Letter of Comment No: 32

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Microsoft^{*}

December 2, 2002

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. 1125-001

Dear Sue:

Microsoft appreciates the opportunity to respond to the Proposal, "Principles-Based Approach to U.S. Standard Setting". We support the proposal for a principles-based approach to U.S. standard setting and believe that the amount of interpretive and implementation guidance in accounting standards to try to ensure comparability between entities is the biggest culprit in driving much of the detail and complexity in current accounting standards.

As noted in FASB Concepts Statement 2, Qualitative Characteristics of Accounting Information, relevance and reliability are the two primary qualities that make accounting information useful for decision making. Comparability, which includes consistency, is a secondary quality that interacts with relevance and reliability to contribute to the usefulness of information. CON 2 also indicates that while it does distinguish between primary and other qualities, it does not assign priorities among qualities, for the relative weight to be given to different qualities must vary according to circumstances. Unfortunately, in our opinion, it seems accounting standards are developed with undue weight placed on comparability at the expense of relevance and reliability.

Microsoft agrees that exceptions to the principles have also contributed to the problem, but it is important to understand the exceptions in light of the overriding goal of providing information that is useful to present and potential investors and creditors and other users in making investment, credit, and other similar decisions. In regards to the issue of exceptions, the Proposal indicates the following:

Other participants in the U.S. financial accounting and reporting process, including preparers, investors, creditors, and other users of financial information, must accept the consequences of applying accounting standards with fewer exceptions, including increased volatility of reported earnings.

Microsoft does not believe that reporting volatility per se is undesirable, but it is important to determine whether that volatility is a faithful representation of the phenomenon it purports to represent. For example, Microsoft uses options to hedge a portion of forecasted international revenue in order to reduce currency risks. As noted in Attachment A of the Proposal, some believe principle 3(d) of Statement 133 (which provides special accounting under certain circumstances for items designated as being hedged) to be an exception to a strict principles-based approach, which would not allow hedge accounting. If hedge accounting were not allowed, we would be reporting increased earnings volatility for a transaction entered into for risk reduction purposes. As noted in the excerpt in the Proposal from former FASB Board member Robert Sprouse, ". . . it is especially important that, where it actually exists, volatility be revealed rather than concealed by accounting practices". Wouldn't the reverse of this also be true, that is, it is especially important that, where it does not actually exist, volatility should not be created by accounting practices?

Our responses to the request for comments in the Proposal are attached. If you have any questions, please contact me at (425) 703-6094.

Sincerely,

Bob Laux Director, External Reporting

Attachment

1. Do you support the Board's proposal for a principles-based approach to U.S. standard setting? Will that approach improve the quality and transparency of U.S. financial accounting and reporting?

Response: Yes, Microsoft supports the proposal for a principles-based approach to U.S. standard setting. While we agree that exceptions to the principles have contributed to the problem, Microsoft believes that the amount of interpretive and implementation guidance in accounting standards to ensure comparability is the biggest culprit in driving much of the detail and complexity in accounting standards.

As noted in FASB Concepts Statement 2, Qualitative Characteristics of Accounting Information, relevance and reliability are the two primary qualities that make accounting information useful for decision making. Comparability, which includes consistency, is a secondary quality that interacts with relevance and reliability to contribute to the usefulness of information. CON 2 also indicates that while it does distinguish between primary and other qualities, it does not assign priorities among qualities, for the relative weight to be given to different qualities must vary according to circumstances. Unfortunately, in our opinion, it seems accounting standards are developed with undue weight placed on comparability at the expense of relevance and reliability.

2. Should the Board develop an overall reporting framework as in IAS 1 and, if so, should that framework include a true and fair view override?

Response: No, Microsoft does not believe the Board needs to develop an overall reporting framework as in IAS 1. Rather, we believe that guidance on issues such as materiality assessments and professional judgments could be addressed in a project to improve the conceptual framework. Furthermore, we do not see the need to make changes to Rule 203 of the AICPA Code of Professional Conduct, which prohibits expressing an opinion that financial statements conform with GAAP if those statements contain a material departure from an accounting principle promulgated by the FASB, unless it can be demonstrated that because of unusual circumstances the financial statements otherwise would have been misleading.

3. Under what circumstances should interpretive and implementation guidance be provided under a principles-based approach to U.S. standard setting? Should the Board be the primary standard setter responsible for providing that guidance?

Response: Interpretive and implementation guidance should be provided as an educational tool for applying the principles inherent in an accounting standard. The Board should be the primary standard setter responsible for providing that guidance and can delegate some of that responsibility, with appropriate oversight, to the Emerging Issues Task Force. The Accounting Standards Executive Committee (AcSEC) of the

AICPA should be utilized for industry specific interpretive and implementation guidance, subject to oversight by the Board.

4. Will preparers, auditors, the SEC, investors, creditors, and other users of financial information be able to adjust to a principles-based approach to U.S. standard setting? If not, what needs to be done and by whom?

Response: All the constituents of accounting standard setting and financial reporting will have to adjust to a principles-based approach to U.S. standard setting or we are doomed to accept a never ending increase in the detail and complexity of accounting standards. Preparers will need to resist the urge to request standard setters to provide additional guidance and have the conviction to exercise professional judgment. The same will be true of auditors, in addition to a commitment to resist client pressures on items with which they truly disagree. The SEC will have to avoid "20/20 hindsight" and accept decisions based on good faith professional judgment. Users of financial statements will have to accept the possible loss of some comparability in exchange for more relevant and reliable financial reporting.

In addition, the Board will have to adjust to a principles-based approach by avoiding what many perceive as an atmosphere of "secoundrel" accounting standards setting, that is, setting accounting standards based on the belief that all preparers are trying to "game" the system. Even with the current crisis of confidence in financial reporting, it is evident that the large majority of the preparer community is trying to do the right thing.

5. What are the benefits and costs (including transition costs) of adopting a principles-based approach to U.S. standard setting? How might those benefits and costs be quantified?

Response: Microsoft believes that the benefits of adopting a principles-based approach to U.S. standard setting include the ability of accounting professional to stay current with the accounting literature, easier implementation of new accounting standards, more timely accounting guidance, more robust accounting guidance for future developments in the marketplace, and an increased reflection of the economic substance of transactions. Costs include the possible decrease in comparability among entities and the possibility of abuse by those not acting in good faith. We believe it would be difficult to quantify these, or other, benefits and costs; however, from a strictly qualitative viewpoint, Microsoft agrees that an approach focusing more clearly on the principles in accounting standards is necessary to improve the quality and transparency of U.S. financial accounting and reporting.

6. What other factors should the Board consider in assessing the extent to which it should adopt a principles-based approach to U.S. standard setting?

We believe the FASB has done a good job in the Proposal laying out the factors to consider in assessing the extent to which the Board should adopt a principles-based

approach to U.S. standard setting. Again, Microsoft believes that the amount of interpretive and implementation guidance in accounting standards to ensure comparability is the biggest culprit in driving much of the detail and complexity in current accounting standards.