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October 22, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: File Reference No. 1820-100

Dear Technical Director:

Microsoft appreciates the opportunity to respond to the Exposure Draft (ED), “Revenue from Contracts with Customers”. Microsoft supports the ED and believes it is critical in order to reach the goal of a single set of high-quality international accounting standards. However, we believe changes are needed in the areas of product warranties, time value of money/collectability, disclosures, and transition in order to make the ED more operational.

Product Warranties

Microsoft opposes the guidance in the ED on product warranties and believes the guidance needs to be changed to make the ED more operational. The ED distinguishes between two types of product warranties – a warranty that provides a customer with coverage for latent defects (“latent defect warranty”), which is accounted for as a failed sale, and a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer (“insurance warranty”), which is accounted for as a performance obligation.

In the software industry, we are struggling with how to make this guidance operational. For instance, is a bug fix a latent defect warranty or an insurance warranty? We believe an argument could be made for either. It is not always clear whether security updates are fixing defects that existed when the software was transferred to the customer or whether they are in response to new software viruses that were created after the software was transferred to the customer.

The guidance in ASC 985-605, “Software Revenue Recognition”, seems to indicate that bug fixes are corrections of latent defects by stating that “bug fixes are necessary to maintain compliance with published specifications”. The Implementation Guidance of the ED indicates that, “If the entity would be required to repair defective products, it does not recognize revenue for the portion of the transaction price attributable to the products’ components expected to be replaced in the repair process”. This guidance may be

operational for a tangible product, but is not operational for software, as components of software are not replaced.

Furthermore, Microsoft provides bug fixes for software for up to 10 years after the introduction of the software, which under the guidance in the ED, could result in the deferral of revenue for 10 years. We believe this result is not consistent with the economics of the arrangements and could mislead readers as to our true operating results. In order to make the ED more operational, Microsoft recommends that the Board retain the existing guidance in ASC 460 on how to account for warranty obligations that are incurred in connection with the sale of goods and services.

Time Value of Money/Collectability

A large portion of Microsoft's revenue is derived from multi-year volume licensing agreements, which consist of perpetual software licenses as well as rights to future versions of the software products on a when-and-if-available basis over a specified time period. Under the guidance of ASC 985-605, Microsoft accounts for these arrangements as subscriptions and recognizes revenue ratably over the term of the arrangement. Under the guidance in the ED, we believe we will have to account for the software licenses separately from the rights to future versions of the software products, with revenue for the software licenses recognized upfront and revenue attributable to the rights to future versions of the software products recognized ratably over the term of the arrangement.

Generally, customers pay for these arrangements with annual installments at the beginning of each year of the arrangement. In essence, these arrangements contain payments in arrears for the software licenses and payments in advance for the rights to future versions of the software products. Microsoft has thousands upon thousands of these contracts and, in order to make the ED more operational, we recommend that the ED require an entity to recognize the effects of financing only if the time period exceeds one year, consistent with the guidance in ASC 835 and also consistent with the current Exposure Drafts on Leases and Financial Instruments.

Further complicating the operationally of the ED is the requirement to include the impact of collectability in the transaction price. This complexity is compounded by the requirement that if the effect of the time value of money is also material to a contract, the adjustment for collectability would be made through the discount rate. Microsoft recommends that collectability be accounted for as bad debt expense in connection with an entity's allowance for doubtful accounts.

Disclosures

Microsoft agrees that disclosures are necessary to help users of financial statements understand and analyze how contracts with customers affect an entity's financial statements. However, as we have pointed out on a number of occasions, we continue to be concerned with the significant increase in the volume of required disclosures and 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. We were

surprised the ED did not contain a comprehensive disclosure example, so that one could judge the potential new disclosures in the context of all existing disclosures.

Transition

As indicated previously, we believe the ED will result in a change to Microsoft's revenue recognition. While we understand the importance of comparable prior period information to users of financial statements, full retrospective application will be burdensome to us given our numerous revenue arrangements. Microsoft recommends a transition alternative similar to that allowed under Accounting Standards Update 2009-13. This alternative will provide users comparable information while lessening the burden of adoption on preparers.

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

Recognition of revenue (paragraphs 8–33)

Question 1: Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:

- (a) combine two or more contracts and account for them as a single contract;
- (b) segment a single contract and account for it as two or more contracts; and
- (c) account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

Response: Microsoft agrees with the price interdependence principle to help an entity determine the combination and segmentation of contracts.

Question 2: The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

Response: Microsoft agrees with the principle for determining when a good or service is distinct. However, when the entity, or another entity, does not sell an identical or similar good or service separately, we are concerned how practice may interpret whether an entity can separately identify the resources needed to provide the good or service for purposes of determining whether a distinct profit margin exists. We believe the Board should make clear that a distinct profit margin exists if an entity can reasonably estimate the costs needed to provide the good or service, despite the fact that certain resources (such as programmers) are used for multiple goods or services.

Question 3: Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

Response: Yes, we believe the proposed guidance in the ED and the related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer.

Measurement of revenue (paragraphs 34–53)

Question 4: *The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.*

Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

Response: Microsoft agrees that an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated and agrees with the proposed criteria in the ED.

Question 5: *Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?*

Response: No, we believe the proposed requirement to include the impact of collectability in the transaction price unnecessarily complicates the operationally of the ED. Microsoft recommends that collectability be accounted for as bad debt expense in connection with an entity's allowance for doubtful accounts.

Question 6: *Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?*

Response: A large portion of Microsoft's revenue is derived from multi-year volume licensing agreements, which consist of perpetual software licenses as well as rights to future versions of the software products on a when-and-if-available basis over a specified time period. Under the guidance of ASC 985-605, Microsoft accounts for these arrangements as subscriptions and recognizes revenue ratably over the term of the arrangement. Under the guidance in the ED, we believe we will have to account for the software licenses separately from the rights to future versions of the software products, with revenue for the software licenses recognized upfront and revenue attributable to the rights to future versions of the software products recognized ratably over the term of the arrangement.

Generally, customers pay for these arrangements with annual installments at the beginning of each year of the arrangement. In essence, these arrangements contain payments in arrears for the software licenses and payments in advance for the rights to future versions of the software products. Microsoft has thousands upon thousands of

these contracts and, in order to make the ED more operational, we recommend that the ED require an entity to recognize the effects of financing only if the time period exceeds one year, consistent with the guidance in ASC 835 and also consistent with the current Exposure Drafts on Leases and Financial Instruments.

Question 7: *Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?*

Response: Microsoft agrees that an entity should allocate the transaction price to all separate performance obligations in proportion to the standalone selling price, estimated if necessary.

Contract costs (paragraphs 57–63)

Question 8: *Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, Intangible Assets), an entity should recognize an asset only if those costs meet specified criteria.*

Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?

Response: Yes, we believe the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient.

Question 9: *Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation.*

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

Response: We agree with the costs specified.

Disclosure (paragraphs 69–83)

Question 10: *The objective of the Boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?*

Question 11: *The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.*

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

Question 12: *Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?*

Response (Questions 10, 11 and 12): Microsoft agrees that disclosures are necessary to help users of financial statements understand and analyze how contracts with customers affect an entity's financial statements. However, as we have pointed out on a number of occasions, we continue to be concerned with the significant increase in the volume of required disclosures and 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. We were surprised the ED did not contain a comprehensive disclosure example, so that one could judge the potential new disclosures in the context of all existing disclosures.

Effective date and transition (paragraphs 84 and 85)

Question 13: *Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why?*

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

Response: As indicated previously, we believe the ED will result in a change to Microsoft's revenue recognition. While we understand the importance of comparable prior period information to users of financial statements, full retrospective application will be burdensome to us given our numerous revenue arrangements. Microsoft recommends a transition alternative similar to that allowed under Accounting Standards Update 2009-13. This alternative will provide users comparable information while lessening the burden of adoption on preparers.

Implementation guidance (paragraphs IG1–IG96)

Question 14: *The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?*

Response: Except for the items noted in our response, we believe the implementation guidance is sufficient to make the proposals operational.

Question 15: *The Boards propose that an entity should distinguish between the following types of product warranties:*

(a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.

(b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

Response: Microsoft opposes the guidance in the ED on product warranties and believes the guidance needs to be changed to make the ED more operational. In the software industry, we are struggling with how to make this guidance operational. For instance, is a bug fix a latent defect warranty or an insurance warranty? We believe an argument could be made for either. It is not always clear whether security updates are fixing defects that existed when the software was transferred to the customer or whether they are in response to new software viruses that were created after the software was transferred to the customer.

The guidance in ASC 985-605 seems to indicate that bug fixes are corrections of latent defects by stating that “bug fixes are necessary to maintain compliance with published specifications”. The Implementation Guidance of the ED indicates that, “If the entity would be required to repair defective products, it does not recognize revenue for the portion of the transaction price attributable to the products’ components expected to be replaced in the repair process”. This guidance may be operational for a tangible product, but is not operational for software, as components of software are not replaced.

Furthermore, Microsoft provides bug fixes for software for up to 10 years after the introduction of the software, which under the guidance in the ED, could result in the deferral of revenue for 10 years. We believe this result is not consistent with the economics of the arrangements and could mislead readers as to our true operating results. In order to make the ED more operational, Microsoft recommends that the Board retain the existing guidance in ASC 460 on how to account for warranty obligations that are incurred in connection with the sale of goods and services.

Question 16: *The Boards propose the following if a license is not considered to be a sale of intellectual property:*

(a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and

(b) if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license.

Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?

Response: Microsoft does not believe that whether a license to use intellectual property is exclusive or nonexclusive should be determinative of the pattern of revenue recognition. In both situations, we believe the entity satisfies its obligation when the customer is able to use and benefit from the license.

Consequential amendments

***Question 17:** The Boards propose that in accounting for the gain or loss on the sale of some nonfinancial assets (for example, intangible assets and property, plant, and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?*

Response: Microsoft agrees with this guidance.