Line-by-Line Tour: 2015
Intel® Financial Statements

CONTENTS

Introduction

Intel Corporation designs and manufactures advanced integrated digital technology platforms with microprocessors and chipsets as well as other hardware, software, and services. These platforms are used in a wide range of applications, such as PCs, servers, tablets, smartphones, automobiles, automated factory systems, and medical devices. Intel also develops and sells software and services primarily focused on security and technology integration.[1]

Intel is a publicly held company, meaning its common stock is traded on stock exchanges. Financial information about the company is freely available on the U.S. Securities and Exchange Commission's (SEC) web site (www.sec.gov) as well as Intel's investor relations web site (www.intc.com).

Here we take you on a line-by-line tour of Intel's financial statements as reported in its **2015 Form 10-K annual report** (all numbers are reported in millions). Along the way, we discuss related concepts central to the accounting behind what you see on the statements. We cover each of Intel's financial-statements: balance sheets, income statements, statements of cash-flows, and statements of stockholders' equity.

The goal of this tour is to help you further understand the financial statements and provide you a reference for interpreting other companies' financial statements.

U.S. GAAP

Intel's financial statements are in conformity with U.S. generally accepted accounting principles (U.S. GAAP).

We start the tour with Intel's balance sheet and a discussion of Intel's assets and related concepts.

1 Source: Intel's 2015 Form 10-K Annual Report, page 1.

Intel's Balance Sheet

INTEL CORPORATION
CONSOLIDATED BALANCE SHEETS

December 26, 2015 and December 27, 2014

(In Millions--Except Par Value)	2015	2014
Assets		
Current assets:		
Cash and cash equivalents	$ 15,308	$ 2,561
Short-term investments	2,682	2,430
Trading assets	7,323	9,063
Accounts receivable, net of allowance for doubtful accounts of $40 ($38 in 2014)	4,787	4,427
Inventories	5,167	4,273
Deferred tax assets	2,036	1,958
Other current assets	3,053	3,018
Total current assets	**40,356**	**27,730**
Property, plant and equipment, net	**31,858**	**33,238**
Marketable equity securities	**5,960**	**7,097**
Other long-term investments	**1,891**	**2,023**
Goodwill	**11,332**	**10,861**
Identifiable intangible assets, net	**3,933**	**4,446**
Other long-term assets	**7,735**	**6,505**
Total assets	**$ 103,065**	**$ 91,900**
Liabilities, temporary equity, and stockholders' equity		
Current liabilities:		
Short-term debt	$ 2,634	$ 1,596
Accounts payable	2,063	2,748
Accrued compensation and benefits	3,138	3,475
Accrued advertising	960	1,092
Deferred income	2,188	2,205
Other accrued liabilities	4,684	4,895
Total current liabilities	**15,667**	**16,011**
Long-term debt	**20,036**	**12,059**
Long-term deferred tax liabilities	**2,539**	**3,775**
Other long-term liabilities	**2,841**	**3,278**
Commitments and contingencies (Notes 17 and 25)		
Temporary equity	**897**	**912**
Stockholders' equity:		
Preferred stock, $0.001 par value, 50 shares authorized; none issued		
Common stock, $0.001 par value, 10,000 shares authorized; 4,752 issued and outstanding (4,752 issued and 4,748 outstanding in 2014) and capital in excess of par value	23,411	21,781
Accumulated other comprehensive income (loss)	60	666
Retained earnings	37,614	33,418
Total stockholders' equity	**61,085**	**55,865**
Total liabilities, temporary equity, and stockholders' equity	**$ 103,065**	**$ 91,900**

Intel's 2015 Form 10-K, page 67. www.sec.gov
See accompanying notes in the 10-K.

IFRS GAAP

International financial reporting standards (IFRS) do not specify the order for reporting. Under IFRS[1], companies may report assets from longer to shorter holding periods, non-current and current assets, respectively. Companies may also report liabilities and equities before assets.

1 IAS 1 ¶57.

Intel's Assets and Related Concepts

Assets are resources that are expected to provide future benefits and are owned or controlled by an entity because of past events. A balance sheet generally organizes assets according to their expected holding periods—the time expected to elapse between the date the asset is acquired and the date when it will be sold or expire (the point at which its benefits will be completely realized). This ordering is not meant to be precise. Intel orders its assets from shorter to longer expected holding periods. Cash generally has a shorter expected holding period than other assets, so it is the first asset listed on Intel's balance sheets. Inventories for resale to customers generally have a shorter expected holding period than land, factories, computers, and automobiles, so inventories are listed before property, plant, and equipment.

Cash and Cash Equivalents

Cash equivalents are short-term investments readily convertible to known amounts of cash and not significantly affected by interest rate fluctuations. Thus, they are highly liquid. **Liquidity** is the ease with which assets can be converted to cash through a market or negotiated sale. By contrast, Intel's wafer fabrication plants are extremely illiquid because they are highly specialized factories that cost billions of dollars each to build and thus, are seldom traded. While balance sheets distinguish cash from cash equivalents, users of financial statements generally refer to this line item as cash. That is, they treat cash equivalents as cash. We will follow this convention. Intel's accounting policies footnote states[1]:

> "We consider all liquid available-for-sale debt instruments with original maturities from the date of purchase of approximately three months or less to be cash and cash equivalents."

The original maturity of a debt security is the time between issuing a debt agreement and the date when the debt must be completely repaid with interest. For example, if Intel purchases a United States Treasury Bill with an original maturity of three months, the U.S. government must repay the money with interest within three months. Because there is a highly liquid active market for U.S. Treasury Bills, Intel can readily sell the debt to another party. In that case, the U.S. Treasury would pay the new holder of this security when the bill matures.

Often users want to know why cash balances change from year to year. Increases or decreases in cash balances can be good or bad news depending on the events that caused the changes and the expected future consequences of those events. There is so much interest in why cash changes, an entire statement is devoted to these changes—the statement of cash flows.

Short-Term Investments

Short-term investments are typically stocks or bonds expected to be held up to one year. The debt instrument investments section of Intel's accounting policies footnote states[2]:

> "Available-for-sale debt instruments with original maturities at the date of purchase greater than approximately three months and remaining maturities of less than one year are classified as short-term investments."

Thus, Intel expects to hold its short-term investments longer (up to one year) than its cash equivalents (three months or less). Companies purchase cash equivalents when they have excess cash today and anticipate needing cash in the very near future, within three months for Intel.

When items are not described in the footnotes, you need to interpret them from their context and name. For example, "marketable securities" is the second line item on Coca-Cola's balance sheet[3]. Marketable securities are not defined in Coca-Cola's accounting policies footnote, however, because these securities are described as "marketable" and are classified as current assets after cash and cash equivalents, we can reasonably conclude they represent a similar concept as "short-term investments" reported by Intel.

All companies report cash and cash equivalents, but they do not all report short-term investments. For example, none of the items reported on Walt Disney's balance sheet[4] resemble short-term investments. Disney did not disclose short-term investments, but this does not mean none were recognized in current assets. The company might have recognized them in other current assets.

IFRS GAAP

Under IFRS[1], companies may classify short-term investments as other financial assets.

1 IAS 1 ¶54.

1 Intel's 2015 Form 10-K, page 71.
2 Intel's 2015 Form 10-K, page 71.
3 Coca-Cola Company's 2006 Form 10-K, page 68.
4 Walt Disney Company's 2008 Form 10-K, page 63.

Some key lessons have emerged:

- When in doubt about the meaning of a financial statement line item, go to the company's accounting policies footnote in its annual report and look for a related subtitle.
- Companies often use synonyms to describe similar concepts and context helps identify these concepts.

Trading Assets

Trading assets, also know as **trading securities**, are investments in debt or equity securities purchased with the intent to generate profits on short-term price changes. Trading assets are similar to short-term investments and cash equivalents in that they are securities with relatively short holding periods. Cash equivalents and short-term investments are acquired to meet anticipated demands for cash in the near future. By contrast, trading assets are purchased to make a profit through trading. Trading assets are unusual for a company like Intel that is not a financial institution (banking, insurance, or mutual fund).

Accounts Receivable, Net of Allowance for Doubtful Accounts

For most companies, accounts receivable is mostly comprised of trade receivables, which are amounts owed by customers for goods or services purchased on account, rather than cash. But it can also reflect amounts owed by employees, suppliers, or other debtors who borrowed money from the company. The **allowance for doubtful accounts,** also called **allowance for bad debts**, is an estimate of amount owed at the reporting date that the company does not expected to collect because customers or other debtors might not meet their obligations.

Gross accounts receivable is the total amount owed by customers (and possibly others) at the reporting date. Net accounts receivable is the portion of gross accounts receivable the company expects to collect: it equals gross accounts receivable less the allowance for doubtful accounts. For example, Intel's 2015 balance sheet recognizes $4,827 gross accounts receivable, ($4,787 accounts receivable, net + $40 allowance for doubtful accounts). Intel expects to only collect the net accounts receivable of $4,787.

More key lessons:

- "Net" has several meanings in accounting and can not be interpreted out of context. For example, Intel reported a $360 net inrease in net accounts receivable during 2015 ($4,787 - $4,427).
- The first "net" indicates that some events increased accounts receivable during 2015 while other events decreased it, and $360 is the sum of these increases and decreases.
- Several events generally explain the net change in a balance sheet line item during a reporting period. For example, accounts receivable increases each time a company bills customers for delivered goods and decreases each time it collects cash from customers.
- The second "net" indicates that the $4,787 recognized on the balance sheet at the end of 2015 is gross receivables less the allowance for doubtful accounts.

Inventories

Inventories include tangible assets that companies buy or manufacture to sell to customers in exchange for cash or promised future payment (accounts receivable), as well as the raw materials and parts that will be included in manufactured products. The future benefits of inventories is that they can be sold to customers in exchange for cash or promised future payment.

A footnote in the inventories section features a table that classifies Intel's inventories according to stages in the production process.

Intel's Inventories

(in millions)	2015	2014
Raw materials	$ 532	$ 462
Work in process	2,893	2,375
Finished goods	1,742	1,436
Total inventories	$ 5,167	$ 4,273

Intel's 2015 Form 10-K, page 75.

At the end of 2015, Intel had $532 of raw materials available for production. It had assigned $2,893 of manufacturing costs to partially completed products (Work in process), and $1,742 of costs to finished goods that were available to sell to customers.

When interpreting footnotes, it is important to connect footnote numbers to financial statement numbers. In particular, the numbers in a footnote table's last row often match those reported elsewhere. For example, in the above footnote disclosure, the total inventory numbers in the last row of the table match those shown as inventories on Intel's balance sheet.

Deferred Tax Assets

Deferred tax assets represent future tax benefits, usually future tax deductions, that arise from timing differences between financial and tax reporting. The benefits associated with deferred tax assets represent tax breaks on future income taxes because of events that have already occurred. For example, Intel will get a tax deduction when it pays employees deferred compensation they have already earned but not received.

IFRS GAAP

Under IFRS[1], companies are required to report deferred tax assets and liabilities as non-current. Thus, working capital or current ratio analysis could differ under IFRS and U.S. GAAP.

1 IAS 1 ¶56.

Other Current Assets

Other current assets include such items as prepaid insurance, prepaid advertising, or supplies, where the benefits are expected to be realized within one year by converting the assets to cash or otherwise using them and realizing their benefits.

Total Current Assets

This is a subtotal of assets classified as current. Their benefits are expected to be realized within one year. Non-current assets' benefits are expected to be realized beyond one year.

IFRS GAAP

Under IFRS[1], companies classify assets as current when they expect to realize the benefits within their normal **operating cycle**—the time between the acquisition of assets and their realization in cash. When the normal operating cycle is not clearly identifiable, it is assumed to be twelve months.

1 IAS 1 ¶66 & ¶68.

Property, Plant, and Equipment, Net

Property, plant, and equipment (PP&E) are tangible assets a company purchases to support day-to-day operations, such as land, buildings, office furniture and equipment, store fixtures, factories and machinery. The property, plant, and equipment section of the Intel's accounting policies footnote describes Intel's PP&E at the end of 2015[5]:

(1) Land and buildings, $25,578

(2) Machinery and equipment, $48,459 and

(3) Construction in progress, $9,359

These are **historical costs**—amounts Intel paid for these assets when they were acquired. This total is subject to **depreciation**, which measures the extent to which the assets' benefits have been used up since they were acquired. Intel estimated that $51,538 of the $83,396 of historical cost had been used up by the end of 2015. Thus, Intel's *net* PP&E was $31,858 ($83,396 historical costs - $51,538 accumulated depreciation) at the end of 2015.

5 Intel's 2015 Form 10-K, page 75.

Accumulated depreciation is a **contra asset**, meaning it is deducted from another asset with which it is paired on the balance sheet. We say accumulated depreciation is a contra asset to property, plant, and equipment. Similarly, the allowance for bad debts is a contra asset to accounts receivable. You can think of contra assets as negative assets because they reduce total assets.

Because PP&E is recognized at historical costs less accumulated depreciation, the reported numbers likely differ from the amount Intel would receive if it were to sell these assets to unrelated parties—the assets' fair values.

Marketable Equity Securities

Marketable equity securities represents highly liquid securities listed on exchanges and thus can be readily bought or sold. A footnote in the available-for-sale-investments section of Intel's accounting policies states[6]:

> "We acquire these equity investments to promote business and strategic objectives. To the extent that these investments continue to have strategic value, we typically do not attempt to reduce or eliminate the equity market risks through hedging activities."

IFRS GAAP

Under IFRS[1], companies may classify marketable securities as other financial assets.

1 IAS 1 ¶54.

Other Long-Term Investments

Other long-term investments include debt and equity security investments in other companies' bonds or stock that Intel intends to hold for more than one year in the future.

Goodwill

Goodwill only appears on balance sheets when one company acquires another. Goodwill is the excess amount paid when acquiring another company over the fair value of the net assets acquired. Goodwill is an **intangible asset**, meaning a non-monetary asset that does not have physical, tangible substance.

More specifically, a company records goodwill when the consideration it pays for acquiring control over another company exceeds the fair value of the separable (identifiable) tangible and intangible assets it acquires. Separable intangible assets include intangible assets that can be sold without selling the entire company. Examples of separable intangible assets include patents, copyrights, trademarks, and customer lists.

Goodwill is an intangible asset, but it is not separable. You can think it as "everything else" acquired that can't be identified and sold separately. For example, goodwill includes a company's ability to invent, develop, and market innovative products.

Suppose Company A acquires Company B for $100 million cash. This is the total fair value of Company B's common stock on the acquisition date (its share price multiplied by the number of shares held by investors). An appraiser estimates that, at the acquisition date, the fair value of Company B's tangible assets is $25 million and the fair value of its intangible assets other than goodwill (such as patents, brands, and customer lists) is $45 million. At the time it acquires Company B, therefore, Company A recognizes $30 million of goodwill: the $100 million acquisition cost less $25 for identifiable tangibles and $45 for separable intangibles.

Note that Company B would not have recognized $30 of goodwill on its balance sheet. Also notice that the $30 goodwill valuation on Company A's balance sheet depends on Company B's stock price at the acquisition date. Goodwill valuations can increase dramatically when a company's share price increases dramatically. Thus, the timing of an acquisition can have a significant impact on the value of goodwill.

Under U.S. GAAP prior to 2002, goodwill was amortized along with other intangible assets. **Amortization** is similar to depreciation except that it pertains to intangible assets. In particular, accumulated amortization measures the extent to which the benefits associated with the intangible assets have been used up by the reporting date. Goodwill is no

6 Intel's 2015 Form 10-K, page 71.

longer amortized[7]. Instead, it continues to be recognized at its historical cost (the amount recorded when the acquisition occurred) unless the asset becomes impaired, meaning its estimated fair value falls below its historical cost.

Goodwill impairments can have a significant impact on a company's balance sheet. In April 2002, AOL/Time Warner took a $54 billion impairment related to the goodwill and intangibles recognized when Time Warner and America On Line merged in 2000. The original valuations of the related goodwill and other intangibles was largely attributable to the dramatic increases in asset valuations that occurred in the late 1990's. The $54 billion impairment reflects the financial consequences for AOL/Time-Warner of the subsequent decline in these valuations that occurred when the internet bubble burst.

While goodwill can be written down as assets become impaired, GAAP precludes writing up goodwill to its fair value when its fair value exceeds its historical cost.

IFRS GAAP

Similar to the current U.S. standard, under IFRS[1], goodwill is not amortized. Instead, it is regularly tested for impairment.

1 IFRS 3 ¶55.

Identified Intangible Assets, net

Intel discloses that its identified intangible assets include acquisition-related developed technology, customer relationships, brands, in addition to licensed technology and patents.[8] Generally under U.S. GAAP, intangible assets are purchased from third parties through a business combination or in separate transactions. When acquired through a business combination, accountants must determine whether intangible assets can be identified separately from goodwill. The criteria to be classified as an identified intangible asset are the asset must be separable from other assets (capable of being sold, transferred, licensed, rented, or exchanged) or arise from contractual or other legal rights.[9] Additionally, the asset's fair value must be reliably measurable. When these criteria are not met, the asset is implicitly included in goodwill. For example, Intel reports:[10]

> "As a result of our acquisition of McAfee during the first quarter of 2011, we recorded $3.6 billion of identified intangible assets."

Similar to property, plant, and equipment that's subject to depreciation and impairments; intangible assets are subject to amortization and impairments. Thus, the balance sheet reports identified intangible assets, net: historical cost net of accumulated amortization and impairments.

Other Long-term Assets

Other long-term assets could represent any collection of assets not included in more specific asset classifications listed elsewhere on the balance sheet. For example, Intel discloses that its other long-term assets includes non-marketable and other equity investments[11]. Because these assets are classified as long-term their benefits are expected beyond one or more years.

Total Assets

Total assets is the sum of all recognized assets: "Assets" in the balance-sheet equation[12].

Balance Sheet Equation

A	=	L	+	OE
Assets		Liabilities		Owners' Equity

7 FASB 350-20-35-1.
8 Intel's 2015 Form 10-K, page 76.
9 FASB Master Glossary.
10 Intel's 2012 Form 10-K, page 70.
11 Intel's 2015 Form 10-K, page 72.
12 Intel's 2015 balance sheet, Form 10-K, page 67 also recognizes "Temporary equity" that we ignore here and explain later.

Intel's Liabilities and Related Concepts

Liabilities are creditors' claims on the company's assets. Companies generally incur liabilities when they do something today, or discover they did something in the past, that indicates they are obligated to sacrifice economic benefits in the future to other entities (creditors) to meet an obligation.

Liabilities are typically organized on balance sheets according to when the obligation is expect to be met; where current liabilities are due within a year. Similar to its current assets, Intel's current liabilities are listed first among its total liabilities.

The riskiness of these creditors' claims can vary considerably depending on: (1) whether they are secured or unsecured and (2) whether they are subordinate to other creditors' claims in the event of bankruptcy and liquidation.

Creditors who lend money have a claim on the company's assets that can be secured or unsecured. For example, if the bank loans you money for a car, the bank will require a secured interest in your car, and the car is called **collateral**. The creditor can seize collateral if the borrower fails to pay the loan. When you take out a car loan, you own the car, but the bank can seize it if you fail to make your payments. Secured interests offer important protections for lenders. Without such protection, the interest rates on car loans would be much higher to compensate for the added risk of default. Banks would also be reluctant to make car loans to individuals if they think there is a high risk of not being repaid, or if the risk is too difficult to assess.

Collateral is used extensively for business loans. Buildings, equipment, receivables, and inventory are all used as collateral to secure commercial loans. For instance, Intel's "Concentrations of Credit Risk" footnote[13] indicates it sometimes requires collateral to reduce the risk that customers will not pay their bills.

When debt is unsecured, creditors have a claim on the unsecured assets. If the company goes bankrupt, it sells its unsecured assets and split the proceeds. This usually falls considerably short of meeting the company's outstanding obligations. In these situations, financial claims with seniority over other claims are paid first. Debt claims always have seniority over equity claims, and certain types of debt claims can have seniority over others. Provisions in debt agreements and bankruptcy laws often establish the seniority of debt claims.

Short-term Debt

Short-term debt represents amounts owed to financial institutions and other creditors that must be paid within one year of the date the debt was incurred.

Generally, short-term debt levels fluctuate greatly during the year, especially for companies with seasonal peak demands such as toy companies whose sales peak in October through December. These companies borrow heavily early in the year to finance production and repay these loans 6-9 months later after they collect cash from customers. Debt footnotes in annual reports often describe the extent to which companies borrow short-term during the year and the sources of this financing.

Intel recognized very little short-term debt relative to most companies because Intel has generated large quantities of cash from operations. Indeed, at the ends of 2015 and 2014 Intel had large reservoirs of short-term investments that it could liquidate to generate cash. As a result, unlike most companies, Intel likely borrows cash from creditors only when it can do so at extremely favorable rates.

Accounts Payable

Accounts payable is the amount owed to suppliers and other creditors for supplies and other resources purchased on account. In these arrangements, Intel, the debtor, recognizes accounts payable and the supplier-creditors recognize accounts receivable.

13 Intel's 2015 Form 10-K, page 92.

Intel's accounts payable balance at the end of 2015 is about the same as its short-term debt balances. Unlike short-term debt, Intel probably is not paying interest on accounts payable if it pays them in the near future.

Accrued Compensation and Benefits

Accrued compensation and benefits is the amount owed to employees because of services rendered, but not yet paid. More generally, liabilities are accrued when a company receives rights or services prior to paying for them. Most companies make promises to their employees for services rendered in the form of deferred bonuses, deferred commissions, pensions, or other benefits. In this regard, employees are creditors who hold risky claims on their companies' assets.

Accrued Advertising

Accrued advertising is the amount owed for advertising and promotional work that has already been delivered, but not yet paid. Several events explain the change in accrued advertising. For example, this liability increased when Intel received advertising benefits prior to paying for them and it decreased when Intel made related payments.

Deferred Income

Deferred income represents income Intel deferred when it made sales that did not meet its revenue recognition policy by the end of the reporting period. For example, when it shipped components to its distributors or when it sold software and services.

Deferred income is a very different kind of liability from those discussed thus far. For the earlier liabilities, Intel recognized the liability when it owed cash to creditors. By contrast, for the deferred income liability recognized for shipments of components to distributors, Intel has an obligation to accept returned merchandise and provide a cash refund or extinguish unpaid receivables. This type of liability typically arises when there is a higher than usual probability that merchandise will be returned or the company can't reliably estimate these returns. For the deferred income liability recognized for sales for software or services, Intel has an obligation to perform under the service and support agreements so the related revenue was deferred and recognized ratably over the performance period. More generally, deferred income arises when a company still has significant performance obligations under sales agreements or there is uncertainly regarding the ultimate settlement of these obligations, such as for product returns.

Other Accrued Liabilities

Other accrued liabilities include numerous liabilities accrued when a company receives rights or services prior to paying for them. For instance, Intel's other accrued liabilities might include obligations to pay royalties to licensors or to pay lease payments to lessors.

Total Current Liabilities

Liabilities are classified as current if obligations must be paid or otherwise fulfilled within one year. Creditors, shareholders, and financial analysts often examine a company's **working capital:** current assets less current liabilities. This computation is used to assess whether a company can generate enough cash from its current assets to meet its current liabilities during the upcoming year. As working capital decreases, the risk increases that the company will not meet its obligations, or will forego new opportunities unless it secures additional external financing.

Intel recognized $24,689 of working capital ($40,356 current assets - $15,667 current liabilities) at the end of 2015. This is a very healthy level of working capital.

IFRS GAAP

Under IFRS[1], companies classify liabilities as current when they expect to settle the liability within their normal **operating cycle**. When the normal operating cycle is not clearly identifiable, it is assumed to be twelve months.

1 IAS 1 ¶69 & ¶70.

Long-term Debt

Long-term debt consists of amounts owed on loans or other obligations for a fixed amount (**principal**), not including interest, by a maturity date one or more years from the date the loan was issued. Examples include mortgages, banks loans, and bonds. Relative to most companies, Intel has very little long-term debt. Intel has not needed much debt financing because it has generated so much cash from operations.

Not all long-term obligations are recognized as long-term debt. First, the portion of long-term debt due to be paid within one year may be disclosed as a current liability. Second, interest due on the long-term debt, but not yet paid, may be recognized as interest payable or other accrued liabilities. Moreover, not all long-term debt is recognized on balance sheets. For example, a company may have long-term obligations to make lease payments under a lease agreement for rented space. Even though the company has an obligation to make the payments, the lease may meet the criteria to be accounted for "off-balance sheet". However, in these situations, companies provide footnote disclosures of any significant off-balance sheet arrangements.

Long-term Deferred Tax Liabilities

Deferred tax liabilities represent expected future tax costs that arise from timing differences between financial and tax reporting. Often, deferred tax liabilities arise because something happened this year or in earlier years that caused taxes to be deferred (postponed) until future years. Both deferred tax liabilities and income taxes payable arise from events that have already occurred. However, in contrast to income taxes payable, deferred tax liabilities are related to future-years' tax forms rather than current or past years' forms.

Deferred tax liabilities often arise from government initiatives to promote economic activity. For example, in the past, the U.S. Federal government has attempted to stimulate the economy by passing laws that allow companies to recognize tax deductions for depreciation immediately, rather then having to wait to deduct it in future years. This reduced taxable income in the year the law passed, but increased it in later years. Thus, in effect, income taxes were deferred from the legislation year until future years. The legislation helped stimulate the economy the year it was passed because companies had more money to spend on their businesses.

Companies will only pay taxes in the future if they have taxable income. Deferred tax liabilities are thus an example of a contingent claim, or contingent liability, that governments' have on a company's assets. Contingent liabilities arise from prior events but their realization is contingent on future events. Thus, a company must have taxable income in future years to be obligated to pay the deferred tax liability.

IFRS GAAP

Under IFRS, companies often report provisions in their liabilities. **Provisions** are liabilities of uncertain timing or amount[1], such as a provision for warranty or product returns.

1 IAS 37 ¶10.

Other Long-term Liabilities

Other long-term liabilities represent long-term liabilities not recognized elsewhere.

Intel's Temporary Equity and Related Concepts

Temporary equity includes equity instruments for which redemption could be required at the option of the holder or upon the occurrence of events not solely within the control of the issuer.[14] Intel's temporary equity is related to convertible debt that has an equity component that is currently partly redeemable for cash (at the holder's option). This means the holder of the convertible debt could exchange the debt for cash and Intel shares.

Reclassifying this equity from permanent to temporary signals to investors that factors outside Intel's control will determine whether Intel continues to recognize this equity on its balance sheet. These financial instruments do not meet the definition of assets or liabilities and are classified outside of permanent owners' equity, often called the 'mezzanine" between liabilities and owners' equity.

This is a very unusual item. In fact, 2014 was the first time Intel recognized temporary equity on its balance sheet.

14 FASB 480-10-S99

Intel's Stockholders' Equities and Related Concepts

Stockholders' equity, also called shareholders' equity or owners' equity, represents the owners' residual claim on the company's assets. In the event of bankruptcy, creditors' claims are paid first and stockholders divide anything that remains. Rearranging the balance sheet equation emphasizes the residual nature of the owners' claims:

Rearranged Balance-Sheet Equation

A	-	L	=	OE
Assets		Liabilities		Owners' equity

Expressing the equation this way makes clear the value of the owners' equity recognized on the balance sheet equals the recognized value of the **net assets** (assets less liabilities).[15]

Preferred Stock

Preferred stock is a class of owners' equity that has priority over common stockholders' claims. Balance sheets recognize the historical value of the net resources contributed in exchange for the preferred stock outstanding at the reporting period (resources received such as cash, net of obligations assumed), adjusted for stock repurchases.

Preferred stock has features of both debt and owners' equity; some companies classify it as debt and others as owners' equity. In the event of bankruptcy and liquidation, preferred stock has priority over common stockholders' claims but is subordinate to debt claims. Preferred stock generally pays a guaranteed dividend that resembles interest. Preferred stock owners, however, do not have voting rights and thus exercise no control over the business.

Intel recognized $0 preferred stock at the ends of 2015 and 2014, respectively. You might be wondering why Intel would include this line item since it has zero balances both years. The reason is balance sheets also report the number of **shares authorized**, meaning the maximum shares that could be issued if Intel chose to do so (50 million at the end of 2015). Corporate charters specify the number of authorized preferred and common shares.

The **shares issued** (preferred or common) refers to the number of shares a company has distributed to shareholders in exchange for cash or other resources. The **shares outstanding** are the number of shares that are currently owned by shareholders. The shares issued and outstanding differ when companies buy back shares from shareholders and hold them for subsequent reissuance. Shares bought back and held for reissuance are called **treasury shares**. Shares that are bought back and retired are no longer considered issued. Intel retires common shares it buys back and thus its common shares issued and outstanding are the same.

Intel's balance-sheet reports its preferred stock has a $0.001 par value. A note in parenthesis near the top left corner of Intel's balance sheet states all amounts are expressed in millions, except par values. Thus, the par value of the preferred stock is 1/10 of a penny per share. This is also the par value of Intel's common stock.

Par value is a nominal value assigned to stock in the corporate charter and printed on the face of each share of stock. Not all states require companies to assign par values. Stock that does not have a par value is called non-par stock. Do not spend much time trying to understand the concept of par value. It is mostly a historical artifact that has limited legal significance and no economic significance. This said, you will likely see the terms par value and non-par value frequently in financial statements.

IFRS GAAP

Under IFRS[1], equity capital is disaggregated into various classes, such as paid-in capital and share premium. IFRS companies commonly report **share capital** rather than preferred or common stock and **share premium** rather than additional paid-in capital.

1 IAS 1 ¶78.

15 Intel's balance sheet, 2015 Form 10-K, page 67 also recognizes "Temporary equity" that we ignore here and explained earlier.

Common Stock

Common stock is a basic class of owners' equity and subordinate to any preferred stock issued by the company. Balance sheets recognize the historical value of the net resources contributed in exchange for the common stock outstanding at the reporting period (resources received such as cash, net of obligations assumed), adjusted for stock repurchases.

Common stock entitles holders to voting rights on select corporate decisions and to share in the company's earnings via dividend payments or capital gains. **Dividends** are distributions (usually cash) to shareholders. **Capital gains** are increases in share prices beyond their historical cost. For example, if an investor buys a share of common stock for $100, receives a $30 dividend, and sells the stock for $150, she will earn a $50 capital gain ($150 proceeds - $100 original investment). She will earn a total of $80: $30 dividend plus $50 capital gain.

Common stock is the most junior claim on the company's assets, meaning in the event of liquidation, debt and preferred stock claims have priority. Preferred stock dividends also have a priority over common stock dividends.

When stock, either common or preferred, has an assigned par value, the par value and the excess over par value of the net resources contributed in exchange for the stock is recognized separately. The excess over par is called **paid-in capital**, additional paid-in capital, or contributed capital in excess of par. Intel does not disclose the separate amounts, but rather reports the combined par value and capital in excess of par value (paid-in capital).

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) sums the effects of income that standard setters have decided not to include in net income. Other comprehensive income (loss) is one of the two subcomponents of comprehensive income.

Comprehensive income is a broad performance measure that reflects the effects of all events and transactions that affect owners' equity, except those arising from transactions involving the owners. Comprehensive income is defined as net income plus other comprehensive income:

Comprehensive Income Equation

Comprehensive Income = Net Income + Other Comprehensive Income

Net income is the famous "bottom line" on income statements discussed frequently in the press. If you hear someone mention income without specifying the type of income they are referring to, you can be pretty confident that they are referring to net income.

Other comprehensive income (OCI) is income not included in net income. Standard setters have not specified formal criteria to determine when items should be included in other comprehensive income. So far they have only allowed this category to include changes in the values of assets and liabilities during the period that satisfy three conditions:

(1) Valuation changes due to economic factors are not controlled or influenced by the company, such as interest rates, currency exchange rates, and stock prices;

(2) Company can inadvertently profit from these valuation changes when carrying out its primary business activities, but it can not be in the business of intentionally profiting from them; and

(3) Revalued assets and liabilities are still on the balance sheet at the end of the period.

For example, suppose ABC Company, a retail car dealer, purchases $100,000 of IBM stock at the beginning of 2014. The stock is classified as available-for-sale investments because

IFRS GAAP

Under IFRS[1], companies report **reserves** rather than accumulated other comprehensive income.

1 IAS 1 ¶54.

IFRS GAAP

Under IFRS[1], companies report **profit or loss** rather than net income(loss).

1 IAS 1 ¶82.

it was purchased with the intent of selling the stock at a future date if the company needs cash. ABC recognizes $100,000 of marketable securities when it purchases the stock. At the end of 2014, ABC had not sold the IBM stock and the stock's market value had increased to $110,000. ABC thus has a $10,000 pretax gain on the stock during 2014. This has three consequences for ABC's balance sheet:

(1) ABC increases marketable securities from $100,000 to $110,000 at the end of 2014. Thus, this asset is recognized at its fair value.

(2) Assuming a 40% tax rate, the deferred income tax liability increases by $4,000. This is the governments' contingent claim on the $10,000 gain. If ABC sells the IBM shares in the future for a $10,000 pretax gain and ABC has taxable income (e.g., other losses do not offset the gain), it will owe the government $4,000 in taxes.

(3) Accumulated other comprehensive income increases by $6,000. This represents the owners' claim on the $10,000 gain, net of taxes. More generally, accumulated other comprehensive income at a reporting date is the total other comprehensive income accumulated by that date on assets and liabilities still on the balance sheet on that date.

Thus, the pretax gain has a $10,000 impact on the asset side of the balance sheet (to marketable securities) that is "balanced" by two consequences on the equities side of the balance sheet ($4,000 increase to the deferred tax liability + $6,000 increase to accumulated other comprehensive income). The government and ABC's owners are both better off because of the increase in IBM's share price.

The $10,000 gain is called an unrealized gain. Gains or losses are realized when assets are sold and unrealized until then. As we saw in the example, **unrealized gains or losses** associated with the available-for-sale investments accumulate in other comprehensive income until the assets are sold. **Realized gains or losses** when the assets are sold are recognized in net income.

Retained Earnings

Retained earnings is the cumulative earnings that have not been distributed to owners. For most companies, retained earnings is accumulated net income (regular income) less accumulated dividends declared to shareholders.

Let's look at the effect of net income on retained earnings. Suppose, for example, DEF Company sells cars to customers for $100 million cash during 2014 and the total cost associated with these sales is $60, including the cost to purchase, store, display, and sell the cars. DEF will recognize $40 of income before taxes for 2014 ($100 - $60). If the income tax rate is 40%, DEF will pay $16 of income taxes and recognize $24 of net income ($40 - $16). Here net means net of income taxes. The $24 of net income increases both owners' equity and net assets by $24. The $24 increase in owners' equity is recognized in retained earnings. This represents the increase in the recognized value of the owners' claim associated with the 2014 net income.

Notice that shareholders' equity increases when net income is positive and decreases when net income is negative (a loss). Thus, retained earnings can be negative, especially for start-up companies that accumulate losses for several years before becoming profitable.

For some companies, including Intel, other items besides net income and declared dividends can affect retained earnings. For example, retained earnings can decrease when companies buy back their own stock from shareholders at prices that exceed the prices the shares were originally issued.

Total Stockholders' Equity

Total stockholders' equity, also called total owners' equity or shareholders' equity, is the accounting or **book value** of the owners' claims at year-end, which generally differ from their fair values (also called market values).

For example, the stock-market value of Intel's stockholders' claims at the end of 2015, which is generally regarded as a reliable measure of fair value, was approximately $154 billion. The **market value** is estimated by multiplying the $32.50 share price at year-end by the 4,752 million shares outstanding as reported on the balance sheet. This is considerably more than the $61 billion recognized on Intel's balance sheet as total stockholders' equity—the **book value**. Why does the book values of Intel's owners' equity differ so dramatically from its fair market value (approximately $61 versus $154 billion)? The key is the market value of Intel's assets.

Assuming book and market values of Intel's liabilities are the same, which is reasonable, the market value of Intel's assets can be derived from the balance sheet equation: Assets = Liabilities + Owners' Equity. Thus, the market value of Intel's assets is $196 billion ($41 liabilities plus $154 owners' equity). There are two reasons why the fair value of Intel's assets is approximately $93 billion more than the book value ($196 - $103): several assets are not recognized on the balance sheet and others are recognized at historical costs that are considerably less than their fair values, in conformity with GAAP.

For example, Intel recognizes its property, plant, and equipment at historical cost adjusted for depreciation and, in particular, Intel does not write these assets up to their fair values when the fair values exceed the historical cost adjusted for depreciation. In addition, GAAP precludes Intel from recognizing the fair value of its patents on its balance sheets because these values are difficult to estimate reliably. As a result of GAAP's recognition criteria, the book values of Intel's assets and owners' equity are considerably smaller than their fair values.

The opposite can also be true. When assets are overstated on the balance sheet relative to their fair values, owners' equity is generally overstated. This is precisely what happened in the Worldcom accounting scandal reported in 2002. Worldcom reported that its assets and owners' equity were overstated by nearly $4 billion relative to what they should have been if Worldcom had conformed to GAAP. More precisely, the assets and retained earnings were overstated by $4 billion because Worldcom had reported excessive net income in prior years.

Total Liabilities and Stockholders' Equity

Total liabilities and stockholders' equity is the sum of the right side of the balance-sheet equation, which is also equal to total assets on the left side of the equation.[16]

Balance Sheet Equation

A	=	L	+	OE
Assets		Liabilities		Owners' Equity

16 Intel's balance sheet, 2015 Form 10-K, page 57 also recognizes "Temporary equity" that we ignore here and explained earlier.

Intel's Income Statement

INTEL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

Three Years Ended December 26 2015

(In Millions--Except Per Share Amounts)	2015	2014	2013
Net revenue	**$ 55,355**	**$ 55,870**	**$ 52,708**
Cost of sales	20,676	20,261	21,187
Gross margin	**34,679**	**35,609**	**31,521**
Research and development	12,128	11,537	10,611
Marketing, general and administrative	7,930	8,136	8,088
Restructuring and asset impairment charges	354	295	240
Amortization of acquisition-related intangibles	265	294	291
Operating expenses	**20,677**	**20,262**	**19,230**
Operating income	**14,002**	**15,347**	**12,291**
Gains (losses) on equity method investments, net	315	411	471
Interest and other, net	(105)	43	(151)
Income before taxes	**14,212**	**15,801**	**12,611**
Provision for taxes	2,792	4,097	2,991
Net income	**$ 11,420**	**$ 11,704**	**$ 9,620**
Basic earnings per common share	**$ 2.41**	**$2.39**	**$1.94**
Diluted earnings per common share	**$ 2.33**	**$2.31**	**$1.89**
Weighted average shares outstanding			
Basic	**4,742**	**4,901**	**4,970**
Diluted	**4,894**	**5,056**	**5,097**

Intel's 2015 Form 10-K, page 65. www.sec.gov
See accompanying notes in the 10-K.

Intel's Revenue and Related Concepts

Revenues are changes in owners' equity that arise from increases in **net assets** (assets - liabilities) during a reporting period associated with delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing or central operations. Generally revenues pertain to inflows from customer sales.

Revenues are usually recognized when goods or services are exchanged for cash or claims to cash (accounts receivable). For example, when a company sells a product to a customer for $100 cash (and meets its criteria for recognizing revenue), it recognizes $100 of revenue and $100 of cash. The balance sheet balances: (1) net assets increase by $100 because cash increases by $100; and (2) owners' equity increases by $100 because revenues increase by $100.

Companies do not always recognize revenues when they receive cash from customers or bill customers. For instance, when Intel delivers products to distributors and is concerned the products will be returned or the price will eventually be discounted, Intel's revenue recognition policy[1] is to defer recognizing revenue until the distributor sells the goods to its customers. In a hypothetical example, if Intel sells microprocessors to distributors in these situations for $50 on account, it would recognize a $50 increase in both accounts receivable (an asset) and deferred income to distributors (a liability)[2]. Net assets do not increase because the $50 increase in an asset (cash) is offset by the $50 increase in

1 Intel's 2015 Form 10-K, page 77.
2 Although not part of this deferred revenue example, Intel would also defer related cost of sales.

a liability (deferred income). Intel would recognize revenue in these situations when distributors sell the products to their customers. At that time, Intel would decrease deferred income to distributors by $50 and increase revenue by $50.

Net Revenues

Net revenues are gross revenues adjusted for product returns, early payment discounts, and possibly price-protection discounts. Its also called **net sales** or **turnover**. Like most companies, Intel does not disclose gross sales or revenue adjustments. However, Intel does disclose the source of its revenues—its key customers[3].

> "Hewlett-Packard Company, our largest customer in 2014, separated into HP Inc. and Hewlett Packard Enterprise Company on November 1, 2015. In 2015, these entities collectively accounted for 18% of our net revenue (18% in 2014 and 17% in 2013) ... "

Intel also discussed net revenues in the results of operations section of the Management's Discussion and Analysis (**MD&A**)[4].

> "For full year 2015, our net revenue of $55.4 billion was down 1% from 2014, operating income of $14.0 billion, was down 9% from 2014, and diluted earnings per share of $2.33 were up 1% from 2014. CCG [Client Computing Group] net revenue was down 8% as we continued to see weakness in the macroeconomic environment and, in particular, the PC market as we were coming off of a strong growth rate in the second half of 2014 with the Microsoft Windows XP refresh. We continue to see growth in DCG [Data Center Group], with net revenue up 11% and platform unit sales and average selling prices up 8% and 3%, respectively."

Management's discussion and analysis (MD&A) sections of annual reports are not audited; but they provide valuable information for interpreting financial statements.

Intel's Expenses and Related Concepts

Expenses are changes in owners' equity that arise from decreases in **net assets** (assets - liabilities) during a reporting period associated with inventing, developing, producing, and delivering goods and services, or performing other activities central to the company's operations. For example, when a company pays an employee $200, it recognizes a $200 expense and decreases cash by $200. The balance sheet balances: (1) net assets decrease by $200 because cash decreases by $200; and (2) owners' equity decreases by $200 because expenses increase by $200.

Increasing expenses decreases net income, which decreases owners' equity and thus decreases net assets. But, not all decreases in net assets give rise to expenses, only those associated with performing activities central to the company's operations.

Cost of Sales

Cost of sales, also known as **cost of goods sold,** is an expense attributable to sales of a company's goods or services. When a sale is recognized as revenue, cost of sales is recognized as an expense. To the extent possible, cost of sales reflects costs of activities or events directly related to sales. Direct costs includes the cost of materials used in manufacturing the goods and other direct costs, such as production labor costs, used to create the goods or services. Cost of sales doesn't include indirect costs such as sales and marketing costs.

Inventoried costs associated with sales are an example of costs directly related to sales. For a merchandising company that buys finished goods and sells them to customers,

3 Intel's 2015 Form 10-K, page 51.
4 Intel's 2015 Form 10-K, page 33.

inventoried costs primarily include the cost of purchasing and storing merchandise. For a manufacturing company, such as Intel, inventoried costs are costs added to inventory as goods are produced and are subsequently assigned to individual products through a process called **product costing**. These individual product costs are recognized as cost of sales with the product is sold.

Gross Margin

Gross margin, also known as **gross profit**, is revenues less cost of sales. Some companies do not report gross margin; but it is frequently computed by financial analysts and others when it is not disclosed. They also compute **gross margin percentage**, which is gross margin divided by revenues. Analysts follow this ratio very closely in most industries.

When a product's gross margin percentage increases, it means either the product's price increased, its cost decreased, or a combination of both. Price increases can signal a company has competitively superior products. Cost decreases can mean a company is controlling its costs either because of operating efficiencies or price cuts from suppliers or both. When a company's gross margin percentage increases, it generally means:

(1) some products' gross margin percentages are increasing, or

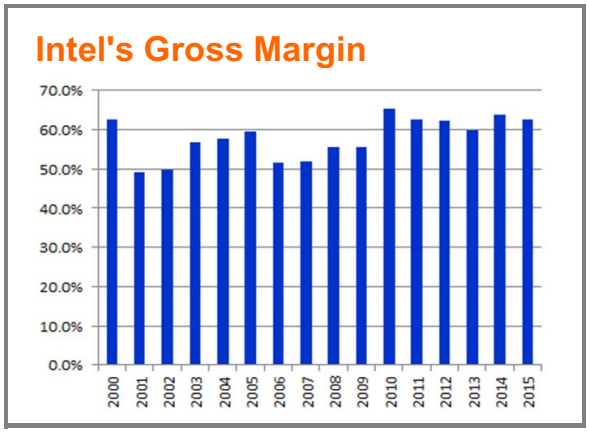
(2) product mix of sales have shifted towards products with higher gross margin: relatively more sales dollars are associated with products that have higher gross margins.

The opposite is true when gross margins decrease.

In the MD&A, Intel discussed its gross margin[5]:

> "Gross margin of 63% was down approximately one point from 2014, driven by higher platform unit costs ... and lower platform unit sales. These decreases were partially offset by higher platform average selling prices ..."

Intel's gross margin percentage from 2000-2015 reflects significant drops in 2001 when the Internet bubble burst and in 2006 just prior to the financial crisis. It has gradually recovered and has been fairly stable in recent years.



Intel's 2000-2015 Form 10-Ks.

Research and Development

Research and development (R&D) expenses are costs associated with creating new products or services—a critical success factor for most companies. The fact that Intel's R&D expense has increased most every year over the past two decades indicates Intel's commitment to innovation even though its revenues dropped significantly in 2001 and 2002.

5 Intel's 2015 Form 10-K, page 33.

Assuming the R&D expense was invested wisely, Intel demonstrated one of the advantages of having a strong balance sheet laden with highly liquid assets. Intel's stock price traded between $50-$80 for most of 2000 and between $15-$40 for most of 2001. Thus, if Intel had been forced to raise cash by issuing stock to support R&D and other investments during 2001, it would have had to issue at least twice as many shares as it would have had to issue in 2000 to raise the same cash.

Unlike Intel, in situations like this, often a company that does not have enough liquid investments to finance R&D internally must cut back on R&D expenses. Moreover, it may cut back to meet Wall Street's earnings expectations: cutting expenses increases net income. Yet, cutting R&D expenses can be very counterproductive because the company may be getting clobbered by competitors that have more innovative products.

Marketing, General and Administrative

Marketing, general, and administrative expenses, also called **selling, general, and administrative** or **SG&A**, pertain to a wide array of costs. These costs include, among other things, costs for advertising, commissions paid to the sales staff, salaries for employees not involved with research and development (R&D) or production, costs to use buildings and equipment not associated with production, and numerous other costs to run the company.

Restructuring and Asset Impairment Charges

Restructuring expenses pertain to costs associated with major changes in the business such as plant closings and layoffs. Generally, an impairment charge is an expense related to reducing the value of an asset to its lower fair value.

Amortization of Acquisition-Related Intangibles

Amortization expense for intangibles is similar to depreciation expense for tangible assets. Thus, amortization expenses measure the extent to which acquisition-related intangibles are used up during the reporting period.

Separable (identifiable) intangibles, such as trademarks and patents, acquired from other companies are recognized as assets. Prior to 2002, U.S. GAAP presumed these assets were used up and thus amortized. Starting in 2002, companies were required to classify intangibles as to whether they have definite or indefinite lives (will or will not get used up in the foreseeable future). Those with definite lives are amortized over the estimated useful life.

Operating Expenses

Operating expenses pertain to costs for ongoing activities that support a company's primary business purpose. Some companies, like Intel, report operating expenses as a subtotal. Interpreting it is straightforward since it is the sum of several line items that report specific types of operating expenses.

Intel's operating expense subtotal demonstrates income-statement's **signing conventions**. Notice the $20,677 Intel recognized as operating expenses for 2015 is a positive number even though it is an expense and is subtracted from gross margin to determine net income. GAAP does not specify signing conventions and, in particular, companies can sign expenses negatively or positively. Thus, to interpret the effects numbers have on net income, you need to know what they represent and how they are combined with other line items to derive net income.

For example, you need to know that the $20,677 of operating expenses in 2015 is the sum of the expenses immediately above it. Hence, we can conclude that Intel signs expenses positively and subtracts the total from gross margin to derive operating income. In contrast, other companies sign expenses negatively by putting them in parenthesis.

- You should always determine how numbers are signed and combined before you start analyzing statements.
- Companies can sign expenses negatively or positively. Thus, to interpret numbers, you need to know what they represent and how they are combined with other line items to derive net income.

Operating Income

Operating income, also known as **operating profit**, is gross margin less operating expenses. Operating income is closely followed by analysts because it indicates how well companies have performed in core business activities and profoundly impacts estimates of future profitability. In particular, operating income does not include more transient components of pre-tax income such as gains and losses on marketable securities, or interest income. Thus, it measures how well companies performed independent of the level of financing.

Intel's Gains, Losses, Other Income, and Related Concepts

Gains, losses, and other income are not as prominent on income statements as revenues and expenses. Companies often recognize these items without disclosing them by aggregating them, or netting them, with other line items.

Gains are changes in owners' equity that arise from *increases* in **net assets** (assets - liabilities) during a reporting period associated with events and circumstances peripheral to a company's primary business activities, are outside the company's control, and largely unpredictable when the assets or liabilities are originally recognized. For example, selling a corporate headquarters for more than its book value gives rise to a gain. The sale is peripheral to the company's business and the company had very little control over the market value of the building and could not predict the gain when the building was acquired.

An example will demonstrate how gains are computed. If ABC Company purchased a building for $10 (million) in 1995 and sold it in 2014 for $5 cash when its book value was $2 ($10 historical cost - $8 of depreciation), ABC would recognize a $3 gain in 2014 ($5 cash proceeds less the $2 book value). Recognizing the gain increased net assets by $3. Assets increased by $3 because $2 of property, plant, and equipment, net (the building) was replaced with $5 of cash. Owners' equity increased by $3 because a $3 gain was recognized in net income.

> Gains are similar to revenues in that they arise from increases in net assets, but revenues arise from events and circumstances related to customer sales—a core business activity—while gains arise from events and circumstances peripheral to companies' primary business activities and are largely unpredictable and outside the company's control.

IFRS GAAP

Under IFRS[1], **gains** meet the definition of income and may, or may not, arise in the course of ordinary activities. Gains represent increases in economic benefits and as such are no different in nature from revenue.

1 IASB Framework ¶75.

Losses are changes in owners' equity that arise from *decreases* in **net assets** during a reporting period associated with events and circumstances peripheral to a company's primary business activities, are outside the company's control, and largely unpredictable when the assets or liabilities are originally recognized. For the above example, if the proceeds from the sale were less than the $2 million book value of the building prior to the sale, the difference would be a loss.

> Losses are similar to expenses in that they arise from decreases in net assets, but expenses arise from activities central to the companies' operations and losses arise from events and circumstances peripheral to companies' primary business activities and are largely unpredictable and outside the company's control.

IFRS GAAP

Under IFRS[1], **losses** meet the definition of an expense and may, or may not, arise in the course of ordinary activities.

1 IASB Framework ¶79.

Unrealized gains or losses are associated with assets or liabilities the company still owns or is obligated to at the end of the reporting period. **Realized** gains or losses are associated with assets or liabilities the company sold or settled before the end of the reporting period.

Other income is changes in owners' equity that arises from *increases* in **net assets** during a reporting period that are not associated with revenues or gains, but rather from such

activities as dividends or interest received from investments. In contrast to gains and losses, other income is somewhat predictable.

Gains (Losses) on Equity Investments, Net

Gains (losses) on equity investments reflects the net gains and losses for investments accounted for under the equity and cost methods.

Intel discussed its accounting for investments in its accounting policies[6]:

> "We account for non-marketable equity and other investments for which we do not have control over the investee as:
>
> - *Equity method investments* when we have the ability to exercise significant influence, but not control, over the investee. Equity method investments include marketable and non-marketable investments. Our proportionate share of the income or loss is recognized on a one-quarter lag and is recorded in gains (losses) on equity investments, net.
> - *Non-marketable cost method investments* when the equity method does not apply.
>
> We record the realized gains or losses on the sale of equity method and non-marketable cost method investments in gains (losses) on equity investments, net."

This quote illustrates the two ways Intel accounts for its equity investments.

The **equity method** is applied when the company has significant influence over, but does not control, the investee. In this context, net is the sum of gains and losses; where a positive number represents a net gain and a negative number represents a net loss.

Companies' investments in other companies' common stock span the continuum from owning a few shares to owning entire companies. The risks assumed by investors and the degree of influence or control they exert over these companies generally depends on the percentage of outstanding shares investors own. However, actually determining when investors exert significant influence or control over investees can require substantial judgment. Still, investments are accounted for differently depending on how much influence or control investors have over investees: either the equity method or cost method.

Absent evidence to the contrary, investors that own 20-50% of the outstanding shares of investees are assumed to exert significant influence over, but not control, the investees and are required to use the equity method of accounting. Nevertheless, an investor with less than 20% would be required to use the equity method if they demonstrated significant influence in other ways such as having broad representation on the investee's board of directors or considerable participation in the investee's policy making processes.

Under the equity method of accounting, companies report their proportionate share of the investee's financial performance. On the balance sheet, the cost basis of the investment is adjusted up or down, proportionate to the percentage of stock ownership, as investee's owners' equity increases or decreases. On the income statement, the proportionate share of the investee's income is reported as equity method income.

The **cost method** is applied when the company owns less than 20% of the outstanding shares or otherwise does not exert significant influence over the investee. Such investments include equity securities classified as available-for-sale or trading assets.

Under the cost method, companies account for their investment independent from their proportionate share of ownership in the investee. On the balance sheet, the cost basis of the investment may be adjusted up or down to its fair market value (depending of the classification of the investment), which is, again, independent from changes in investee's owners' equity. On the income statement, income is recognized when dividends are recognized and when fair-value valuation adjustments are recognized.

6 Intel's 2015 Form 10-K, page 72.

For most companies, these equity related gains and losses pertain to only available-for-sale equity investments because very few companies classify their equity investments as trading assets.[7] This classification is based on management's intention:

- **Available-for-sale investments**: Management purchased securities for liquidity and thus plans to sell them when the company needs cash. Until these investments are sold, unrealized gains and losses are recognized in other comprehensive income. When sold, realized gains and losses are recognized in net income.
- **Trading assets**: Management purchased securities with a speculative intent. They expect the value of the shares to appreciate quickly. Companies actively buying and selling shares frequently have trading desks where traders speculate on very short-term opportunities (they buy and sell the same security within a very short time interval, perhaps a few hours or less). The portfolio of these shares is typically classified as trading assets. Some of Intel's securities are classified this way, but generally only banks and other financial institutions use this classification. Unlike available-for sale investments, both unrealized and realized gains and losses on trading assets are recognized in net income.

For example, let's hypothetically suppose:

1. Intel purchased shares of XYZ Company for $20 in 2014;
2. The fair value of the XYZ shares was $30 at the end of 2014;
3. Intel sold the XYZ shares for $15 in 2015.

Available-for-Sale Classification

First, let's assume Intel classified the XYZ shares as available-for-sale, meaning Intel purchased the shares for liquidity and plans to sell them when it needs cash. Here are the pretax balance-sheet and income-statement consequences of classifying the securities as available-for-sale:

- When the shares were purchased in 2014, Intel would recognize a $20 decrease in cash and $20 increase in other long-term investments on its balance sheet.
- At the end of 2014, Intel would recognize a $10 unrealized gain in accumulated other comprehensive income (loss) and $10 increase in other long-term investments (so the XYZ shares would be recognized at their $30 fair value) on its balance sheet.
- Importantly, the $10 unrealized gain would not be recognized in 2014 net income. In particular, it would not be included in gains (losses) on equity investments, net on its 2014 income statement.
- When the shares were sold for $15 in 2015, Intel would recognize a $5 loss ($20 original cost - $15 proceeds from sale) on its income statement as gains (losses) on other equity investments, net. This is the accumulated realized loss in value from the time the security was purchased for $20 until it was sold for $15.
- When the shares were sold, Intel would decrease other long-term investments by $30 (the fair value at the end of 2014) and increase cash by $15 on its balance sheet. This $15 net decrease in assets would be balanced by decreasing accumulated other comprehensive income (loss) by $10 (to reverse the unrealized gain recognized at the end of 2014) and recognizing a $5 loss in gain (losses) on equity securities, net.

Trading Assets Classification

Now, let's maintain the three assumptions above except assume Intel classified the shares as trading assets when they were purchased. This means Intel purchased the shares with

7 There are three classes of investments under U.S. GAAP: available-for-sale, trading securities, and held-to-maturity. Held-to-maturity are debt securities, such as bonds, with a date (maturity) when the debt must be completely repaid with interest. Intel most likely reports interest related to held-to-maturity debt as other income.

the intent to generate profits on short-term price changes. Here are the pretax balance-sheet and income-statement consequences of classifying the securities as trading assets:

- When the shares were purchased in 2014, Intel would recognize a $20 decrease in cash and $20 increase in trading assets on its balance sheet.
- At the end of 2014, Intel would record a $10 unrealized gain on its income statement as gains (losses) on other equity securities, net and $10 increase in trading assets (so that the XYZ shares would be recognized at their $30 fair value) on its balance sheet.
- Thus, in contrast to when the securities were classified as available-for-sale, when they are classified as trading assets, the $10 unrealized gain would be recognized in 2014 net income.
- When the shares were sold for $15 in 2015, Intel would recognize a $15 loss ($30 - $15) on its income statement as gains (losses) on other equity securities, net. This is the loss in value during 2015 (from a $30 fair value at the end of 2014, which is also the beginning of 2015, to $15 at the sales date in 2015).
- When the shares were sold, Intel would decrease trading assets by $30 and increase cash by $15 on its balance sheet. This $15 net decrease in assets would be balanced by recognizing a $15 loss in gains (losses) on other equity securities, net.

The same cumulative loss is recognized in gains (losses) on other equity securities, net over the two-year period regardless of the classification. For the trading assets, a $10 gain was recognized in 2014 and $15 loss in 2015 for an accumulated loss of $5. By contrast, for the available-for-sale securities, no gain was recognized in 2014 and only a $5 loss was recognized in 2015. In addition, the same comprehensive income (net income plus other comprehensive income) is recognized each year regardless of the classification: $10 gain in 2014 and $15 loss in 2015.

- In 2014, the $10 gain was recognized in net income for the trading asset classification and in other comprehensive income for the available-for-sale classification. Thus, for both classifications comprehensive income increased by $10 in 2014.
- In 2015, the $15 loss was recognized in net income for the trading asset classification. For the available-for-sale classification, the $15 loss had two components: a $5 loss was recognized in net income and a $10 loss was recognized in other comprehensive income (to reverse the $10 balance in accumulated other comprehensive income). Thus, for both classifications comprehensive income decreased by $15 in 2015.

Interest and Other, Net

Interest and other, net is the sum of interest income, interest expense and other income or expense not associated with core business activities. In this context, net is the sum of interest income plus interest expense; where a positive number represents a net interest income and a negative number represents a net interest expense. For example, Intel's footnote demonstrates the net effects of interest income and expense associated with this line item:

Intel's Interest and other, net

(in millions)	2015	2014
Interest income	$ 124	$ 141
Interest expense	(337)	(192)
Other, net	108	94
Total interest and other, net	$ (105)	$ 43

Intel's 2015 Form 10-K, page 115.

IFRS GAAP

Under IFRS[1], companies must report **finance costs**. Thus, it is common practice to use the captions finance income and finance costs rather than interest income and interest expense.

1 IAS 1 ¶82.

For 2015, a footnote indicates Intel recognized: $124 interest income, presumably associated with investments in government bonds and other interest-bearing investments; $337 of interest expense associated with debt; and $108 of other interest, net.

To interpret the positive $108 "Other, net" you need to determine the signing convention for this footnote by observing the positively signed "Interest income" and negatively signed "Interest expense". Thus, positive $108 "Other, net" indicates the net effect for these other items was more interest income than interest expense during 2015.

Income before Taxes

Income before taxes, or **profit before taxes**, as the name suggests, is the company's income before subtracting tax expense. In other words, income before taxes is revenue less expenses (other than tax expense) plus gains(losses) and other income. It is reported as a subtotal by all companies. Financial analysts often use income before taxes to estimate a company's effective tax rate, which is the tax expense divided by income before taxes.

Provision for Taxes

The provision for taxes is an expense associated with state, federal, and foreign income taxes only and does not include other taxes such as real estate taxes or sales taxes. This line is also called the **tax provision** or **tax expense**.

Income tax expense aggregates two components: (1) the current tax provision and (2) the deferred tax provision. In general, the **current tax provision** is that portion of the tax expense owed based on the taxable income recognized on the current year's income tax forms. However, it can also include amounts arising from settlements of disputes associated with prior years' forms. The **deferred tax provision** is that portion of the tax expense that is not currently owed due to timing differences between financial reporting and tax reporting.

For example, Intel's tax footnote indicates the portion of the tax provision associated with current and deferred taxes and further splits the current and deferred provisions for U.S. federal income taxes, state income taxes, and foreign income taxes:

Intel's Income Taxes

(in millions)	2015	2014	2013
Income before taxes:			
U.S.	$ 8,800	$ 11,565	$ 9,374
Non-U.S.	5,412	4,236	3,237
Total income before taxes	**$ 14,212**	**$ 15,801**	**$ 12,611**
Provision for taxes:			
Current:			
Federal	$ 2,828	$ 3,374	$ 2,730
State	40	38	68
Non-U.S.	842	969	716
	3,710	4,381	3,514
Deferred:			
Federal	(862)	(263)	(412)
Other	(56)	(21)	(111)
	(918)	(284)	(523)
Total provision for taxes	**$ 2,792**	**$ 4,097**	**$ 2,991**
Effective tax rate	**19.6%**	**25.9%**	**23.7%**

Intel's 2015 Form 10-K, page 116.

Deferred taxes arise from timing differences in balance-sheet recognition rules for financial reporting and tax reporting. If the balance sheets companies reported to shareholders were the same as the ones they reported to tax authorities, there would be no deferred provision.

IFRS GAAP

Under IFRS, a **provision** is a liability of uncertain timing or amount[1], such as a provision for warranty. In contrast, in the U.S. a provision typically refers to an expense, such as provision for taxes. Thus, provision refers to a balance at a point in time under IFRS; but to a change over a period in the U.S. **Beware of this significant difference: 'provision' must be interpreted in context.**

1 IAS 37 ¶10.

Generally, balance sheet differences between financial and tax reporting are associated with pretax income differences. The financial and tax reporting income recognition rules differ because they serve different purposes. For financial reporting, recognition criteria try to ensure income is a reliable performance measure. By contrast, for tax reporting recognition criteria can have multiple objectives, including establishing a fair and equitable basis for raising money to finance government services, redistributing wealth, and stimulating economic development. However, notwithstanding these differences, the recognition criteria also have many similarities because there is widespread belief that tax rules are more equitable when more profitable companies pay more taxes.

Net Income

Net income is revenue less expenses (including tax expense) plus gains(losses) and other income. It is also called **net profit** or **net earnings**, meaning net of taxes. If net income is negative, it is referred to as a net loss.

Often "net" is dropped with the understanding that the measure is net of taxes. Thus, when you see the terms earnings, income, and profit, you can generally assume they are net of taxes. By contrast, pretax measures are virtually always identified explicitly as pretax income, income before taxes, pretax earnings, earnings before taxes, pretax profits or profits before taxes.

Basic Earnings per Common Share

Basic earnings per share (**EPS**) is computed by dividing net income (or earnings) by the average daily shares outstanding during the year. The average daily shares outstanding, or equivalently the weighted average common shares outstanding, is the average of the shares outstanding at the end of each day during the year. For most companies, the weighted average can be approximated by averaging the shares outstanding at the start and end of the year.

Diluted Earnings per Common Share

Diluted earnings per share is computed by dividing net income (or earnings) by the *diluted* average daily shares outstanding during the year. This computation adjusts the denominator, shares outstanding, in the basic earnings per share computation for the possibility that outstanding stock options could be exercised by employees and others, increasing the common shares outstanding and thus diluting (decreasing) earnings per share.

Weighted Average Shares Outstanding

Basic

Basic weighted average shares outstanding is the number of shares used to compute the basic earnings per share. Because shares may be bought and sold on a daily basis, the weighted average differs from the number of shares issued and outstanding reported on the balance sheet.

Diluted

Diluted weighted average shares outstanding is the number of shares used to compute the diluted earnings per share. The diluted number of shares includes the basic shares outstanding plus the possible effect of exercising stock options, warrants, and other convertible securities.

For example, Intel reported 4,894 million shares as the diluted weighted average number of common shares used in its 2015 computation for diluted earnings per share. This weighted average assumes that 152 million incremental shares would be issued, for example, if employees and others exercise stock options (4,894 diluted - 4,742 basic shares outstanding).

Intel's Comprehensive Income Statement

INTEL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Three Years Ended December 26, 2015

(In Millions)	2015	2014	2013
Net income	**$11,420**	**$11,704**	**$9,620**
Other comprehensive income (loss), net of tax:			
Change in net unrealized holding gain (loss) on available-for-sale investments	(710)	577	1,181
Change in net deferred tax asset valuation allowance	(18)	(41)	(26)
Change in net unrealized holding gain (loss) on derivatives	157	(427)	(89)
Change in net prior service (costs) credits	7	(33)	18
Change in net actuarial valuation	128	(402)	520
Change in net foreign currency translation adjustment	(170)	(251)	38
Other comprehensive income (loss)	**(606)**	**(577)**	**1,642**
Total comprehensive income	**$10,814**	**$11,127**	**$11,262**

Intel's 2015 Form 10-K, page 66. www.sec.gov
See accompanying notes in the 10-K.

Intel's Comprehensive Income and Related Concepts

Like many companies, Intel reports two income statements: an income statement and a statement of comprehensive income. Alternatively, companies may combine the two into a single statement.

Comprehensive income, the broadest measure of a company's performance, captures the extent to which management increased net assets during a reporting period, excluding transactions with owners and accounting changes and restatements. Comprehensive income has two components: net profit (loss) and other comprehensive income.

- **Net profit (loss)** is revenues less expenses (including tax expense) plus gains less losses plus other income (expense). This is the famous "bottom line" on income statements. It is the accounting measure users of financial statements tend to place the most reliance on when assessing performance since many items recognized in net profit (loss) are recurring to varying degrees and thus useful when forecasting future performance.
- **Other comprehensive income** (**OCI**) is income that's not included in net profit (loss). It's comprised of items standard setters have decided not to include in net profits primarily because these items are mostly transient and result from factors largely outside a company's influence.

Comprehensive income and other comprehensive income are relatively new concepts in accounting. In fact, until recently comprehensive income and OCI were only disclosed in footnotes. Now, a comprehensive income statement is required, which gives more prominence to the components of OCI.

When analyzing the components of net profit (loss), investors try to calibrate the extent to which the components are transient, persistent, or somewhere in between. The fact that OCI tends to be transient and net profits (losses) tend to be recurring to varying degrees largely explains why investors and the media tend to focus on net profits. Still investors need to recognize that there can be significant differences in what's included in OCI across companies and across time for the same company.

U.S. GAAP

U.S. GAAP requires comprehensive income statements. Under both U.S. GAAP and IFRS, companies may report either two statements or a single statement that presents the components of net income and other comprehensive income. In the two statement format, the top line of the comprehensive income statement is net profit (loss) – the same as the bottom line on the income statement.

Net Income

Net income reported here is the same as reported on the bottom of the income statement. If Intel had used a single-statement format for comprehensive income, the top line items would include net revenue through net income.

Other Comprehensive Income (loss), net of tax

The other comprehensive income (OCI) portion of the comprehensive income statement reports the events that changed accumulated other comprehensive income (AOCI) during the year.[1] Generally, these include changes in the values of assets and liabilities during the period that satisfy three conditions:

(1) Valuation changes due to economic factors are not controlled or influenced by the company, such as interest rates, currency exchange rates, and stock prices;

(2) Company can inadvertently profit from these valuation changes when carrying out its primary business activities, but it can not be in the business of intentionally profiting from them; and

(3) Revalued assets and liabilities are still on the balance sheet at the end of the period.

Each line item of OCI is reported net of its tax effect, which differs from the reporting of net income, which includes a single, aggregate line item for tax expense.

Total Comprehensive Income

Total comprehensive income is the sum of net income plus other comprehensive income.

Comprehensive Income Equation

Comprehensive Income = Net Income + Other Comprehensive Income

1 See the discussion of Accumulated other comprehensive income (loss) for an example that would give rise to OCI, page page 16.

Intel's Statement of Cash Flows

INTEL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

Three Years Ended December 26, 2015

(In Millions)	2015	2014	2013
Cash and cash equivalents, beginning of year	**$ 2,561**	**$ 5,674**	**$ 8,478**
Cash flows provided by (used for) operating activities:			
Net income	11,420	11,704	9,620
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	7,821	7,380	6,790
Share-based compensation	1,305	1,148	1,118
Restructuring and asset impairment charges	354	295	240
Excess of tax benefit from share-based payment arrangements	(159)	(122)	(49)
Amortization of intangibles	890	1,169	1,242
(Gains) losses on equity investments, net	(263)	(354)	(425)
Deferred taxes	(1,270)	(703)	(900)
Changes in assets and liabilities:			
Accounts receivable	(355)	(861)	271
Inventories	(764)	(98)	563
Accounts payable	(312)	(249)	267
Accrued compensation and benefits	(711)	4	155
Income taxes payable and receivable	386	(286)	1,019
Other assets and liabilities	675	1,391	865
Total adjustments	7,597	8,714	11,156
Net cash provided by operating activities	**19,017**	**20,418**	**20,776**
Cash flows provided by (used for) investing activities:			
Additions to property, plant, and equipment	(7,326)	(10,105)	(10,711)
Acquisitions, net of cash acquired	(913)	(934)	(925)
Purchases of available-for-sale investments	(8,259)	(7,007)	(12,493)
Sales of available-for-sale investments	2,090	1,227	934
Maturities of available-for-sale investments	6,168	8,944	8,336
Purchases of trading assets	(11,485)	(14,397)	(16,718)
Maturities and sales of trading assets	13,372	13,165	13,677
Investments in loans receivable and reverse repurchase agreements	(2,550)	(150)	(200)
Collection of loans receivable and reverse repurchase agreements	2,116	117	50
Investments in non-marketable equity investments	(2,011)	(1,377)	(440)
Purchase of licensed technology and patents	(120)	(92)	(36)
Other investing activities	735	704	453
Net cash used for investing activities	**(8,183)**	**(9,905)**	**(18,073)**
Cash flows provided by (used for) financing activities:			
Increase (decrease) in short-term debt, net	(474)	235	(31)
Proceeds from government grants	105	104	129
Excess tax benefit from share-based payment arrangements	159	122	49
Issuance of long-term debt, net of issuance costs	9,476	-	-
Proceeds from sales of shares through employee equity incentive plans	866	1,660	1,588
Repurchase of common stock	(3,001)	(10,792)	(2,147)
Restricted stock unit withholdings	(442)	(332)	(293)
Payment of dividends to stockholders	(4,556)	(4,409)	(4,479)
Collateral associated with repurchase of common stock	325	(325)	-
Increase (decrease) in liability due to collateral associated with repurchase of common stock	(325)	325	-
Other financing	(221)	(199)	(314)
Net cash used for financing activities	**1,912**	**(13,611)**	**(5,498)**
Effect of exchange rate fluctuations on cash and cash equivalents	1	(15)	(9)
Net increase (decrease) in cash and cash equivalents	12,747	(3,113)	(2,804)
Cash and cash equivalents at the end of the year	**$ 15,308**	**$ 2,561**	**$ 5,674**
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest, net of capitalized interest	$ 186	$ 167	$ 204
Income taxes, net of refunds	$ 3,439	$ 4,639	$ 2,874

Intel's 2015 Form 10-K, page 68. www.sec.gov
See accompanying notes in the 10-K.

Intel's Cash-flow Statement and Related Concepts

Often financial analysts and others want to know why a company's cash balance changes from year to year. In fact, interpreting increases or decreases in cash can be good or bad news depending on the events that caused the changes and the expected future consequences of those events. Thus, understanding the changes help analysts better predict the company's future cash flows. Moreover, cash flows can differ from income so understanding the differences between income and cash further helps analysts assess the quality of net income and predict when income will be converted to cash. The purpose of the cash-flow statement is to disclose information to assist in these analyses and predictions.

At the big picture level, the cash-flow statement explains the change in a company's cash balance from the beginning of the year to the end of the year. The balance sheet reports these balances and the cash-flow statement reports why these balances changed—the activities that caused the cash balance to increase or decrease during the year. The explanation is presented in terms of operating, investing, and financing business activities.

Operating cash flows pertain to ongoing activities that support the company's primary business purpose including events associated with research and development, purchasing, manufacturing, sales, marketing, distribution, customer collections, and support.

Investing cash flows are primarily associated with buying or selling property, plant, and equipment, intangibles, and most types of investment securities. They also include cash flows associated with buying or selling complete companies.

Financing cash flows primarily result from transactions with owners (e.g., dividend distributions, stock issues, and stock repurchases), issuing debt, and repaying debt principal (but not interest, which is an operating cash flow).

With regards to cash-flow statements, U.S. GAAP defines operating activities as a residual concept to include all activities that do not meet the criteria to be classified as investing or financing activities. As a result, cash from operating activities also includes a few items that seem to have very little to do with operating activities such as income tax payments, interest payments, and interest and dividends received from investments. The decision to include these items in operating cash flows was extremely controversial. Those who opposed classifying them in operations argued that the classifications are inconsistent with those used on income statements: interest expense, tax expense, and interest and dividend income are not included in operating income on the income statement.

IFRS GAAP

Under IFRS,[1] interest and dividends received and paid may be classified as operating, investing, or financing. Taxes are classified as operating unless they can be specifically identified with financing or investing activities.

1 IAS 7 ¶31 & ¶35.

Under U.S. GAAP, income tax payments, interest payments, and interest and dividends received from investments are all included in operating cash flows on the cash-flow statement. This classification is inconsistent with their classification on income statements.

Within the operating, investing, and financing sections of the statement, companies report line items that disclose the related cash inflows and outflows. Line items in the investing and financing sections provide details about these activities that are relatively easy to interpret. By contrast, operating sections can be more challenging to interpret.

Operating Section Overview

The operating section of the cash-flow statement reports the company's net cash provided by operating activities for the reporting period—the net change in cash from the company's primary business activities. Generating positive cash from operating activities, such as collecting more cash from customers than cash spent to run the business, is a critical success factor. Thus, the purpose of the operating section is to provide insights into the activities that affected operating cash flows.

Companies can use a direct or indirect format for the operating section of their cash-flow statements. (The investing and financing sections always have the same format.) The direct format reports cash flows such as cash collected from customers, cash payments to suppliers, etc. These direct cash flows are netted to report the company's net cash provided by operating activities during the reporting period. Most companies only provide the

indirect format. It indirectly derives net cash from operating activities by starting with net income, from the income statement, and explaining the reasons income differs from net cash from operations, the same number as determined under the direct format.

For example, if net income is $10, the indirect format would be:

Net income	$10
Adjustments to reconcile net income to cash from operation	4
Net cash from operations	$14

There are many reasons why net income may differ from net cash from operations. For example, revenues and expenses can be recognized before, after, or at the same time as the related cash flows. Thus, income and cash differ. Also, expenses associated with a resource can be prepaid in one reporting period (which reduces cash from operations in the current period but does not affect net income) and expensed in the next period as the company receives the benefits from the resource (which increases expenses the next period and thus reduces net income, but does not affect cash from operations). Similarly, revenues can be recognized when products are sold on account in one period (which increases net income but does not affect cash from operations) and collected in the next period (which increases cash from operations but does not affect income).

Consequently, there are numerous reasons income differs from cash and the indirect format explains the differences. Importantly, these differences are not explained in terms of cash flows, rather in terms of reconciliation line items. Net cash from operations is a cash flow, but net income and the reconciliation items are generally not cash flows.

> For an indirect cash-flow statement, the line items above net cash from operations help explain the reasons net income differs from cash from operations. Generally, they are not cash flows.

In the above example, a single item explained the difference between the $10 of net income and the $14 of net cash from operations. Companies report many reconciliation items that explain how net income differs from net cash from operations. They are mostly one of three types (or a combination of these types):

- Adjustments associated with gains or losses, like a gain on investments.
- Adjustments associated with assets, such as an accounts receivable adjustment.
- Adjustments associated with liabilities, for example, an accounts payable adjustment.

Because most all of the items are adjustments, not cash flows, interpreting them can be more challenging. However, these non-cash reconciliation items can be very useful for forecasting future income and cash flows. Indeed, analyzing the differences between net income and cash from operations is critical for assessing the quality of income and predicting when income will be converted to cash.

Investing Section Overview

Investing cash flows are inflows and outflows associated with investing activities. These items are relatively easy to identify from their descriptions. Generally, companies report three types of cash flows in this section:

- Buying and selling property, plant, and equipment.
- Buying and selling investment securities such as government bonds.
- Buying and selling complete companies or business subunits.

Most companies include net at the end of the description, meaning cash outflows net of cash inflows. For example, cash outflows used to purchase equipment less cash inflows

from selling equipment the company no longer needs. Most companies sign net cash outflows negatively.

Investors and other users of financial statements often need to assess the expected risks and rewards associated with these investments when forecasting a company's future performance. For example, depending on their assessment of the long-term demand for the company's products, they would likely react quite differently to major investments in new factories versus equivalent investments in government treasury bonds. The line items in the investing section help them better understand the net cash flows related to these investment activities.

Financing Section Overview

Financing cash flows are inflows and outflows associated with financing activities. The financing section generally reports two types of cash flows:

- All cash transactions with owners, which includes cash inflows from issuing shares, cash outflows from repurchasing shares or paying dividends, and cash inflows associated with exercising stock options.
- All cash transactions with debt holders except interest payments.

When analyzing financing cash flows, it is important to relate them to the business context and, in particular, to the company's development stage and the state of the economy. For example, financing activities will be quite different for a high tech start-up in a booming economy than for a mature company in an economic downturn. High-tech start-ups tend to use mostly equity financing, because they have very little collateral to offer to debt holders, and they generally do not pay dividends. By contrast, a mature company may rely heavily on debt financing and add debt during economic downturns.

Cash and Cash Equivalents, beginning of year

Cash and cash equivalents at the start of the year is the same as the cash and cash equivalents balance recognized on the balance sheet for the end of the prior year. The purpose of the cash-flow statement is to explain why the beginning cash balance changed during the year. It is explained in terms of operating, investing, and financing business activities.

Operating Section

The operating section of the cash-flow statement reports the company's net cash provided by (used for) operating activities for the reporting period—the net change in cash from the company's primary business activities.

Net Income

Like most companies, Intel reports an indirect statement of cash flows, where the objective is to reconcile net income to net cash from operations. Thus, net income or profits, as reported on the income statement, is the first line item of the operating section followed by adjustments to reconcile net income to net cash provided by operating activities.

Depreciation

Depreciation is a common reconciliation adjustment on cash-flow statements. Depreciation measures the extent to which assets' benefits have been used up since they were acquired. For companies that do not manufacture the products they sell, the depreciation adjustment simply reverses depreciation expense recognized in net income that does not affect

net cash from operations. For manufacturing companies, the depreciation adjustment also reverses depreciation expense recognized in net income. But in addition, as described below, it can reverse depreciation associated with production as well.

For manufacturing companies, depreciation associated with property, plant, and equipment used to produce products, such as factories and assembly-line equipment, is recorded differently than non-production depreciation, such as depreciation for office furniture. Both production and non-production depreciation increase accumulated depreciation and decrease net PP&E. However, what differs is the other side of the entry.

When production depreciation is recorded inventories increase. Part of the cost of the PP&E is transferred to inventories signifying that the future benefits associated with using the PP&E increase the value of the inventories produced. Thus, costs are transferred from one asset to another. In fact, part of the depreciation cost associated with production for the period is assigned to every product produced during the period through a process called product costing. These depreciation costs remain in inventory, along with other production costs, until products are sold, at which time they are included in cost of sales. Thus two entries associated with production-related depreciation affect inventories: (1) recording depreciation associated with units produced, which increase inventories, and (2) recording cost of sales (that includes depreciation), which decreases inventories.

Unfortunately, neither U.S. GAAP nor IFRS specify how production-related depreciation should be treated in the reconciliation. There would seem to be three acceptable alternatives:

- **Production and Non-production Depreciation Adjustment:** Report a depreciation reconciliation adjustment that equals the total production and non-production depreciation recorded during the year and an inventories adjustment that includes the net effect of the two production-related depreciation entries that affect inventories (discussed above). This would seem to be the approach followed by many companies reporting under IFRS: they must reconcile changes in accumulated depreciation in the footnotes, so it is generally possible to determine whether the depreciation adjustment matches the combined production and non-production depreciation recorded for the year. We checked several IFRS companies and all of them seem to use this format. We suspect most, if not all, U.S. GAAP companies also use this format but it is impossible to determine conclusively.
- **Non-production Depreciation Adjustment:** Report a depreciation reconciliation adjustment that only includes non-production-related depreciation and an inventories adjustment that includes the effects of production-related deprecation included in cost of sales but does not include production-related depreciation recorded into inventories during the year.
- **Non-production and Cost-of-sales Related Depreciation Adjustment:** Report a depreciation reconciliation adjustment that equals the total depreciation expensed implicitly and explicitly on the income statement (non-production depreciation expense and production depreciation implicit in cost of sales) and report an inventories adjustment that does not include the effects of either of the production-related depreciation entries (discussed above). This would seem to be the best approach conceptually because the depreciation adjustment precisely reconciles the income effects of depreciation to their cash effects, which are $0.

Regardless of the approach for reporting the depreciation reconciliation adjustment, for both manufacturing and non-manufacturing companies, the adjustment is a non-cash item that reconciles net income to net cash from operations. The difference is what the depreciation adjustment represents and how to interpret it in the context of the inventories adjustment.

Share-Based Compensation

Share-based compensation, also called **stock-based compensation** or **share-based payment arrangements**, awards employees, and possibly others, with equity shares, options,

or other equity instruments in lieu of cash payments. Share-based compensation is a common reconciliation adjustment for companies that issue stock options to employees. This adjustment reverses the non-cash share-based compensation expense recognized in net income that does not affect net cash from operations.

In 2015, Intel recognized a $1,305 reconciliation adjustment related to stock options and other share-based compensation plans. This adjustment reflects the non-cash expense Intel recognized in cost of sales and operating expenses on its income statement[1]. The entry to record the related expense would increase compensation expense $1,305 and increase paid-in capital $1,305. The net effect on owners' equity is $0 because the decrease in retained earnings associated with the expense is offset by the increase in paid-in capital.

While share-based compensation expense was only recently required by U.S. GAAP, strictly speaking it does not meet the expense definition. Expenses are defined to be decreases in net assets associated with operations central to the company's business. However, share-based compensation expense has no net affect on net assets (assets - liabilities), which is the same as owners' equity. Because the expense does not affect assets nor liabilities, the related adjustment is not the typical asset or liability adjustment found on cash-flow statements. Rather it is associated with a paid-in capital adjustment.

For a manufacturing company like Intel, a portion of the share-based compensation cost maybe capitalized as part of inventory and then subsequently expensed. Thus, the first entry would increase inventory and increase paid-in capital and a second entry would increase cost of sales expense and decrease inventory when the inventory is sold.

By understanding the underlying concepts and entries, you can combine several disclosures to get insights you might not otherwise see. For example, you can analyze footnote disclosures, cash-flow statement adjustments, and income statement line items to estimate the cash and non-cash effects.

- Knowing what's behind cash-flow reconciliation adjustments will help you better understand the underlying events and adjust your forecasts of a company's future performance appropriately.

Restructuring and Asset Impairment Charges

The restructuring and asset impairment charges adjustment represents a collection of items recognized in net income that did not have the same affect on net cash from operations. Restructuring pertains to major changes in the business such as plant closings and layoffs. Generally, an asset impairment relates to reducing the value of an asset to its lower fair value and recognizing a related expense. Consequently, this adjustment reverses the combined effect of the non-cash portion of the expenses recognized in net income.

This adjustment combines two of the typical types of reconciliation adjustments. Restructuring adjustments are associated with liabilities (such as obligations for employee severance). Asset impairment adjustments are associated with assets. Although these particular adjustments are not typical of all companies, asset and liability adjustments are common.

From Intel's footnote disclosures, together with the cash-flow and income statement information, we could gain insights into separate effects and therefore analyze the income and cash implications for future forecasts of Intel's financial performance. In particular, these types of events may not be reflective of the future and by better understanding the underlying charges, analysts could adjust their forecasts appropriately.

- By understanding the underlying concepts and entries, you can combine several disclosures to get insights you might not otherwise see. For example, you can analyze footnote disclosures, cash-flow statement adjustments, and income statement line items to estimate the cash and non-cash effects.
- Knowing what's behind cash-flow reconciliation adjustments will help you better understand the underlying events and adjust your forecasts of a company's future performance appropriately.

1 Intel's 2015 Form 10-K, page 65.

Excess Tax Benefit from Share-Based Payment Arrangements

Excess tax benefit from share-based payment arrangements, or **excess tax benefit**, is the additional tax deduction (benefit) received for share-based compensation costs for tax reporting beyond that previously recognized in net income for financial reporting. This represents the taxes the company would have paid if it had not received the deduction.

The excess tax benefit adjustment in the operating section is offset in the financing section, often with a line item with the same caption. Thus, the net effect of excess tax benefits on cash is $0.

Currently, U.S. GAAP mandates that companies report these offsetting line items. However, cash was not directly affected when the tax benefit was recognized. Rather, less cash was paid to the government than would have been paid. Thus, the excess tax benefit reported as a financing cash inflow is not a real cash flow, so let's call it a pseudo cash flow.

Including a non-cash, pseudo cash inflow within the financing section is a big break from tradition. Otherwise, items in the financing and investing sections are associated with direct, real cash flows.

Because U.S. GAAP requires a non-cash inflow to be recognized in the financing section, an offsetting non-cash outflow must be included elsewhere to ensure the statement explains the change from the beginning to the ending cash balance. To this end, U.S. GAAP mandates that the operating section includes the excess tax benefits: taxes that would have been paid if the company had not received the tax benefit from the options, a pseudo cash outflow. In other words, the operating section includes the taxes actually paid (a real cash outflow) plus an additional amount (pseudo cash outflow) for taxes that would have been paid if the excess tax benefit had not been received. This is equivalent to mandating cash from operations reflect the taxes that would have been paid without the tax benefit adjusted for the portion of the benefit recognized in income in prior years.

Consequently, having required a non-cash item in cash from operations, even companies reporting *direct* cash-flow statements now include this non-cash item on their direct statements. As a result, direct cash-flow statements are no longer purely direct.

What's more, U.S. GAAP does not specify how companies should report the excess tax benefit adjustment in the operating section. One approach is to report a separate line item for the excess tax benefit adjustment in the operating section that exactly offsets the one reported in the financing section. Another approach is to aggregate the excess tax benefit adjustment with the income taxes payable adjustment and not separately disclose the excess tax benefit in the operating section, only separately disclose it in the financing section. You will see both approaches when analyzing company's cash-flow statements. Regardless of the approach, you can trust that the excess tax benefit disclosed in the financing section is also included in the operating section—it just may be aggregated with other numbers.

Returning to Intel, we now know how to interpret Intel's related disclosures. On its 2015 cash-flow statement, Intel uses the approach to separately disclose its excess tax benefit in the operating and financing sections. Intel's ($159) excess tax benefit adjustment in the operating section is offset with a similarly named $159 line item in the financing section. The net effect of the excess tax benefit on cash is $0. This $159 million excess tax benefit represents the taxes Intel would have paid the government if it had not received the deduction.

U.S. GAAP

The Financial Standards Accounting Board (FASB) recently decided to no longer mandate the reporting of these offsetting excess tax benefit line items.[1] Thus, similar to IFRS, you will not see these non-cash excess tax benefits line items in the future.

1 FASB ASC 230-10-45-13:14

IFRS GAAP

Under IFRS,[1] companies are precluded from reporting non-cash investing and financing transactions on the cash-flow statement. Thus, excess tax benefits associated with share-based payments can not be reported in the finance section, which means an offsetting adjustment can't be reported in the operating section..

1 IAS 7 ¶43.

Amortization of Intangibles

Amortization measures the extent to which intangible assets' benefits have been used up since they were acquired, where intangible assets are non-monetary assets that don't have physical, tangible substance. Amortization is similar to depreciation for tangible assets. Therefore, this adjustment has almost the same interpretation as the earlier one for depreciation. This adjustment reverses the non-cash amortization expense recognized in several line items on the income statement that does not affect net cash from operations.

(Gains) Losses on Equity Investments, Net

Gains and losses on equity investments reflect the gains and losses for investments accounted for under the equity method, where the company has significant influence over, but does not control, the investee and the and the cost method, where the company owns less than 20% of the outstanding shares or otherwise does not exert significant influence over the investee.

In the context of an *adjustment* on the cash flow statement, a negative number represents a net gain and a positive number represents a net loss—as indicated by the line item's description of "(gains) losses". This adjustment reverses the gains and losses on equity method investments recognized in net income that do not affect net cash from operations.

Why reverse the effect of gains and losses? There are two reasons, depending on the underlying events that gave rise to the gain or loss:

(1) Gains and losses reported in net income generally arise from selling assets (such as investments) which are investing activities, not operating activities. So the associated cash flow is reported in the investing section. If the gains and losses reported in net income were not reversed as a adjustment, they would be counted twice: first in the operating section as part of net income and second in the financing section.

(2) Gains and losses reported in net income may also arise from revaluation of assets. For example, companies recognize an impairment loss when they reduce the carrying amount (**book value**) of assets (such as investments) to their lower fair value. In these situations there is no cash associated with the transaction. Thus, this adjustment reverses the non-cash gains and losses recognized in net income.

Regardless of the underlying events, adjustments for net gains are negative and adjustments for net losses are positive to reverse their effects on net income.

Returning to Intel's 2015 cash-flow and income statements, we observe "(Gains) losses on equity investments, net" is a negative $263 cash-flow adjustment. This reverses the $263 non-cash portion of the $315 "Gains (losses) on equity investments, net" on the income statement. Thus, the net effect on Intel's *cash from operations* is $0: + $263 in net income at the top of the operating section - $263 reconciliation adjustment.

- When financial-statements report a net number, such as net gains and losses, the line item's description provides insights to interpret the net number. For example, on the cash-flow statement the caption "(gains) losses" means a negative number is a net gain. In contrast, on the income statement, the caption "gains (losses)" means a positive number is a net gain.
- Knowing the concept behind a reported number and carefully observing the related line item's description will help you interpret numbers that have been netted together.

Deferred Taxes

Deferred taxes represent the portion of the tax expense currently not owed due to timing differences between financial reporting and tax reporting. Tax expenses have current and deferred portions and the deferred portion does not affect current-period cash flows. As a result, this adjustment generally reverses the non-cash deferred tax expense recognized in net income.

The difference between Intel's deferred provision in net income and this deferred taxes adjustment could include many items such as settlements with government tax authorities, changes in tax accounting policies, or reclassification of deferred taxes as income taxes payable or receivable (another adjustment on the cash-flow statement).

Changes in Assets and Liabilities

The changes in assets and liabilities portion of the operating section reports reconciliation adjustments related to non-cash current assets and current liabilities. These are also called **working capital adjustments**. Adjustments associated with assets represent the opposite, or negative, of the effect of operating entries on the related assets and the ones associated with liabilities represent the same as the effect of operating entries associated with liabilities.

Why do asset adjustments have the opposite sign?
The operating section is a vertical form of the balance-sheet equation (A=L+OE). To isolate cash in the equation, the non-cash assets move to the opposite side of the equation, changing signs. So asset adjustments have the opposite sign as the balance-sheet effect.

Here are some general guidelines for interpreting **asset adjustments**:

- Asset reconciliation adjustments are the *opposite* of the effect of the period's operating entries on the related asset.
- Thus, negative asset reconciliation adjustments are associated with net increases in the related asset and positive adjustments with net decreases.
- Equivalently, asset adjustments are the *negative* of the net effect of the period's operating entries. This means asset adjustments *subtract* the net effect.

For example, if an accounts receivable adjustment is + $10, it means the net effect of operating entries on accounts receivable is - $10. In other words, accounts receivable on the balance sheet decreased $10 due to operating events during the year. Caution: accounts receivable on the balance sheet may have decreased more or less than $10 due to *non-operating* events, such as acquiring a business that had accounts receivable on its balance sheet. The purpose of the adjustment is to reflect the *operating* activities effects only. After all, these adjustments are in the operating section of the cash-flow statement.

Here are some general guidelines for interpreting **liability adjustments**:

- Liability reconciliation adjustments are the *same* as the effect of the period's operating entries on the related liabilities.
- Thus, positive liability reconciliation adjustments are associated with net increases in the related liability and negative adjustments with net decreases.
- Equivalently, liability reconciliation adjustments *add* the net effect of the period's operating entries on the related liabilities.

For example, if an accounts payable adjustment is + $20, it means the net effect of operating entries on accounts payable is + $20. In other words, accounts payable on the balance sheet increased $20 due to operating events during the year. Caution: accounts payable on the balance sheet may have increased more or less than $20 due to *non-operating* events. The purpose of the adjustment is to reflect the *operating* activities effects only.

For small retail companies, we can typically use the asset and liability adjustments to reliably estimate customer collections, inventory purchases, and vendor payments because only two operating entries affected the related assets and liabilities and one of these effects is disclosed on the income statement. We also can sometimes estimate the separate effects of non-operating entries by comparing the reconciliation adjustment to the change on the balance sheet. In this case, we assume we can ignore relatively small effects of other entries or find related information in footnotes or elsewhere.

However, it is generally not possible to estimate the separate effects of operating entries on inventories and accounts payable for manufacturing companies. Among other things, production depreciation significantly affects inventories and we can not estimate production depreciation. There are similar complexities when estimating customer collections in contexts where revenues are deferred and other entries besides customer collections and sales on account significantly affect accounts receivable.

Net Cash Provided by Operating Activities

Net cash provided by operating activities reports the company's net cash from operating activities for the reporting period—the change in cash from the company's primary business activities. Generating positive cash from operating activities is a critical success factor.

Net cash provided by operating activities is the same number for direct and indirect formats of the cash-flow statement. However, for companies that report the *direct* format, this subtotal is the sum of line items above that report cash inflows and outflows (with one exception related to stock options), such as cash collected from customers and cash paid to suppliers. In contrast, for companies that report the indirect format, the line items above net cash from operations help explain the reasons net income differs from cash from operations. Generally, they are not cash flows.

For companies that report the *indirect* format, you must interpret this subtotal very carefully. A very common mistake is to assume all items summed to derive this subtotal are cash flows. For example, a newcomer to cash-flow statements would very likely conclude incorrectly that (gains) losses are cash flows. This is not true. This adjustment reverses the gains and losses recognized in net income that do not affect net cash from operations. It is an adjustment, not a cash flow.

Investing Section

Investing cash flows are inflows and outflows associated with investing activities—buying and selling property, plant, and equipment; buying and selling investment securities such as government bonds; and buying and selling complete companies or business subunits. These items are relatively easy to identify from their descriptions.

Additions to Property, Plant, and Equipment

Additions to property, plant, and equipment (PP&E) are assets purchased to support day-to-day operations. For example, cash purchases of land, buildings, furniture, equipment, and factories. Most companies include net at the end, meaning cash outflows to purchase PP&E net of cash inflows from selling PP&E. This line item does not include PP&E acquired when a company buys another company. Nor does it include PP&E purchased using debt financing. Rather, this line item reflects the purchases of PP&E for cash.

From Intel's cash-flow statement, we see that Intel spent over $7 billion on PP&E purchases during 2015. Knowing the business context, we can presume that most of this was likely spent on wafer fabrication plants, which cost $2-$3 billion each to construct. The cutting edge equipment in these plants is constantly evolving, allowing Intel to put increasingly complex circuity on microprocessor chips. Moreover, to keep its competitive edge, Intel has invested nearly $28 billion dollars in PP&E during the past three years. These were risky gambles because, for example, it takes 2-3 years to complete a wafer fabrication plant and demand for Intel's microprocessors can change dramatically during that time.

Acquisitions, Net of Cash Acquired

Acquisitions, net of cash acquired represents the cash used to purchase other companies, less the cash on the acquired company's books when the acquisition occurred. For example, if one company paid $100 for another company that had $20 of cash on the acquisition date, the net cash outflow related to the acquisition was $80. This $80 is reported on the acquiring company's cash-flow statement.

Importantly, companies frequently give other consideration besides cash when they acquire companies. For example, they give their common stock as part or all of the consideration. For example, in 2011, Intel's statement of stockholders' equity[2] reports it issued $48 million of common stock in connection with acquisitions during 2011. This stock was

2 Intel's 2011 Form 10-K, page 47.

in addition to $8,721 million in cash spent on acquisitions during 2011, as reported on Intel's cash-flow statement[3].

- Analysis of one line item can be extended by using diverse sources of information, such as the cash-flow and stockholders' equity statements to estimate cash and non-cash effects, for example.
- Knowing the underlying concepts and entries behind numbers will help you 'connect the dots' across all available information to deepen your understanding of the financial performance of a company.

Purchases of Available-for-Sale Investments

Purchases of available-for-sale investments represents the cash outflow to buy investments purchased for liquidity—investments classified as available-for-sale.

Its cash-flow statement reports that Intel purchased nearly $28 billion of available-for-sale investments during the past three years. Intel's treasury department, which is the department that manages cash flows, investments, and financing, is very busy relative to most companies that are not financial institutions (e.g., banks, insurance companies, or mutual funds). Assuming 250 business days a year, on average Intel purchased over $37 million of available-for-sale investments each day during 2013–2015. Moreover, as we shall see, the treasury department was also busy selling securities.

Sales of Available-for-Sale Investments

Sales of available-for-sale investments are the cash inflows for these types of investments. **Available-for-sale** investments are investments purchased for liquidity. Thus, this line item reflects the cash received when available-for-sale investments were sold during the year.

GAAP requires companies to report purchases and sales as separate line items when they are significant so users can gauge the volume of activity. However, a good deal can also be learned by netting the purchases and sells. For example in 2015, Intel's $2,090 cash inflow from sales of investments was $6,169 less than its $8,259 cash outflow for purchases, suggesting Intel increased its portfolio of securities; yet Intel maintained a large stockpile of highly liquid cash and cash equivalents to use in the future (Intel recognized $15.3 billion in cash and cash equivalents on its balance sheet at year end 2015).

Maturities of Available-for-Sale Investments

Maturities of available-for-sale investments are the cash inflows for these types of investments. **Maturities** are debt securities, such as bonds, with a date (maturity) when the debt must be completely repaid with interest. When debt securities mature, the debtors pay the creditors the balance due.

Purchases of Trading Assets

Purchases of trading assets represents the cash outflow to buy investments classified as trading assets or trading securities. Trading assets are investments in debt or equity securities purchased with the intent to generate profits on short-term price changes. Trading assets are unusual for a company like Intel that is not a financial institution (banking, insurance, or mutual fund).

Maturities and Sales of Trading Assets

Maturities and sales of trading assets represents the cash inflow from investments classified as trading assets. Examples include debt securities that became due and the sale of other investments previously held for speculative profits that were classified as trading assets.

3 Intel's 2011 Form 10-K, page 46.

Investments in Loans Receivable and Reverse Repurchase Agreements

This line item represents cash outflows associated with new loans made to third parties (loans receivable) and purchases of securities, or other financial assets, with the agreement to sell them at a specific future date (reverse repurchase agreements).

The expected liquidity of these investments determines where they are recognized on Intel's balance sheet: cash equivalents, other current assets, or other long-term assets, depending on their maturity dates (within three months, a year, or greater than one year, respectively).

Collections of Loans Receivable and Reverse Repurchase Agreements

This line item represents the cash inflows associated with the above related investments.

Investments in Non-Marketable Equity Investments

Investments in non-marketable equity investments represents the cash outflow to buy investments that are not actively traded on stock exchanges. Examples include private companies' stock or restricted stock. These are highly illiquid investments.

Intel purchased over $3.8 billion of non-marketable equity investments during the last three years. Its management discussion and analysis (MD&A) describes these investments[4]:

> "We regularly invest in non-marketable equity instruments of private companies, which range from early-stage companies that are often still defining their strategic direction to more mature companies with established revenue streams and business models."

Proceeds from the Sale of Select Assets

This line item represents cash inflows associated with the sale select assets: IM Flash Singapore, LLP assets and certain IM Flash Technologies, LLC assets.

Purchases of Licensed Technology and Patents

This line item represents Intel's cash outflows to purchase technology licenses and patents that's above and beyond acquisition-related technology and patents.

Other Investing Activities

Other investing activities presumably includes cash flows for activities such as non-controlling strategic investments in other companies. For example, if Intel acquires 10% of another company and intends to hold it for strategic reasons it would be reported here.

Net Cash Used for Investing Activities

Net cash used for investing activities reports the company's inflows and outflows from investing activities for the reporting period—buying and selling investments, property, plant, and equipment, and acquiring and divesting complete companies or business sub-units. Net cash used for investing activities is the same number for direct and indirect formats of the cash-flow statement.

4 Intel's 2015 Form 10-K, page 37.

Financing Section

Financing cash flows are inflows and outflows associated with financing activities—cash transactions with owners and cash transactions with debt holders, except interest payments which are operating cash flows. Most line items reported in this section are relatively easy to identify from their descriptions.

Increase (decrease) in Short-term Debt, Net

Increase (decrease) in short-term debt, net represents the cash inflows and outflows related to issuing and repaying short-term debt. Short-term debt represents amounts owed (**principal**) to financial institutions and other creditors that must be paid within one year of the date the debt was incurred, not including interest.

Companies continually borrow and repay short-term debt throughout the year. This is especially true for seasonal businesses, such as toy companies that stock-up inventory for the holiday season. As a result, often net borrowings at year-end can mask larger borrowing peaks that occur during the year.

Proceeds from Government Grants

Proceeds from government grants are cash inflows from governments. This line item means Intel has received cash grants from one or more governments. Unlike proceeds from issuing debt, government grants are not required to be paid back.

Excess Tax Benefit from Share-Based Payment Arrangements

Excess tax benefit from share-based payment arrangements, or **excess tax benefit**, is the additional tax deduction (benefit) a company received for share-based compensation costs for tax reporting beyond that previously recognized in net income for financial reporting. This tax benefit represents the taxes the company would have paid the government if it had not received the deduction. It is not a cash flow.

The excess tax benefit adjustment in the financing section is offset by a line item in the operating section, often with the same line item caption. Thus, the net effect of excess tax benefits on cash is $0. U.S. GAAP mandates that companies report these offsetting line items.

IFRS GAAP

Under IFRS,[1] companies are precluded from reporting non-cash investing and financing transactions on the cash-flow statement.

1 IAS 7 ¶43.

Issuance of Long-term Debt, net of issuance costs

Issuance of long-term debt represents the net cash inflows from issuing long-term debt less the direct costs incurred to issue the debt, such as fees and commissions to banks and lawyers. This includes the amounts owed on loans or other obligations for a fixed amount (**principal**), not including interest, on debt with a maturity date one or more years from the date the loan was issued. Examples include mortgages, bank loans, and bonds. While short-term debt borrowings and repayments are usually netted on cash-flow statements, long-term debt borrowings and repayments are typically reported separately.

Proceeds from Employee Equity Incentive Plans

Proceeds from sales of shares through employee equity incentive plans are cash inflows from employees who exercised stock options or other share-based awards.

Repurchase of Common Stock

Repurchase of common stock are cash outflows to buy back shares from shareholders. When stock is repurchased the number of shares outstanding decreases. The repurchased shares may be held as **treasury stock**. Treasury stock are still considered issued, but not outstanding. Alternatively, the repurchased shares may be retired, reducing both the number of shares issued and outstanding.

Intel's cash-flow statement reports it spent nearly $10.8 billion during 2014 to repurchase shares from its shareholders. Its statement of stockholders' equity[5] discloses it repurchased 332 million shares, reducing common stock and capital in excess of par value and retained earnings. By repurchasing the shares, this is one way Intel gives cash back to its shareholders.

Restricted Stock Unit Withholdings

Restricted Stock Unit Withholdings are taxes Intel paid on employees' behalf related to income the employees earned as share-based compensation in the form of restricted stock units. These units, also called restricted shares, are company shares for which sale is contractually or governmentally prohibited for a specified period of time.[6] Intel's annual report describes their restricted stock unit withholdings [7]:

> "For the majority of RSUs [restricted stock units] granted, the number of shares of common stock issued on the date the RSUs vest is net of the minimum statutory withholding requirements that we pay in cash to the appropriate taxing authorities on behalf of our employees."

Payment of Dividends to Stockholders

Payment of dividends to stockholders are cash outflows for previously declared dividends. Dividends are distributions of the company's retained earnings to its shareholders.

Collateral Associated with Repurchase of Common Stock

This line item represents Intel's investments with cash it received as collateral from another party. This $325 cash inflow is related to the $325 cash outflow reported in the next line item. Intel's footnote describes the business context behind these line items:

> "In the fourth quarter of 2014, we entered into a stock repurchase agreement, a portion of which was executed as a forward contract. We received collateral from the counterparty for the value attributable to the forward portion of this contract and invested the collateral into permitted investments considered restricted from other uses. As of December 27, 2014, $325 million of collateral, which approximates fair value, remains recorded as both a current asset and current liability on the consolidated balance sheet."[8]

Intel likely received collateral from the counterparty because Intel's share price had increased to the point where the counterparty would need to pay more for the shares it would purchase from the stock market than it would receive from Intel in exchange for the repurchased shares.

When Intel received the collateral, it recognized a liability representing its obligation to repay the counterparty. This is the next line item below. Intel then used this cash flow

5 Intel's 2015 Form 10-K, page 69.
6 FASB Master Glossary.
7 Intel's 2015 Form 10-K, page 114.
8 Intel's 2014 Form 10-K, page 27.

to purchase investments. While cash flows for investments would normally be classified as investing cash flows, U.S. GAAP requires both cash flows for derivative instruments such as forward contracts to be classified as financing cash flows.[9]

Increase (Decrease) in Liability due to Collateral Associated with Repurchase of Common Stock

See previous item.

Other Financing Activities

Other financing activities includes cash flows associated with financing not reported elsewhere.

Net Cash Used for Financing Activities

Net cash used for financing activities reports the company's inflows and outflows from financing activities for the reporting period—cash transactions with owners and cash transactions with debt holders, except interest payments. Net cash used for financing activities is the same number for direct and indirect formats of the cash-flow statement.

Effect of Exchange Rates on Cash and Cash Equivalents

The effect of exchange rate fluctuations on cash and cash equivalents represents the net effects of currency changes on cash and cash equivalents held in a foreign currency. This amount does not represent a cash flow; rather, it is the exchange rate effect needed to reconcile beginning and ending cash and cash equivalents for the period.

Net Increase (Decrease) in Cash and Cash Equivalents

Net increase (decrease) in cash and cash equivalents is the sum of the net cash provided by (used) for operating activities, used for investing activities and used for financing activities, plus the effect of exchange rate fluctuations. This is the net change in the cash and cash equivalents balance during the year.

Cash and Cash Equivalents, end of year

Cash and cash equivalents, end of year is the cash and cash equivalents balance at year end, which is the same as the balance recognized on the balance sheet.

Supplemental Disclosures of Cash Flow Information

Companies are required to disclose interest and tax payments, and other supplementary information, either at the bottom of their cash-flow statements or in footnotes. Interest and tax **expenses** can differ from interest and tax **payments** so this disclosure provides valuable insights. For example, Intel recognizes $2,792 tax expense on its income statement[10] for 2015, but the supplementary disclosure at the bottom of the cash-flow statement indicates it paid $3,439 of taxes, net of refunds. This difference maybe due to the net effect of several factors.

9 FASB 815-10-45-12 and 815-10-45-15.
10 Intel's 2015 Form 10-K, page 65.

Intel's Statement of Shareholders' Equity

INTEL CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Three Years Ended December 26, 2015 (In Millions--Except Per Share Amounts)	Common Stock and Capital in Excess of Par Value		Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
	Number of Shares	Amount			
Balance as of December 29, 2012	**4,944**	**$ 19,464**	**$ (399)**	**$ 32,138**	**$ 51,203**
Components of comprehensive income, net of tax:					
Net income	-	-	-	9,620	9,620
Other comprehensive income (loss)	-	-	1,642	-	1,642
Total comprehensive income					11,262
Proceeds from sales of shares through employee equity incentive plans, net tax deficiency, and other	130	1,593	-	-	1,593
Share-based compensation	-	1,117	-	-	1,117
Repurchase of common stock	(94)	(345)	-	(1,802)	(2,147)
Restricted stock unit withholdings	(13)	(293)			(293)
Cash dividends declared ($0.90 per common share)				(4,479)	(4,479)
Balance as of December 28, 2013	**4,967**	**$ 21,536**	**$ 1,243**	**$ 35,477**	**$ 58,256**
Components of comprehensive income, net of tax:					
Net income	-	-	-	11,704	11,704
Other comprehensive income (loss)	-	-	(577)	-	(577)
Total comprehensive income					11,127
Proceeds from sales of shares through employee equity incentive plans, net tax deficiency, and other	125	1,787	-	-	1,787
Share-based compensation	-	1,140	-	-	1,140
Temporary equity reclassification	-	(912)	-	-	(912)
Repurchase of common stock	(332)	(1,438)	-	(9,354)	(10,792)
Restricted stock unit withholdings	(12)	(332)	-	0	(332)
Cash dividends declared ($0.90 per common share)	-	-	-	(4,409)	(4,409)
Balance as of December 27, 2014	**4,748**	**$ 21,781**	**$ 666**	**$ 33,418**	**$ 55,865**
Components of comprehensive income, net of tax:					
Net income	-	-	-	11,420	11,420
Other comprehensive income (loss)	-	-	(606)	-	(606)
Total comprehensive income					10,814
Proceeds from sales of shares through employee equity incentive plans, net tax deficiency, and other	87	1,076	-	-	1,076
Share-based compensation	-	1,314	-	-	1,314
Temporary equity reclassification	-	15	-	-	15
Repurchase of common stock	(96)	(453)	-	(2,548)	(3,001)
Restricted stock unit withholdings	(14)	(322)	-	(120)	(442)
Cash dividends declared ($0.96 per common share)	-	-	-	(4,556)	(4,556)
Balance as of December 26, 2015	**4,725**	**$ 23,411**	**$ 60**	**$ 37,614**	**$ 61,085**

Intel's 2015 Form 10-K, page 69. www.sec.gov
See accompanying notes in the 10-K.

Intel's Statement of Shareholders' Equity

IFRS GAAP
Under IFRS,[1] companies are required to report a **statement of changes in equity**.

To supplement balance sheets, companies report **statements of owners' equity**, also called the **statements of shareholders' equity** or **statements of stockholders' equity**. These statements explain changes in the owners' equity line items reported on balance sheets, usually for the past three years.

Like balance sheets, statements of shareholders' equity report balances at points in time. However, they also explain the reasons these balances change during reporting periods. Since they report both balances and the flows that caused changes, the format of the statement is typically laid out with more columns than other statements.

1 IAS 1 ¶106.

Typically, the columns are all the line items reported in the owners' equity section of the balance sheet. For example, retained earnings is a line item on the balance sheet and is one of the columns on the statement of shareholder's equity.

The rows are two types of items: balances reported at year ends, which are the same as the balance sheet, and the events that caused owners' equity to change. For example, the first row reports the beginning balances, like the beginning balance for retained earnings. The following rows report the interim events that explain changes in owners' equity. For example, dividends declared. The row reports the description, dividends declared, and the amount in the retained earnings column. Thus, declaring dividends, in our example, explains part of the change in retained earnings during the period. In addition, rows may also report the net effect on owners' equity of changes to accounting policies with the adoption of a new accounting standard. The last row reports the ending balances, exactly the same as on the balance sheet.

Although many companies layout their statement as described above, some companies reverse the rows and columns: the rows represent the items reported in the owners' equity section of the balance sheet and the columns report balances reported at year ends and the interim events that caused owners' equity to change. Regardless of the format, the purpose is the same—to explain the changes in owners' equity during the reporting period.

Intel's statement of stockholders' equity is laid out with the typical rows and columns. The columns are from Intel's balance sheet: common stock and capital in excess of par value, accumulated other comprehensive income (loss), retained earnings, and total [stockholders' equity]. The rows are balances reported at year ends and the interim events that caused them to change.

Next, let's look at Intel's changes in owner's equity for the most recent year, starting near the bottom of the statement with the beginning balances for 2015.

IFRS GAAP

Under IFRS,[1] companies' statement of changes in equity commonly have more columns that report **reserves** for each item of other comprehensive income.

1 IAS 1 ¶106.

Balance as of December 27, 2014

Balance as of December 27, 2014 reports Intel's **ending** 2014 owners' equity balance, which is the same as its **beginning** owners' equity balance for 2015.

To see how Intel's statement of stockholders' equity relates to its balance sheet, focus on the rows near the bottom that begin with "Balance as of December 27, 2014" and end with "Balance as of December 26, 2015." (Intel's fiscal yearend is the last Saturday in December.) The numbers reported in these rows correspond to those reported on Intel's balance sheet[1]. For example, Intel's balance sheet recognized $33,418 and $37,614 of retained earnings for 2014 and 2015, respectively. These amounts are also reported in the retained earnings column of the statement of stockholders' equity and on the rows named "Balance as of December 27, 2014" and "Balance as of December 26, 2015", respectively.

Components of Comprehensive Income, net of tax

Components of comprehensive income, net of tax explains the related effects on owners' equity for the period. Comprehensive income is net income plus other comprehensive income (loss). Thus, this line item reports the separate effects of the components: Net income affects retained earnings and other comprehensive income (loss) affects accumulated other comprehensive income (loss). Thus, this line item demonstrates the effects of closing entries, including ones that close temporary income accounts to retained earnings.

Proceeds from Sales of Shares Through Employee Equity Incentive Plans, net tax deficiency, and other

Proceeds from sales of shares through employee equity incentive plans, net tax deficiency, and other explains the related effects on owners' equity for the period—the number of shares sold and the effect on owners' equity.

1 Intel's 2015 Form 10-K, page 67.

For 2015, Intel's cash-flow statement[2] reports $866 cash proceeds from sales of shares through employee equity incentive plans. In contrast, Intel's statement of stockholders' equity reports $1,076 increase in common stock and capital in excess of par value for similar events. The difference in the line items' *descriptions* on the two statements is a signal to interpret the numbers differently.

- Line items' descriptions are clues to properly interpreting reported numbers. For example, line items on statement of owners' equity may include "other" or be "net of taxes", where a similar disclosure elsewhere may not include these items. Care must be taken to properly interpret and correlate similar information.

Share-based Compensation

Share-based compensation explains the related effects on owners' equity for share-based compensation costs recognized during the year. For 2015, Intel reports a $1,314 increase to "common stock and capital stock in excess of par value" related to share-based compensation. However, Intel recognized $1,305 as a reconciliation adjustment related to stock options and other share-based compensation plans on its statement of cash flows[3]. The difference is most likely the amount of share-based compensation costs capitalized in inventory during 2015, and thus, effected owners' equity, but not needed as a cash flow adjustment to reconcile net income to net cash from operations.

Temporary Equity Reclassification

Temporary equity includes equity instruments with redemption features that are not solely within the control of the issuer. This line item discloses that Intel reduced its common stock and capital in excess of par value (part of permanent owners' equity) when it reclassified this equity as temporary. Also see the balance sheet description on page 14.

Repurchase of Common Stock

Repurchase of common stock explains the related effects on owners' equity. Intel's 2015 statement of stockholders' equity discloses it repurchased 96 million shares (the first column of the statement), reducing common stock and capital in excess of par value by $453 and retained earnings by $2,548 for a total effect on owners' equity of $3,001. Intel's cash-flow statement reported the same $3,001 as a financing cash outflow.

Restricted Stock Unit Withholdings

Restricted stock units, also called restricted shares, are company shares for which sale is contractually or governmentally prohibited for a specified period of time.[4] Also see the cash flow statement description on page 44.

Cash Dividends Declared

Cash dividends declared explains the related effects on owners' equity for the period. Dividends are distributions of retained earnings to shareholders. Management must approve (declare) dividends prior to payment. In this context, "cash dividends" represents declared dividends that will be paid in cash rather than other consideration.

The statement of owners' equity reports the dividends declared during the reporting period and the cash-flow statement reports dividends paid during the reporting period, which may or may not be the same due to timing.

2 Intel's 2015 Form 10-K, page 68.
3 Intel's 2015 Form 10-K, page 68.
4 FASB Master Glossary.

Balance as of December 26, 2015

Balance as of December 26, 2015 reports Intel's ending 2015 owners' equity balance. Analyzing the rows and columns explains the reasons why owners' equity changed during the year. For example, we see retained earnings increased $4,196 during 2015 (from $33,418 at the end of 2014 to $37,614 at the end of 2015). There are four numbers in the retained earnings column that explain the change: $11,420, ($2,548), ($120) and ($4,556).

Connecting these numbers to the descriptions on the left side of the corresponding rows, we see the events that caused the change in Intel's retained earnings: net income, repurchase of stock, restricted stock unit withholdings, and dividends. Intel's statement includes the two most common events that affect retained earnings during a reporting period: net income and dividends.

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