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By

Special Report

# Executive Summary

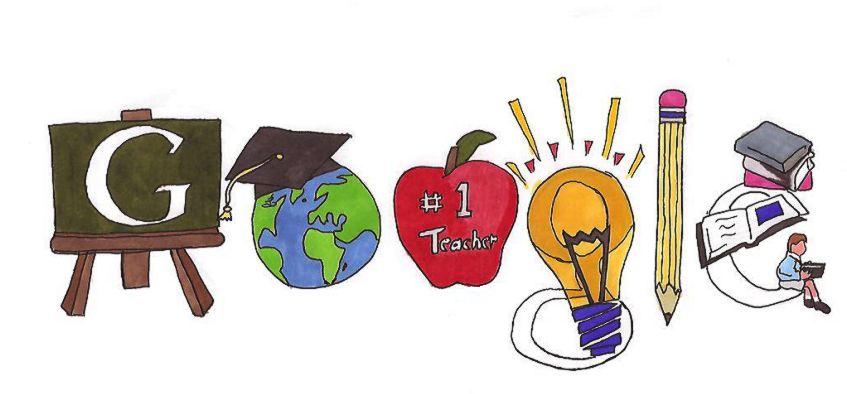
The following report is an in depth analysis of Google, Inc. (GOOG), concerning the 2014 consolidated financial statements. To tackle the analysis of this fortune 100 company and gain insight into the inner workings of such a vast and diverse company, our team began by reviewing the annual 10k report, then delegating sections for examination. This report specifically addresses ten questions relating to Google’s accounting and consolidation strategies. More specifically our team’s goal with this report is to investigate what’s really going on at Google and what is driving key factors behind the company’s successful operations. With that regard, we have come to the conclusion that Google is very forward looking with regards to world economic views and establishing a plan for growth in a period of uncertainty and risk across the globe. Furthermore, we have discovered that the company has minimal involvement with noncontrolling interests and VIE’s. As Google continues to forecast and reach into an ambiguous future, they have planned accordingly and engage in an extensive foreign exchange risk management program aimed at hedging certain foreign risks.



# Question 1:

### SUMMARIZE THE COMPANY’S “BASIS FOR PRESENTATION AND PRINCIPLES OF CONSOLIDATION.”

As a large multinational technology company, Google has numerous subsidiaries worldwide. As such, Google is required to provide consolidated financial statements, encompassing the operations of its subsidiaries. In 2014, Google reported its disposition of key interests in two subsidiaries. These subsidiaries were, Motorola Home and Motorola Mobile that were actually acquired two years prior in 2012. Google’s 10-K also states that all intercompany balances and transactions have been eliminated, in accordance with GAAP.



# Question 2:

### Summarize the method(s) used by the company to account for their investments. Include discussion of how the company accounts for available for sale securities and trading securities if any.

Google classifies its marketable securities as available-for-sale. Specifically, the company defines marketable securities as highly liquid investments with stated maturities of over three months. They include government bonds and collateralized securities. These particular marketable securities are reported at fair value as part of Stockholders’ Equity, prior to being sold. Moreover, any unrealized gains or losses on these securities are recorded under interest and other income, net of tax. On the other hand, Google reports all realized gains or losses as interest and other income, net of tax. Furthermore, Google records its non-marketable securities by either the equity or cost method. The equity method is used if the company recognizes significant influence, but not control, over the investee, while the cost method is used if they do not have significant influence.



# Question 3:

### Summarize the company’s goodwill accounting and impairment of goodwill if any. Include any methodologies described by the company.

According to Google’s year-end consolidated financials, the company accounts for goodwill as the excess of a purchase agreements fair value, divided by the fair value of the net, of identifiable assets and liabilities. Since Google is a technology-based company with a tremendous global presence, the company on average has an unusually heavy weighted amount of goodwill on its balance sheet. After discussing the inherent reasons behind these figures we’ve determined that due to the nature of Google’s business and brand strength, that goodwill, is only going to increase in the future. In 2014, the total amount of goodwill capped at $15,599 million, $4,100 million more than the year prior. This increase in goodwill is the residual of Google’s various acquisitions. In particular these acquisitions included Nest Labs, Inc. with $2.3 billion in goodwill, Dropcam, Inc. with $452 million in goodwill, Skybox Imaging, Inc. with $388 million in goodwill, and various other immaterial acquisitions. This tech giants’ impairment of goodwill is measured annually, if not more often, due to certain events or changes in circumstances that can, and more likely than not reduce the fair value of a reporting unit below its carrying value. This makes sense as Google is a very acquisitive company. Since the tests of goodwill impairment are highly dependent on management’s judgment, and the fair value of high-tech companies will usually decrease largely due to technological advancements and obsolescence, our team has concluded that this high volume of goodwill may be cause for concern that the financial statements are less valuable to investors in projecting the inherent financial stability of the company. As of December 31, 2014, no goodwill impairment has been identified in any of the years presented.



# Question 4:

### SUMMARIZE THE COMPANY’S ACCOUNTING FOR THEIR FOREIGN CURRENCY TRANSLATION ADJUSTMENTS. IDENTIFY AND DESCRIBE THE IMPACT ANY FOREIGN CURRENCY ADJUSTMENTS.

In general, the functional currency of Google’s international subsidiaries is the local currency, in which that subsidiary primarily operates. As a result, Google uses the current rate method to translate financial statements of these subsidiaries to U.S. dollars. It uses month-end rates of exchange for assets and liabilities, and average rates for the annual period derived from month-end spot rates for revenues, costs, and expenses, and records translation gains and losses in accumulated other comprehensive income as a component of stockholders’ equity.

To offset the effects of fluctuations in foreign currency exchange rates, Google established a foreign exchange risk management program designed to reduce effects caused by fluctuations. Foreign exchange option contracts and foreign exchange forward contracts are used to offset the adverse changes in foreign currency exchange rates on dollar-equivalent earnings and assets and liabilities denominated in currencies other than the local currency of the subsidiary. The value of foreign exchange contracts outstanding was $9.4 billion and $6.2 billion as of December 31, 2013 and December 31, 2014. However this program does not fully offset their effect on revenues and earnings. The total change in foreign currency exchange loss is $514 million, $379 million, and 402 million in 2012, 2013, and 2014 respectively.



# Question 5:

### SUMMARIZE THE ACCOUNTING TREATMENT FOR THE COMPANY’S VIE’S, IF ANY.

The only treatment talked about regarding Variable Interest Entities in the 2014 Google 10K report is that they are accounted for at fair value with changes on gains and losses recorded in Accumulated Other Comprehensive Income until the securities are sold.

# Question 6:

### SUMMARIZE ANY ACQUISITIONS MADE DURING THE YEAR AND THE ACCOUNTING TREATMENT FOR THE ACQUISITIONS DESCRIBED IN THE FINANCIAL STATEMENTS. INCLUDE ANY SUMMARIES OF CONTINGENT CONSIDERATION PAID. DESCRIBE BARGAIN PURCHASES, IF ANY.

In 2014, Google made several acquisitions, along with some traffic acquisition costs. Traffic acquisition costs are payments made by Internet search companies to online firms and affiliates that direct consumer and business traffic to their websites. In other words, they are a critical cost of revenue for Google and are important when it comes to the company’s profitability. They tend to fluctuate, mainly increasing as time progresses due to increasing distribution fees paid for additional traffic directed to Google websites, as well as more advertiser fees. Also, the increase this year was driven by an impairment charge that dealt with a parent licensing royalty asset acquired in connection with the Motorola Acquisition. This year, Google’s cost of revenues was at $25.7 billion, which consisted of $13.5 billion in traffic acquisition costs and $12.2 billion in other cost of revenues. Google’s traffic acquisition costs consist of advertising revenues that are shared with Google network members and distribution partners. Below is a chart that further details these costs.



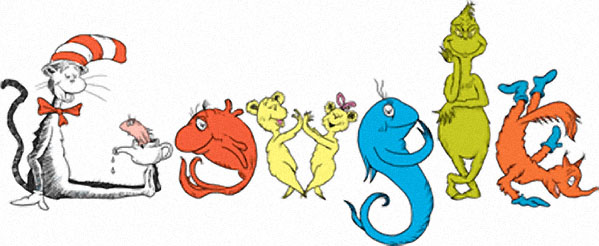
|  |  |
| --- | --- |
| Traffic acquisition costs to Google Network Members: | $9.864 billion |
| Traffic acquisition costs to distribution partners: | $3.633 billion |
| Traffic acquisition costs: | $13.497 billion |

2014 Acquisitions

In February 2014, Google acquired Nest Labs, Inc. (Nest) for $2.6 billion with a fair value held in equity interest of $152 million, $51 million in cash acquired, $430 million was attributed to intangible assets, $2.3 billion went to goodwill, and $84 million was attributed to net liabilities assumed. The transaction was considered a “step acquisition” under GAAP, which means that the ownership interest in Nest held before the acquisition was remeasured to fair value on the date of the acquisition. The gain of $103 million as a result of the remeasurement in interest and other income under Google’s Consolidated Statements of Income for the year. Goodwill is not expected to be deductible for tax purposes.

In July 2014, Google acquired Dropcam, Inc. (Dropcam) for approximately $517 million. Out of the $517 million, $11 million was cash acquired, $55 million was attributed to intangible assets, $452 million was attributed to goodwill, and $1 million was attributed to net liabilities assumed. Goodwill is not expected to be deductible for tax purposes.

In August 2014, Google acquired Skybox Imaging, Inc. (Skybox) for approximately $478 million in cash. Out of this amount, $6 million was cash acquired, $69 million was attributed to intangible assets, $388 million went to goodwill, and $15 million was attributed to net assets acquired. Goodwill is not expected to be deductible for tax purposes.



Other smaller acquisitions and purchases of intangible assets added up to approximately $1.466 billion with a fair value equity interest of $33 million. In total, $65 million was cash acquired, $405 million was attributed to intangible assets, $1.045 billion was attributed to goodwill, and $49 million was attributed to net liabilities assumed. The amount of goodwill expected to be deductible for tax purposes is $55 million.

# Question 7:

### SUMMARIZE THE COMPANY’S HEDGING STRATEGY(S) IF ANY. THERE COULD BE SEVERAL STRATEGIES.

Google engages in a foreign exchange risk management program. The reason for having such a program stems from the company’s diverse revenue streams. As Google generates a hefty portion of its revenues from outside the U.S. it’s in the company’s best interest to actively manage currency exchanges. In fact, Google has such a large presence abroad that the company benefits from a weaker dollar, in relation to the rest of the world. The three main currencies that Google actively manages are the British pound, the Euro Zone’s Euro and the Japanese Yen. Google uses a few different hedging tools to manage and hedge negative foreign exchange impacts on earnings. A few of these tools include options contracts, forward contracts, and even rate swaps.

Google records options contracts as Cash Flow Hedges, and for accounting purposes, splitting their fair values into intrinsic and time value components.

In 2014, Google actually realized Cash Flow hedging gains net of tax, of $527 million. Furthermore, despite the impressive half of a billion in gains, the principle of these contracts amounted to a staggering $13.6 billion. However, it’s important to note that if a hedged transaction become unlikely to occur, it gets reclassified from AOCI to net interest and other income. At the end of 2014 Google had a large portion of its cash flow hedges prior to tax of $817 million, of which $645 million expected to be reclassified by the end of 2015.

With regards to Google’s utilization of forward contracts, the company had a balance of $1.5 billion at the end of 2014. For accounting purposes all related gains and losses on these particular contracts are recorded in as net interest and other income. Importantly though, Google is not permitted to classify any forward or option contracts meant for hedging intercompany transactions and other monetary assets or liabilities, as hedging derivatives.

Additionally, referencing the hedging revenues from the United Kingdom, Google only recorded $3 million. However, in relation to the rest of the world, hedging gains reached upwards of $168 million. As previously mentioned, these gains are recorded as foreign exchange hedging activities and flow into net interest and other income. In 2014, this line item was recorded as $763 million. Finally, while hedging cannot be credited as the bulk of this cost item, its value is nonetheless baked into it. Going further, these costs are mainly derived from the notional amount of each contract, their related time duration, the movement of foreign exchange rates globally relative to those contracts prices, and in general, the volatility of foreign exchange rates. As Google expands its international business, these hedging costs are expected to increase in 2015.

In 2015, the U.S. dollar has risen sharply in strength. In particular, this relation has manifested quite apparently in comparison to the Euro. As central banks engage in long term monetary policy, like quantitative easing, in efforts of stimulating global markets, the U.S. Dollar will only continue to strengthen. As investors chase safety and higher returns, demand and thus the strength of the dollar will only continue to rise. For Google this means the success of their foreign exchange risk management program will only become more crucial to the firm's bottom line in the coming years.

# Question 8:

### Summarize the operating segments of the company and highlight any facts you find interesting and why.



Google’s operating segments consist of advertising revenue from Google websites, Google Network Members' websites, and other revenues. Google’s main form of revenue comes from advertisements from its own websites, which comprises approximately 68% of its revenue. This includes paid clicks from YouTube “engagement ads” and other owned entities including Maps and Finance. Google’s revenue from its network members' websites mainly comes from advertising programs like AdSense for search, AdSense for content, AdExchange, AdMob, and DoubleClick Bid Manager. Google’s network revenues represent approximately 21% of its revenues. Google’s “other revenues” represent approximately 11% of its revenue. This segment consists of the sale of “digital content products”, such as apps, Chrome related products such as Chromecast, directly-sold Nexus products, and Chrome OS devices along with other sources of on the Google Play store.

# Question 9:

### SUMMARIZE THE NONCONTROLLING INTERESTS ACCOUNTING IN THE CONSOLIDATED FINANCIAL STATEMENTS.

Since Google makes entire purchases of companies, there are no noncontrolling interests accounted for in Google’s consolidated statements. Noncontrolling interests occur when another firms owns a minority interest in the company that is being purchased and this interest must be accounted for. Since there is no minority interest in any of Google’s acquisitions, no noncontrolling interests are recorded.

# Question 10

### FIND AN INTERIM FINANCIAL STATEMENT AND DISCLOSURES AND SUMMARIZE AND SIMILARITIES AND DIFFERENCES YOU FIND WHEN COMPARING THE INTERIM FINANCIAL STATEMENTS TO THE ANNUAL CONSOLIDATED YEAR-END FINANCIAL STATEMENTS. FOR INSTANCE, WAS THERE EVIDENCE OF EARNINGS MANAGEMENT EACH QUARTER OR OTHER MANIPULATIONS DURING THE YEAR?



In observance with the 10-K for the quarter ended on Dec 31, 2014 as well as the company’s previous three quarterly earnings releases for 2014 on March 31, June 30 and September 30, there is no clear evidence of earnings management.

For a company as large, as popular and as scrutinized as Google, senior management would be foolish to attempt Earnings Management. The public eye is too sharp and critical to allow such practices as “big baths”, “flushing” investments or even disposing of the “problem child” to occur.

**Acctg 304 Grading Rubric for Written Assignments**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Criteria: | Very Poor (0) | Poor (1) | Average (2) | Good (3) | Excellent (4) | Score |
| **CONTENT:**  **Completeness**  **Accuracy** | Misses two or more elements of the case; major factual errors; misinterprets case assignment. | Misses one major element of the case; leaves out essential information; some minor factual errors. | Handles case material competently; includes essential information; factually correct. | Handles all elements of the case with skill; develops and supports ideas in a better-than-average way. | Handles all elements of the case professionally; develop and supports ideas using well-chosen examples and creative details. | 4 |
| **LITERACY: grammar, spelling, punctuation** | Makes repeated grammatical or syntactical errors. Frequently misspells homonyms. | Makes disruptive grammatical/  syntactical errors such as run-ons, fragments, unintelligible sentences. | Writes generally correct prose; occasionally fails to catch minor grammatical errors. | Proofreads well enough to eliminate most grammatical errors; may have minor problems with punctuation or usage. | Makes virtually no grammatical or syntactical errors. Establishes credibility with the audience. | 4 |
| **AUDIENCE: "you" attitude; awareness of reader's needs** | Lacks audience awareness. Is rude, hostile, discourteous, or insulting to the reader. | Writer-focused; lacks you attitude, positive emphasis, audience awareness. | Is polite; does not slight the reader. Uses positive emphasis. | Is courteous; addresses readers' needs and/or concerns; makes no unreasonable demands. | Reader-focused; addresses readers' questions and/or objections; creates goodwill. | 4 |
| **STRATEGY: purpose, effectiveness of approach, professionalism, means used.** | Presents a disorganized, unprofessional document. Projects a negative image of the writer and of the organization. | Is unclear about purpose; unclear topic sentences, arrangement of ideas, and transitions. | Is clear; correctly uses the "checklist" approach; makes no serious false step; gets the job done. | Employs good strategy; finds a fresh way of solving the problem; effective sequencing of ideas. | Adopts strategy to achieve desired outcome; clearly defines purpose and uses logical and/or emotional appeal effectively. | 3 |
| **STYLE:**  **a) tone, word choice**  \_ \_ \_ \_ \_ \_ \_  **b) document design** | a) Uses garbled style. Plagiarizes.  \_ \_ \_ \_ \_ \_ \_  b) Format interferes with readability. | a) Writes in a notably awkward manner: misuses words and idioms; uses slang; wordy; uses some borrowed language.  \_ \_ \_ \_ \_ \_ \_  b) Imbalanced or cluttered design. | a) Writes serviceable prose; uses active voice, strong, action verbs; rarely uses jargon or clichés.  \_ \_ \_ \_ \_ \_ \_  b) Readable format. | a) Writes clearly, concisely, and coherently; employs syntactical variety with general success. Creates a friendly, business-like, positive style.  \_ \_ \_ \_ \_ \_ \_  b) Design helps readers find the information they need. | a) Demonstrates a sophisticated grasp of the language; writes in a fluid manner; varies syntax and vocabulary; uses original language.  \_ \_ \_ \_ \_ \_ \_  b) Design helps readers understand and remember information. | 4  \_ \_ \_ \_ \_ \_ \_  4 |

One of the best reports produced. Only a few minor issues. I gave you a 98. Very nice work! Showed a lot of effort.