

## General Mills Inc.—Understanding Financial Statements

*General Mills, Inc., incorporated in Delaware in 1928, is a leading producer of packaged consumer foods. The company has three segments U.S. Retail, International, and Bakeries and Foodservice. U.S. Retail sells ready-to-eat cereals, meals, frozen dough products, baking products, snacks, yogurt and organic foods. The International segment includes retail business in Canada, Europe, Latin America and the Asia/Pacific region. Bakeries and Foodservice sells to retail and wholesale bakeries, and convenience stores. (Source: Company 2006 Form 10-K)*

### Learning Objectives

- Become familiar with a set of financial statements including auditor opinions and significant accounting policy footnotes.
- Perform a basic analysis and interpretation of the financial statements, including common-size income statements and balance sheets.
- Recognize the role of estimation in the preparation of financial statements.

Refer to the General Mills financial statements for fiscal year 2006 (that is, the year ended May 28, 2006).

### ◆ Concepts ◆

- a. What is the nature of General Mills' business? That is, based on what you know about the company and on the accompanying financial statements, how does General Mills make money?
- b. What financial statements are commonly prepared for external reporting purposes? What titles does General Mills give these statements? What does "consolidated" mean?
- c. How often do publicly traded corporations typically prepare financial statements for external reporting purposes?
- d. Who is responsible for the financial statements? Discuss the potential users of the General Mills financial statements and the type of information they are likely interested in.
- e. Who are General Mills external auditors? Describe the two "opinion" letters that General Mills received in 2006. In your own words, what do these opinions mean? Why are both opinions dated several months after General Mills' year end?

### ◆ Analysis ◆

- f. Use a spreadsheet to construct common-size income statements (which General Mills calls Statements of Earnings) and balance sheets for 2006 and 2005. Common-size income statements scale each income statement line item by *net* sales. Common-size balance sheets are created by dividing each figure on a given year's balance sheet by that year's total assets, thereby creating a balance sheet on a "percent of assets" basis. You will use these common-size statements in answering several of the questions below.
- g. Refer to General Mills' balance sheet for fiscal 2006 (the year ended May 28, 2006).
  - i. Show that the accounting equation holds for General Mills. Recall that the accounting equation is:  $\text{Assets} = \text{Liabilities} + \text{Equity}$ .
  - ii. What are General Mills' major assets? Calculate the proportion of short-term and long-term assets for 2006. Does this seem appropriate for a company such as General Mills?
  - iii. In general, what are intangible assets? What is goodwill? What specific intangible assets might General Mills have?
  - iv. How is General Mills financed? What proportion of total financing comes from non-owners?

- h. Refer to General Mills' Statement of Earnings for fiscal 2006 (the year ended May 28, 2006) and to the common-size income statement you developed in part f, above.
  - i. Review the revenue recognition policies of General Mills discussed in Note 1 (Summary of Significant Accounting Policies). Discuss how the recognition policies for recording net sales and the treatment of returns and promotions are consistent with the revenue recognition criteria under Generally Accepted Accounting Principles (GAAP).
  - ii. What are General Mills' major expenses?
  - iii. Were there any significant changes in the cost structure during the most recent year?
  - iv. In fiscal 2005, General Mills separately reports the following three items: Restructuring and other exit costs, Divestitures, and Debt repurchase costs. Why didn't the company just include all of these amounts within the line item for Selling, general and administrative expenses?
  - v. Was the company profitable during 2006? During 2005? Explain your definition of "profitable."
  - vi. Compute the percentage change in net earnings from fiscal 2005 to 2006 and from fiscal 2004 to 2005. How would your answers change if the special items for Divestitures and Debt repurchase costs were excluded from fiscal 2005 net earnings? *Caution:* Divestitures and Debt repurchase costs are reported on the income statement before tax implications while net earnings is an after-tax number. Assume a marginal tax rate of 38.3% when considering the tax effects of the special items.
- i. Refer to General Mills' fiscal 2006 Statement of Cash Flows.
  - i. Compare General Mills' net earnings to net cash provided by operating activities and explain the difference.
  - ii. How much cash did General Mills use for expenditures for land, building and equipment during fiscal 2006?
  - iii. What amount of dividends did General Mills pay during the year?
- j. Several notes to the financial statements refer to the use of "estimates." Which accounts on General Mills' balance sheet require estimates? List as many accounts as you can. Are any accounts estimate-free?

# ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of General Mills, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control system was designed to provide reasonable assurance to our management and the Board of Directors regarding the preparation and fair presentation of published financial statements. Under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, we conducted an assessment of the effectiveness of our internal control over financial reporting as of May 28, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework.

Based on our assessment using the criteria set forth by COSO in Internal Control—Integrated Framework, management concluded that our internal control over financial reporting was effective as of May 28, 2006.

KPMG LLP, an independent registered public accounting firm, has issued an audit report on management's assessment of the Company's internal control over financial reporting.



S. W. Sanger  
Chairman of the Board  
and  
Chief Executive Officer



J. A. Lawrence  
Vice Chairman and  
Chief Financial Officer

July 27, 2006

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM REGARDING INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Stockholders  
General Mills, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that General Mills, Inc. and subsidiaries maintained effective internal control over financial reporting as of May 28, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). General Mills' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that General Mills maintained effective internal control over financial reporting as of May 28, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by COSO. Also, in our opinion, General Mills maintained, in all material respects, effective internal control over financial reporting as of May 28, 2006, based on criteria established in Internal Control—Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of General Mills, Inc. and subsidiaries as of May 28, 2006 and May 29, 2005, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows, for each of the fiscal years in the three-year period ended May 28, 2006, and our report dated July 27, 2006 expressed an unqualified opinion on those consolidated financial statements.

**KPMG LLP**

Minneapolis, Minnesota  
July 27, 2006

REPORT OF MANAGEMENT RESPONSIBILITIES

The management of General Mills, Inc. is responsible for the fairness and accuracy of the consolidated financial statements. The statements have been prepared in accordance with accounting principles that are generally accepted in the United States, using management's best estimates and judgments where appropriate. The financial information throughout this Annual Report on Form 10-K is consistent with our consolidated financial statements.

Management has established a system of internal controls that provides reasonable assurance that assets are adequately safeguarded and transactions are recorded accurately in all material respects, in accordance with management's authorization. We maintain a strong audit program that independently evaluates the adequacy and effectiveness of internal controls. Our internal controls provide for appropriate separation of duties and responsibilities, and there are documented policies regarding use of our assets and proper financial reporting. These formally stated and regularly communicated policies demand highly ethical conduct from all employees.

The Audit Committee of the Board of Directors meets regularly with management, internal auditors and our independent auditors to review internal control, auditing and financial reporting matters. The independent auditors, internal auditors and employees have full and free access to the Audit Committee at any time.

The Audit Committee reviewed and approved the Company's annual financial statements and recommended to the full Board of Directors that they be included in the Annual Report. The Audit Committee also recommended to the Board of Directors that the independent auditors be reappointed for fiscal 2007, subject to ratification by the stockholders at the annual meeting.



S. W. Sanger  
Chairman of the Board  
and  
Chief Executive Officer



J. A. Lawrence  
Vice Chairman and  
Chief Financial Officer

July 27, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON THE CONSOLIDATED FINANCIAL STATEMENTS AND RELATED FINANCIAL STATEMENT SCHEDULE

The Board of Directors and Stockholders  
General Mills, Inc.:

We have audited the accompanying consolidated balance sheets of General Mills, Inc. and subsidiaries as of May 28, 2006 and May 29, 2005, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the fiscal years in the three-year period ended May 28, 2006. In connection with our audits of the consolidated financial statements we also have audited the accompanying financial statement schedule. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of General Mills, Inc. and subsidiaries as of May 28, 2006 and May 29, 2005, and the results of their operations and their cash flows for each of the fiscal years in the three-year period ended May 28, 2006 in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the accompanying financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of General Mills' internal control over financial reporting as of May 28, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated July 27, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

The logo for KPMG LLP, featuring the letters 'KPMG' in a large, stylized, handwritten-style font, with 'LLP' in a smaller, simpler font to the right.

Minneapolis, Minnesota  
July 27, 2006

GENERAL MILLS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF EARNINGS

In Millions, Except per Share Data  
Fiscal Year Ended

	May 28, 2006	May 29, 2005	May 30, 2004
<b>Net Sales</b>	<b>\$11,640</b>	<b>\$11,244</b>	<b>\$11,070</b>
<b>Costs and Expenses:</b>			
Cost of sales	6,966	6,834	6,584
Selling, general and administrative	2,678	2,418	2,443
Interest, net	399	455	508
Restructuring and other exit costs	30	84	26
Divestitures (gain)	—	(499)	—
Debt repurchase costs	—	137	—
<b>Total Costs and Expenses</b>	<b>10,073</b>	<b>9,429</b>	<b>9,561</b>
Earnings before Income Taxes and After-tax Earnings from Joint Ventures	1,567	1,815	1,509
Income Taxes	541	664	528
After-tax Earnings from Joint Ventures	64	89	74
<b>Net Earnings</b>	<b>\$ 1,090</b>	<b>\$ 1,240</b>	<b>\$ 1,055</b>
<b>Earnings per Share – Basic</b>	<b>\$ 3.05</b>	<b>\$ 3.34</b>	<b>\$ 2.82</b>
<b>Earnings per Share – Diluted</b>	<b>\$ 2.90</b>	<b>\$ 3.08</b>	<b>\$ 2.60</b>
<b>Dividends per Share</b>	<b>\$ 1.34</b>	<b>\$ 1.24</b>	<b>\$ 1.10</b>

See accompanying notes to consolidated financial statements.

GENERAL MILLS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

In Millions	May 28, 2006	May 29, 2005
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 647	\$ 573
Receivables	1,076	1,034
Inventories	1,055	1,037
Prepaid expenses and other current assets	216	203
Deferred income taxes	182	208
<b>Total Current Assets</b>	<b>3,176</b>	<b>3,055</b>
Land, Buildings and Equipment	2,997	3,111
Goodwill	6,652	6,684
Other Intangible Assets	3,607	3,532
Other Assets	1,775	1,684
<b>Total Assets</b>	<b>\$18,207</b>	<b>\$18,066</b>
<b>LIABILITIES AND EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 1,151	\$ 1,136
Current portion of long-term debt	2,131	1,638
Notes payable	1,503	299
Other current liabilities	1,353	1,111
<b>Total Current Liabilities</b>	<b>6,138</b>	<b>4,184</b>
Long-term Debt	2,415	4,255
Deferred Income Taxes	1,822	1,851
Other Liabilities	924	967
<b>Total Liabilities</b>	<b>11,299</b>	<b>11,257</b>
Minority Interests	1,136	1,133
Stockholders' Equity:		
Cumulative preference stock, none issued	-	-
Common stock, 502 shares issued	50	50
Additional paid-in capital	5,737	5,691
Retained earnings	5,107	4,501
Common stock in treasury, at cost, shares of 146 in 2006 and 133 in 2005	(5,163)	(4,460)
Unearned compensation	(84)	(114)
Accumulated other comprehensive income	125	8
<b>Total Stockholders' Equity</b>	<b>5,772</b>	<b>5,676</b>
<b>Total Liabilities and Equity</b>	<b>\$18,207</b>	<b>\$18,066</b>

See accompanying notes to consolidated financial statements.

GENERAL MILLS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

In Millions Fiscal Year Ended	May 28, 2006	May 29, 2005	May 30, 2004
<b>Cash Flows – Operating Activities</b>			
Net earnings	\$ 1,090	\$ 1,240	\$ 1,055
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	424	443	399
Deferred income taxes	26	9	109
Changes in current assets and liabilities	184	258	(186)
Tax benefit on exercised options	41	62	63
Pension and other postretirement costs	(74)	(70)	(21)
Restructuring and other exit costs	30	84	26
Divestitures (gain)	–	(499)	–
Debt repurchase costs	–	137	–
Other, net	50	47	16
Net Cash Provided by Operating Activities	1,771	1,711	1,461
<b>Cash Flows – Investing Activities</b>			
Purchases of land, buildings and equipment	(360)	(434)	(653)
Investments in businesses	(26)	–	(10)
Investments in affiliates, net of investment returns and dividends	78	84	32
Purchases of marketable securities	–	(1)	(7)
Proceeds from sale of marketable securities	1	33	129
Proceeds from disposal of land, buildings and equipment	11	24	36
Proceeds from disposition of businesses	–	799	–
Other, net	4	(9)	2
Net Cash Provided (Used) by Investing Activities	(292)	496	(470)
<b>Cash Flows – Financing Activities</b>			
Change in notes payable	1,197	(1,057)	(1,023)
Issuance of long-term debt	–	2	576
Payment of long-term debt	(1,386)	(1,115)	(248)
Proceeds from issuance of preferred membership interests of subsidiary	–	835	–
Common stock issued	157	195	192
Purchases of common stock for treasury	(885)	(771)	(24)
Dividends paid	(485)	(461)	(413)
Other, net	(3)	(13)	(3)
Net Cash Used by Financing Activities	(1,405)	(2,385)	(943)
Increase (Decrease) in Cash and Cash Equivalents	74	(178)	48
Cash and Cash Equivalents – Beginning of Year	573	751	703
Cash and Cash Equivalents – End of Year	\$ 647	\$ 573	\$ 751
<b>Cash Flow from Changes in Current Assets and Liabilities:</b>			
Receivables	\$ (18)	\$ (9)	\$ (22)
Inventories	(6)	30	24
Prepaid expenses and other current assets	(7)	9	(15)
Accounts payable	14	(19)	(161)
Other current liabilities	201	247	(12)
Changes in Current Assets and Liabilities	\$ 184	\$ 258	\$ (186)

See accompanying notes to consolidated financial statements.

GENERAL MILLS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1. Summary of Significant Accounting Policies

*Basis of Presentation* Our consolidated financial statements include the accounts of General Mills, Inc. and all subsidiaries in which it has a controlling financial interest. Intercompany transactions and accounts are eliminated in consolidation. Certain prior years' amounts have been reclassified to conform to the current year presentation.

Our fiscal year ends on the last Sunday in May. Fiscal years 2006 and 2005 each consisted of 52 weeks, and fiscal 2004 consisted of 53 weeks. Our International segment, with the exception of Canada and our export operations, is reported for the 12 calendar months ended April 30.

*Cash and Cash Equivalents* We consider all investments purchased with an original maturity of three months or less to be cash equivalents.

*Inventories* Most U.S. inventories are valued at the lower of cost, using the last-in, first-out (LIFO) method, or market. Grain inventories are valued at market. The balance of the U.S. inventories and inventories of consolidated operations outside of the U.S. are valued at the lower of cost, using the first-in, first-out (FIFO) method, or market.

Shipping costs associated with the distribution of finished product to our customers are recorded as selling, general and administrative expense and are recognized when the related finished product is shipped to the customer.

*Land, Buildings, Equipment and Depreciation* Land is recorded at historical cost. Buildings and equipment are recorded at historical cost and depreciated over estimated useful lives, primarily using the straight-line method. Ordinary maintenance and repairs are charged to operating costs. Buildings are usually depreciated over 40 to 50 years, and equipment is usually depreciated over three to 15 years. Accelerated depreciation methods generally are used for income tax purposes. When an item is sold or retired, the accounts are relieved of its cost and related accumulated depreciation; the resulting gains and losses, if any, are recognized in earnings.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss would be recognized when estimated undiscounted future cash flows from the operation and disposition of the asset group are less than the carrying amount of the asset group. Asset groups are identifiable and largely independent of other asset groups. Measurement of an impairment loss would be based on the excess of the carrying amount of the asset group over its fair value. Fair value is measured using discounted cash flows or independent appraisals as appropriate.

*Goodwill and Other Intangible Assets* Goodwill represents the difference between the purchase prices of acquired

companies and the related fair values of net assets acquired. Goodwill is not subject to amortization and is tested for impairment annually for each of our reporting units and whenever events or changes in circumstances indicate that an impairment may have occurred. Impairment testing compares the carrying amount of goodwill for a reporting unit with its fair value. Fair value is estimated based on discounted cash flows. When the carrying amount of goodwill exceeds its fair value, an impairment has occurred. We have completed our annual impairment testing and determined none of our goodwill is impaired.

The costs of patents, copyrights and other intangible assets with finite lives are amortized over their estimated useful lives. Intangibles with indefinite lives, principally brands, are carried at cost. Finite and indefinite-lived intangible assets are also tested for impairment annually and whenever events or changes in circumstances indicate that their carrying value may not be recoverable. An impairment loss would be recognized when estimated undiscounted future cash flows are less than the carrying amount of the intangible. Measurement of an impairment loss would be based on the excess of the carrying amount of the intangible over its fair value. We have completed our annual impairment testing and determined none of our other intangible assets are impaired.

*Investments in Joint Ventures* Our investments in companies over which we have the ability to exercise significant influence are stated at cost plus our share of undistributed earnings or losses. We also receive royalty income from certain joint ventures, incur various expenses (primarily research and development) and record the tax impact of certain joint venture operations that are structured as partnerships.

*Variable Interest Entities* At May 28, 2006, we had invested in four variable interest entities (VIEs). We are the primary beneficiary (PB) of General Mills Capital, Inc. (GM Capital), a subsidiary that we consolidate as set forth in Note Eight. We also have an interest in a contract manufacturer at our former facility in Geneva, Illinois. Even though we are the PB, we have not consolidated this entity because it is not material to our results of operations, financial condition, or liquidity at May 28, 2006. This entity had property and equipment of \$50 million and long-term debt of \$50 million at May 28, 2006. We are not the PB of the remaining two VIEs. Our maximum exposure to loss from these VIEs is limited to the \$150 million minority interest in GM Capital, the contract manufacturer's debt and our \$6 million equity investments in the remaining two VIEs.

*Revenue Recognition* We recognize sales revenue upon acceptance of the shipment by our customers. Sales are reported net of consumer coupon, trade promotion and other costs, including estimated returns. Coupons are

expensed when distributed based on estimated redemptions. Trade promotions are expensed based on estimated participation and performance levels for offered programs. We generally do not allow a right of return. However, on a limited case-by-case basis with prior approval, we may allow customers to return product in saleable condition for redistribution to other customers or outlets. Returns are expensed as reductions of net sales.

*Advertising Production Costs* We expense the production costs of advertising the first time that the advertising takes place.

*Research and Development* All expenditures for research and development are charged against earnings in the year incurred.

*Foreign Currency Translation* Results of foreign operations are translated into U.S. dollars using the average exchange rates each month. Assets and liabilities of these operations are translated at the period-end exchange rates, and the differences from historical exchange rates are reflected within Accumulated Other Comprehensive Income in Stockholders' Equity as cumulative translation adjustments.

*Derivative Instruments* We use derivatives primarily to hedge our exposure to changes in foreign exchange rates, interest rates and commodity prices. All derivatives are recognized on the Consolidated Balance Sheets at fair value based on quoted market prices or management's estimate of their fair value and are recorded in either current or noncurrent assets or liabilities based on their maturity. Changes in the fair values of derivatives are recorded in earnings or other comprehensive income, based on whether the instrument is designated as a hedge transaction and, if so, the type of hedge transaction. Gains or losses on derivative instruments reported in other comprehensive income are reclassified to earnings in the period the hedged item affects earnings. If the underlying hedged transaction ceases to exist, any associated amounts reported in other comprehensive income are reclassified to earnings at that time. Any ineffectiveness is recognized in earnings in the current period.

*Stock-based Compensation* We use the intrinsic value method for measuring the cost of compensation paid in our common stock. This method defines our cost as the excess of the stock's market value at the time of the grant over the amount that the employee is required to pay. Our stock option plans require that the employee's payment (i.e., exercise price) be at least the market value as of the grant date.

Restricted share awards, including restricted stock and restricted stock units, are measured at the fair market value of our stock on the date of the award, and are initially

recorded in Stockholders' Equity as unearned compensation, net of estimated forfeitures. Unearned compensation is amortized to compensation expense on a straight-line basis over the requisite service period.

The following table illustrates the pro forma effect on net earnings and earnings per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standard (SFAS) No. 123, (SFAS 123) "Accounting for Stock-Based Compensation," to all employee stock-based compensation, net of estimated forfeitures.

In Millions, Except per Share Data, Fiscal Year Ended	May 28, 2006	May 29, 2005	May 30, 2004
Net earnings, as reported	\$1,090	\$1,240	\$1,055
Add: After-tax stock-based employee compensation expense included in reported net earnings	28	24	17
Deduct: After-tax stock-based employee compensation expense determined under fair value requirements of SFAS 123	(48)	(62)	(67)
Pro forma net earnings	\$1,070	\$1,202	\$1,005
Earnings per share:			
Basic – as reported	\$ 3.05	\$ 3.34	\$ 2.82
Basic – pro forma	\$ 2.99	\$ 3.24	\$ 2.68
Diluted – as reported	\$ 2.90	\$ 3.08	\$ 2.60
Diluted – pro forma	\$ 2.84	\$ 2.99	\$ 2.49

The weighted-average grant date fair values of the employee stock options granted were estimated as \$8.04 in fiscal 2006, \$8.32 in fiscal 2005, and \$8.54 in fiscal 2004 using the Black-Scholes option-pricing model with the following assumptions:

Fiscal Year	2006	2005	2004
Risk-free interest rate	4.3%	4.0%	3.9%
Expected life	7 years	7 years	7 years
Expected volatility	20.0%	21.0%	21.0%
Expected dividend growth rate	10.2%	9.8%	10.0%

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(Revised) "Share-Based Payment" (SFAS 123R), which generally requires public companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value and to recognize this cost over the period during which the employee is required to provide service in exchange for the award. The standard is effective for public companies for annual periods beginning after June 15, 2005, with several transition options regarding prospective versus retrospective application. We will adopt SFAS 123R in the first quarter of fiscal 2007, using the modified prospective method. Accordingly, prior year results will not be restated, but fiscal 2007 results will

be presented as if we had applied the fair value method of accounting for stock-based compensation from the beginning of fiscal 1997. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as currently required, thereby reducing net operating cash flows and increasing net financing cash flows in periods following adoption. While those amounts cannot be estimated for future periods, the amount of operating cash flows generated in prior periods for such excess tax deductions was \$41 million for fiscal 2006, \$62 million for fiscal 2005 and \$63 million for fiscal 2004.

Certain equity-based compensation plans contain provisions that accelerate vesting of awards upon retirement, disability or death of eligible employees and directors. For the periods presented, we generally recognized stock compensation expense over the stated vesting period of the award, with any unamortized expense recognized immediately if an acceleration event occurred. SFAS No. 123R specifies that a stock-based award is vested when the employee's retention of the award is no longer contingent on providing subsequent service. Accordingly, beginning in fiscal 2007, we will prospectively revise our expense attribution method so that the related compensation cost is recognized immediately for awards granted to retirement-eligible individuals or over the period from the grant date to the date retirement eligibility is achieved, if less than the stated vesting period.

*Use of Estimates* Preparing our consolidated financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from our estimates.

*New Accounting Standards* The FASB ratified in October 2004, Emerging Issues Task Force Issue No. 04-8, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share" (EITF 04-8). EITF 04-8 was effective for us in the third quarter of fiscal 2005. The adoption of EITF 04-8 increased diluted shares outstanding to give effect to shares that were contingently issuable related to our zero coupon convertible debentures issued in October 2002. Also, net earnings used for earnings per share calculations were adjusted, using the if-converted method. See Note Eleven.

In the second quarter of fiscal 2006, we adopted SFAS No. 153, "Exchanges of Nonmonetary Assets – An Amendment of APB Opinion No. 29." SFAS 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets and replaces it with an exception for exchanges that do not have commercial

substance. The adoption of SFAS 153 did not have any impact on our results of operations or financial condition.

In March 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" (FIN 47). FIN 47 requires that liabilities be recognized for the fair value of a legal obligation to perform asset retirement activities that are conditional on a future event if the amount can be reasonably estimated. We adopted FIN 47 in the fourth quarter of fiscal 2006 and it did not have a material impact on our results of operations or financial condition.

## 2. Acquisitions and Divestitures

On March 3, 2006, we acquired Elysées Consult S.A., the franchise operator of a *Häagen-Dazs* shop in France. On November 21, 2005, we acquired Croissant King, a producer of frozen pastry products in Australia. On October 31, 2005, we acquired a controlling financial interest in Pinedale Holdings Pte. Limited, an operator of *Häagen-Dazs* cafes in Singapore and Malaysia. The aggregate purchase price of our fiscal 2006 acquisitions was \$26 million. The pro forma effect of these acquisitions was not material.

On February 28, 2005, Snack Ventures Europe (SVE), our snacks joint venture with PepsiCo, Inc., was terminated and our 40.5 percent interest was redeemed. On April 4, 2005, we sold our Lloyd's barbecue business to Hormel Foods Corporation. We received \$799 million in cash proceeds from these dispositions and recorded \$499 million in gains in fiscal 2005.

## 3. Restructuring and Other Exit Costs

In fiscal 2006, we recorded restructuring and other exit costs of \$30 million pursuant to approved plans consisting of: \$13 million related to the closure of our Swedesboro, New Jersey plant; \$6 million related to the closure of a production line at our Montreal, Quebec plant; \$4 million related to restructuring actions at our Allentown, Pennsylvania plant; \$3 million of asset impairment charges for one of our plants; and \$4 million related primarily to fiscal 2005 initiatives. The fiscal 2006 restructuring charges included \$17 million to write down assets to fair value, \$7 million of severance costs for 425 employees being terminated, and \$6 million of other exit costs. The carrying value of the assets written down was \$18 million. The fair values of the assets written down were determined using discounted cash flows.

The fiscal 2006 initiatives were undertaken to increase asset utilization and reduce manufacturing costs. The actions included decisions to: close our leased frozen dough foodservice plant in Swedesboro, New Jersey, affecting 101 employees; shut down a portion of our frozen dough foodservice plant in Montreal, Quebec, affecting 77 employees; realign and modify product and manufacturing