Activision Blizzard, Inc.
Form 10-Q
November 09, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the Quarterly Period Ended September 30, 2011

OR

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

For the transition period from to

Commission File Number 1-15839

ACTIVISION BLIZZARD, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**95-4803544** (I.R.S. Employer Identification No.)
3100 Ocean Park Boulevard, Santa Monica, CA (Address of principal executive offices)	**90405** (Zip Code)

(310) 255-2000

(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 x No o

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 x No o

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. (Check one):

Large Accelerated Filer x	Accelerated Filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of the registrant s Common Stock outstanding at November 1, 2011 was 1,144,219,705.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

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CAUTIONARY STATEMENT

This Quarterly Report on Form 10-Q contains, or incorporates by reference, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements consist of any statement other than a recitation of historical fact and include, but are not limited to: (1) projections of revenues, expenses, income or loss, earnings or loss per share, cash flow or other financial items; (2) statements of our plans and objectives, including those relating to product releases; (3) statements of future economic performance; and (4) statements of assumptions underlying such statements. We generally use words such as outlook, forecast, will, could, should, would, to be, plans, believes, may, expects, intends, anticipates, estimate, future, positioned, potential, project, remain, scheduled, set to, subject to, upcoming and other similar expressions to help identify forward-looking statements. Forward-looking statements are subject to business and economic risk, reflect management s current expectations, estimates and projections about our business, and are inherently uncertain and difficult to predict. Our actual results could differ materially. Risks and uncertainties that may affect our future results include, but are not limited to, sales levels of Activision Blizzard s titles, increasing concentration of titles, shifts in consumer spending trends, the impact of the current macroeconomic environment and market conditions within the video game industry, Activision Blizzard s ability to predict consumer preferences, including interest in specific genres such as first-person action and massively multiplayer online games and preferences among competing hardware platforms, the seasonal and cyclical nature of the interactive game market, changing business models including digital delivery of content, competition including from used games and other forms of entertainment, possible declines in software pricing, product returns and price protection, product delays, adoption rate and availability of new hardware (including peripherals) and related software, rapid changes in technology and industry standards, litigation risks and associated costs, protection of proprietary rights, maintenance of relationships with key personnel, customers, licensees, licensors, vendors, and third-party developers, including the ability to attract, retain and develop key personnel and developers that can create high quality hit titles, counterparty risks relating to customers, licensees, licensors and manufacturers, domestic and international economic, financial and political conditions and policies, foreign exchange rates and tax rates, and the identification of suitable future acquisition opportunities and potential challenges associated with geographic expansion, and the other factors identified in Risk Factors included in Part II, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010. The forward-looking statements contained herein are based upon information available to us as of the date of this Quarterly Report on Form 10-Q and we assume no obligation to update any such forward-looking statements. Although these forward-looking statements are believed to be true when made, they may ultimately prove to be incorrect. These statements are not guarantees of our future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and may cause actual results to differ materially from current expectations.

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Amounts in millions, except share data)

	At September 30, 2011	At December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 2,469	$ 2,812
Short-term investments	432	696
Accounts receivable, net of allowances of $221 million and $377 million at September 30, 2011 and December 31, 2010, respectively	139	640
Inventories	207	112
Software development	150	147
Intellectual property licenses	42	45
Deferred income taxes, net	507	648
Other current assets	136	299
Total current assets	4,082	5,399
Long-term investments	25	23
Software development	114	55
Intellectual property licenses	13	28
Property and equipment, net	167	169
Other assets	15	15
Intangible assets, net	138	160
Trademark and trade names	433	433
Goodwill	7,126	7,132
Total assets	$ 12,113	$ 13,414
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	$ 250	$ 363
Deferred revenues	487	1,726
Accrued expenses and other liabilities	542	838
Total current liabilities	1,279	2,927
Deferred income taxes, net	95	120
Other liabilities	168	164
Total liabilities	1,542	3,211
Commitments and contingencies (Note 14)		
Shareholders equity:		

Common stock, $0.000001 par value, 2,400,000,000 shares authorized, 1,142,796,893 and 1,382,479,839 shares issued at September 30, 2011 and December 31, 2010, respectively				
Additional paid-in capital		9,751		12,353
Less: Treasury stock, at cost, 0 and 199,159,987 shares at September 30, 2011 and December 31, 2010, respectively				(2,194)
Retained earnings		849		57
Accumulated other comprehensive income (loss)		(29)		(13)
Total shareholders equity		10,571		10,203
Total liabilities and shareholders equity	$	12,113	$	13,414

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(Amounts in millions, except per share data)

	For the Three Months Ended September 30, 2011	2010	For the Nine Months Ended September 30, 2011	2010
Net revenues				
Product sales	$ 369	$ 397	$ 2,197	$ 2,025
Subscription, licensing, and other revenues	385	348	1,151	994
Total net revenues	754	745	3,348	3,019
Costs and expenses				
Cost of sales product costs	138	194	650	765
Cost of sales massively multi-player online role-playing game (MMORPG)	59	61	181	168
Cost of sales software royalties and amortization	24	61	133	211
Cost of sales intellectual property licenses	16	33	69	105
Product development	133	118	390	361
Sales and marketing	115	110	264	291
General and administrative	104	113	333	253
Restructuring	3		24	
Total costs and expenses	592	690	2,044	2,154
Operating income	162	55	1,304	865
Investment and other income, net	3	14	7	15
Income before income tax expense	165	69	1,311	880
Income tax expense	17	18	325	229
Net income	$ 148	$ 51	$ 986	$ 651
Earnings per common share				
Basic	$ 0.13	$ 0.04	$ 0.84	$ 0.53
Diluted	$ 0.13	$ 0.04	$ 0.84	$ 0.52
Weighted-average shares outstanding				
Basic	1,140	1,212	1,151	1,230
Diluted	1,148	1,227	1,160	1,245
Dividends per common share	$	$	$ 0.165	$ 0.15

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Amounts in millions)

	For the Nine Months Ended September 30, 2011	2010
Cash flows from operating activities:		
Net income	$ 986	$ 651
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	124	51
Depreciation and amortization	77	97
Loss on disposal of property and equipment	1	
Amortization and write-off of capitalized software development costs and intellectual property licenses (1)	151	182
Stock-based compensation expense (2)	61	94
Excess tax benefits from stock option exercises	(21)	(11)
Changes in operating assets and liabilities:		
Accounts receivable	516	471
Inventories	(96)	(19)
Software development and intellectual property licenses	(181)	(238)
Other assets	170	218
Deferred revenues	(1,268)	(810)
Accounts payable	(117)	(60)
Accrued expenses and other liabilities	(301)	(243)
Net cash provided by operating activities	102	383
Cash flows from investing activities:		
Proceeds from maturities of investments	603	473
Payment of contingent consideration	(3)	(4)
Purchases of short-term investments	(325)	(681)
Capital expenditures	(47)	(76)
Increase in restricted cash	(18)	(35)
Net cash provided by (used in) investing activities	210	(323)
Cash flows from financing activities:		
Proceeds from issuance of common stock to employees	39	54
Repurchase of common stock	(524)	(613)
Dividends paid	(194)	(187)
Excess tax benefits from stock option exercises	21	11
Net cash used in financing activities	(658)	(735)
Effect of foreign exchange rate changes on cash and cash equivalents	3	30
Net decrease in cash and cash equivalents	(343)	(645)
Cash and cash equivalents at beginning of period	2,812	2,768
Cash and cash equivalents at end of period	$ 2,469	$ 2,123

(1) Excludes deferral and amortization of stock-based compensation expense.

(2) Includes the net effects of capitalization, deferral, and amortization of stock-based compensation expense.

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

For the Nine Months Ended September 30, 2011

(Unaudited)

(Amounts in millions)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock Shares	Treasury Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
Balance at December 31, 2010	**1,382**	**$**	**$ 12,353**	**(199)**	**$ (2,194)**	**$ 57**	**$ (13)**	**$ 10,203**
Components of comprehensive income:								
Net income						986		986
Unrealized appreciation on investments, net of taxes							2	2
Foreign currency translation adjustment							(18)	(18)
Total comprehensive income								970
Issuance of common stock pursuant to employee stock options and restricted stock rights	7		39					39
Stock-based compensation expense related to employee stock options and restricted stock rights			77					77
Dividends ($0.165 per common share) (See Note 13)						(194)		(194)
Shares repurchased (See Note 13)				(47)	(524)			(524)
Retirement of treasury shares	(246)		(2,718)	246	2,718			
Balance at September 30, 2011	**1,143**	**$**	**$ 9,751**		**$**	**$ 849**	**$ (29)**	**$ 10,571**

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Description of business and basis of consolidation and presentation

Description of Business

Activision Blizzard, Inc. is a worldwide online, personal computer (PC), console, handheld and mobile game publisher. The terms Activision Blizzard, the Company, we, us, and our are used to refer collectively to Activision Blizzard, Inc. and its subsidiaries.

The common stock of Activision Blizzard is traded on The NASDAQ Stock Market under the ticker symbol ATVI. Vivendi S.A. (Vivendi) owned approximately 63% of Activision Blizzard s outstanding common stock at September 30, 2011.

We maintain significant operations in the United States, Canada, the United Kingdom, France, Germany, Ireland, Italy, Sweden, Spain, the Netherlands, Australia, South Korea and China.

Basis of Consolidation and Presentation

Activision Blizzard prepared the accompanying unaudited condensed consolidated financial statements in accordance with the rules and regulations of the Securities and Exchange Commission for interim reporting. As permitted under those rules and regulations, certain notes or other information that are normally required by accounting principles generally accepted in the United States of America (U.S. GAAP) have been condensed or omitted if they substantially duplicate the disclosures contained in the annual audited consolidated financial statements. The year-end condensed balance sheet data was derived from audited financial statements but does not include all disclosures required by U.S. GAAP. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair statement of our financial position and results of operations in accordance with U.S. GAAP have been included in the accompanying unaudited condensed consolidated financial statements.

The accompanying unaudited condensed consolidated financial statements include the accounts and operations of Activision Blizzard. All intercompany accounts and transactions have been eliminated. The condensed consolidated financial statements have been prepared in conformity with U.S. GAAP. The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements. Actual results could differ from these estimates and assumptions.

Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

The Company considers events or transactions that occur after the balance sheet date, but before the financial statements are issued, to provide additional evidence relative to certain estimates or to identify matters that require additional disclosures.

2. Summary of significant accounting policies

Revenue Recognition

Revenue Arrangements with Multiple Deliverables

On January 1, 2011, we adopted amendments to an accounting standard related to revenue recognition for arrangements with multiple deliverables (which standard, as amended, is referred to herein as the new accounting principles). The new accounting principles establish a selling price hierarchy for determining the selling price of a deliverable and require the application of the relative selling price method to allocate the arrangement consideration to each deliverable in a multiple deliverables revenue arrangement. Certain of our revenue arrangements have multiple deliverables and, as such, are accounted for under the new accounting principles. These revenue arrangements include product sales consisting of both software and hardware deliverables (such as peripherals or other ancillary collectors items sold together with physical boxed software) and our sales of *World of Warcraft* boxed products, expansion packs and value-added services, each of which is considered with the related subscription

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services for these purposes. Our assessment of deliverables and units of accounting does not change under the new accounting principles.

Pursuant to the guidance of ASU 2009-13, when a revenue arrangement contains multiple elements, such as hardware and software products, licenses and/or services, we allocate revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its vendor-specific-objective-evidence (VSOE) if it is available, third-party evidence (TPE) if VSOE is not available, or best estimated selling price (BESP) if neither VSOE nor TPE is available. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy. If the arrangement contains more than one software deliverable, the arrangement consideration allocated to the software deliverables as a group is then allocated to each software deliverable using the guidance for recognizing software revenue.

As noted above, when neither VSOE nor TPE is available for a deliverable, we use BESP. We do not have significant revenue arrangements that require BESP for the three or nine months ended September 30, 2011. The inputs we use to determine the selling price of our significant deliverables include the actual price charged by the Company for a deliverable that the Company sells separately, which represents the VSOE, and the wholesale prices of the same or similar products, which represents TPE. The pattern and timing of revenue recognition for deliverables and allocation of the arrangement consideration did not change upon the adoption of the new accounting principles. Also, we do not expect the adoption of the new accounting principles to have a material effect on our financial statements in the periods after our initial adoption.

Product Sales

We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers and once any performance obligations have been completed. Certain products are sold to customers with a street date (*i.e.,* the earliest date these products may be sold by retailers). For these products, we recognize revenue on the later of the street date and the sale date. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection.

For our software products with online functionality, we evaluate whether those features or functionality are more than an inconsequential separate deliverable in addition to the software product. This evaluation is performed for each software product and any online transaction, such as a digital download of a title or product add-ons, when it is released.

When we determine that a software title contains online functionality that constitutes a more-than-inconsequential separate service deliverable in addition to the product, principally because of its importance to gameplay, we consider our performance obligations for this title to extend beyond the sale of the game. VSOE of fair value does not exist for the online functionality, as we do not separately charge for this component of the title. As a result, we recognize all of the software-related revenue from the sale of the title ratably over the estimated service period, which is estimated to begin the month after the later of the sale date and the street date of the title. In addition, we initially defer the costs of sales for the title (excluding intangible asset amortization), and recognize the costs of sales as the related revenues are recognized. Cost of sales includes manufacturing costs, software royalties and amortization, and intellectual property licenses costs.

We recognize revenues from *World of Warcraft* boxed product, expansion packs and value-added services, in each case with the related subscription service revenue, ratably over the estimated service periods beginning upon activation of the software and delivery of the related services. Revenues attributed to the sale of *World of Warcraft* boxed software and related expansion packs are classified as product sales and revenues attributable to subscriptions and other value-added services are classified as subscription, licensing and other revenues.

Revenues for software products with more-than-inconsequential separate service deliverables and *World of Warcraft* products are recognized over the estimated service periods, which range from a minimum of five months to a maximum of less than a year.

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For our software products with features we consider to be incidental to the overall product offering and an inconsequential deliverable, such as products which provide limited online features at no additional cost to the consumer, we recognize the related revenue from them upon the transfer of title and risk of loss of the product to our customer.

With respect to online transactions, such as online downloads of titles or product add-ons that do not include a more-than-inconsequential separate service deliverable, revenue is recognized when the fee is paid by the online customer to purchase online content, the product is available for download and is activated for gameplay. In addition, persuasive evidence of an arrangement must exist and collection of the related receivable must be probable.

Sales incentives and other consideration given by us to our customers, such as rebates and product replacement fees, are considered adjustments of the selling price of our products and are reflected as reductions to revenue. Sales incentives and other consideration that represent costs incurred by us for assets or services received, such as the appearance of our products in a customer s national circular ad, are reflected as sales and marketing expenses when the benefit from the sales incentive is separable from sales to the same customer and we can reasonably estimate the fair value of the benefit.

Subscription Revenues

Subscription revenues are derived from *World of Warcraft*, a game that is playable through Blizzard s servers on a subscription-only basis. After the first month of free usage that is included with the *World of Warcraft* boxed software, the *World of Warcraft* end user may enter into a subscription agreement for additional future access. Revenues associated with the sale of subscriptions via boxed software and prepaid subscription cards, as well as prepaid subscriptions sales, are deferred until the subscription service is activated by the consumer and recognized ratably over the subscription period. Revenue from internet gaming rooms in Asia is recognized upon usage of the time packages sold. Value-added service revenues associated with subscriptions are recognized ratably over the estimated service periods.

Licensing Revenues

Third-party licensees in Russia, China and Taiwan distribute and host Blizzard s *World of Warcraft* game in their respective countries under license agreements with Blizzard. We receive royalties from the licensees as a result. We recognize these royalties as revenues based on the end users activation of the underlying prepaid time, if all other performance obligations have been completed, or based on usage by the end user when we have continuing service obligations. We recognize any upfront licensing fee received over the term of the contracts.

With respect to license agreements that provide customers the right to make multiple copies in exchange for guaranteed amounts, revenue is generally recognized upon delivery of a master copy. Per copy royalties on sales that exceed the guarantee are recognized as earned. In addition, persuasive evidence of an arrangement must exist and collection of the related receivable must be probable.

Breakage Revenues

World of Warcraft boxed product sales and subscription revenues are recognized upon activation of the game. We analyze historical activation patterns over time to determine when the likelihood of activation ever occurring becomes remote. We recognize revenues from subscriptions that have not yet been activated, prepaid subscription cards, as well as prepaid subscription sales, when the likelihood of future activation occurring is remote (defined as breakage revenues).

Other Revenues

Other revenues primarily include licensing activity of intellectual property other than software to third-parties. Revenue is recorded upon receipt of licensee statements, or upon the receipt of cash, provided the license period has begun.

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3. Inventories

Our inventories consist of the following (amounts in millions):

	At September 30, 2011	At December 31, 2010
Finished goods	$ 143	$ 98
Purchased parts and components	64	14
Inventories	$ 207	$ 112

4. Intangible assets, net

Intangible assets, net consist of the following (amounts in millions):

	At September 30, 2011			
	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
Acquired definite-lived intangible assets:				
License agreements	3 - 10 years	$ 88	$ (77)	$ 11
Game engines	2 - 5 years	32	(32)	
Internally-developed franchises	11 - 12 years	309	(184)	125
Distribution agreements	4 years	18	(16)	2
Acquired indefinite-lived intangible assets:				
Activision trademark	Indefinite	386		386
Acquired trade names	Indefinite	47		47
Total		$ 880	$ (309)	$ 571

	At December 31, 2010			
	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
Acquired definite-lived intangible assets:				
License agreements	3 - 10 years	$ 88	$ (74)	$ 14
Game engines	2 - 5 years	32	(30)	2
Internally-developed franchises	11 - 12 years	309	(167)	142
Distribution agreements	4 years	18	(16)	2
Acquired indefinite-lived intangible assets:				
Activision trademark	Indefinite	386		386
Acquired trade names	Indefinite	47		47
Total		$ 880	$ (287)	$ 593

Amortization expense of intangible assets was $7 million and $22 million for the three and nine months ended September 30, 2011, respectively. Amortization expense of intangible assets was $21 million and $50 million for the three and nine months ended September 30, 2010, respectively.

The carrying amounts as of September 30, 2011 and December 31, 2010 in the tables above reflect a new cost basis for license agreements, game engines and internally-developed franchises due to impairment charges taken for the year ended December 31, 2010. The new cost basis represents the original gross carrying amount, less accumulated amortization and impairment charges of the impaired assets as of December 31, 2010.

At September 30, 2011, future amortization of definite-lived intangible assets is estimated as follows (amounts in millions):

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2011 (remaining three months)	$	48
2012		36
2013		18
2014		10
2015		8
Thereafter		18
Total	$	138

5. Income taxes

The income tax expense of $17 million for the three months ended September 30, 2011 reflected an effective tax rate of 10.7%. The effective tax rate of 10.7% for the three months ended September 30, 2011 differed from the statutory rate of 35.0%, primarily due to foreign income taxes levied at relatively lower rates, geographic mix in profitability, recognition of federal and California research and development credits and federal domestic production deductions and the beneficial impact from certain discrete items recognized in the quarter as we filed our tax returns.

For the nine months ended September 30, 2011, the tax rate was based on our projected annual effective tax rate for 2011, and also included certain discrete tax items recorded during the period. Our tax expense of $325 million for the nine months ended September 30, 2011 reflected an effective tax rate of 24.8%, which was slightly lower than the effective tax rate of 26.0% for the nine months ended September 30, 2010, primarily due to the recognition of federal research and development credits and lower taxes in certain states.

The overall effective income tax rate for the year could be different from the effective tax rate for the three and nine months ended September 30, 2011 and will be dependent, in part, on our profitability for the remainder of the year. In addition, our effective income tax rates for the remainder of 2011 and future periods will depend on a variety of factors, such as changes in the mix of income by tax jurisdiction, applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audits and other matters, and variations in the estimated and actual level of annual pre-tax income or loss. Further, the effective tax rate could fluctuate significantly on a quarterly basis and could be adversely affected by the extent that income (loss) before income tax expenses (benefit) is lower than anticipated in foreign regions where taxes are levied at lower statutory rates and/or higher than anticipated in our domestic region where taxes are levied at higher statutory rates.

The Internal Revenue Service (IRS) is currently examining the Company s federal tax returns for the 2009 tax year. The Company also has several state and non-U.S. audits pending Although the final resolution of the Company s global tax disputes is uncertain, based on current information, in the opinion of the Company s management, the ultimate resolution of these matters will not have a material adverse effect on the Company s consolidated financial position, liquidity or results of operations. However, an unfavorable resolution of the Company s global tax disputes could have a material adverse effect on the Company s business and results of operations in an interim period in which the matters are ultimately resolved.

6. Software development and intellectual property licenses

The following table summarizes the components of our software development costs and intellectual property licenses (amounts in millions):

	At September 30, 2011	At December 31, 2010
Internally developed software costs	$ 172	$ 142
Payments made to third-party software developers	92	60
Total software development costs	$ 264	$ 202
Intellectual property licenses	$ 55	$ 73

Amortization, write-offs and impairments are comprised of the following (amounts in millions):

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	Three months ended September 30, 2011	2010	Nine months ended September 30, 2011	2010
Amortization of capitalized software development costs and intellectual property licenses	$ 28	$ 50	$ 158	$ 217
Write-offs and impairments		1		16

7. Comprehensive income and accumulated other comprehensive income (loss)

Comprehensive Income

The components of comprehensive income were as follows (amounts in millions):

	Three months ended September 30, 2011	2010	Nine months ended September 30, 2011	2010
Net income	$ 148	$ 51	$ 986	$ 651
Other comprehensive income (loss):				
Foreign currency translation adjustment	(58)	48	(18)	15
Unrealized appreciation on investments, net of taxes			2	
Other comprehensive income (loss)	(58)	48	(16)	15
Comprehensive income	$ 90	$ 99	$ 970	$ 666

The components of accumulated other comprehensive income (loss) were as follows (amounts in millions):

	At September 30, 2011	At December 31, 2010
Foreign currency translation adjustment	$ (29)	$ (11)
Unrealized depreciation on investments, net of deferred income taxes of $0 at September 30, 2011 and $(1) at December 31, 2010		(2)
Accumulated other comprehensive income (loss)	$ (29)	$ (13)

Income taxes were not provided for foreign currency translation items as these are considered indefinite investments in non-U.S. subsidiaries.

8. Fair value measurements

Fair Value Measurements on a Recurring Basis

Financial Accounting Standards Board (FASB) literature regarding fair value measurements for financial and non-financial assets and liabilities establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities.

- Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets or other inputs that are observable or can be corroborated by observable market data.

- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

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The table below segregates all assets that are measured at fair value on a recurring basis (which means they are so measured at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date (amounts in millions):

		Fair Value Measurements at September 30, 2011 Using			
	As of September 30, 2011	**Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance Sheet Classification**
Financial assets:					
Money market funds	$ 2,329	$ 2,329	$	$	Cash and cash equivalents
U.S. treasuries with original maturities of three months or less	11	11			Cash and cash equivalents
U.S. treasuries and government agency securities	391	391			Short-term investments
ARS held through Morgan Stanley Smith Barney LLC	25			25	Long-term investments
Total financial assets at fair value	$ 2,756	$ 2,731	$	$ 25	

		Fair Value Measurements at December 31, 2010 Using			
	As of December 31, 2010	**Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance Sheet Classification**
Financial assets:					
Money market funds	$ 2,216	$ 2,216	$	$	Cash and cash equivalents
U.S. treasuries and foreign government bonds with original maturities of three months or less	332	332			Cash and cash equivalents
U.S. treasuries and government agency securities	672	672			Short-term investments
ARS held through Morgan Stanley Smith Barney LLC	23			23	Long-term investments
Foreign exchange contract derivatives	1		1		Other assets current
Total financial assets at fair value	$ 3,244	$ 3,220	$ 1	$ 23	

The following tables provide a reconciliation of the beginning and ending balances of our financial assets and financial liabilities classified as Level 3 by major categories (amounts in millions) at September 30, 2011 and 2010, respectively:

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	Level 3			
	ARS (a)		Total financial assets at fair value	
Balance at January 1, 2011	$	23	$	23
Total unrealized gains included in other comprehensive income		2		2
Balance at September 30, 2011	$	25	$	25

	Level 3							
	ARS (a)		ARS rights from UBS (b)		Total financial assets at fair value		Other financial liabilities	
Balance at January 1, 2010	$	77	$	7	$	84	$	(23)
Total gains (losses) (realized/unrealized) included in investment and other income, net		7		(7)				13
Purchases of acquired sales, issuances and settlements		(61)				(61)		
Balance at September 30, 2010	$	23	$		$	23	$	(10)
The amount of total gains(losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2010	$		$		$		$	13

(a) Fair value measurements of the auction rate securities (ARS) have been estimated using an income-approach model (specifically, discounted cash-flow analysis). When estimating the fair value, we consider both observable market data and non-observable factors, including credit quality, duration, insurance wraps, collateral composition, maximum rate formulas, comparable trading instruments and the likelihood of redemption. Significant assumptions used in the analysis include estimates for interest rates, spreads, cash flow timing and amounts, and holding periods of the securities. Assets measured at fair value using significant unobservable inputs (Level 3) represent 1% of our financial assets measured at fair value on a recurring basis at September 30, 2011.

In June 2010, we sold the remainder of our ARS held with UBS at par and recognized a gain of $7 million, which is included within investment and other income, net in our condensed consolidated statement of operations for the nine months ended September 30, 2010.

(b) ARS rights from UBS represented an offer from UBS providing us with the right to require UBS to purchase our ARS held through UBS at par value. To value the ARS rights, we considered the intrinsic value, time value of money, and our assessment of the credit worthiness of UBS. We exercised our ARS rights with UBS on June 30, 2010 and recorded a loss of $7 million, which is included within investment and other income, net in our condensed consolidated statement of operations for the nine months ended September 30, 2010.

Foreign Currency Forward Contracts Not Designated as Hedges

We transact business in various currencies other than the U.S. dollar and have significant international sales and expenses denominated in currencies other than the U.S. dollar, subjecting us to currency exchange rate risks. To mitigate our risk from foreign currency fluctuations we periodically enter into currency derivative contracts, primarily swaps and forward contracts with maturities of twelve months or less, with Vivendi as our principal counterparty. We do not hold or purchase any foreign currency contracts for trading or speculative purposes and we do not designate these forward contracts or swaps as hedging instruments.

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Accordingly, we report the fair value of these contracts in our condensed consolidated balance sheet with changes in fair value recorded in our condensed consolidated statement of operations. The fair value of foreign currency contracts is estimated based on the prevailing exchange rates of the various hedged currencies as of the end of the period.

Fair Value Measurements on a Non-Recurring Basis

We measure the fair value of certain assets on a non-recurring basis, generally annually or when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. For the nine-month period ended September 30, 2011, there were no impairment charges related to assets that are measured on a non-recurring basis.

The table below presents intangible assets that are not subject to recurring fair value measurement at December 31, 2010 (amounts in millions):

		Fair Value Measurements at December 31, 2010 Using			
	As of December 31, 2010	**Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Losses**
Non-financial assets:					
Intangible assets, net	$	$	$	$	$