GOOGLE INC.
Form 10-Q
October 29, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from   to

Commission file number: 001-36380

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

Delaware	77-0493581
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

1600 Amphitheatre Parkway
Mountain View, CA 94043
(Address of principal executive offices, including zip code)
(650) 253-0000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).   Yes ý   No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer (Do not check if a smaller reporting company)	¨	Smaller reporting company	¨

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

As of October 22, 2015, there were 291,327,781 shares of Alphabet Inc.’s (the successor issuer pursuant to Rule 12g-3(a) under the Exchange Act as of October 2, 2015) (Alphabet) Class A common stock outstanding, 50,893,362 shares of Alphabet's Class B common stock outstanding, and 345,504,021 Alphabet's Class C capital stock outstanding.

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NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, among other things, statements regarding:

- the growth of our business and revenues and our expectations about the factors that influence our success and trends in our business;
- our plans to continue to invest in new businesses, products and technologies, systems, facilities, and infrastructure, to continue to hire aggressively and provide competitive compensation programs, as well as to continue to invest in acquisitions;
- seasonal fluctuations in internet usage and advertiser expenditures, traditional retail seasonality and macroeconomic conditions, which are likely to cause fluctuations in our quarterly results;
- the potential for declines in our revenue growth rate;
- our expectation that growth in advertising revenues from our websites will continue to exceed that from our Google Network Members' websites, which will have a positive impact on our operating margins;
- our expectation that we will continue to take steps to improve the relevance of the ads we deliver and to reduce the number of accidental clicks;
- fluctuations in the rate of change in revenue and revenue growth, as well as the rate of change in paid clicks and average cost-per-click and various factors contributing to such fluctuations;
- our belief that our foreign exchange risk management program will not fully offset our net exposure to fluctuations in foreign currency exchange rates;
- the expected increase of costs related to hedging activities under our foreign exchange risk management program;
- our expectation that our cost of revenues, research and development expenses, sales and marketing expenses, and general and administrative expenses will increase in dollars and may increase as a percentage of revenues;
- our potential exposure in connection with pending investigations, proceedings, and other contingencies;
- our expectation that our traffic acquisition costs will fluctuate in the future;
- our continued investments in international markets;
- estimates of our future compensation expenses;
- fluctuations in our effective tax rate;
- the sufficiency of our sources of funding;
- our payment terms to certain advertisers, which may increase our working capital requirements;
- fluctuations in our capital expenditures;
- our expectations related to the new operating structure implemented pursuant to the holding company reorganization, which will be introduced in phases, and the associated disclosure implications;
- the expected timing and amount of Alphabet Inc.'s stock repurchase;

as well as other statements regarding our future operations, financial condition and prospects, and business strategies. Forward-looking statements may appear throughout this report and other documents we file with the Securities and Exchange Commission (SEC), including without limitation, Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations"; in this Quarterly Report on Form 10-Q and Part I, Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014, as may be updated in our subsequent Quarterly Reports on Form 10-Q. Forward-looking statements generally can be identified by words such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," "projects," "will be," "will continue," "will likely result," and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q, and in particular, the risks discussed in Part I, Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014, and those discussed in other documents we file with the SEC. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

As used herein, “Google,” “we,” “our,” and similar terms include Google Inc. and its subsidiaries, unless the context indicates otherwise.

“Google” and other trademarks of ours appearing in this report are our property. This report contains additional trade names and trademarks of other companies. We do not intend our use or display of other companies’ trade names

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or trademarks to imply an endorsement or sponsorship of us by such companies, or any relationship with any of these companies.

PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Google Inc.
CONSOLIDATED BALANCE SHEETS
(In millions, except share and par value amounts which are reflected in thousands and par value per share amounts)

	As of December 31, 2014	As of September 30, 2015 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$18,347	$18,068
Marketable securities	46,048	54,699
Total cash, cash equivalents, and marketable securities (including securities loaned of $4,058 and $4,351)	64,395	72,767
Accounts receivable, net of allowance of $225 and $291	9,383	9,749
Receivable under reverse repurchase agreements	875	400
Deferred income taxes, net	1,322	2,212
Income taxes receivable, net	591	287
Prepaid revenue share, expenses and other assets	3,412	2,688
Total current assets	79,978	88,103
Prepaid revenue share, expenses and other assets, non-current	3,280	3,329
Non-marketable investments	3,079	4,813
Property and equipment, net	23,883	28,338
Intangible assets, net	4,607	4,023
Goodwill	15,599	15,675
Total assets	$130,426	$144,281
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$1,715	$1,549
Short-term debt	2,009	3,237
Accrued compensation and benefits	3,069	2,988
Accrued expenses and other current liabilities	4,434	4,598
Accrued revenue share	1,952	1,899
Securities lending payable	2,778	3,266
Deferred revenue	752	705
Income taxes payable, net	96	215
Total current liabilities	16,805	18,457
Long-term debt	3,228	1,994
Deferred revenue, non-current	104	133
Income taxes payable, non-current	3,340	3,596
Deferred income taxes, net, non-current	1,971	1,976
Other long-term liabilities	1,118	1,884
Commitments and contingencies		
Stockholders’ equity:		
Convertible preferred stock, $0.001 par value per share, 100,000 shares authorized; no shares issued and outstanding	0	0
	28,767	31,864

Class A and Class B common stock, and Class C capital stock and additional paid-in capital, $0.001 par value per share: 15,000,000 shares authorized (Class A 9,000,000, Class B 3,000,000, Class C 3,000,000); 680,172 (Class A 286,560, Class B 53,213, Class C 340,399) and par value of $680 (Class A $287, Class B $53, Class C $340) and 687,693 (Class A 291,214, Class B 50,990, Class C 345,489) and par value of $688 (Class A $291, Class B $51, Class C $346) shares issued and outstanding		
Accumulated other comprehensive income (loss)	27	(1,592)
Retained earnings	75,066	85,969
Total stockholders' equity	103,860	116,241
Total liabilities and stockholders' equity	$130,426	$144,281

See accompanying notes.

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Google Inc.
CONSOLIDATED STATEMENTS OF INCOME
(In millions, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2015	2014	2015
	(unaudited)			
Revenues	$16,523	$18,675	$47,898	$53,660
Costs and expenses:				
Cost of revenues	6,695	7,037	18,770	19,976
Research and development	2,655	3,230	7,019	8,772
Sales and marketing	2,084	2,223	5,754	6,368
General and administrative	1,365	1,477	4,258	4,564
Total costs and expenses	12,799	13,967	35,801	39,680
Income from operations	3,724	4,708	12,097	13,980
Interest and other income, net	133	183	635	471
Income from continuing operations before income taxes	3,857	4,891	12,732	14,451
Provision for income taxes	933	912	2,820	3,026
Net income from continuing operations	2,924	3,979	9,912	11,425
Net loss from discontinued operations	(185)	0	(451)	0
Net income	$2,739	$3,979	$9,461	$11,425
Less: Adjustment Payment to Class C capital stockholders	0	0	0	522
Net income available to all stockholders	$2,739	$3,979	$9,461	$10,903
Basic net income (loss) per share of Class A and B common stock:				
Continuing operations	$4.32	$5.80	$14.69	$15.95
Discontinued operations	(0.27)	0.00	(0.67)	0.00
Basic net income per share of Class A and B common stock	$4.05	$5.80	$14.02	$15.95
Basic net income (loss) per share of Class C capital stock:				
Continuing operations	$4.32	$5.80	$14.69	$17.47
Discontinued operations	(0.27)	0.00	(0.67)	0.00
Basic net income per share of Class C capital stock	$4.05	$5.80	$14.02	$17.47
Diluted net income (loss) per share of Class A and B common stock:				
Continuing operations	$4.25	$5.73	$14.44	$15.77
Discontinued operations	(0.27)	0.00	(0.66)	0.00
Diluted net income per share of Class A and B common stock	$3.98	$5.73	$13.78	$15.77
Diluted net income (loss) per share of Class C capital stock:				
Continuing operations	$4.25	$5.73	$14.44	$17.27
Discontinued operations	(0.27)	0.00	(0.66)	0.00
Diluted net income per share of Class C capital stock	$3.98	$5.73	$13.78	$17.27

See accompanying notes.

Google Inc.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2015	2014	2015
	(unaudited)			
Net income	$2,739	$3,979	$9,461	$11,425
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	(677)	(145)	(623)	(850)
Available-for-sale investments:				
Change in net unrealized gains (losses)	(195)	(389)	250	(504)
Less: reclassification adjustment for net (gains) losses included in net income	(15)	4	(122)	(73)
Net change (net of tax effect of $66, $2, $38, and $29)	(210)	(385)	128	(577)
Cash flow hedges:				
Change in net unrealized gains	310	79	304	580
Less: reclassification adjustment for net (gains) losses included in net income	(7)	(212)	(16)	(772)
Net change (net of tax effect of $122, $58, $113, and $68)	303	(133)	288	(192)
Other comprehensive income (loss)	(584)	(663)	(207)	(1,619)
Comprehensive income	$2,155	$3,316	$9,254	$9,806

See accompanying notes.

Google Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)

	Nine Months Ended September 30,	
	2014	2015
	(unaudited)	
Operating activities		
Net income	$9,461	$11,425
Adjustments:		
Depreciation expense and impairment of property and equipment	2,513	2,979
Amortization and impairment of intangible assets	1,199	680
Stock-based compensation expense	3,092	3,767
Excess tax benefits from stock-based award activities	(467)	(354)
Deferred income taxes	(498)	(566)
Gain on equity interest	(126)	0
(Gain) loss on marketable and non-marketable investments, net	(251)	32
Other	157	157
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(490)	(336)
Income taxes, net	577	1,093
Prepaid revenue share, expenses and other assets	506	204
Accounts payable	(113)	(168)
Accrued expenses and other liabilities	416	820
Accrued revenue share	36	(69)
Deferred revenue	0	(55)
Net cash provided by operating activities	16,012	19,609
Investing activities		
Purchases of property and equipment	(7,408)	(7,815)
Purchases of marketable securities	(43,192)	(56,217)
Maturities and sales of marketable securities	36,650	46,860
Purchases of non-marketable investments	(536)	(1,771)
Cash collateral related to securities lending	2,029	488
Investments in reverse repurchase agreements	(725)	475
Acquisitions, net of cash acquired, and purchases of intangibles and other assets	(4,632)	(244)
Net cash used in investing activities	(17,814)	(18,224)
Financing activities		
Net payments related to stock-based award activities	(1,548)	(1,610)
Excess tax benefits from stock-based award activities	467	354
Adjustment Payment to Class C capital stockholders	0	(47)
Proceeds from issuance of debt, net of costs	9,167	10,332
Repayments of debt	(9,181)	(10,341)
Net cash used in financing activities	(1,095)	(1,312)
Effect of exchange rate changes on cash and cash equivalents	(236)	(352)
Net decrease in cash and cash equivalents	(3,133)	(279)
Cash and cash equivalents at beginning of period	18,898	18,347
Reclassification of assets previously held for sale	(160)	0
Cash and cash equivalents at end of period	$15,605	$18,068

Supplemental disclosures of cash flow information		
Cash paid for taxes	$2,382	$2,317
Cash paid for interest	$56	$66
Non-cash financing activity:		
Shares issued in connection with the Class C Adjustment Payment	$0	$475

See accompanying notes.

Google Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Google Inc. and Summary of Significant Accounting Policies

We were incorporated in California in September 1998 and re-incorporated in the State of Delaware in August 2003. We generate revenues primarily by delivering relevant, cost-effective online advertising.

On October 29, 2014, we sold the Motorola Mobile business (Motorola Mobile) to Lenovo Group Limited (Lenovo). The financial results of Motorola Mobile are presented as net loss from discontinued operations on the Consolidated Statements of Income for the three and nine months ended September 30, 2014. See Note 8 for further discussion of the sale.

On August 10, 2015, we announced plans to create a new public holding company, Alphabet Inc. (Alphabet), and a new operating structure. On October 2, 2015, we announced the implementation of the holding company reorganization, in which Alphabet became the successor issuer to Google.

Basis of Consolidation

The consolidated financial statements include the accounts of Google Inc. and our subsidiaries. All intercompany balances and transactions have been eliminated.

Unaudited Interim Financial Information

The accompanying Consolidated Balance Sheet as of September 30, 2015, the Consolidated Statements of Income for the three and nine months ended September 30, 2014 and 2015, the Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2014 and 2015, and the Consolidated Statements of Cash Flows for the nine months ended September 30, 2014 and 2015 are unaudited. These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (GAAP). In our opinion, the unaudited interim consolidated financial statements include all adjustments of a normal recurring nature necessary for the fair presentation of our financial position as of September 30, 2015, our results of operations for the three and nine months ended September 30, 2014 and 2015, and our cash flows for the nine months ended September 30, 2014 and 2015. The results of operations for the three and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015. These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014, filed with the SEC on February 6, 2015.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from these estimates. On an ongoing basis, we evaluate our estimates, including those related to the accounts receivable and sales allowances, fair values of financial instruments, intangible assets and goodwill, useful lives of intangible assets and property and equipment, income taxes, and contingent liabilities, among others. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09 (ASU 2014-09) "Revenue from Contracts with Customers." ASU 2014-09 supersedes the revenue recognition requirements in “Revenue Recognition (Topic 605)”, and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. As currently issued and amended, ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, though early adoption is permitted for annual reporting periods beginning after December 15, 2016. We are currently in the process of evaluating the impact of the adoption of ASU 2014-09 on our consolidated financial statements.

In June 2014, the FASB issued Accounting Standards Update No. 2014-10 (ASU 2014-10) "Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable

Interest Entities Guidance in Topic 810, Consolidation". ASU 2014-10 removes the definition of a development stage entity from the Master Glossary of the Accounting Standards Codification (ASC) thereby removing the financial reporting distinction between development stage entities and other reporting entities. The additional elimination of related consolidation guidance will require companies with interests in development stage entities to reassess whether such entities are variable interest entities under ASC Topic 810, Consolidation. ASU 2014-10 will be applied retrospectively for annual reporting periods beginning after December 15, 2015, and interim periods therein. Early application of these amendments is permitted. We are currently in the process of evaluating the impact of the adoption of ASU 2014-10 on our consolidated financial statements.

In February 2015, the FASB issued Accounting Standards Update No. 2015-02 (ASU 2015-02) "Consolidation (Topic 810): Amendments to the Consolidation Analysis." ASU 2015-02 changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. It is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. We are currently in the process of evaluating the impact of the adoption of ASU 2015-02 on our consolidated financial statements.

Revision of Previously Issued Financial Statements

In the second quarter of 2015, we identified an incorrect classification of certain revenues between legal entities, and as a consequence, we revised our income tax expense for periods beginning in 2008 through the first quarter of 2015 in the cumulative amount of $711 million. We evaluated the materiality of the income tax expense impact quantitatively and qualitatively and concluded it was not material to any of the prior periods impacted and that correction of income tax expense as an out of period adjustment in the quarter ended June 30, 2015 would not be material to our consolidated financial statements for the year ending December 31, 2015. Consolidated revenues are not impacted. We elected to revise previously issued consolidated financial statements for the periods impacted. Refer to Note 15 for additional information.

Note 2. Financial Instruments

Fair Value Measurements

We measure our cash equivalents, marketable securities, foreign currency and interest rate derivative contracts, and non-marketable debt securities at fair value on a recurring basis. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or a liability. Assets and liabilities recorded at fair value are measured and classified in accordance with a three-tier fair value hierarchy based on the observability of the inputs available in the market used to measure fair value:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - Inputs that are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant inputs are observable in the market or can be derived from observable market data. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, foreign exchange rates, and credit ratings.

Level 3 - Unobservable inputs that are supported by little or no market activities.

The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

We classify our cash equivalents and marketable securities within Level 1 or Level 2 because we use quoted market prices or alternative pricing sources and models utilizing market observable inputs to determine their fair value. We classify our foreign currency and interest rate derivative contracts primarily within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments. We classify our non-marketable investments within Level 3 as the valuation inputs are not observable in an active market.

Cash, Cash Equivalents and Marketable Securities

The following tables summarize our cash, cash equivalents and marketable securities by significant investment categories as of December 31, 2014 and September 30, 2015 (in millions):

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	As of December 31, 2014					
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash and Cash Equivalents	Marketable Securities
Cash	$9,863	$0	$0	$9,863	$9,863	$0
Level 1:						
Money market and other funds	2,532	0	0	2,532	2,532	0
U.S. government notes	15,320	37	(4)	15,353	1,128	14,225
Marketable equity securities	988	428	(64)	1,352	0	1,352
	18,840	465	(68)	19,237	3,660	15,577
Level 2:						
Time deposits[1]	2,409	0	0	2,409	2,309	100
Money market and other funds[2]	1,762	0	0	1,762	1,762	0
Fixed-income bond funds[3]	385	0	(38)	347	0	347
U.S. government agencies	2,327	8	(1)	2,334	750	1,584
Foreign government bonds	1,828	22	(10)	1,840	0	1,840
Municipal securities	3,370	33	(6)	3,397	3	3,394
Corporate debt securities	11,499	114	(122)	11,491	0	11,491
Agency mortgage-backed securities	8,196	109	(42)	8,263	0	8,263
Asset-backed securities	3,456	1	(5)	3,452	0	3,452
	35,232	287	(224)	35,295	4,824	30,471
Total	$63,935	$752	$(292)	$64,395	$18,347	$46,048

	As of September 30, 2015					
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash and Cash Equivalents	Marketable Securities
	(unaudited)					
Cash	$10,986	$0	$0	$10,986	$10,986	$0
Level 1:						
Money market and other funds	3,668	0	0	3,668	3,668	0
U.S. government notes	18,146	114	0	18,260	0	18,260
Marketable equity securities	1,014	196	(315)	895	0	895
	22,828	310	(315)	22,823	3,668	19,155
Level 2:						
Time deposits[1]	3,434	0	0	3,434	1,458	1,976
Money market and other funds[2]	1,855	0	0	1,855	1,855	0
Fixed-income bond funds[3]	370	0	(84)	286	0	286
U.S. government agencies	1,331	6	0	1,337	100	1,237
Foreign government bonds	2,422	17	(23)	2,416	0	2,416
Municipal securities	3,629	37	(4)	3,662	0	3,662
Corporate debt securities	13,536	79	(239)	13,376	1	13,375
Agency mortgage-backed securities	9,434	101	(24)	9,511	0	9,511
Asset-backed securities	3,084	2	(5)	3,081	0	3,081
	39,095	242	(379)	38,958	3,414	35,544
Total	$72,909	$552	$(694)	$72,767	$18,068	$54,699

(1) The majority of our time deposits are foreign deposits.

(2) The balances as of December 31, 2014 and September 30, 2015 were related to cash collateral received in connection with our securities lending program, which was invested in reverse repurchase agreements maturing within three months. See section titled "Securities Lending Program" below for further discussion of this program.

(3) Fixed-income bond funds consist of mutual funds that primarily invest in corporate and government bonds.

We determine realized gains or losses on the sale of marketable securities on a specific identification method. We recognized gross realized gains of $33 million and $189 million for the three and nine months ended September 30, 2014 and $54 million and $235 million for the three and nine months ended September 30, 2015. We recognized gross realized losses of $15 million and $49 million for the three and nine months ended September 30, 2014 and $60 million and $156 million for the three and nine months ended September 30, 2015. We reflect these gains and losses as a component of interest and other income, net, in the accompanying Consolidated Statements of Income.

The following table summarizes the estimated fair value of our investments in marketable debt securities, accounted for as available-for-sale securities and classified by the contractual maturity date of the securities (in millions):

	As of September 30, 2015 (unaudited)
Due in 1 year	$8,525
Due in 1 year through 5 years	27,725
Due in 5 years through 10 years	7,244
Due after 10 years	10,024
Total	$53,518

Non-marketable Investments

We included $90 million and $991 million of available-for-sale debt securities in our non-marketable investments as of December 31, 2014 and September 30, 2015. These debt securities are primarily preferred stock with certain features and convertible notes issued by private companies that do not have readily determinable market values and are categorized accordingly as Level 3 in the fair value hierarchy. To estimate the fair value of these securities, we use a combination of valuation methodologies, including market and income approaches based on prior transaction prices; estimated timing, probability, and amount of cash flows; and illiquidity considerations. Financial information of the private companies may not be available and consequently we will estimate the value based on the best available information at the measurement date. As of December 31, 2014 and September 30, 2015, the estimated fair value of these debt securities approximated their carrying value. In addition, since these securities do not have contractual maturity dates and we do not intend to liquidate them in the next 12 months, we have classified them as non-current assets on the accompanying Consolidated Balance Sheet as of December 31, 2014 and September 30, 2015.

The following table presents reconciliations for our assets measured and recorded at fair value on a recurring basis, using significant unobservable inputs (Level 3) (in millions):

	Level 3 (unaudited)
Balance as of December 31, 2014	$90
Purchases, issuances, and settlements[1]	901
Balance as of September 30, 2015	$991

(1) Purchases of securities included our $900 million investment in SpaceX, a space exploration and space transport company, made during January 2015.

Impairment Considerations for Available-for-sale Investments

The following tables present gross unrealized losses and fair values for those marketable investments that were in an unrealized loss position as of December 31, 2014 and September 30, 2015, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in millions):

	As of December 31, 2014					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government notes	$4,490	$(4)	$0	$0	$4,490	$(4)
U.S. government agencies	830	(1)	0	0	830	(1)
Foreign government bonds	255	(7)	43	(3)	298	(10)
Municipal securities	877	(3)	174	(3)	1,051	(6)
Corporate debt securities	5,851	(112)	225	(10)	6,076	(122)
Agency mortgage-backed securities	609	(1)	2,168	(41)	2,777	(42)
Asset-backed securities	2,388	(4)	174	(1)	2,562	(5)
Fixed-income bond funds	347	(38)	0	0	347	(38)
Marketable equity securities	690	(64)	0	0	690	(64)
Total	$16,337	$(234)	$2,784	$(58)	$19,121	$(292)

	As of September 30, 2015					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(unaudited)					
Foreign government bonds	$873	$(19)	$27	$(4)	$900	$(23)
Municipal securities	356	(3)	23	(1)	379	(4)
Corporate debt securities	7,152	(187)	651	(52)	7,803	(239)
Agency mortgage-backed securities	1,355	(8)	739	(16)	2,094	(24)
Asset-backed securities	1,650	(4)	230	(1)	1,880	(5)
Fixed-income bond funds	0	0	286	(84)	286	(84)
Marketable equity securities	790	(315)	0	0	790	(315)
Total	$12,176	$(536)	$1,956	$(158)	$14,132	$(694)

We periodically review our available-for-sale debt and equity securities for other-than-temporary impairment. We consider factors such as the duration, severity and the reason for the decline in value, the potential recovery period and our intent to sell. For debt securities, we also consider whether (i) it is more likely than not that we will be required to sell the debt securities before recovery of their amortized cost basis, and (ii) the amortized cost basis cannot be recovered as a result of credit losses. During the three and nine months ended September 30, 2014 and 2015, we did not recognize any other-than-temporary impairment loss.

Securities Lending Program

From time to time, we enter into securities lending agreements with financial institutions to enhance investment income. We loan certain securities which are collateralized in the form of cash or securities. Cash collateral is usually invested in reverse repurchase agreements which are collateralized in the form of securities.

We classify loaned securities as cash equivalents or marketable securities and record the cash collateral as an asset with a corresponding liability in the accompanying Consolidated Balance Sheets. We classify reverse repurchase agreements maturing within three months as cash equivalents and those longer than three months as receivable under reverse repurchase agreements in the accompanying Consolidated Balance Sheets. For security collateral received, we do not record an asset or liability except in the event of counterparty default.

Our securities lending transactions were accounted for as secured borrowings with significant investment categories as follows (in millions):

	As of September 30, 2015				
	Remaining Contractual Maturity of the Agreements				
Securities Lending Transactions	Overnight and Continuous	Up to 30 days	30 - 90 Days	Greater Than 90 Days	Total
	(unaudited)				
U.S. government notes	$1,779	$1,001	$0	$101	$2,881
U.S. government agencies	192	0	0	0	192
Corporate debt securities	193	0	0	0	193
Total	$2,164	$1,001	$0	$101	$3,266
Gross amount of recognized liabilities for securities lending in offsetting disclosure					$3,266
Amounts related to agreements not included in securities lending in offsetting disclosure					$0

Derivative Financial Instruments

We recognize derivative instruments as either assets or liabilities in the accompanying Consolidated Balance Sheets at fair value. We record changes in the fair value (i.e. gains or losses) of the derivatives in the accompanying Consolidated Statements of income as interest and other income, net, as part of revenues, or as a component of accumulated other comprehensive income (AOCI) in the accompanying Consolidated Balance Sheets, as discussed below.

We enter into foreign currency contracts with financial institutions to reduce the risk that our cash flows and earnings will be adversely affected by foreign currency exchange rate fluctuations. We use certain interest rate derivative contracts to hedge interest rate exposures on our fixed income securities and our anticipated debt issuance. Our program is not used for trading or speculative purposes.

We enter into master netting arrangements, which reduce credit risk by permitting net settlement of transactions with the same counterparty. To further reduce credit risk, we enter into collateral security arrangements under which the counterparty is required to provide collateral when the net fair value of certain financial instruments fluctuates from contractually established thresholds. We can take possession of the collateral in the event of counterparty default. As of December 31, 2014 and September 30, 2015, we received cash collateral related to the derivative instruments under our collateral security arrangements of $268 million and $105 million.

Cash Flow Hedges

We use options designated as cash flow hedges to hedge certain forecasted revenue transactions denominated in currencies other than the U.S. dollar. The notional principal of these contracts was approximately $13.6 billion and $9.7 billion as of December 31, 2014 and September 30, 2015. These foreign exchange contracts have maturities of 36 months or less.

In 2012, we entered into forward-starting interest rate swaps, with a total notional amount of $1.0 billion and terms calling for us to receive interest at a variable rate and to pay interest at a fixed rate, that effectively locked in an interest rate on our anticipated debt issuance of $1.0 billion in 2014. We issued $1.0 billion of unsecured senior notes in February 2014 (see details in Note 3). As a result, we terminated the forward-starting interest rate swaps upon the debt issuance. The gain associated with the termination is reported within operating activities in the Consolidated Statement of Cash Flows for the nine months ended September 30, 2014, consistent with the impact of the hedged item.

We reflect gains or losses on the effective portion of a cash flow hedge as a component of AOCI and subsequently reclassify cumulative gains and losses to revenues or interest expense when the hedged transactions are recorded. If the hedged transactions become probable of not occurring, the corresponding amounts in AOCI would be immediately reclassified to interest and other income, net. Further, we exclude the change in the time value of the options from our assessment of hedge effectiveness. We record the premium paid or time value of an option on the date of purchase as an asset. Thereafter, we recognize changes to this time value in interest and other income, net.

As of September 30, 2015, the effective portion of our cash flow hedges before tax effect was $556 million, of which $466 million is expected to be reclassified from AOCI into earnings within the next 12 months.

Fair Value Hedges

We use forward contracts designated as fair value hedges to hedge foreign currency risks for our investments denominated in currencies other than the U.S. dollar. We exclude changes in the time value for these forward contracts from the assessment of hedge effectiveness. The notional principal of these contracts was $1.5 billion and $2.0 billion as of December 31, 2014 and September 30, 2015.

We use interest rate swaps designated as fair value hedges to hedge interest rate risk for certain fixed rate securities. The notional principal of these contracts was $175 million and $290 million as of December 31, 2014 and September 30, 2015.

Gains and losses on these forward contracts and interest rate swaps are recognized in interest and other income, net, along with the offsetting losses and gains of the related hedged items. Cash flows from these forward contracts and interest rate swaps are reported within investment activities in the Consolidated Statements of Cash Flows, consistent with the impact of the hedged items.

Other Derivatives

Other derivatives not designated as hedging instruments consist of forward contracts that we use to hedge intercompany transactions and other monetary assets or liabilities denominated in currencies other than the local currency of a subsidiary. We recognize gains and losses on these contracts, as well as the related costs in interest and other income, net along with the foreign currency gains and losses on monetary assets and liabilities. The notional principal of foreign exchange contracts outstanding was $6.2 billion and $5.7 billion as of December 31, 2014 and September 30, 2015.

We also use exchange-traded interest rate futures contracts and “To Be Announced” (TBA) forward purchase commitments of mortgage-backed assets to hedge interest rate risks on certain fixed income securities. The TBA contracts meet the definition of derivative instruments in cases where physical delivery of the assets is not taken at the earliest available delivery date. Our interest rate futures and TBA contracts (together interest rate contracts) are not designated as hedging instruments. We recognize gains and losses on these contracts, as well as the related costs, in interest and other income, net. The gains and losses are generally economically offset by unrealized gains and losses in the underlying available-for-sale securities, which are recorded as a component of AOCI until the securities are sold or other-than-temporarily impaired, at which time the amounts are moved from AOCI into interest and other income, net. The total notional amounts of interest rate contracts outstanding were $150 million as of December 31, 2014 and $450 million as of September 30, 2015.

The fair values of our outstanding derivative instruments were as follows (in millions):

	Balance Sheet Location	As of December 31, 2014 Fair Value of Derivatives Designated as Hedging Instruments	Fair Value of Derivatives Not Designated as Hedging Instruments	Total Fair Value
Derivative Assets:				
Level 2:				
Foreign exchange contracts	Prepaid revenue share, expenses and other assets, current and non-current	$851	$0	$851
Interest rate contracts	Prepaid revenue share, expenses and other assets, current and non-current	1	0	1
Total		$852	$0	$852
Derivative Liabilities:				
Level 2:				
Foreign exchange contracts	Accrued expenses and other current liabilities	$0	$3	$3
Interest rate contracts	Accrued expenses and other liabilities, current and non-current	1	0	1
Total		$1	$3	$4

	Balance Sheet Location	As of September 30, 2015 Fair Value of Derivatives Designated as Hedging Instruments (unaudited)	Fair Value of Derivatives Not Designated as Hedging Instruments	Total Fair Value
Derivative Assets:				
Level 2:				
Foreign exchange contracts	Prepaid revenue share, expenses and other assets, current and non-current	$545	$1	$546
Total		$545	$1	$546
Derivative Liabilities:				
Level 2:				
Foreign exchange contracts	Accrued expenses and other current liabilities	$0	$3	$3
Interest rate contracts	Accrued expenses and other liabilities, current and non-current	6	1	7
Total		$6	$4	$10

The effect of derivative instruments in cash flow hedging relationships on income and other comprehensive income (OCI) is summarized below (in millions):

	Gains (Losses) Recognized in OCI on Derivatives Before Tax Effect (Effective Portion)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
Derivatives in Cash Flow Hedging Relationship	2014	2015	2014	2015
	(unaudited)			
Foreign exchange contracts	$436	$97	$458	$813
Interest rate contracts	0	0	(31)	0
Total	$436	$97	$427	$813

		Gains Reclassified from AOCI into Income (Effective Portion)			
		Three Months Ended September 30,		Nine Months Ended September 30,	
Derivatives in Cash Flow Hedging Relationship	Income Statement Location	2014	2015	2014	2015
		(unaudited)			
Foreign exchange contracts	Revenues	$10	$286	$24	$1,068
Interest rate contracts	Interest and other income, net	1	1	2	3
Total		$11	$287	$26	$1,071

		Gains (Losses) Recognized in Income on Derivatives [(1)] (Amount Excluded from Effectiveness Testing and Ineffective Portion)			
		Three Months Ended September 30,		Nine Months Ended September 30,	
Derivatives in Cash Flow Hedging Relationship	Income Statement Location	2014	2015	2014	2015
		(unaudited)			
Foreign exchange contracts	Interest and other income, net	$(52)	$(63)	$(186)	$(230)
Interest rate contracts	Interest and other income, net	0	0	4	0
Total		$(52)	$(63)	$(182)	$(230)

[(1)] Gains (losses) related to the ineffective portion of the hedges were not material in all periods presented.

The effect of derivative instruments in fair value hedging relationships on income is summarized below (in millions):

		Gains (Losses) Recognized in Income on Derivatives[2]			
		Three Months Ended September 30,		Nine Months Ended September 30,	
Derivatives in Fair Value Hedging Relationship	Income Statement Location	2014	2015	2014	2015
		(unaudited)			
Foreign Exchange Hedges:					
Foreign exchange contracts	Interest and other income, net	$73	$72	$52	$139
Hedged item	Interest and other income, net	(75)	(73)	(58)	(144)
Total		$(2)	$(1)	$(6)	$(5)
Interest Rate Hedges:					
Interest rate contracts	Interest and other income, net	$0	$(5)	$0	$(6)
Hedged item	Interest and other income, net	0	5	0	6
Total		$0	$0	$0	$0

(2) Losses related to the amount excluded from effectiveness testing of the hedges were $2 million and $6 million for the three and nine months ended September 30, 2014 and $1 million and $5 million for the three and nine months ended September 30, 2015.

The effect of derivative instruments not designated as hedging instruments on income is summarized below (in millions):

		Gains (Losses) Recognized in Income on Derivatives			
		Three Months Ended September 30,		Nine Months Ended September 30,	
Derivatives Not Designated As Hedging Instruments	Income Statement Location	2014	2015	2014	2015
		(unaudited)			
Foreign exchange contracts	Interest and other income, net and net loss from discontinued operations	$172	$150	$59	$241
Interest rate contracts	Interest and other income, net	2	3	2	0
Total		$174	$153	$61	$241

Offsetting of Derivatives, Securities Lending and Reverse Repurchase Agreements

We present our derivatives, securities lending and reverse repurchase agreements at gross fair values in the Consolidated Balance Sheets. However, our master netting and other similar arrangements allow net settlements under certain conditions. As of December 31, 2014 and September 30, 2015, information related to these offsetting arrangements was as follows (in millions):

Offsetting of Assets

	As of December 31, 2014						
				Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset			
Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Presented in the Consolidated Balance Sheets	Financial Instruments	Cash Collateral Received	Non-Cash Collateral Received	Net Assets Exposed
Derivatives	$852	$ 0	$ 852	$(1)[1]	$(251)	$(412)	$188
Reverse repurchase agreements	2,637	0	2,637 [2]	0	0	(2,637)	0
Total	$3,489	$ 0	$ 3,489	$(1)	$(251)	$(3,049)	$188

	As of September 30, 2015						
				Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset			
Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Consolidated Balance Sheets	Net Presented in the Consolidated Balance Sheets	Financial Instruments	Cash Collateral Received	Non-Cash Collateral Received	Net Assets Exposed
	(unaudited)						
Derivatives	$546	$ 0	$ 546	$(2)[1]	$(93)	$(303)	$148
Reverse repurchase agreements	2,255	0	2,255 [2]	0	0	(2,255)	0
Total	$2,801	$ 0	$ 2,801	$(2)	$(93)	$(2,558)	$148

(1) The balances as of December 31, 2014 and September 30, 2015 were related to derivative liabilities which are allowed to be net settled against derivative assets in accordance with our master netting agreements.

(2) The balances as of December 31, 2014 and September 30, 2015 included $1,762 million and $1,855 million recorded in cash and cash equivalents, respectively, and $875 million and $400 million recorded in receivable under reverse repurchase agreements, respectively.

Offsetting of Liabilities

As of December 31, 2014

Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheets	Net Presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset: Financial Instruments	Cash Collateral Pledged	Non-Cash Collateral Pledged	Net Liabilities
Derivatives	$4	$ 0	$ 4	$(1)[3]	$0	$0	$3
Securities lending agreements	2,778	0	2,778	0	0	(2,740)	38
Total	$2,782	$ 0	$ 2,782	$(1)	$0	$(2,740)	$41

As of September 30, 2015

Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Consolidated Balance Sheets	Net Presented in the Consolidated Balance Sheets	Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset: Financial Instruments	Cash Collateral Pledged	Non-Cash Collateral Pledged	Net Liabilities
	(unaudited)						
Derivatives	$10	$ 0	$ 10	$(2)[3]	$(4)	$0	$4
Securities lending agreements	3,266	0	3,266	0	0	(3,245)	21
Total	$3,276	$ 0	$ 3,276	$(2)	$(4)	$(3,245)	$25

(3) The balances as of December 31, 2014 and September 30, 2015 were related to derivative assets which are allowed to be net settled against derivative liabilities in accordance with our master netting agreements.

Note 3. Debt

Short-Term Debt

We have a debt financing program of up to $3.0 billion through the issuance of commercial paper. Net proceeds from this program are used for general corporate purposes. As of December 31, 2014 and September 30, 2015, we had $2.0 billion of outstanding commercial paper recorded as short-term debt with weighted-average interest rates of 0.1% and 0.2% respectively. In conjunction with this program, we have a $3.0 billion revolving credit facility which expires in July 2016. The interest rate for the credit facility is determined based on a formula using certain market rates. As of December 31, 2014 and September 30, 2015, we were in compliance with the financial covenants in the credit facility, and no amounts were outstanding under the credit facility as of December 31, 2014 and September 30, 2015. The estimated fair value of the commercial paper approximated its carrying value as of December 31, 2014 and September 30, 2015.

Our short-term debt balance also includes the short-term portion of certain long-term debt, as described in the section below.

Long-Term Debt

We issued $1.0 billion of unsecured senior notes (the "2014 Notes") in February 2014 and $3.0 billion of unsecured senior notes in three tranches (collectively, the "2011 Notes") in May 2011. We used the net proceeds from the issuance of the 2011 Notes to repay a portion of our outstanding commercial paper and for general corporate purposes. We used the net proceeds from the issuance of the 2014 Notes for the repayment of the portion of the principal amount of our 2011 Notes which matured on May 19, 2014 and for general corporate purposes. The total outstanding Notes are summarized below (in millions):

	As of December 31, 2014	As of September 30, 2015 (unaudited)
Short-Term Portion of Long-Term Debt		
2.125% Notes due on May 19, 2016[1]	$0	$999
Capital Lease Obligation	10	238
Total	$10	$1,237
Long-Term Debt		
2.125% Notes due on May 19, 2016	$1,000	$0
3.625% Notes due on May 19, 2021	1,000	1,000
3.375% Notes due on February 25, 2024	1,000	1,000
Unamortized discount for the Notes above	(8)	(6)
Subtotal	2,992	1,994
Capital Lease Obligation	236	0
Total	$3,228	$1,994

[1] The outstanding Notes as of September 30, 2015 are net of unamortized discount of $1 million.

The effective interest yields of the Notes due in 2016, 2021, and 2024 were 2.241%, 3.734% and 3.377%, respectively. Interest on the 2011 and 2014 Notes is payable semi-annually. The 2011 and 2014 Notes rank equally with each other and with all of our other senior unsecured and unsubordinated indebtedness from time to time outstanding. We may redeem the 2011 and 2014 Notes at any time in whole or in part at specified redemption prices. We are not subject to any financial covenants under the 2011 Notes or the 2014 Notes. The total estimated fair value of the outstanding 2011 and 2014 Notes was approximately $3.1 billion as of December 31, 2014 and September 30, 2015. The fair value of the outstanding 2011 and 2014 Notes was determined based on observable market prices of identical instruments in less active markets and is categorized accordingly as Level 2 in the fair value hierarchy.

In August 2013, we entered into a capital lease obligation on certain property which expires in 2028. We intend to exercise the option to purchase the property in 2016, and as such the long term portion of the capital lease obligation was reclassified as short term. The effective rate of the capital lease obligation approximates the market rate. The estimated fair value of the capital lease obligation approximated its carrying value as of December 31, 2014 and September 30, 2015.

Note 4. Balance Sheet Components

Property and Equipment

Property and equipment consisted of the following (in millions):

	As of December 31, 2014	As of September 30, 2015 (unaudited)
Land and buildings	$13,326	$15,353
Information technology assets	10,918	13,354
Construction in progress	6,555	7,799
Leasehold improvements	1,868	2,321
Furniture and fixtures	79	81
Property and equipment, gross	32,746	38,908
Less: accumulated depreciation and amortization	(8,863)	(10,570)
Property and equipment, net	$23,883	$28,338

Property under capital lease with a cost basis of $258 million was included in land and buildings as of September 30, 2015.

Prepaid Revenue Share, Expenses and Other Assets, Non-Current

Note Receivable

In connection with the sale of our Motorola Mobile business on October 29, 2014, we received an interest-free, three-year prepayable promissory note (the "Note Receivable") due October 2017 from Lenovo. The Note Receivable is included in prepaid revenue share, expenses and other assets, non-current, on our Consolidated Balance Sheets. Based on the general market conditions and the credit quality of Lenovo, we discounted the Note Receivable at an effective interest rate of 4.5% as shown in the table below (in millions):

	As of December 31, 2014	As of September 30, 2015 (unaudited)
Principal of the Note Receivable	$1,500	$1,500
Less: unamortized discount for the Note Receivable	(175)	(129)
Total	$1,325	$1,371

As of December 31, 2014 and September 30, 2015, we did not recognize a valuation allowance on the Note Receivable.

Accumulated Other Comprehensive Income (Loss)

The components of AOCI, net of tax, were as follows (in millions, unaudited):

	Foreign Currency Translation Adjustments	Unrealized Gains (Losses) on Available-for-Sale Investments	Unrealized Gains on Cash Flow Hedges	Total
Balance as of December 31, 2013	$16	$ 50	$59	$125
Other comprehensive income (loss) before reclassifications	(623)	250	304	(69)
Amounts reclassified from AOCI	0	(122)	(16)	(138)
Other comprehensive income (loss)	(623)	128	288	(207)
Balance as of September 30, 2014	$(607)	$ 178	$347	$(82)

	Foreign Currency Translation Adjustments	Unrealized Gains (Losses) on Available-for-Sale Investments	Unrealized Gains on Cash Flow Hedges	Total
Balance as of December 31, 2014	$(980)	$ 421	$586	$27
Other comprehensive income (loss) before reclassifications	(850)	(504)	580	(774)
Amounts reclassified from AOCI	0			