$13,131	$11,876	$10,790
United Kingdom	724	583	504
Japan	446	306	265
Germany	294	184	225
France	287	201	165
Canada	253	230	203
Other international	1,290	962	1,026
Total Revenues	$16,425	$14,342	$13,178

14. COMMITMENTS AND CONTINGENCIES

Commitments

TWE's total rent expense amounted to $193 million in 2002, $225 million in 2001 and $240 million in 2000. The minimum net rental commitments under noncancellable long-term operating leases are: 2003-$144 million; 2004-$136 million; 2005-$131 million; 2006-$121 million; 2007-$114 million; and after 2007-$833 million. Additionally, TWE recognized sublease income of approximately $19 million in 2002 and as of December 31, 2002, the Company had future sublease income commitments of approximately $133 million.

TWE's minimum commitments and guarantees under certain programming, licensing, franchise and other agreements aggregated approximately $16.5 billion at December 31, 2002, which are payable principally over a five-year period. A summary of the Company's firm commitments, including net operating leases and outstanding debt, and contingent commitments is as follows.

Firm Commitments and Outstanding Debt	2003	2004-2006	2007 and thereafter	Total
		(millions)		
Programming and production deals	$2,178	$5,076	$ 5,455	$12,709
Operating leases	144	388	947	1,479
Other firm commitments	163	57	10	230
Total firm commitments	$2,485	$5,521	$ 6,412	$14,418
Total principal outstanding on long-term debt	—	2,370	4,367	6,737
Total firm commitments and outstanding debt	$2,485	$7,891	$10,779	$21,155

Following is a description of TWE's firm commitments at December 31, 2002:

- The Networks segment (HBO and The WB Network) enters into agreements with movie studios to air movies they produce. In addition, the Cable segment enters into commitments to purchase programming from cable network providers to provide service to its subscribers (e.g. programming deals). The commitments represent an estimate of future programming costs based on per subscriber rates contained in contracts existing as of December 31, 2002 applied to the number of consolidated subscribers on that date. Such amounts are subject to variability based on changes in the number of future subscribers, the extension

of existing contracts, and the entering into of new contracts. These arrangements are collectively referred to as programming production deals.

- Operating lease obligations primarily relate to the minimum lease rental obligations for the Company's real estate and operating equipment in various locations around the world.

- Other firm commitments include obligations to actors and directors. In addition, other firm commitments includes a payment of $128 million made in January 2003 to acquire an additional 11% interest in The WB Network.

Nature of Contingent Commitments	Total Commitments	Expiration of Commitments		
		2003	2004-2006	2007 and thereafter
		(millions)		
Guarantees	$2,637	$62	$444	$2,131
Letters of credit and other contingent commitments	170	8	1	161
Total contingent commitments	$2,807	$70	$445	$2,292

Following is a description of the Company's contingent commitments at December 31, 2002:

- Guarantees include guarantees the Company has provided on certain lease and operating commitments entered into by formerly owned entities and joint ventures in which TWE was or is a venture partner.

- The Cable segment provides letters of credit for several of its joint ventures. Should these joint ventures default on their debts, TWE would be obligated to cover these costs to the extent of the letters of credit. In addition, the Company provides for letters of credit and surety bonds related to insurance premiums and the Cable segment provides for letters of credit and surety bonds that are required by certain local governments when cable is being installed.

Contingencies

On June 24, 1997, plaintiffs in *Six Flags Over Georgia LLC et al. v. Time Warner Entertainment Company, L.P. et al.*, filed an amended complaint in the Superior Court of Gwinnett County, Georgia, claiming that, inter alia, defendants, which include TWE, violated their fiduciary duties in operating the Six Flags Over Georgia theme park. On December 18, 1998, following a trial, a jury returned a verdict in favor of plaintiffs. The total awarded to plaintiffs was approximately $454 million in compensatory and punitive damages. The case was appealed to the Georgia Court of Appeals, which affirmed the trial court's judgment, and denied reconsideration. The Supreme Court of Georgia denied certiorari on January 18, 2001. On February 28, 2001, the compensatory damages portion of the award plus accrued interest was paid to plaintiffs. On March 1, 2001, the United States Supreme Court granted a stay as to payment of the punitive damages part of the jury's original award, pending the resolution of a petition for certiorari to be filed by TWE, which was filed on June 15, 2001. On October 1, 2001, the United States Supreme Court granted certiorari, vacated the opinion of the Georgia Court of Appeals and remanded the case for further consideration as to punitive damages. On March 29, 2002, the Georgia Court of Appeals affirmed and reinstated its earlier decision regarding the punitive damage award. On April 18, 2002, TWE filed a petition for certiorari to the Georgia Supreme Court seeking review of the decision of the Georgia Court of Appeals, which was denied on September 16, 2002. The Georgia Supreme Court subsequently denied TWE's motion for reconsideration of its September 16th ruling. Plaintiffs have agreed not to pursue payment of the punitive damages award and accrued interest until the resolution of TWE's petition for writ of certiorari to the United States Supreme Court, which TWE filed on December 23, 2002. The petition is pending.

On April 8, 2002, three former employees of certain subsidiaries of the Company filed *Henry Spann et al. v. AOL Time Warner Inc. et al.*, a purported class action, in the U. S. District Court for the Central District of California. Plaintiffs have named as defendants the Company, TWE, WEA Corp., WEA Manufacturing Inc., Warner Bros. Records, Atlantic Recording Corporation, various pension plans sponsored by the companies and the administrative committees of those plans. Plaintiffs allege that defendants miscalculated the proper amount of pension benefits owed to them and other class members as required under the plans in violation of ERISA. The lawsuit has been transferred to the U. S. District Court for the Southern District of New York. Due to the preliminary status of this matter, the Company is unable to predict the outcome of this suit.

The costs and other effects of pending or future litigation, governmental investigations, legal and administrative cases and proceedings (whether civil or criminal), settlements, judgments and investigations, claims and changes in those matters (including those matters described above), and developments or assertions by or against the Company relating to intellectual property rights and intellectual property licenses, could have a material adverse effect on the Company's business, financial condition and operating results.

15. RELATED PARTY TRANSACTIONS

Transactions with AOL Time Warner

In the normal course of conducting their businesses, TWE has various transactions with AOL Time Warner and its subsidiaries. Under the provisions of the TWE partnership agreement, AOL Time Warner provides certain management services to TWE. For example, employees of TWE participate in various AOL Time Warner medical, stock option and other benefit plans, for which TWE is charged its allocable share of plan expenses, including administrative costs. In addition, AOL Time Warner provides TWE with certain corporate services, including accounting, tax, legal and administration, for which TWE pays a fee, which was established in the agreement.

TWE has management services agreements with AOL Time Warner, pursuant to which TWE manages, or provides services to, the cable television systems owned by AOL Time Warner. The fee is based in part upon the number of AOL Time Warner cable television subscribers under management of TWE in relation to total AOL Time Warner and TWE subscribers. Such cable television systems also pay fees to TWE for the right to carry cable television programming provided by TWE's cable networks. Similarly, TWE's cable television systems pay fees to AOL Time Warner for the right to carry cable television programming provided by AOL Time Warner's cable networks.

TWE's Filmed Entertainment segment has various service agreements with AOL Time Warner's Filmed Entertainment segment, pursuant to which TWE's Filmed Entertainment segment provides certain management and distribution services for AOL Time Warner's theatrical, television and animated product, as well as certain services for administrative and technical support.

AOL Time Warner's Networks segment has license agreements with TWE, pursuant to which the cable networks have acquired broadcast rights to certain film and television product. In addition, AOL Time Warner's Music segment provides home videocassette distribution services to certain TWE operations, and certain TWE units place advertising in magazines published by AOL Time Warner's Publishing segment.

For the year ended December 31, 2002, the accompanying statement of operations includes revenue, cost of revenue and selling, general and administrative expenses from transactions with AOL Time Warner of $335 million, $197 million and $217 million, respectively. For the year ended December 31, 2001, revenue, cost of revenue and selling, general and administrative expenses from transactions with AOL Time Warner were $423 million, $175 million and $138 million, respectively. For the year ended December 31, 2000, revenue, cost of revenue, and selling, general and administrative expenses from transactions with AOL Time Warner were $264 million, $85 million and $95 million, respectively.

Transactions with Equity Method Investees

In addition, the Company has transactions with certain unconsolidated investees accounted for under the equity method of accounting of both TWE and AOL Time Warner, generally with respect to sales of products and services in the ordinary course of business. Such transactions include the licensing of broadcast rights to film and television product by the Filmed Entertainment segment and the licensing of rights to carry cable television programming provided by the Cable Networks segment. For the year ended December 31, 2002, the accompanying statement of operations includes revenue and cost of revenue from the aforementioned transactions of $222 million and $125 million, respectively. For the year ended December 31, 2001, revenue and cost of revenue from the aforementioned transactions were $152 million and $190 million, respectively. For the year ended December 31, 2000, the accompanying statement of operations includes revenue and cost of revenues from the aforementioned transactions of $161 million and $123 million, respectively.

Transactions with Comcast

The Company has also entered into various transactions with Comcast, a minority owner of TWE, and its subsidiaries, primarily related to the sale of programming to Comcast cable systems by the Networks segment. These transactions are executed on terms comparable to those of unrelated third parties. For the years ended December 31, 2002 and 2001, the accompanying statement of operations includes revenue from the aforementioned transactions of $378 million and $365 million, respectively. These amounts reflect transactions with only those cable systems in which Comcast had on ownership interest during the periods covered.

Other Transactions

In addition to the above transactions in the normal course of business, in January 2003, the Company acquired an additional 11% interest in The WB Network from certain executives of The WB Network for $128 million.

16. ADDITIONAL FINANCIAL INFORMATION

Cash Flows

Additional financial information with respect to cash (payments) and receipts are as follows:

	Years Ended December 31,		
	2002	2001	2000
		(millions)	
Cash payments made for interest	$(391)	$(554)	$(539)
Interest income received	10	27	24
Cash interest expense, net	$(381)	$(527)	$(515)
Cash payments made for income taxes, net	$(165)	$(174)	$(114)
Income tax refunds received	12	4	7
Cash taxes, net	$(153)	$(170)	$(107)

Noncash investing activities in 2002, 2001 and 2000 included the exchange of certain cable television systems.

Interest Expense, Net

Interest expense, net, consists of:

	Years Ended December 31,		
	2002	2001	2000
		(millions)	
Interest income	$ 25	$ 24	$ 22
Interest expense	(426)	(554)	(634)
Total interest expense, net	$(401)	$(530)	$(612)

Other Expense, Net

Other expense, net, consists of:

	Years Ended December 31,		
	2002	2001	2000
		(millions)	
Writedown of Cable television joint ventures	$(363)	$ —	$ —
Other investment activity, principally income (losses) from equity method investees	26	(353)	(135)
Losses on accounts receivable securitization programs	(18)	(25)	(59)
Gains on unconsolidated cable systems	—	39	—
Miscellaneous	(2)	(7)	(34)
Total other expense, net	$(357)	$(346)	$(228)

Other Current Liabilities

Other current liabilities consist of:

	Years Ended December 31,	
	2002	2001
	(millions)	
Accrued expenses	$2,074	$1,940
Accrued compensation	292	275
Deferred revenues	301	350
Accrued income taxes	46	51
Total other current liabilities	$2,713	$2,616

REPORT OF INDEPENDENT AUDITORS

The Partners of
Time Warner Entertainment Company, L.P.

We have audited the accompanying consolidated balance sheet of Time Warner Entertainment Company, L.P. ("TWE") as of December 31, 2002 and 2001, and the related consolidated statements of operations, partnership capital and cash flows for each of the three years in the period ended December 31, 2002. Our audits also included the financial statement schedule listed in the index at Item 15(a). These financial statements and schedule are the responsibility of TWE's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of TWE at December 31, 2002 and 2001, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, in 2000 TWE changed its film accounting method and in 2002 TWE changed its method of accounting for goodwill and intangible assets.

ERNST & YOUNG LLP

New York, New York
January 29, 2003

TIME WARNER ENTERTAINMENT COMPANY, L.P.
SELECTED FINANCIAL INFORMATION

The selected financial information for each of the five years in the period ended December 31, 2002 set forth below has been derived from and should be read in conjunction with the consolidated financial statements and other financial information presented elsewhere herein. Capitalized terms are as defined and described in such consolidated financial statements, or elsewhere herein. The selected historical information prior to 2001 represent the financial results of TWE prior to the America Online — Time Warner merger. In addition, certain reclassifications have been made to conform to the 2001 presentation.

The selected historical financial information for 1998 reflects (i) the TWE-A/N Transfers, effective as of January 1, 1998, (ii) the Primestar Roll-up Transaction, effective as of April 1, 1998, (iii) the formation of Road Runner, effective as of June 30, 1998, (iv) the Time Warner Telecom Reorganization, effective as of July 1, 1998 and (v) the formation of the Texas Cable Joint Venture, effective as of December 31, 1998.

Selected Operating Statement Information	Years Ended December 31,				
	2002	2001	2000	1999	1998
			(millions)		
Revenues	$ 16,425	$14,342	$13,178	$12,434	$11,595
Depreciation and amortization	(1,279)	(3,538)	(1,260)	(1,568)	(1,618)
Operating income (loss)[(a)]	308	(31)	1,722	2,554	1,408
Interest expense, net[(b)]	(401)	(530)	(612)	(532)	(525)
Other income (expense), net[(c)]	(357)	(346)	(228)	976	(292)
Income (loss) before discontinued operations and cumulative effect of accounting change	(635)	(998)	807	2,878	414
Net income (loss)[(d)]	(21,219)	(1,032)	229	2,759	326

Selected Balance Sheet Information	Years Ended December 31,				
	2002	2001	2000	1999	1998
			(millions)		
Cash and equivalents	$ 1,012	$ 250	$ 306	$ 517	$ 87
Total assets	54,355	85,058	24,901	24,843	22,230
Debt due within one year	8	2	3	6	6
Long-term debt	6,947	8,049	7,108	6,655	6,578
Preferred stock of subsidiary	—	—	—	—	217
Time Warner General Partners' Senior Capital	—	—	—	—	603
Partners' capital	37,117	65,405	6,926	7,149	5,107

(a) In 2002, includes non-cash charge of $2.355 billion relating to the impairment of goodwill at the Cable segment (Note 2). In 1999, includes pretax gains of approximately $215 million relating to the early termination and settlement of a long-term, home video distribution agreement and $897 million relating to the sale or exchange of certain consolidated cable television systems offset by a non-cash charge of $106 million relating to Warner Bros.' retail stores.

(b) Includes additional interest expense of approximately $26 million in 2000 related to the Six Flags litigation.

(c) Includes pretax charge of $363 million in 2002 to reduce the carrying value of TWE's investments in certain unconsolidated cable television joint ventures (Note 5) and pretax gains of $10 million in 2000, $40 million in 1999 and $30 million in 1998 relating to (i) the partial recognition of a deferred gain in connection with the 1998 sale of Six Flags, (ii) net pretax gains of approximately $65 million in 2000 and $97 million in 1999, principally related to the sale of an interest in CanalSatellite, (iii) a pretax charge of $24 million recognized in 2000 in connection with the Six Flags litigation, (iv) net pretax gains of approximately $1.080 billion in 1999 relating to the sale or exchange of certain unconsolidated cable television systems and investments and (v) a pretax charge of approximately $210 million in 1998 to reduce the carrying value of an interest in Primestar.

(d) Includes a non-cash charge of $21.763 billion related to the cumulative effect of an accounting change in connection with the adoption of FAS 142. In 2000, includes a cumulative effect of accounting change of $524 million in connection with the adoption of a new film accounting standard.

TIME WARNER ENTERTAINMENT COMPANY, L.P.
QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarter	Revenues	Operating Income	Net Income (Loss)
		(millions)	
2002[a]			
1st	$ 3,717	$ 532	$(21,383)
2nd	4,247	645	483
3rd	3,935	612	1,655
4th	4,526	(1,481)	(1,974)
Year	16,425	308	(21,219)
2001[b]			
1st	$ 3,320	$ (98)	$ (350)
2nd	3,396	(42)	(232)
3rd	3,559	19	(241)
4th	4,067	90	(209)
Year	14,342	(31)	(1,032)

[a] TWE's net loss in 2002 has been affected by certain significant transactions and nonrecurring items. These items consisted of (i) a non-cash charge of $21.763 billion in the first quarter to reduce the carrying value of goodwill upon adoption of FAS 142 (Note 1), (ii) a non-cash pretax charge of $2.355 billion in the fourth quarter to reduce the carrying value of goodwill and other intangible assets (Note 1), (iii) a non-cash charge of $363 million in the fourth quarter to reduce the carrying value of TWE's investment in certain unconsolidated cable television system joint ventures that experienced other-than-temporary declines in market value (Note 5) and (iv) discontinued operations net of tax of $(1) million in the first quarter, $2 million in the second quarter and $112 million in the third quarter, thereby aggregating $113 million for the year, to reflect the results of the Advance/Newhouse Systems (Note 1).

[b] TWE's net loss in 2001 has been affected by a certain significant transaction and nonrecurring item. This item consisted of discontinued operations net of tax of $(10) million in the first quarter, $(9) million in the second quarter, $(10) million in the third quarter and $(10) million in the fourth quarter, thereby aggregating $(39) million for the year, to reflect the results of the Advance/Newhouse Systems (Note 1).

TIME WARNER ENTERTAINMENT COMPANY, L.P.
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
Years Ended December 31, 2002, 2001 and 2000

Description	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Deductions	Balance At End of Period
		(millions)		
2002:				
Reserves deducted from accounts receivable:				
Allowance for doubtful accounts	$500	$ 221	$(182)[a]	$ 539
Reserves for sales returns and allowances	410	1,029	(800)[b]	639
Total	$910	$1,250	$(982)	$1,178
2001:				
Reserves deducted from accounts receivable:				
Allowance for doubtful accounts	$359	$ 262	$(121)[a]	$ 500
Reserves for sales returns and allowances	318	606	(514)[b]	410
Total	$677	$ 868	$(635)	$ 910
2000:				
Reserves deducted from accounts receivable:				
Allowance for doubtful accounts	$290	$ 158	$ (89)[a]	$ 359
Reserves for sales returns and allowances	378	448	(508)[b]	318
Total	$668	$ 606	$(597)	$ 677

(a) Represents uncollectible receivables charged against the reserve.
(b) Represents returns or allowances applied against the reserve.

TWE GENERAL PARTNERS
MANAGEMENT'S DISCUSSION AND ANALYSIS
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

INTRODUCTION

Management's discussion and analysis of results of operations and financial condition ("MD&A") is provided as a supplement to the accompanying consolidated financial statements and footnotes to help provide an understanding of Warner Communications Inc.'s ("WCI") and American Television and Communications Corporation's ("ATC"), (collectively, the "General Partners") financial condition, changes in financial condition and results of operations. The MD&A is organized as follows:

- *Overview.* This section provides a general description of the General Partners' businesses, as well as recent developments that have occurred during 2002 that the General Partners believe are important in understanding results of operations, as well as to anticipate trends in those operations.
- *Results of operations.* This section provides an analysis of WCI's results of operations for all three years presented in the accompanying consolidated statement of operations. WCI is the only General Partner with independent business operations; therefore, the results of ATC are not discussed. In addition, a brief description is provided of transactions and events that impact the comparability of the results being analyzed.
- *Financial condition and liquidity.* This section provides an analysis of WCI's cash flows, as well as a discussion of WCI's outstanding debt and commitments, both firm and contingent, that existed as of December 31, 2002. Included in the discussion of outstanding debt is a discussion of the amount of financial capacity available to fund WCI's future commitments, as well as a discussion of other financing arrangements.
- *Market risk management.* This section discusses how the General Partners manage exposure to potential loss arising from adverse changes in foreign currency exchange rates and changes in the market value of investments.
- *Critical accounting policies.* This section discusses those accounting policies that are considered important to the General Partners' financial condition and results, and require significant judgment and estimates on the part of management in their application. In addition, all of the General Partners' significant accounting policies, including the critical accounting policies, are summarized in Note 1 to the accompanying consolidated financial statements.
- *Risk factors and caution concerning forward-looking statements.* This section provides a description of risk factors that could adversely affect the operations, business or financial results of the General Partners or its business segments and how certain forward-looking statements made by the General Partners in this report, including throughout MD&A and in the consolidated financial statements, are based on management's current expectations about future events and are inherently susceptible to uncertainty and changes in circumstances.

OVERVIEW

Description of Business

On June 30, 1992, thirteen direct or indirect subsidiaries of Time Warner Companies, Inc. ("TW Companies") contributed the assets and liabilities or the rights to the cash flows of substantially all of TW Companies' Filmed Entertainment, Cable Networks and Cable businesses to Time Warner Entertainment Company, L.P. ("TWE"), a Delaware limited partnership, for general partnership interests, and each general partner guaranteed a pro rata portion of substantially all of TWE's debt and accrued interest based on the relative fair value of the net assets each contributed to TWE (the "General Partner Guarantees"), (See Note 9). Since then, eleven of the thirteen original general partners have been merged or dissolved into the other two. WCI and ATC are the two remaining general partners of TWE. They have succeeded to the

general partnership interests and have assumed the General Partner Guarantees of the eleven former general partners.

WCI conducts substantially all of AOL Time Warner Inc.'s ("AOL Time Warner" or the "Company") music operations, including interests in recorded music, music publishing and CD and DVD manufacturing. These music operations include copyrighted music from many of the world's leading recording artists that is produced and distributed by a family of established record labels such as Warner Bros. Records, Atlantic Records, Elektra Entertainment and Warner Music International. In addition, WCI has investments in TWE, TW Companies, IPC Group Limited, Turner Broadcasting System, Inc. ("TBS") and Time Warner Telecom Inc. ("Time Warner Telecom"). The financial position and results of operations of ATC are principally derived from its investments in TWE, TW Companies, TBS and Time Warner Telecom.

On January 11, 2001, America Online, Inc. ("America Online") and Time Warner Inc. ("Time Warner") merged to form AOL Time Warner, the world's leading media and entertainment company (the "Merger"). As a result of the Merger, America Online and Time Warner each became a wholly owned subsidiary of AOL Time Warner and WCI and ATC each became an indirect, wholly owned, subsidiary of AOL Time Warner.

Use of EBITDA

WCI, the only General Partner with independent business operations, evaluates operating performance based on several factors, including its primary financial measure of operating income (loss) before non-cash depreciation of tangible assets, amortization of intangible assets and impairment write-downs related to goodwill and intangible assets ("EBITDA"). WCI considers EBITDA an important indicator of the operational strength and performance of its businesses, including the ability to provide cash flows to service debt and fund capital expenditures. In addition, EBITDA eliminates the considerable amounts of non-cash depreciation of tangible assets and amortization of intangible assets recognized in business combinations accounted for by the purchase method. As such, the following comparative discussion of the results of operations of WCI includes, among other factors, an analysis of changes in EBITDA. However, EBITDA should be considered in addition to, not as a substitute for, operating income (loss), net income (loss) and other measures of financial performance reported in accordance with accounting principles generally accepted in the U.S. In addition, EBITDA should not be used as a substitute for the General Partners' various cash flow measures (e.g., operating cash flow), which are discussed in detail under "Financial Condition and Liquidity."

Recent Developments

Investment in Time Warner Entertainment Company, L.P.

Prior to the change in ownership relating to the exercise of an option by AT&T Corp. ("AT&T"), which is discussed below, the General Partners in the aggregate held 63.27% of the pro rata priority capital ("Series A Capital") and residual equity capital ("Residual Capital") of TWE and 100% of the junior priority capital ("Series B Capital") of TWE. TW Companies held, directly or indirectly, 11.22% of the Series A Capital and Residual Capital limited partnership interests. The remaining 25.51% limited partnership interests in the Series A Capital and Residual Capital of TWE were held by MediaOne TWE Holdings, Inc., a subsidiary of AT&T.

During the second quarter of 2002, AT&T exercised a one-time option to increase its ownership in the Series A Capital and Residual Capital of TWE. As a result, on May 31, 2002, AT&T's interest in the Series A Capital and Residual Capital of TWE increased by approximately 2.13% to approximately 27.64%. This resulted in a decrease in WCI's and ATC's corresponding interest in the Series A Capital and Residual Capital of TWE of approximately 1.07% and 0.74%, respectively, to approximately 36.43% and 25.03%, respectively. Similarly, TW Companies' interest in the Series A Capital and Residual Capital of TWE

decreased by approximately 0.32% to approximately 10.90%. In accordance with Staff Accounting Bulletin No. 51, "Accounting For Sales of Stock of a Subsidiary," WCI and ATC have reflected the pretax impact of the dilution of their interests in TWE of approximately $365 million and $240 million, respectively, as an adjustment to paid-in-capital (Note 5). During the third quarter of 2002, TW Companies' 10.90% interest in TWE was transferred to WCI and ATC, increasing WCI's and ATC's interest in the Series A and Residual Capital of TWE to 41.88% and 30.48%, respectively. AT&T's interest in TWE was acquired by Comcast Corp. ("Comcast") upon consummation of the merger of Comcast and AT&T's broadband business in November 2002.

In August 2002, AOL Time Warner and AT&T announced that they had agreed to restructure TWE. The restructuring is expected to be completed on March 31, 2003. The restructuring will result in the following: (i) WCI will acquire complete ownership of TWE's content assets (including Warner Bros., the Warner Bros. Library and Home Box Office, which will become separate, wholly owned subsidiaries of WCI); (ii) all of AOL Time Warner's directly-owned cable television system interests will be contributed to a separate company which will become a majority-owned subsidiary of AOL Time Warner and will be renamed Time Warner Cable Inc. ("TWC Inc."); (iii) TWE will become a subsidiary of TWC Inc. and will continue to own the cable television system interests it previously owned; (iv) Comcast will receive $2.1 billion in cash, which the Company anticipates will be funded through a new credit facility at TWC Inc. that has not yet been established and AOL Time Warner equity securities valued at $1.5 billion; (v) a Comcast Trust will also retain a 21% economic interest in the Company's cable business, through a 17.9% direct ownership interest in TWC Inc. (representing a 10.7% voting interest) and a limited partnership interest in TWE representing a 4.7% residual equity interest; and (vi) AOL Time Warner will retain an overall 79% economic interest in the cable business, through an 82.1% ownership interest in TWC Inc. (representing an 89.3% voting interest) and a partnership interest in TWE representing a 1% residual equity interest and a $2.4 billion preferred component. The 1% direct interest and $2.4 billion preferred interest in TWE, as well as, part of AOL Time Warner's ownership interest in WCI, will be held through ATC.

Based upon its 89.3% controlling voting interest in TWC Inc., AOL Time Warner will consolidate the results of TWC Inc. for accounting purposes. WCI will account for its interest in TWC Inc. under the equity method of accounting. ATC will account for its common and preferred interests in TWE at cost. At the closing of the restructuring, it is anticipated that TWC Inc. will have approximately $8.1 billion in consolidated net debt and preferred equity, including the $2.4 billion preferred interest held by AOL Time Warner. Subject to market and other conditions, AOL Time Warner expects to complete an initial public offering of TWC Inc. common stock during 2003. It is anticipated that the first $2.1 billion of net proceeds raised in any such offering would be used to repay TWC Inc.'s debt incurred to fund the $2.1 billion cash payment to Comcast. Thereafter, Comcast will have certain priority registration rights with respect to its interest in TWC Inc. (Note 5).

Sale of Columbia House

In June 2002, AOL Time Warner and Sony Corporation of America each sold 85% of their respective 50% interest in the Columbia House Company Partnerships ("Columbia House") to Blackstone Capital Partners III LP ("Blackstone"), an affiliate of The Blackstone Group, a private investment bank. The sale resulted in WCI recognizing a pretax gain of approximately $97 million, which is included in other income (expense), net, in the accompanying consolidated statement of operations. In addition, WCI has deferred an approximate $5 million gain on the sale. The deferred gain primarily relates to the estimated fair value of the portion of the proceeds received as a note receivable, which will be deferred until such time as the realization of such note becomes more fully assured. As part of the transaction, AOL Time Warner, including WCI, will continue to license music and video product to Columbia House for a five-year period (Note 7).

Acquisition of Word Entertainment

In January 2002, WCI completed its purchase of Word Entertainment ("Word") from Gaylord Entertainment Company for approximately $84 million in cash. Word is a leader in the multi-faceted contemporary Christian music industry with over 30 active artists on several record labels, approximately 45 songwriters under contract and a catalog containing more than 75,000 masters. The acquisition was accounted for using the purchase method of accounting for business combinations. During the third quarter of 2002, WCI exchanged 20% of its interest in Word to Curb Records, for non-cash consideration of equal value.

RESULTS OF OPERATIONS

Transactions Affecting Comparability of Results of Operations

America Online-Time Warner Merger

As a result of the Merger, the accompanying historical operating results and financial condition reflect the allocation of the estimated $147 billion cost to acquire Time Warner to its underlying net assets, including the net assets of WCI and ATC. In addition, the historical operating results and financial condition reflect reclassifications to conform to AOL Time Warner's 2001 financial statement presentation.

New Accounting Principles

In the first quarter of 2002, the General Partners adopted new accounting guidance in several areas, which impacted the comparability of WCI's and ATC's financial results and are discussed below.

New Accounting Standard for Goodwill and Other Intangible Assets

During 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" ("FAS 142"), which requires that, effective January 1, 2002, goodwill, including the goodwill included in the carrying value of investments accounted for using the equity method of accounting, and certain other intangible assets deemed to have an indefinite useful life, cease amortizing. The new rules also require that goodwill and certain intangible assets be assessed for impairment using fair value measurement techniques. During the first quarter of 2002, WCI and ATC completed their impairment review and recorded non-cash pretax charges of $18.962 billion and $9.603 billion, respectively, for the impairment of goodwill, substantially all of which was generated in the Merger. Approximately $14 billion of WCI's charge and all of ATC's charge was the result of goodwill impairment charges recorded at TWE and certain other AOL Time Warner consolidated subsidiaries, which are accounted for by the General Partners under the equity method of accounting. These charges reflect overall market declines since the Merger was announced in January 2000, are non-operational in nature and are reflected as a cumulative effect of an accounting change in the accompanying consolidated financial statements (Note 1).

During the fourth quarter of 2002, WCI and ATC performed their annual impairment reviews for goodwill and other intangible assets. As a result, WCI recorded an additional non-cash charge of $1.499 billion which is recorded as a component of operating income in the accompanying consolidated statement of operations. The $1.499 billion charge at WCI includes a $646 million charge to reduce the carrying value of goodwill and an $853 million charge to reduce the carrying value of other intangible assets of WCI's music operations, which reflects declining valuations in the music industry, primarily due to the negative effects of piracy.

In addition, the General Partners recognized a $1.572 billion charge at WCI and $1.146 billion charge at ATC relating to goodwill impairment charges at TWE, due to decreasing valuations of TWE's cable systems, as evidenced by the decline in the stock prices of comparable cable television companies. These charges are