

COGNIZANT TECHNOLOGY SOLUTIONS CORP  
Form 10-Q  
October 30, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

Quarterly  
Report  
pursuant to  
Section 13 or  
15(d) of the  
Securities  
Exchange  
Act of 1934  
For the  
quarterly  
period ended  
September  
30, 2018  
Transition  
Report  
pursuant to  
Section 13 or  
15(d) of the  
Securities  
Exchange  
Act of 1934  
For the  
transition  
period from

to

Commission File Number 0-24429

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION  
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	13-3728359 (I.R.S. Employer Identification No.)
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Glenpointe Centre West 500 Frank W. Burr Blvd.	07666
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Teaneck, New Jersey

(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (201) 801-0233

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No:

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's class of common stock, as of October 23, 2018:

Class	Number of Shares
Class A Common Stock, par value \$.01 per share	579,028,009

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## PART I. FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements (Unaudited).

COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION  
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Unaudited)

(in millions, except par values)

	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,339	\$ 1,925
Short-term investments	3,424	3,131
Trade accounts receivable, net of allowances of \$68 and \$65, respectively	3,187	2,865
Unbilled accounts receivable	—	357
Other current assets	777	833
Total current assets	8,727	9,111
Property and equipment, net	1,362	1,324
Goodwill	3,037	2,704
Intangible assets, net	1,021	981
Deferred income tax assets, net	391	418
Long-term investments	93	235
Other noncurrent assets	643	448
Total assets	\$ 15,274	\$ 15,221
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 223	\$ 210
Deferred revenue	244	383
Short-term debt	100	175
Accrued expenses and other current liabilities	2,126	2,071
Total current liabilities	2,693	2,839
Deferred revenue, noncurrent	72	104
Deferred income tax liabilities, net	157	146
Long-term debt	624	698
Long-term income taxes payable	490	584
Other noncurrent liabilities	260	181
Total liabilities	4,296	4,552
Commitments and contingencies (See <a href="#">Note 13</a> )		
Stockholders' equity:		
Preferred stock, \$0.10 par value, 15.0 shares authorized, none issued	—	—
Class A common stock, \$0.01 par value, 1,000 shares authorized, 580 and 588 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	6	6
Additional paid-in capital	119	49
Retained earnings	11,041	10,544
Accumulated other comprehensive income (loss)	(188 )	70
Total stockholders' equity	10,978	10,669
Total liabilities and stockholders' equity	\$ 15,274	\$ 15,221

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in millions, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues	\$4,078	\$3,766	\$11,996	\$10,982
Operating expenses:				
Cost of revenues (exclusive of depreciation and amortization expense shown separately below)	2,480	2,337	7,298	6,792
Selling, general and administrative expenses	734	674	2,250	2,069
Depreciation and amortization expense	119	107	340	297
Income from operations	745	648	2,108	1,824
Other income (expense), net:				
Interest income	47	34	128	97
Interest expense	(6 )	(6 )	(19 )	(18 )
Foreign currency exchange gains (losses), net	(122 )	(16 )	(233 )	41
Other, net	(2 )	(2 )	(2 )	(2 )
Total other income (expense), net	(83 )	10	(126 )	118
Income before provision for income taxes	662	658	1,982	1,942
Provision for income taxes	(185 )	(164 )	(530 )	(421 )
Income from equity method investments	—	1	1	1
Net income	\$477	\$495	\$1,453	\$1,522
Basic earnings per share	\$0.82	\$0.84	\$2.49	\$2.56
Diluted earnings per share	\$0.82	\$0.84	\$2.48	\$2.55
Weighted average number of common shares outstanding - Basic	579	590	584	594
Dilutive effect of shares issuable under stock-based compensation plans	1	2	1	2
Weighted average number of common shares outstanding - Diluted	580	592	585	596
Dividends declared per common share	\$0.20	\$0.15	\$0.60	\$0.30

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	\$477	\$495	\$1,453	\$1,522
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(12 )	33	(46 )	100
Change in unrealized gains and losses on cash flow hedges	(82 )	(22 )	(205 )	56
Change in unrealized gains and losses on available-for-sale securities	—	—	(6 )	2
Other comprehensive income (loss)	(94 )	11	(257 )	158
Comprehensive income	\$383	\$506	\$1,196	\$1,680

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited)

(in millions)

	Class A Common Stock			Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Total
	Shares	Amount	Additional Paid-in Capital		Income	(Loss)	
Balance, December 31, 2017	588	\$ 6	\$ 49	\$10,544	\$ 70		\$10,669
Cumulative effect of changes in accounting principle <sup>(1)</sup>	—	—	—	122	(1	)	121
Net income	—	—	—	1,453	—		1,453
Other comprehensive income (loss)	—	—	—	—	(257	)	(257 )
Common stock issued, stock-based compensation plans	5	—	142	—	—		142
Stock-based compensation expense	—	—	199	—	—		199
Repurchases of common stock	(13 )	—	(271 )	(723 )	—		(994 )
Dividends	—	—	—	(355 )	—		(355 )
Balance, September 30, 2018	580	\$ 6	\$ 119	\$11,041	\$ (188	)	\$10,978

	Class A Common Stock			Retained Earnings	Accumulated Other Comprehensive Income (Loss)		Total
	Shares	Amount	Additional Paid-in Capital		Income	(Loss)	
Balance, December 31, 2016	608	\$ 6	\$ 358	\$10,478	\$ (114	)	\$10,728
Net income	—	—	—	1,522	—		1,522
Other comprehensive income (loss)	—	—	—	—	158		158
Common stock issued, stock-based compensation plans	6	—	146	—	—		146
Stock-based compensation expense	—	—	161	—	—		161
Repurchases of common stock	(24 )	—	(457 )	(1,100 )	—		(1,557 )
Dividends	—	—	—	(179 )	—		(179 )
Balance, September 30, 2017	590	\$ 6	\$ 208	\$10,721	\$ 44		\$10,979

(1) Reflects the adoption of accounting standards as described in Note 1.

The accompanying notes are an integral part of the unaudited consolidated financial statements.



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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in millions)

	For the Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$1,453	\$1,522
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	367	321
Provision for doubtful accounts	5	12
Deferred income taxes	46	(46)
Stock-based compensation expense	199	161
Other	196	(49)
Changes in assets and liabilities:		
Trade accounts receivable	(313)	(284)
Other current assets	338	21
Other noncurrent assets	(194)	(65)
Accounts payable	(5)	(5)
Deferred revenues, current and noncurrent	(116)	(21)
Other current and noncurrent liabilities	(86)	4
Net cash provided by operating activities	1,890	1,571
Cash flows from investing activities:		
Purchases of property and equipment	(281)	(204)
Purchases of available-for-sale investment securities	(1,356)	(2,163)
Proceeds from maturity or sale of available-for-sale investment securities	1,516	2,352
Purchases of held-to-maturity investment securities	(1,093)	(1,015)
Proceeds from maturity of held-to-maturity investment securities	750	208
Purchases of other investments	(479)	(363)
Proceeds from maturity or sale of other investments	345	835
Payments for business combinations, net of cash acquired	(479)	(72)
Net cash (used in) investing activities	(1,077)	(422)
Cash flows from financing activities:		
Issuance of common stock under stock-based compensation plans	142	146
Repurchases of common stock	(994)	(1,557)
Repayment of term loan borrowings and capital lease obligations	(89)	(62)
Net change in notes outstanding under the revolving credit facility	(75)	—
Dividends paid	(352)	(179)
Net cash (used in) financing activities	(1,368)	(1,652)
Effect of exchange rate changes on cash and cash equivalents	(31)	46
(Decrease) in cash and cash equivalents	(586)	(457)
Cash and cash equivalents, beginning of year	1,925	2,034
Cash and cash equivalents, end of period	\$1,339	\$1,577

The accompanying notes are an integral part of the unaudited consolidated financial statements.



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COGNIZANT TECHNOLOGY SOLUTIONS CORPORATION  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited)

Note 1 —  
 Interim  
 Consolidated  
 Financial  
 Statements

The terms “Cognizant,” “we,” “our,” “us” and “the Company” refer to Cognizant Technology Solutions Corporation and its subsidiaries unless the context indicates otherwise. We have prepared the accompanying unaudited consolidated financial statements included herein in accordance with generally accepted accounting principles in the United States of America, or U.S. GAAP, and Regulation S-X under the Securities Exchange Act of 1934, as amended, or the Exchange Act. The accompanying unaudited consolidated financial statements should be read in conjunction with our audited consolidated financial statements (and notes thereto) included in our Annual Report on Form 10-K for the year ended December 31, 2017. In our opinion, all adjustments considered necessary for a fair statement of the accompanying unaudited consolidated financial statements have been included and all adjustments are of a normal and recurring nature. Operating results for the interim periods are not necessarily indicative of results that may be expected to occur for the entire year.

Recently Adopted Accounting Pronouncements

Date Issued and Topic	Date Adopted and Method	Description	Impact
May 2014 Revenue	January 1, 2018 Modified Retrospective	The new standard, as amended, sets forth a single comprehensive model for recognizing and reporting revenues. The standard also requires additional financial statement disclosures that enable users to understand the nature, amount, timing and uncertainty of revenues and cash flows relating to customer contracts. The standard allows for two methods of adoption: the full retrospective adoption, which requires the standard to be applied to each prior period presented, or the modified retrospective adoption, which requires the cumulative effect of adoption to be recognized as an adjustment to opening retained earnings in the period of adoption.	See <a href="#">Note 3</a> for the impact of adoption of this standard.
November 2016 Statement of Cash Flows	January 1, 2018 Retrospective	This update requires restricted cash to be included with cash and cash equivalents when reconciling the beginning and ending amounts on the statement of cash flows. It also requires a reconciliation of such totals to the amounts on the statement of financial position and disclosure as to the nature of the restrictions.	There were no restricted cash balances as of September 30, 2018. The adoption of this update had no impact on our financial statements for the three and nine months ended September 30, 2018.
February 2018 Income Statement - Reporting	January 1, 2018	This update provides an option for entities to reclassify stranded tax effects caused by the recently-enacted Tax Cuts and Jobs Act, or Tax Reform Act, from accumulated other comprehensive income to retained	We have early adopted this update as of January 1, 2018. The adoption resulted in a decrease of \$1 million

Comprehensive Income    In the period of adoption    earnings.

in accumulated other comprehensive income and a corresponding increase of \$1 million to opening retained earnings.

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## New Accounting Pronouncements

Date Issued and Topic	Effective Date	Description	Impact
February 2016 Leases	January 1, 2019	The new standard replaces the existing guidance on leases and requires the lessee to recognize a right-of-use asset and a lease liability for all leases with lease terms equal to or greater than twelve months. For finance leases, the lessee would recognize interest expense and amortization of the right-of-use asset, and for operating leases, the lessee would recognize total lease expense on a straight-line basis. The standard offers several practical expedients for transition and certain expedients specific to lessees or lessors. The standard allows for two methods of adoption: retrospective to each prior reporting period presented with the cumulative effect of adoption recognized at the beginning of the earliest period presented or retrospective to the beginning of the period of adoption through a cumulative-effect adjustment.	While we are continuing to evaluate the provisions of this standard, the primary effect will be to require recording of right-of-use assets and corresponding lease obligations for current operating leases. We expect the adoption of this standard to have a material impact on our consolidated statement of financial position, but not on the consolidated statements of operations or cash flows. As of December 31, 2017, our undiscounted operating lease commitments were \$943 million. We are currently planning to elect the package of practical expedients which permits us to not reassess prior conclusions related to contracts containing leases, lease classification and initial direct costs. We intend to adopt the standard retrospectively to the beginning of the period of adoption through a cumulative-effect adjustment.
March 2017 Nonrefundable Fees and Other Costs	January 1, 2019	This update shortens the amortization period for certain callable debt securities held at a premium to the earliest call date. The amendments do not require an accounting change for securities held at a discount. Upon adoption, entities will be required to use a modified retrospective transition with the cumulative effect adjustment recognized to retained earnings as of the beginning of the period of adoption.	We do not expect the adoption of this update to have a material impact on our financial statements.
August 2018 Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement (CCA) that is a Service Contract	January 1, 2020	This update aligns the accounting for costs incurred to implement a CCA that is a service arrangement with the guidance on capitalizing costs associated with developing or obtaining internal-use software. The update clarifies that a customer should capitalize certain implementation costs and subsequently amortize such costs over the term of the hosting arrangement as operating expenses.	We are currently evaluating the effect this update will have on our consolidated financial statements and related disclosures.
Note 2 — Internal			

Investigation  
and Related  
Matters

We have substantially completed our internal investigation focused on whether certain payments relating to Company-owned facilities in India were made improperly and in possible violation of the U.S. Foreign Corrupt Practices Act, or FCPA, and other applicable laws. The investigation, which began in 2016, has also examined various other payments made in small amounts in India that may not have complied with Company policy or applicable law. In September 2016, we voluntarily notified the U.S. Department of Justice, or DOJ, and Securities and Exchange Commission, or SEC, and are cooperating fully with both agencies. The investigation has been conducted under the oversight of the Audit Committee, with the assistance of outside counsel. In connection with the investigation, during the year ended December 31, 2016, we recorded out-of-period corrections related to \$4 million of potentially improper payments between 2009 and 2016 that had been previously capitalized when they should have been expensed. These out-of-period corrections were not material to any previously issued financial statements. There were no adjustments recorded during 2018 and 2017 related to the amounts under investigation.

The Company's discussions with the DOJ and SEC have progressed to a point where the Company can now reasonably estimate a probable loss and has recorded an accrual of \$28 million, or FCPA Accrual, in the caption "Accrued expenses and other

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current liabilities” in our consolidated statements of financial position. There can be no assurance as to the timing of a final resolution of these matters with the DOJ and SEC.

Note 3 —  
Revenues

Adoption of ASC Topic 606, “Revenue from Contracts with Customers”

On January 1, 2018, we adopted ASC Topic 606, “Revenue from Contracts with Customers,” or the New Revenue Standard, using the modified retrospective method applied to contracts that were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under the New Revenue Standard, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting policies. For contracts that were modified before the effective date, the Company aggregated the effect of all contract modifications prior to identifying performance obligations and allocating transaction price in accordance with the practical expedient ASC 606-10-65-1-(f)-4. Upon adoption of the New Revenue Standard on January 1, 2018, we recorded a net increase to opening retained earnings of approximately \$121 million, after a tax impact of \$37 million. The impact of adoption primarily relates to (1) changes in the method used to measure progress on our fixed-price application maintenance, consulting and business process services contracts, (2) the longer period of amortization for costs to fulfill a contract, (3) the timing of revenue recognition and allocation of purchase price on our software license contracts, (4) the reclassification of balances representing receivables, as defined by the New Revenue Standard, from Unbilled accounts receivable to Trade accounts receivable, net, (5) the reclassification of balances representing contract assets, as defined by the New Revenue Standard, from Unbilled accounts receivable to Other current assets, as well as (6) the income tax impact of the above items, as applicable.

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The following tables compare the financial statement line items materially affected by the adoption of the New Revenue Standard as of and for the three and nine months ended September 30, 2018 to the pro-forma amounts had the previous guidance been in effect, or Pro-forma Amounts:

	September 30, 2018					
	As Reported	Pro-forma Amounts	Impacts of the New Revenue Standard	As Reported	Pro-forma Amounts	Impacts of the New Revenue Standard
	(in millions)					
<b>Assets:</b>						
Trade accounts receivable, net <sup>(1), (2)</sup>	\$3,187	\$ 3,073	\$ 114			
Unbilled accounts receivable <sup>(1), (3)</sup>	—	432	(432 )			
Other current assets <sup>(2), (3)</sup>	777	457	320			
Total current assets			2			
Other noncurrent assets <sup>(4)</sup>	643	589	54			
Total assets			\$ 56			
<b>Liabilities:</b>						
Deferred revenue <sup>(2)</sup>	\$244	\$ 417	\$ (173 )			
Total current liabilities			(173 )			
Deferred revenue, noncurrent <sup>(2)</sup>	72	106	(34 )			
Deferred income tax liabilities, net <sup>(5)</sup>	157	100	57			
Total liabilities			(150 )			
<b>Stockholders' equity:</b>						
Retained earnings	11,041	10,835	206			
Total stockholders' equity			206			
Total liabilities and stockholders' equity			\$ 56			
	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	As Reported	Pro-forma Amounts	Impacts of the New Revenue Standard	As Reported	Pro-forma Amounts	Impacts of the New Revenue Standard
	(in millions)			(in millions)		
Revenues <sup>(2)</sup>	\$4,078	\$ 4,045	\$ 33	\$11,996	\$11,911	\$ 85
Cost of revenues <sup>(4)</sup>	2,480	2,484	(4 )	7,298	7,317	(19 )
Selling, general and administrative expenses	734	734	—	2,250	2,250	—
Depreciation and amortization expense	119	119	—	340	340	—
Income from operations	745	708	37	2,108	2,004	104
Other income (expense), net	(83 )	(84 )	1	(126 )	(127 )	1
Income before provision for income taxes <sup>(5)</sup>	662	624	38	1,982	1,877	105
Provision for income taxes	(185 )	(178 )	(7 )	(530 )	(510 )	(20 )
Income (loss) from equity method investment	—	—	—	1	1	—
Net income	\$477	\$ 446	\$ 31	\$1,453	\$1,368	\$ 85
Basic earnings per share	\$0.82	\$ 0.77	\$ 0.05	\$2.49	\$2.34	\$ 0.15
Diluted earnings per share	\$0.82	\$ 0.77	\$ 0.05	\$2.48	\$2.34	\$ 0.14

(1)



Reflects the reclassification of balances representing receivables, as defined by the New Revenue Standard, from Unbilled accounts receivable to Trade accounts receivable, net.

Reflects the impact of changes in the method used to measure progress on our fixed-price application maintenance, consulting and business process services contracts and the timing of revenue recognition and allocation of purchase price on our software license contracts.

(3) Reflects the reclassification of balances representing contract assets, as defined by the New Revenue Standard, from Unbilled accounts receivable to Other current assets.

(4) Reflects the impact of a longer period of amortization for costs to fulfill a contract.

(5) Reflects the income tax impact of the above items.

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### Revenue Recognition

We recognize revenues as we transfer control of deliverables (products, solutions and services) to our customers in an amount reflecting the consideration to which we expect to be entitled. To recognize revenues, we apply the following five step approach: (1) identify the contract with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenues when a performance obligation is satisfied. We account for a contract when it has approval and commitment from all parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable. The Company applies judgment in determining the customer's ability and intention to pay, which is based on a variety of factors including the customer's historical payment experience.

We may enter into arrangements that consist of multiple performance obligations. Such arrangements may include any combination of our deliverables. To the extent a contract includes multiple promised deliverables, we apply judgment to determine whether promised deliverables are capable of being distinct and are distinct in the context of the contract. If these criteria are not met, the promised deliverables are accounted for as a combined performance obligation. For arrangements with multiple distinct performance obligations, we allocate consideration among the performance obligations based on their relative standalone selling price. Standalone selling price is the price at which we would sell a promised good or service separately to the customer. When not directly observable, we typically estimate standalone selling price by using the expected cost plus a margin approach. We typically establish a standalone selling price range for our deliverables, which is reassessed on a periodic basis or when facts and circumstances change.

For performance obligations where control is transferred over time, revenues are recognized based on the extent of progress towards completion of the performance obligation. The selection of the method to measure progress towards completion requires judgment and is based on the nature of the deliverables to be provided. Revenues related to fixed-price contracts for application development and systems integration services, consulting or other technology services are recognized as the service is performed using the cost to cost method, under which the total value of revenues is recognized on the basis of the percentage that each contract's total labor cost to date bears to the total expected labor costs. Revenues related to fixed-price application maintenance, testing and business process services are recognized based on our right to invoice for services performed for contracts in which the invoicing is representative of the value being delivered, in accordance with the practical expedient in ASC 606-10-55-18. If our invoicing is not consistent with value delivered, revenues are recognized as the service is performed based on the cost to cost method described above. The cost to cost method requires estimation of future costs, which is updated as the project progresses to reflect the latest available information; such estimates and changes in estimates involve the use of judgment. The cumulative impact of any revision in estimates is reflected in the financial reporting period in which the change in estimate becomes known and any anticipated losses on contracts are recognized immediately. Revenues related to fixed-price hosting and infrastructure services are recognized based on our right to invoice for services performed for contracts in which the invoicing is representative of the value being delivered, in accordance with the practical expedient in ASC 606-10-55-18. If our invoicing is not consistent with value delivered, revenues are recognized on a straight-line basis unless revenues are earned and obligations are fulfilled in a different pattern. The revenue recognition method applied to the types of contracts described above provides the most faithful depiction of performance towards satisfaction of our performance obligations; for example, the cost to cost method is used when the value of services provided to the customer is best represented by the costs expended to deliver those services.

Revenues related to our non-hosted software license arrangements that do not require significant modification or customization of the underlying software are recognized when the software is delivered as control is transferred at a point in time. For software license arrangements that require significant functionality enhancements or modification of the software, revenues for the software license and related services are recognized as the services are performed in accordance with the methods described above. In software hosting arrangements, the rights provided to the customer,

such as ownership of a license, contract termination provisions and the feasibility of the client to operate the software, are considered in determining whether the arrangement includes a license or a service. Sales and usage-based fees promised in exchange for licenses of intellectual property are not recognized as revenue until the uncertainty related to the variable amounts is resolved. Revenues related to software maintenance and support are generally recognized on a straight-line basis over the contract period.

Revenues related to our time-and-materials, transaction-based or volume-based contracts are recognized over the period the services are provided in a manner that corresponds with the value transferred to the customer to-date relative to the remaining services to be provided.

Revenues also include the reimbursement of out-of-pocket expenses. Our warranties generally provide a customer with assurance that the related deliverable will function as the parties intended because it complies with agreed-upon specifications and is therefore not considered an additional performance obligation in the contract.

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From time to time, we may enter into arrangements with third party suppliers to resell products or services. In such cases, we evaluate whether we are the principal (i.e. report revenues on a gross basis) or agent (i.e. report revenues on a net basis). In doing so, we first evaluate whether we control the good or service before it is transferred to the customer. If we control the good or service before it is transferred to the customer, we are the principal; if not, we are the agent. Determining whether we control the good or service before it is transferred to the customer may require judgment.

Our contracts may be modified to add, remove or change existing performance obligations. The accounting for modifications to our contracts involves assessing whether the services added to an existing contract are distinct and whether the pricing is at the standalone selling price. Services added that are not distinct are accounted for on a cumulative catch up basis, while those that are distinct are accounted for prospectively, either as a separate contract if the additional services are priced at the standalone selling price, or as a termination of the existing contract and creation of a new contract if not priced at the standalone selling price. Services added to our application development and systems integration service contracts are typically not distinct, while services added to our other contracts, including application maintenance, testing and business process services contracts, are typically distinct.

Incentive revenues, volume discounts, or any other form of variable consideration is estimated using either the sum of probability weighted amounts in a range of possible consideration amounts (expected value), or the single most likely amount in a range of possible consideration amounts (most likely amount), depending on which method better predicts the amount of consideration to which we may be entitled. We include in the transaction price variable consideration only to the extent it is probable that a significant reversal of revenues recognized will not occur when the uncertainty associated with the variable consideration is resolved. Our estimates of variable consideration and determination of whether to include estimated amounts in the transaction price may involve judgment and are based largely on an assessment of our anticipated performance and all information that is reasonably available to us.

We assess the timing of the transfer of goods or services to the customer as compared to the timing of payments to determine whether a significant financing component exists. As a practical expedient, we do not assess the existence of a significant financing component when the difference between payment and transfer of deliverables is a year or less. If the difference in timing arises for reasons other than the provision of finance to either the customer or us, no financing component is deemed to exist. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our services, not to receive or provide financing from or to customers. We do not consider set up or transition fees paid upfront by our customers to represent a financing component, as such fees are required to encourage customer commitment to the project and protect us from early termination of the contract.

## Costs to Fulfill

Recurring operating costs for contracts with customers are recognized as incurred. Certain eligible, nonrecurring costs incurred in the initial phases of our application maintenance, business process outsourcing and infrastructure services contracts (i.e. set-up or transition costs) are capitalized when such costs (1) relate directly to the contract, (2) generate or enhance resources of the Company that will be used in satisfying the performance obligation in the future, and (3) are expected to be recovered. These costs are expensed ratably over the estimated life of the customer relationship, including expected renewals. In determining the estimated life of the customer relationship, we evaluate the average contract term, on a portfolio basis by nature of the services to be provided, and apply judgment to evaluate the rate of technological and industry change. Capitalized amounts are monitored regularly for impairment. Impairment losses are recorded when projected remaining undiscounted operating cash flows are not sufficient to recover the carrying amount of the capitalized costs to fulfill.

The following table presents information related to the capitalized costs to fulfill, such as set-up or transition activities, for the nine months ended September 30, 2018. Costs to fulfill are recorded in "Other noncurrent assets" in our consolidated statements of financial position. Costs to obtain contracts were immaterial for the periods disclosed.

	Costs to Fulfill (in millions)
Balance - January 1, 2018	\$ 303
Amortization expense	(50 )
Costs capitalized	132
Other	(2 )
Balance - September 30, 2018	\$ 383

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## Trade Accounts Receivable and Contract Balances

We classify our right to consideration in exchange for deliverables as either a receivable or a contract asset. A receivable is a right to consideration that is unconditional (i.e. only the passage of time is required before payment is due). For example, we recognize a receivable for revenues related to our time and materials and transaction or volume-based contracts when earned regardless of whether amounts have been billed. We present such receivables in Trade accounts receivable, net in our consolidated statements of financial position at their net estimated realizable value. We maintain an allowance for doubtful accounts to provide for the estimated amount of receivables that may not be collected. The allowance is based upon an assessment of customer creditworthiness, historical payment experience, the age of outstanding receivables and other applicable factors.

A contract asset is a right to consideration that is conditional upon factors other than the passage of time. Contract assets are presented in Other current assets in our consolidated statements of financial position and primarily relate to unbilled amounts on fixed-price contracts utilizing the cost to cost method of revenue recognition. The table below shows significant movements in contract assets:

	Contract Assets (in millions)
Balance - January 1, 2018	\$ 306
Revenues recognized during the period but not billed	290
Amounts reclassified to accounts receivable	(273 )
Other	(3 )
Balance - September 30, 2018	\$ 320

Our contract liabilities, or deferred revenue, consist of advance payments and billings in excess of revenues recognized. We classify deferred revenue as current or noncurrent based on the timing of when we expect to recognize the revenues. The noncurrent portion of deferred revenue is included in other noncurrent liabilities in our consolidated statements of financial position.

The table below shows significant movements in the deferred revenue balances (current and noncurrent) for the period disclosed:

	Deferred Revenue (in millions)
Balance - January 1, 2018	\$ 431
Amounts billed but not recognized as revenues	116
Revenues recognized related to the opening balance of deferred revenue	(230 )
Other	(1 )
Balance - September 30, 2018	\$ 316

Our contract assets and liabilities are reported in a net position on a contract by contract basis at the end of each reporting period. The difference between the opening and closing balances of our contract assets and deferred revenues primarily results from the timing difference between our performance obligations and the customer's payment. We receive payments from customers based on the terms established in our contracts, which vary by contract type.

Revenues recognized during the nine months ended September 30, 2018 for performance obligations satisfied or partially satisfied in previous periods were immaterial.



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## Remaining Performance Obligations

ASC 606 requires that we disclose the aggregate amount of transaction price that is allocated to performance obligations that have not yet been satisfied as of September 30, 2018. This disclosure is not required for:

- (1) contracts with a duration of one year or less as determined under ASC 606,
- (2) contracts for which we recognize revenues based on the right to invoice for services performed, variable consideration allocated entirely to a wholly unsatisfied performance obligation or to a wholly
- (3) unsatisfied promise to transfer a distinct good or service that forms part of a single performance obligation in accordance with ASC 606-10-25-14(b), for which the criteria in ASC 606-10-32-40 have been met, or variable consideration in the form of a sales-based or usage based royalty promised in exchange for a license of
- (4) intellectual property.

Many of our performance obligations meet one or more of these exemptions. As of September 30, 2018, the aggregate amount of transaction price allocated to remaining performance obligations, other than those meeting the exclusion criteria above, was \$2,014 million, of which approximately 70% is expected to be recognized as revenues within 2 years.

## Disaggregation of Revenues

The table below presents disaggregated revenues from contracts with customers by customer location, service line and contract-type for each of our business segments. We believe this disaggregation best depicts how the nature, amount, timing and uncertainty of our revenues and cash flows are affected by industry, market and other economic factors.

	Three Months Ended September 30, 2018				
	Financial Services	Healthcare	Products and Resources	Communications, Media and Technology	Total
	(in millions)				
<b>Revenues</b>					
<b>Geography:</b>					
North America	\$1,033	\$ 1,084	\$ 609	\$ 381	\$3,107
United Kingdom	127	23	90	85	325
Rest of Europe	170	69	109	50	398
Europe - Total	297	92	199	135	723
Rest of World	134	13	55	46	248
Total	\$1,464	\$ 1,189	\$ 863	\$ 562	\$4,078
<b>Service line:</b>					
Consulting and technology services	\$902	\$ 645	\$ 512	\$ 292	\$2,351
Outsourcing services	562	544	351	270	1,727
Total	\$1,464	\$ 1,189	\$ 863	\$ 562	\$4,078
<b>Type of contract:</b>					
Time and materials	\$954	\$ 464	\$ 374	\$ 354	\$2,146
Fixed-price	453	452	392	187	1,484
Transaction or volume-based	57	273	97	21	448
Total	\$1,464	\$ 1,189	\$ 863	\$ 562	\$4,078



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Nine Months Ended  
September 30, 2018

	Financial Services	Healthcare	Products and Resources	Communications, Media and Technology	Total
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(in millions)

## Revenues

## Geography:

North America	\$3,133	\$ 3,167	\$ 1,766	\$ 1,083	\$9,149
United Kingdom	357	68	266	253	944
Rest of Europe	497	191	327	138	1,153
Europe - Total	854	259	593	391	2,097
Rest of World	407	40	165	138	750
Total	\$4,394	\$ 3,466			