January 3, 2006

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. 1235-001

Dear Sue:

Microsoft appreciates the opportunity to respond to the Invitation to Comment (IC), “Selected Issues Relating to Assets and Liabilities with Uncertainties”. We commend the FASB for soliciting input from its constituents as it continues to discuss issues in its conceptual framework project.

The Introduction to the IC indicates that, “Responses to this Invitation to Comment will be used by the FASB in the conceptual framework project to evaluate the relative merits of the various uses of probability and uncertainty in the Boards’ frameworks and standards” [Emphasis added]. Microsoft believes using the responses to the IC to evaluate the relative merits of the various uses of probability and uncertainty in FASB’s standards is a mistake and that responses to the IC should be used solely to evaluate the relative merits of the various uses of probability and uncertainty in the conceptual framework.

Probability and uncertainty currently play a role in defining, recognizing, and measuring assets and liabilities. Those roles need to be first discussed in the context of a conceptual framework. Once a converged and improved conceptual framework is completed, it would then be appropriate to consider the use of probability and uncertainty in the context of certain accounting issues (such as legal contingencies, warranties, executory contracts, etc.). Said another way, it is important that a framework is established on the role of probability and uncertainty in defining, recognizing, and measuring assets and liabilities so that framework can be used as a basis for considering the relative merits and use of probability and uncertainty in individual standards. Accordingly, the remainder of our response focuses on the role of probability and uncertainty in defining, recognizing, and measuring assets and liabilities in the context of the conceptual framework. We also comment briefly on the IC’s analysis of unconditional and conditional rights and obligations. Our discussion of the conceptual framework is based on the current
framework and does not incorporate any tentative decisions the Board has made to date in this project.

Role of Probability and Uncertainty in Defining Assets and Liabilities

As the Board knows all too well, the use of the term probable in the definition of assets and liabilities has been misunderstood by many parties. It is our understanding that its use was intended to indicate that something does not have to be certain or proved to qualify as an asset or liability. The FASB Special Report, “The Framework of Financial Accounting Concepts and Standards”, describes the intention succinctly, indicating that, “Probable is not an essential part of the definitions; its function is to acknowledge the presence of uncertainty and to say that the future economic benefits or sacrifices do not have to be certain to qualify the items in question as assets and liabilities, not to specify a characteristic that must be present”. If the Board agrees this was the intention, it should revise the definitions of assets and liabilities accordingly in order to minimize confusion. Using assets as an example, the definition could be as simple as follows:

Assets are future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.¹

¹Future economic benefits do not have to be certain to qualify as assets.

While further explanation may be necessary, the above definition avoids the use of the words probable or expected (in the case of the IASB Framework) and the common understanding of those terms which convey to many that some threshold level of probability or expectation is necessary in order for an item to satisfy the definition of an asset or liability. We note that the Board discussed a proposed working definition of an asset at its December 14, 2005 meeting which excluded using words such as probable or expected.

Microsoft is not opposed to excluding the word probable from the definition of assets and liabilities, but we make this comment in the context that meeting the definition of an element of financial statements (for instance, an asset or liability) is only one of the four current criteria that must be met for an item to be recognized. Concepts Statement No. 5 indicates the following:

An item and information about it should meet four fundamental recognition criteria to be recognized and should be recognized when the criteria are met, subject to a cost-benefit constraint and a materiality threshold. Those criteria are:

Definitions-The item meets the definition of an element of financial statements.
Measurability-It has a relevant attribute measurable with sufficient reliability.
Relevance - The information about it is capable of making a difference in user decisions.  
Reliability - The information is representationally faithful, verifiable, and neutral.

Role of Probability and Uncertainty in Recognizing and Measuring Assets and Liabilities

As indicated in the above referenced FASB Special Report, recognition decisions often cannot be separated from measurement decisions, particular if the decision relates to when to recognize changes in assets and liabilities. Microsoft believes it is appropriate to have a conceptual framework that allows for the consideration of probability and uncertainty in either recognizing or measuring assets and liabilities and it is not necessary that the framework dictate that probability and uncertainty must be considered exclusively in either one or the other. The important factor is whether the information produced is relevant and reliable.

For instance, if it is believed that fair value provides the most relevant and reliable information for a particular item, then probability and uncertainty should be incorporated as part of the measurement of that item. However, Microsoft believes there are other situations where incorporating probability and uncertainty into the recognition of assets and liabilities will produce the most relevant and reliable information for a particular item. The key will be that a converged and improved conceptual framework must provide robust guidelines for determining the relevance and reliability of information and describe how to use those guidelines to determine whether probability and uncertainty should play a role in recognition or measurement.

Unconditional and Conditional Rights and Obligations

Microsoft finds the IC’s notion of unconditional and conditional rights and obligations useful in some circumstances and unworkable in others. While admittedly a generalization, the notion of unconditional and conditional rights and obligations seems to work better in the context of portfolio-type items (or pools of homogeneous items such as certain product warranties) than in the context of specific types of items, such as significant litigation. Furthermore, we struggle with when the unconditional right or obligation actually would occur in certain situations.

For instance, paragraph 41 of the IC provides the example of an entity being a defendant in a lawsuit and the contingency being the entity’s possible obligation to pay any penalties imposed by the courts. In the IASB’s view, this conditional obligation does not meet the definition of a liability, but does point to an unconditional obligation (to stand ready to perform as directed by the courts) that does qualify as a present liability. However, under this analytical approach, it would seem an unconditional obligation exists when the entity actually commits the act that harms/infringes upon the potential plaintiff and the entity has an unconditional obligation to stand ready to perform as directed based upon a
potential plaintiff’s rights under existing laws. Microsoft has serious doubts that this type of analysis will result in more relevant and reliable information.

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
Contingent Assets

Question 1: Do you agree with eliminating the notion of contingent asset? If not, why not?

Response: Yes, with respect to the definition of an asset, Microsoft believes an item is either an asset or it is not. However, just because an item meets the definition of an asset does not automatically mean that it should be recognized.

Question 2: Do you agree with the IASB’s analysis of unconditional and conditional rights in contractual settings, as summarized in paragraphs 30 and 31 of this Invitation to Comment and paragraphs BC10–BC13 of the IASB Exposure Draft? If not, why not?

Question 3: If you answer yes to Question 2, do you agree that the IASB has appropriately applied the notion and supporting reasoning referred to therein in the analysis of Examples 1–3 in paragraphs 33–35 of this Invitation to Comment? If not, why not?

Response: We find the analysis useful in some circumstances and unworkable in others. For instance, paragraph 33 provides an example of an unconditional right when an entity has filed a lawsuit against a defendant for damages. However, it seems an unconditional right may exist when the entity is actually harmed/infringed upon since the entity has an unconditional right to protection/redress under existing laws, regardless of whether it has filed a lawsuit against a defendant for damages.

Question 4: Do you agree with the IASB’s proposal to classify as intangible assets those unconditional rights that are associated with conditional rights and that satisfy the definition of an asset, without shifting the consideration of the uncertainty surrounding the conditional rights from recognition to measurement?

Response: We believe this question detracts from the conceptual discussion of assets with uncertainties since it superimposes the recognition criteria for intangible assets into the discussion.

Contingent Liabilities

Question 5: Do you agree with eliminating the notion of contingent liability? If not, why not?

Response: Yes, with respect to the definition of a liability, Microsoft believes an item is either a liability or it is not. However, just because an item meets the definition of a liability does not automatically mean that it should be recognized.
Question 6: Do you agree with the IASB's analysis of unconditional and conditional obligations in contractual settings, as summarized in paragraphs 39 and 40 of this Invitation to Comment and paragraphs BC24–BC28 of the IASB Exposure Draft? If not, why not?

Question 7: If you answer yes to Question 5, do you agree that the IASB has appropriately applied the notion and supporting reasoning referred to therein in the analysis of the example in paragraph 41 of this Invitation to Comment? If not, why not?

Response: As indicated in our cover letter and our response to Questions 2 and 3 above, we find the analysis useful in some circumstances and unworkable in others.

Probability Recognition Criterion

Question 8: Do you agree with omitting the probability criterion for recognition of nonfinancial liabilities? If not, why not?

Response: No, Microsoft believes it is appropriate to have a conceptual framework that allows for the consideration of probability and uncertainty in either recognizing or measuring assets and liabilities and it is not necessary that the framework dictate that probability and uncertainty must be considered exclusively in either one or the other. The important factor is whether the information produced is relevant and reliable.

Measurement

Question 9: Do you agree with the proposed measurement requirements for nonfinancial liabilities? If not, why not?

Response: No, as mentioned in response to the previous question, we believe it is appropriate to have a conceptual framework that allows for the consideration of probability and uncertainty in either recognizing or measuring assets and liabilities and it is not necessary that the framework dictate that probability and uncertainty must be considered exclusively in either one or the other. The important factor is whether the information produced is relevant and reliable.