Microsoft Corporation One Microsoft Way Redmond, WA 98052-6399

Tel 425 882 8080 Fax 425 936 7329 http://www.microsoft.com/ Letter of Comment No: 26File Reference: 1122-001 Date Received: $|0| \le |0|$



October 5, 2001

Mr. Timothy S. Lucas Director of Research and Technical Activities Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856-5116

Dear Tim:

Microsoft appreciates the opportunity to respond to the Proposals to add two potential major projects to the Board's agenda: reporting financial performance and disclosure about intangibles. We do not currently support the addition to the FASB's agenda of a project on reporting information about the financial performance of business enterprises. On the other hand, Microsoft would support the addition to the FASB's agenda of a project on disclosure of information about intangible assets not recognized in financial statements. However, as noted in our response to the 2001 FASAC Survey on the Priorities of the FASB, we believe there are other projects, in particular, examining the problems associated with standards overload, that warrant greater consideration for addition to the FASB's agenda than a project on disclosure about intangibles.

The term "standards overload" encompasses a number of separate but related issues. In our opinion, the most serious issues are the volume, complexity, and detail of accounting standards, and disclosure effectiveness. Microsoft believes these are problems which need to be addressed immediately. Furthermore, we believe a significant amount of the problems concerning the volume, complexity, and detail of accounting standards comes from what seems to be the issuance of detailed accounting guidance on almost every accounting question that is raised. One of the root causes of this is a complete lack of faith in the professional judgment of preparers and auditors. Unfortunately, this lack of faith results in preparers and auditors looking to standard setters for all of the answers, rather than relying on professional judgment, applied consistently and with integrity. Microsoft suggests that the FASB develop a framework for when formal guidance should be provided on specific issues or questions. We think a framework similar to what exists for when a project should be added to the FASB's agenda would be useful. For instance, what is the pervasiveness of the issue in question and can it be justified that formal accounting guidance should be issued in light of the volume, complexity, and detail of accounting guidance that already exists.

With respect to disclosure effectiveness, it is our position that standard setters put on "blinders" when discussing disclosure requirements and look at them only in the context

of the accounting issue being discussed, rather than within the context of all the disclosures that are currently required. Accordingly, we strongly urge the FASB to again try to develop a framework for disclosures that can be used as a guide when they are discussed in the context of a specific accounting issue.

Microsoft does not believe the FASB can be successful in providing a technically sound solution that will be accepted generally on the issue of reporting financial performance. One of the main reasons for this potential project seems to be increased pro forma reporting and other evidence suggesting that the use of and reliance on net income as an indicator of performance is decreasing. However, in a general sense, it seems like the FASB would have little control over this no matter what it does. While new rules would become GAAP, companies will continue with pro forma reporting if they believe that provides better information to users of their financial statements. Furthermore, we believe the concerns over pro forma reporting have diminished due to voluntary guidelines issued by the preparer community. In April of this year, Financial Executives International and the National Investor Relations Institute jointly issued best practices guidelines for company-issued earnings press releases addressing, in particular, the use of pro forma numbers. FEI and NIRI concluded that although pro forma results may sometimes be more analytically useful, such results should always be accompanied by a clearly described reconciliation to GAAP results, which provides a critical framework for pro forma numbers. Based on a recent meeting between the SEC Subcommittee of the Committee on Corporate Reporting of the FEI and the SEC staff, it is our understanding that the SEC has seen improvements in earnings releases due to these recommendations.

A project on the disclosure of information about intangible assets not recognized in financial statements could be a good first step in evaluating whether changes should be made in how intangible assets are recognized and measured. However, we can't overemphasize our position that a disclosure project should be undertaken without any presumption about eventual recognition issues. After a few years with disclosure, an objective study should be performed to see if the disclosures provide useful information to investors and creditors in relation to the costs companies incur to provide that information. It is only at this time that we believe an informed debate can occur regarding whether the recognition of internally generated intangibles will produce more useful information to investors and creditors.

Additional comments on the issues raised in each of the Proposals are attached. If you have any questions, please contact me at (425) 703-6094.

Sincerely,

Bob Laux Director, External Reporting

REPORTING INFORMATION ABOUT THE FINANCIAL PERFORMANCE OF BUSINESS ENTERPRISES: Focusing on the Form and Content of Financial Statements

Microsoft does not believe the FASB can be successful in providing a technically sound solution that will be accepted generally from a project that comprehensively addresses the reporting of financial information for assessing the financial performance of a business enterprise. One of the main reasons for this potential project seems to be increased pro forma reporting and other evidence suggesting that the use of and reliance on net income as an indicator of performance is decreasing. However, as pointed out in our cover letter, we believe the concerns over pro forma reporting have diminished due to voluntary guidelines issued by the preparer community and, furthermore, it seems like the FASB would have little control over pro forma reporting no matter what it does. In addition, we do not believe a standardized answer even exists for some of the other problems noted. such as "no common definitions of the elements of financial performance" and "no consensus or common definitions for the key financial measures or indicators of financial performance that financial statements or financial reporting should provide", which are heavily influence by company specifics and the type of industry in which a company operates. For example, EBITDA would have absolutely no relevance to users of Microsoft's financial statements since we have no debt and the dollar amount of our fixed assets is small in comparison to other items on our balance sheet.

The proposed scope of the project seems way too ambitious and we think the Board is not being at all realistic if it believes such a project could be completed in three to four years. Even the minimum approach tentatively adopted by the Board has six key issues which each seem like major project on their own. For instance, the second key issue includes what seems to be an innocent comment that, "If specified items of operating cash inflows or outflows were identified as key performance indicators, should companies be required to use the direct method of reporting operating cash flows". We do not believe it would be as simple as mandating that only the direct or indirect method be used. Rather, one would need to define what is the direct method. Would it mean that the cash aspects of certain items would have to be gathered directly from an accounting system or is it that some items can be backed into indirectly? We believe people are being naïve if they think that direct cash flow information can be obtained from existing accounting systems without significant costs and effort. Furthermore, we note that it was approximately seven year from the issuance of the Discussion Memorandum, Reporting Funds Flow, Liquidity, and Financial Flexibility, until FAS 95 was issued.

DISCLOSURE OF INFORMATION ABOUT INTANGIBLE ASSETS NOT RECOGNIZED IN FINANCIAL STATEMENTS

While there are other projects, in particular, examining the problems associated with standards overload, that we believe warrant greater consideration for addition to the FASB's agenda, Microsoft would support the addition to the FASB's agenda of a project on disclosure of information about intangible assets not recognized in financial statements. However, we strongly urge that if this project is added to the FASB's agenda, it be undertaken without any presumption about eventual recognition issues.

A project on the disclosure of information about intangible assets not recognized in financial statements could be a good first step in evaluating whether changes should be made in how intangible assets are recognized and measured. This would allow companies to begin the identification of intangible assets and the collection of information not previously captured in management reporting systems. After a few years with disclosure, an objective study should be performed to see if the disclosures provide useful information to investors and creditors in relation to the costs companies incur to provide that information.

We believe an acceptable objective of the project would be to provide quantitative and qualitative disclosures about unrecognized intangible assets, including the major classes of intangible assets and their characteristics, and expenditures to develop and maintain them. As this would be the first step in readdressing the accounting for intangible assets, Microsoft would be opposed to an objective of the project being that companies report the fair value of their intangible assets. In fact, if this is one of the objectives of the project, we would imagine that our support for the project would quickly evaporate.

As noted in the Proposal for this potential project, we are encouraged that a first step would be to establish a working group of outside experts to assist the FASB, especially in identifying the relevant issues and possible solutions and in refining user surveys, and Microsoft would be willing to assist in that process.