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March 2, 2007

Ms. Suzanne Bielstein Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856-5116

Re: File Reference No. 1510-100

Dear Sue:

Microsoft appreciates the opportunity to respond to the Exposure Draft (ED), "Disclosures about Derivative Instruments and Hedging Activities". While we agree with the objectives of providing users of financial statements with an enhanced understanding of how and why an entity uses derivatives and the overall effect of derivatives on an entity's financial position, results of operations, and cash flows, we do not believe the detailed requirements of the ED fulfill these objectives.

Furthermore, the ED illustrates, yet again, the problem of standard setters considering disclosures on a "one-off" basis without the consideration of an overall disclosure framework for the financial statements. As we indicated in our reply to the 2006 FASAC Survey on the Priorities of the FASB, the disclosure framework portion of the conceptual framework project needs to be accelerated. The SEC's Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 on Arrangements with Off-Balance-Sheet Implications, Special-Purpose Entities, and Transparency of Filings by Issuers highlighted the importance of this issue and the need to look at it currently. One of the problems with a "one-off" process in considering disclosures is that it fails to consider the usefulness of a disclosure in the context of all financial statement disclosures and whether a less relevant disclosure can be damaging or misleading if relevant information is obscured.

Microsoft strongly believes that by reducing the detailed amount of information required by the ED, the Board can better fulfill the objectives of providing users of financial statements with an enhanced understanding of how and why an entity uses derivatives and the overall effect of derivatives on an entity's financial position, results of operations, and cash flows. In particular, required information in the following areas should be reduced or eliminated, as we do not believe they provide significant additional insight into an entity's use of derivative instruments. Importantly, they would pose considerable

operational challenges because, in many cases, we do not record transactions, manage exposures or measure results in such a way that would allow us to report on and disclose derivatives activity as required by the ED.

Notional amounts by primary underlying risk, accounting designation and purpose.

We believe that notional amounts are rarely used by entities to measure their derivative activities and related risks and as such, provide limited benefit to users of financial statements. In addition, there are a number of operational issues related to disclosure of notional amounts in the manner suggested by the ED.

At Microsoft, notional amounts are entered into our front office system and relevant trade information is then transmitted to the accounting system (or module). Since notional amounts are not currently used for accounting or disclosure purposes, complete notional amount information is not maintained in the accounting system. In order to comply with the proposed disclosure requirements, we will either need to make changes to our existing accounting system to accommodate all notional amounts or put in place an intensive manual process to convert existing data to meet the requirements of the ED. Due to the complexity of providing information by underlying risk, accounting designation and purpose, this process will require a trade level analysis and additional reconciliations to ensure accuracy and consistency of the information between the two systems.

Another operational issue associated with disclosure of notional amounts is determining the appropriate unit of measure to provide meaningful information without unnecessary complexity. For example, in order for the notional amount to be meaningful in an instance where a foreign currency forward contract is used to convert an exposure between two currencies at a foreign subsidiary, neither of which are the reporting currency, an entity would need to disclose the notional amount of both currencies involved. This does not allow aggregation of contracts and may require entities to disclose information for each individual currency pair.

Gross asset and liability derivative and related hedged item information. We believe an understanding of how and why an entity uses derivative instruments is not enhanced with information on whether the derivative is in an asset or a liability position for each underlying risk. The requirement to provide information on gross asset and liability positions, regardless of the existence of master netting arrangements, is both contrary to current accounting guidance and how credit risk is managed. This contradiction poses operational difficulties as it differs from how processes are currently configured and necessitates reconciliation between the information used to compile the new disclosure and the information on the balance sheet. Furthermore, the additional requirement to disclose such information by underlying risk and accounting designation increases the level of complexity required to convert existing accounting information in order to meet the disclosure requirements. While the required information is available, the level of effort that will be required to ensure a consistent and accurate presentation for all components of the disclosure will be significant.

In addition, the table in Appendix A of the ED shows the gain or loss for the hedged item related to the derivatives in an asset or a liability position, while the ED requires only the location and amount of hedged item gains and losses. While we understand the desire to know the amount of hedged item gains and losses by primary underlying risk, accounting designation and purpose, we believe it will be extremely cumbersome to attribute this gain or loss based on whether the related derivative is in an asset or a liability position. Although a linkage exists between the derivative and the related hedged item, our accounting system does not allow gain or loss information to be extracted based on this linkage. Again, in order to extract information in the manner shown in the table, substantial systems changes will be required or a manual process which introduces additional operational and financial reporting risks will need to be implemented.

Location and amount of gains and losses on derivative instruments and related hedged items that existed during the reporting period but are no longer held or designated in a hedging relationship at the end of the reporting period. The relevant period during which management is concerned about the effectiveness of its hedging relationships is when the derivative instrument is outstanding. Once the derivative instrument matures or is terminated, reporting on the previous relationship is no longer required. While the gain or loss for the reporting period is captured in the general ledger and accounting subsystems, there has historically never been a need to provide detailed reporting on the link between the gain or loss on matured or terminated derivatives and the related hedged items. In order to comply with the disclosure requirements in the ED, intricate records beyond those that currently exist will need to be retained. Due to the level of detail involved, we anticipate that major enhancements to our current infrastructure will be necessary to store the large volume of historical data. This is particularly true in instances where many short term derivatives are "rolled over" on a continuous basis to hedge a longer-term exposure.

Interim period reporting. We were surprised that there was no discussion in the Basis for Conclusions justifying this level of detailed disclosure on a quarterly basis. In order to extract, convert and compile the information needed to comply with the interim period requirements of the ED, considerable additional resources will need to be engaged throughout the year. This will be particularly onerous given compressed filing deadlines during interim reporting periods.

Our responses to the individual issues raised in the ED are attached. If you have any questions, please contact me at (425) 703-6094.

Sincerely,

Bob Laux Director, Technical Accounting and Reporting

Scope

Issue 1: The Board concluded that prescriptive guidance about how derivative instruments should be presented and classified in the financial statements should be excluded from the project's scope. Including presentation and classification guidance could potentially delay issuing a standard that would significantly improve the transparency about derivative instruments and hedged items. In addition, various presentation and classification issues related to derivatives and hedged items have an impact on the Board's current project on financial statement presentation and also would need to be addressed in the context of that project.

Do you agree with the Board's decision to exclude from the scope of this proposed Statement prescriptive guidance about how derivative instruments should be presented and classified in the financial statements? Why or why not? (See paragraphs B5–B11 for the basis for the Board's conclusions.)

Response: Yes, Microsoft agrees that the presentation and classification of derivative instruments should be addressed as part of the Board's current project on financial statement presentation.

Issue 2: Statement 133 applies to both public and private entities. The requirements in this proposed Statement also would apply to both public and private entities.

Do you agree that this proposed Statement should apply to both public and private entities? Why or why not?

Response: While we do not have expertise in the area of private entity reporting, it seems those entities applying the requirements of Statement 133 should have to provide the disclosure requirements of this proposed Statement.

Costs of Implementing the Proposed Statement's Disclosure Requirements

Issue 3: This proposed Statement would require an entity to provide information on derivative instruments (including, but not limited to, notional amounts and fair value amounts), hedged items, and related gains and losses, by primary underlying risk, accounting designation, and purpose in the tabular format shown in Appendix A.

Do you foresee any significant operational concerns or constraints in compiling the information in the format required by this proposed Statement? Are there any alternative formats of presentation that would provide the data more concisely? (See paragraphs B18–B20 for the basis for the Board's conclusions.)

Response: Microsoft strongly believes that by reducing the detailed amount of information required by the ED, the Board can better fulfill the objectives of providing

users of financial statements with an enhanced understanding of how and why an entity uses derivatives and the overall effect of derivatives on an entity's financial position, results of operations, and cash flows. In particular, required information in the following areas should be reduced or eliminated, as we do not believe they provide significant additional insight into an entity's use of derivative instruments. Importantly, they would pose considerable operational challenges because, in many cases, we do not record transactions, manage exposures or measure results in such a way that would allow us to report on and disclose derivatives activity as required by the ED.

Notional amounts by primary underlying risk, accounting designation and purpose.

We believe that notional amounts are rarely used by entities to measure their derivative activities and related risks and as such, provide limited benefit to users of financial statements. In addition, there are a number of operational issues related to disclosure of notional amounts in the manner suggested by the ED.

At Microsoft, notional amounts are entered into our front office system and relevant trade information is then transmitted to the accounting system (or module). Since notional amounts are not currently used for accounting or disclosure purposes, complete notional amount information is not maintained in the accounting system. In order to comply with the proposed disclosure requirements, we will either need to make changes to our existing accounting system to accommodate all notional amounts or put in place an intensive manual process to convert existing data to meet the requirements of the ED. Due to the complexity of providing information by underlying risk, accounting designation and purpose, this process will require a trade level analysis and additional reconciliations to ensure accuracy and consistency of the information between the two systems.

Another operational issue associated with disclosure of notional amounts is determining the appropriate unit of measure to provide meaningful information without unnecessary complexity. For example, in order for the notional amount to be meaningful in an instance where a foreign currency forward contract is used to convert an exposure between two currencies at a foreign subsidiary, neither of which are the reporting currency, an entity would need to disclose the notional amount of both currencies involved. This does not allow aggregation of contracts and may require entities to disclose information for each individual currency pair.

Gross asset and liability derivative and related hedged item information. We believe an understanding of how and why an entity uses derivative instruments is not enhanced with information on whether the derivative is in an asset or a liability position for each underlying risk. The requirement to provide information on gross asset and liability positions, regardless of the existence of master netting arrangements, is both contrary to current accounting guidance and how credit risk is managed. This contradiction poses operational difficulties as it differs from how processes are currently configured and necessitates reconciliation between the information used to compile the new disclosure and the information on the balance sheet. Furthermore, the additional requirement to disclose such information by underlying risk and accounting designation increases the

level of complexity required to convert existing accounting information in order to meet the disclosure requirements. While the required information is available, the level of effort that will be required to ensure a consistent and accurate presentation for all components of the disclosure will be significant.

In addition, the table in Appendix A of the ED shows the gain or loss for the hedged item related to the derivatives in an asset or a liability position, while the ED requires only the location and amount of hedged item gains and losses. While we understand the desire to know the amount of hedged item gains and losses by primary underlying risk, accounting designation and purpose, we believe it will be extremely cumbersome to attribute this gain or loss based on whether the related derivative is in an asset or a liability position. Although a linkage exists between the derivative and the related hedged item, our accounting system does not allow gain or loss information to be extracted based on this linkage. Again, in order to extract information in the manner shown in the table, substantial systems changes will be required or a manual process which introduces additional operational and financial reporting risks will need to be implemented.

Location and amount of gains and losses on derivative instruments and related hedged items that existed during the reporting period but are no longer held or designated in a hedging relationship at the end of the reporting period. The relevant period during which management is concerned about the effectiveness of its hedging relationships is when the derivative instrument is outstanding. Once the derivative instrument matures or is terminated, reporting on the previous relationship is no longer required. While the gain or loss for the reporting period is captured in the general ledger and accounting subsystems, there has historically never been a need to provide detailed reporting on the link between the gain or loss on matured or terminated derivatives and the related hedged items. In order to comply with the disclosure requirements in the ED, intricate records beyond those that currently exist will need to be retained. Due to the level of detail involved, we anticipate that major enhancements to our current infrastructure will be necessary to store the large volume of historical data. This is particularly true in instances where many short term derivatives are "rolled over" on a continuous basis to hedge a longer-term exposure.

Issue 4: This proposed Statement would require disclosure of (a) the existence and nature of contingent features in derivative instruments (for example, payment acceleration clauses), (b) the aggregate fair value amount of derivative instruments that contain those features, and (c) the aggregate fair value amount of assets that would be required to be posted as collateral or transferred in accordance with the provisions associated with the triggering of the contingent features.

Do you foresee any significant operational concerns or constraints in compiling that information for this disclosure? (See paragraphs B39–B42 for the basis for the Board's conclusions.)

Response: We do not foresee significant operational difficulties in compiling information on contingent features in derivative instruments.

Disclosure of Notional Amounts

Issue 5: This proposed Statement would require disclosure of notional amounts in tables that also will include fair values of derivative instruments by primary underlying risk, accounting designation, and purpose.

Do you agree that this proposed Statement should require the disclosure of notional amounts? Why or why not? (See paragraphs B21–B25 for the basis for the Board's conclusions.)

Issue 6: This proposed Statement would require disclosure of gains and losses on all derivative instruments that existed during the reporting period regardless of whether those derivatives exist at the end of the reporting period. This proposed Statement would not require disclosure of the aggregate notional amounts related to those derivatives that existed during the reporting period but no longer exist at the end of the reporting period.

Do you agree that this proposed Statement should not require the disclosure of the aggregate notional amounts related to derivatives that no longer exist at the end of the reporting period? Why or why not?

Response: Microsoft does not agree that there should be a requirement to disclose notional amounts. As noted in the Basis for Conclusions of the ED, Statement 119 previously required disclosure of notional amounts and this provision was not carried forward in Statement 133. In addition to operational burdens outlined in our response to Issue 3 above, the reasons provided in the Basis for Conclusions of Statement 133 remain valid in support of the elimination of notional amount disclosures.

One of the reasons cited in the Basis for Conclusions of Statement 133 was that "the usefulness for [providing an indication of derivatives activity] may be suspect given that some derivatives are commonly neutralized either by canceling the original derivative—which lowers the reported amount—or by acquiring or issuing an offsetting derivative—which increases the reported amount". In fact, notional amounts may actually be misleading if they are used as an indicator of the magnitude of risk related to the item being hedged. As cited above, offsetting derivatives are often used to neutralize a derivative position. Rather than showing the appropriate reduction of derivative exposure, in these instances, notional amounts would show an increase in outstanding derivatives. Furthermore, in some instances multiple derivatives may be used to hedge a single risk exposure. For example, when an option strategy such as a collar, composed of a written call option and a purchased put option, is used, disclosure of the notional amount would unnecessarily gross up the hedged exposure.

In isolation, notional amounts provide little benefit when used as an indicator of the magnitude of derivative risk exposure. Even with a simple example of a vanilla interest rate swap, without additional information such as the term to maturity, notional amounts only provide an indication of the volume, not the risk, of the exposure. Given the large variety of other derivatives available in the market, factors such as credit spreads, volatility and correlation may also be required to obtain an accurate indication of the magnitude of a derivative's risk exposure. In order to effectively manage risk exposure from a derivative portfolio, management employs certain supplemental risk measurements such as duration, Value at Risk, etc. Discussion of these measures of risk is already required as part of Management's Discussion and Analysis.

Disclosure of Gains and Losses on Hedged Items

Issue 7: This proposed Statement would require disclosure of the gains and losses on hedged items that are in a designated and qualifying hedging relationship under Statement 133. The Board decided that an entity would not be permitted to include information in the tables on "hedged items" that are not in designated and qualifying Statement 133 hedging relationships because "economic hedging" means different things to different people.

Do you agree that information about "hedged items" that are not in designated and qualifying Statement 133 hedging relationships should be excluded from the disclosure tables? Alternatively, should the tables include gains and losses on "hedged items" that are recorded at fair value and are used in hedging relationships not designated and qualifying under Statement 133? Why or why not? Would your answer be affected by the forthcoming FASB Statement on the fair value option for financial assets and financial liabilities, which will provide the option to report certain financial assets and liabilities at fair value? (See paragraphs B33–B35 for the basis for the Board's conclusions.)

Response: While we believe information on "hedged items" that are not designated and qualifying Statement 133 hedging relationships is useful to users of financial statements, we agree with the Board's conclusion given the differing views of what constitutes a hedging relationship in cases that do not qualify for hedge accounting under Statement 133.

Disclosure of Overall Risk Profile

Issue 8: Under this proposed Statement, quantitative information about nonderivative instruments used as part of an entity's overall risk management strategy would not be included in the disclosure tables. However, paragraphs 44 and 45 of Statement 133 would permit an entity to provide qualitative and quantitative information about the derivatives included in the disclosure tables as those derivatives (a) relate to the overall context of its risk management activities and (b) are related by activity to other financial instruments.

Do you agree that information that could be provided in the qualitative and quantitative disclosures encouraged by paragraphs 44 and 45 of Statement 133 would be sufficient to appropriately inform users of financial statements about the risk management strategies of an entity? If not, should additional information about an entity's overall risk management strategies be provided as part of the tabular disclosure required by this proposed Statement?

Response: We agree that the information that could be provided in the qualitative and quantitative disclosures encouraged by paragraphs 44 and 45 of Statement 133 would be sufficient to appropriately inform users of financial statements about the risk management strategies of an entity.

Examples Illustrating Application of This Proposed Statement

Issue 9: This proposed Statement includes examples of qualitative disclosures about objectives and strategies for using derivative instruments, contingent features in derivative instruments, and counterparty credit risk. Those examples are intended to illustrate one potential way of communicating information about how and why an entity uses derivatives and the overall effect of derivatives on an entity's financial position, results of operations, and cash flows. The examples are not intended to be construed as the only way to comply with the disclosure requirements.

Are those examples helpful in communicating the objectives of providing information on how and why an entity uses derivatives and on the overall effect of derivatives on an entity's financial position, results of operations, and cash flows? Or, do you believe those examples would be viewed as a prescribed method to comply with the requirements of this proposed Statement?

Response: We generally do not believe the examples would be viewed as a prescribed method to comply with the requirements of the ED, but care should be taken to ensure that the examples do not illustrate unintended requirements. As noted above, the table in Appendix A of the ED shows the gain or loss for the hedged item related to the derivatives in an asset or a liability position, while the ED requires only the location and amount of hedged item gains and losses. We believe it will be extremely cumbersome to attribute the hedged item gain or loss based on whether the related derivative is in an asset or a liability position, and such a requirement would necessitate substantial systems changes or the implementation of a manual process which introduces additional operational and financial reporting risks.

Amendments Considered but Not Made

Issue 10: The Board considered but decided against requiring additional disclosures as described in paragraphs B55–B63. Those disclosures focused on providing information on an entity's overall risk management profile, methods for assessing hedge effectiveness, and situations in which an entity could have elected the normal purchases and sales exception.

Do you agree with the Board's decisions not to require disclosures in those areas? Why or why not?

Response: Yes, for the reasons articulated in the Basis for Conclusions.

Effective Date

Issue 11: The Board's goal is to issue a final Statement by June 30, 2007. The proposed effective date would be for fiscal years and interim periods ending after December 15, 2007. At initial adoption, comparative disclosures for earlier periods presented would be encouraged, but not required. Beginning in the year after initial adoption, comparative disclosures for earlier periods presented would be required.

Does the effective date provide sufficient time for implementation? (See paragraphs B50–B53 for the basis for the Board's conclusions.)

Response: Besides the numerous implementation issues noted in this response, we were surprised that there was no discussion in the Basis for Conclusions justifying this level of detailed disclosure on a quarterly basis. In order to extract, convert and compile the information needed to comply with the interim requirements of the ED, considerable additional resources will need to be engaged throughout the year. This will be particularly onerous given compressed filing deadlines during interim reporting periods. If the ED is issued as currently drafted, we believe that substantial time and resources will need to be dedicated to prepare for implementation and the proposed effective date may not provide sufficient time for necessary changes. At a minimum, we believe the effective date should be deferred until fiscal years ending after December 15, 2008.