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September 30, 2010

Mr. Russell Golden
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: File Reference No. 1810-100

Dear Russ:

Microsoft appreciates the opportunity to respond to the Exposure Draft (ED), “Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities”. Microsoft agrees that fair value is the relevant attribute for measuring most financial instruments. However, we are strongly opposed to the requirement that unrealized changes in the fair value of all equity securities be recognized in net income each reporting period regardless of an entity’s business strategy. We are also opposed to the quantitative test in paragraph 30 of the ED which is based on recognized assets to determine a measurement attribute mismatch. This guidance ignores the reality of intangible based businesses, where many internally generated intangibles are not recognized on the balance sheet.

Changes in Fair Value Recognized in Net Income

Microsoft’s business strategy is to develop and market software, services, hardware, and solutions that deliver new opportunities, greater convenience, and enhanced value. To support this strategy, Microsoft maintains a liquidity portfolio that consists of relatively short-term high quality fixed income securities with minimal price volatility. Given Microsoft’s expected positive cash flows and the existence of the liquidity portfolio, we also maintain an investment portfolio for purposes of long-term capital preservation and investment return. The investment portfolio consists of securities with more price volatility and includes our investments in marketable equity securities.

We believe that unrealized changes in the fair value of financial instruments that are part of an entity’s long-term investment activities rather than for direct use in its business strategy should be recognized in other comprehensive income rather than in net income. As indicated in our August 2010 response to the FASB’s Exposure Draft, “Statement of Comprehensive Income”, Microsoft is not opposed to a requirement for a continuous statement of comprehensive income, as we believe it will enhance the prominence of the items reported in other comprehensive income. Accordingly, transparent information about these financial instruments will be provided on the face of the financial statements.

Paragraph BC58 of the Basis for Conclusions of the ED indicates that, “By continuing to reflect a ‘business strategy’ approach to what is recognized in net income, it enables entities to preserve most of the current aspects of reporting net income and earnings per share”. Microsoft strongly supports the notion that changes in fair value of financial instruments should reflect a business strategy approach to what is recognized in net income. Unfortunately, the guidance in the ED does not continue to reflect a business strategy approach to what is recognized in net income. Under the guidance in the ED, Microsoft’s net income would have changed by at least 10% in five of the eight quarters of our last two fiscal years, with a change in net income of nearly 25% in one of those quarters.

We note the Board’s focus in the ED on financial institutions and its apparent compromise on the fair value versus amortized cost debate. For instance, paragraph BC58 of the Basis for Conclusions of the ED also indicates that, “The Board recognizes that there are strongly held views on both sides of the fair value versus amortized cost debate and believes that the proposed guidance reflects both viewpoints in the financial statements”. Unfortunately, Microsoft believes that because of this compromise, an entity’s business strategy is ignored with respect to certain financial instruments based on the form of the financial instrument. Rather than accounting for financial instruments in accordance with our business strategy, the ED would have our net income be significantly impacted by market forces which are outside our business strategy and operating model.

Quantitative Test

Given the current mixed attribute model, Microsoft believes that financial liabilities should be classified using the same criteria as financial assets unless measuring the financial liability at fair value would create or exacerbate a measurement attribute mismatch. However, we disagree with the 50 percent quantitative test which is based on *recognized* assets. This guidance ignores the reality of intangible based businesses, where many internally generated intangibles are not recognized on the balance sheet. Microsoft notes that this test may make sense for financial institutions, but will, for purposes of the test, distort the balance sheet of intangible based businesses.

Our responses to the individual questions raised in the ED are attached. We have excluded questions that are not specific to Microsoft. If you have any questions, please contact me at (425) 703-6094.

Sincerely,

Bob Laux
Senior Director, Financial Accounting and Reporting

Attachment

Scope

Question 1: *Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments do you believe should be excluded or which financial instruments should be included that are proposed to be excluded? Why?*

Response: Microsoft does not believe that equity method investments should be included in the scope of this proposed Update and that any changes to the accounting for those instruments should be examined in a separate project.

Question 4: *The proposed guidance would require an entity to not only determine if they have significant influence over the investee as described currently in Topic 323 on accounting for equity method investments and joint ventures but also to determine if the operations of the investee are related to the entity's consolidated business to qualify for the equity method of accounting. Do you agree with this proposed change to the criteria for equity method of accounting? If not, why?*

Response: No, we are concerned that the proposed guidance may lead to diversity in practice and that any changes to the accounting for equity method investments should be examined in a separate project.

Initial Measurement

Question 8: *Do you agree with the initial measurement principles for financial instruments? If not, why?*

Question 9: *For financial instruments for which qualifying changes in fair value are recognized in other comprehensive income, do you agree that a significant difference between the transaction price and the fair value on the transaction date should be recognized in net income if the significant difference relates to something other than fees or costs or because the market in which the transaction occurs is different from the market in which the reporting entity would transact? If not, why?*

Question 10: *Do you believe that there should be a single initial measurement principle regardless of whether changes in fair value of a financial instrument are recognized in net income or other comprehensive income? If yes, should that principle require initial measurement at the transaction price or fair value? Why?*

Question 11: *Do you agree that transaction fees and costs should be (1) expensed immediately for financial instruments measured at fair value with all changes in fair value recognized in net income and (2) deferred and amortized as an adjustment of the yield for financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income? If not, why?*

Question 12: *For financial instruments initially measured at the transaction price, do you believe that the proposed guidance is operational to determine whether there is a significant difference between the transaction price and fair value? If not, why?*

Response: Microsoft agrees that fair value is the relevant attribute for measuring most financial instruments and that it should be the measurement attribute regardless of whether changes in fair value of a financial instrument are recognized in net income or other comprehensive income. Consistent with this measurement attribute, we believe transaction fees and costs should be expensed regardless of whether changes in fair value are recognized in net income or other comprehensive income. We believe that the proposed guidance is operational to determine whether there is a significant difference between the transaction price and fair value.

Subsequent Measurement

Question 13: *The Board believes that both fair value information and amortized cost information should be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows. Most Board members believe that this information should be provided in the totals on the face of the financial statements with changes in fair value recognized in reported stockholders' equity as a net increase (decrease) in net assets. Some Board members believe fair value should be presented parenthetically in the statement of financial position. The basis for conclusions and the alternative views describe the reasons for those views. Do you believe the default measurement attribute for financial instruments should be fair value? If not, why? Do you believe that certain financial instruments should be measured using a different measurement attribute? If so, why?*

Question 14: *The proposed guidance would require that interest income or expense, credit impairments and reversals (for financial assets), and realized gains and losses be recognized in net income for financial instruments that meet the criteria for qualifying changes in fair value to be recognized in other comprehensive income. Do you believe that any other fair value changes should be recognized in net income for these financial instruments? If yes, which changes in fair value should be separately recognized in net income? Why?*

Question 15: *Do you believe that the subsequent measurement principles should be the same for financial assets and financial liabilities? If not, why?*

Question 16: *The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications should be prohibited? If not, in which*

circumstances do you believe that reclassifications should be permitted or required? Why?

Response: Microsoft agrees that fair value is the relevant attribute for measuring most financial instruments. However, we are strongly opposed to the requirement that unrealized changes in the fair value of all equity securities be recognized in net income each reporting period regardless of an entity's business strategy.

Microsoft's business strategy is to develop and market software, services, hardware, and solutions that deliver new opportunities, greater convenience, and enhanced value. To support this strategy, Microsoft maintains a liquidity portfolio that consists of relatively short-term high quality fixed income securities with minimal price volatility. Given Microsoft's expected positive cash flows and the existence of the liquidity portfolio, we also maintain an investment portfolio for purposes of long-term capital preservation and investment return. The investment portfolio consists of securities with more price volatility and includes our investments in marketable equity securities.

We believe that unrealized changes in the fair value of financial instruments that are part of an entity's long-term investment activities rather than for direct use in its business strategy should be recognized in other comprehensive income rather than in net income. As indicated in our August 2010 response to the FASB's Exposure Draft, "Statement of Comprehensive Income", Microsoft is not opposed to a requirement for a continuous statement of comprehensive income, as we believe it will enhance the prominence of the items reported in other comprehensive income. Accordingly, transparent information about these financial instruments will be provided on the face of the financial statements.

Paragraph BC58 of the Basis for Conclusions of the ED indicates that, "By continuing to reflect a 'business strategy' approach to what is recognized in net income, it enables entities to preserve most of the current aspects of reporting net income and earnings per share". Microsoft strongly supports the notion that changes in fair value of financial instruments should reflect a business strategy approach to what is recognized in net income. Unfortunately, the guidance in the ED does not continue to reflect a business strategy approach to what is recognized in net income. Under the guidance in the ED, Microsoft's net income would have changed by at least 10% in five of the eight quarters of our last two fiscal years, with a change in net income of nearly 25% in one of those quarters.

We note the Board's focus in the ED on financial institutions and its apparent compromise on the fair value versus amortized cost debate. For instance, paragraph BC58 of the Basis for Conclusions of the ED also indicates that, "The Board recognizes that there are strongly held views on both sides of the fair value versus amortized cost debate and believes that the proposed guidance reflects both viewpoints in the financial statements". Unfortunately, Microsoft believes that because of this compromise, an entity's business strategy is ignored with respect to certain financial instruments based on the form of the financial instrument. Rather than accounting for financial instruments in accordance with our business strategy, the ED would have our net income be

significantly impacted by market forces which are outside our business strategy and operating model.

Question 18: *Do you agree that a financial liability should be permitted to be measured at amortized cost if it meets the criteria for recognizing qualifying changes in fair value in other comprehensive income and if measuring the liability at fair value would create or exacerbate a measurement attribute mismatch? If not, why?*

Question 21: *The Proposed Implementation Guidance section of this proposed Update provides an example to illustrate the application of the subsequent measurement guidance to convertible debt (Example 10). The Board currently has a project on its technical agenda on financial instruments with characteristics of equity. That project will determine the classification for convertible debt from the issuer's perspective and whether convertible debt should continue to be classified as a liability in its entirety or whether the Board should require bifurcation into a liability component and an equity component. However, based on existing U.S. GAAP, the Board believes that convertible debt would not meet the criterion for a debt instrument under paragraph 21(a)(1) to qualify for changes in fair value to be recognized in other comprehensive income because the principal will not be returned to the creditor (investor) at maturity or other settlement. Do you agree with the Board's application of the proposed subsequent measurement guidance to convertible debt? If not, why?*

Response: Given the current mixed attribute model, Microsoft believes that financial liabilities should be classified using the same criteria as financial assets unless measuring the financial liability at fair value would create or exacerbate a measurement attribute mismatch. However, we disagree with the 50 percent quantitative test which is based on *recognized* assets. This guidance ignores the reality of intangible based businesses, where many internally generated intangibles are not recognized on the balance sheet. Microsoft notes that this test may make sense for financial institutions, but will, for purposes of the test, distort the balance sheet of intangible based businesses.

Hedge Accounting

Question 56: *Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?*

Question 57: *Should no effectiveness evaluation be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term? Why or why not?*

Question 58: *Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? Why or why not?*

Question 61: *Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for cash flow hedging relationships? If yes, what constraints do you foresee and how would you alleviate them?*

Question 62: *Do you foresee any significant operational concerns or constraints in creating processes that will determine when changes in circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness at each reporting period? If yes, what constraints do you foresee and how would you alleviate them?*

Question 63: *Do you foresee any significant operational concerns or constraints arising from the inability to discontinue fair value hedge accounting or cash flow hedge accounting by simply dedesignating the hedging relationship? If yes, what constraints do you foresee and how would you alleviate them?*

Question 64: *Do you foresee any significant operational concerns or constraints arising from the required concurrent documentation of the effective termination of a hedging derivative attributable to the entity's entering into an offsetting derivative instrument? If yes, what constraints do you foresee and how would you alleviate them?*

Response: Microsoft agrees that the Board's modification of the effectiveness threshold from highly effective to reasonably effective is appropriate and that after inception of the hedging relationship, an entity should reassess effectiveness if changes in circumstances suggest that the hedging relationship is no longer reasonably effective. We do not foresee any significant operational concerns or constraints with respect to the changes in hedge accounting.

Disclosures

Question 65: *Do you agree with the proposed disclosure requirements? If not, which disclosure requirement do you believe should not be required and why?*

Response: We continue to be concerned with the significant increase in the volume of required disclosures. As we indicated in our recent input to the FASB's Disclosure Framework Project Team, it is imperative that the FASB have an overarching disclosure criterion that takes into account a potential new disclosure in the context of all existing disclosures, as unnecessary disclosures can be damaging or misleading if relevant information is obscured.

In particular, we are opposed to the requirement to disclose amortized cost information on the face of the statement of financial position. We believe this is another example of the Board's apparent compromise on the fair value versus amortized cost debate.

Effective Date and Transition

Question 68: *Do you agree with the transition provision in this proposed Update? If not, why?*

Question 70: *How much time do you believe is needed to implement the proposed guidance?*

Question 71: *Do you believe the proposed transition provision is operational? If not, why?*

Response: We agree with the proposed transition guidance which requires a cumulative-effect adjustment to the statement of financial position for the reporting period that immediately precedes the effective date, and we believe that guidance is operational. If the ED is finalized as proposed, we believe we would need at least two years to ensure the guidance is implemented properly.