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May 15, 2013

Ms. Susan Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: File Reference No. 2013-220

Dear Sue:

Microsoft appreciates the opportunity to respond to the Exposure Draft (ED), "Recognition and Measurement of Financial Assets and Financial Liabilities". We are opposed to the ED's guidance which will result in changes in fair value being recognized in net income for most equity investments.

The ED indicates that the guidance in the proposed update would improve financial reporting for financial instruments by developing a consistent framework for classifying those instruments that links the measurement of financial assets to the way in which an entity *expects* to benefit from the cash flows embedded in those assets [Emphasis Added]. Given this statement in the ED, it is difficult to understand the requirement to first consider whether the contractual terms of an asset give rise on specified dates to cash flows that are solely payments of principal and interest for purposes of classifying changes in fair value in the Statement of Comprehensive Income.

Said another way, we cannot understand why changes in fair value for simple debt instruments that an entity *may* sell is recognized as a component of other comprehensive income while changes in the fair value of most equity investments are recognized in net income. We do not believe this significant difference in classification in the Statement of Comprehensive Income meets the objective of a consistent framework for the way in which an entity *expects* to benefit from the cash flows embedded in financial assets.

The Board's reasoning for this conclusion seems to be explained in paragraph BC100 of the ED's Basis for Conclusions:

> The characteristics of a financial asset are important to its classification and measurement because those characteristics determine the variability of the related cash flows and how the entity *may* realize them. For example, because an equity instrument has no maturity, the only way to realize its value is to sell it. However, an entity can realize the value of a debt instrument by holding it until maturity or for a substantial portion of its life, as the fair value approaches par value. Therefore, the Board decided that only a debt instrument could qualify for

> measurement at other than fair value with all changes in fair value recognized in net income [Emphasis Added].

Microsoft disagrees with the Board's conclusion that is based on how an entity *may* realize cash flows (sell or hold to maturity). We are unable to reconcile that conclusion to the Board's stated objective of improving financial reporting for financial instruments by developing a consistent framework for classifying those instruments that links the measurement of financial assets to the way in which an entity *expects* to benefit from the cash flows embedded in those assets.

Microsoft believes that the contractual cash flow characteristics criterion should be removed from the proposed guidance and that the classification and measurement of financial assets should be based on a revised business model criterion that is based on how an entity manages its financial assets. This would be more consistent with how an entity *expects* to benefit from the cash flows embedded in those assets.

Impact of the Proposed Guidance

The ED's proposed guidance will have a significant impact on how changes in fair value are classified in the Statement of Comprehensive Income. This is especially true for Microsoft, which has approximately $10 billion invested in equity securities. For instance, under the proposed guidance our first quarter of fiscal year 2012 net income and earnings per share would have changed by 20%, with a difference in net income of $1.1 billion and $0.14 in earnings per share.

Another implication of the proposed guidance occurs when an equity investee goes public, an event over which the equity investor many times has no influence. As an example, Microsoft has an equity investment in Facebook which had an initial public offering in May 2012. Under the proposed guidance, Microsoft's net income and earnings per share would have changed by approximately $450 million or $0.05 per share due to the investment having a readily determinable fair value upon Facebook's IPO.

Microsoft finds the examples above to be especially concerning given that many constituents have suggested the FASB address the concept behind other comprehensive income, including establishing a consistent principle or basis for determining which gains and losses should be reported in OCI. While we do not want to prejudge a potential project to establish a consistent principle for determining which gains and losses should be reported in other comprehensive income, we do not believe that the primary conceptual underpinning of such a principle should be based on what an entity *may* do.

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

Sincerely,

Bob Laux
Treasury Controller

Attachment

Scope

Questions for All Respondents

Question 1*— Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments should be included or excluded from the guidance in this proposed Update and why?*

Response: Microsoft agrees with the scope of financial instruments included in this proposed Update. We do, however, note the comment in paragraph BC23 of the Basis for Conclusions that, "Although the issues that gave rise to the Board's consideration of the accounting for financial instruments were raised in the context of financial institutions, the Board decided that the amended guidance should not be limited to the accounting by those institutions". Microsoft believes the Board's consideration of the accounting for financial instruments has been dominated by a thought process within the context of financial institutions without a thorough consideration of the effects of the proposed guidance on non-financial institutions. We hope there is more attention paid to the impact of the proposed guidance on non-financial institutions during the Board's redeliberations.

Question 2*— Do you agree with the industry-specific specialized guidance scope exceptions in paragraph 825-10-15-9? If not, why? What would you propose instead?*

Response: We agree.

Recognition

Questions for All Respondents

Question 4*— Do the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment? If not, why? What would you propose instead?*

Question 5*— The proposed amendments define principal as the amount transferred by the holder at initial recognition. Should the definition of principal be expanded to include repayment of the principal amount at maturity or other settlement? If so, what instruments would fail (or pass) the contractual cash flow characteristics criterion as a result of this change?*

Response: The ED indicates that the guidance in the proposed update would improve financial reporting for financial instruments by developing a consistent framework for classifying those instruments that links the measurement of financial assets to the way in which an entity *expects* to benefit from the cash flows embedded in those assets [Emphasis Added]. Given this statement in the ED, it is difficult to understand the requirement to first consider whether the contractual terms of an asset give rise on specified dates to cash flows that are solely payments of principal and interest for purposes of classifying changes in fair value in the Statement of Comprehensive Income.

Said another way, we cannot understand why changes in fair value for simple debt instruments that an entity *may* sell is recognized as a component of other comprehensive income while changes in the fair value of most equity investments are recognized in net income. We do not believe this significant difference in classification in the Statement of Comprehensive Income meets the objective of a consistent framework for the way in which an entity *expects* to benefit from the cash flows embedded in financial assets.

The Board's reasoning for this conclusion seems to be explained in paragraph BC100 of the ED's Basis for Conclusions:

> The characteristics of a financial asset are important to its classification and measurement because those characteristics determine the variability of the related cash flows and how the entity *may* realize them. For example, because an equity instrument has no maturity, the only way to realize its value is to sell it. However, an entity can realize the value of a debt instrument by holding it until maturity or for a substantial portion of its life, as the fair value approaches par value. Therefore, the Board decided that only a debt instrument could qualify for measurement at other than fair value with all changes in fair value recognized in net income [Emphasis Added].

Microsoft disagrees with the Board's conclusion that is based on how an entity *may* realize cash flows (sell or hold to maturity). We are unable to reconcile that conclusion to the Board's stated objective of improving financial reporting for financial instruments by developing a consistent framework for classifying those instruments that links the measurement of financial assets to the way in which an entity *expects* to benefit from the cash flows embedded in those assets.

Microsoft believes that the contractual cash flow characteristics criterion should be removed from the proposed guidance and that the classification and measurement of financial assets should be based on a revised business model criterion that is based on how an entity manages its financial assets. This would be more consistent with how an entity *expects* to benefit from the cash flows embedded in those assets.

Question 6*— Do the proposed amendments contain sufficient application guidance and illustrations on implementing the cash flow characteristics assessment? If not, why?*

Question 7*— Should a financial asset with a contractual term that modifies the economic relationship (see paragraphs 825-10-55-17 through 55-20) between principal and interest be considered to contain cash flows that are solely payments of principal and interest? Should this be the case if, and only if, the contractual cash flows could or could* *not be more than insignificantly different from the benchmark cash flows as discussed in paragraph 825-10-55-19? If not, why? What would you propose instead?*

Question 8*— Do the proposed amendments contain sufficient application guidance in paragraphs 825-10-55-17 through 55-20 on assessing a modified economic relationship? If not, why?*

Question 9*— For beneficial interests in securitized financial assets, the proposed amendments would require an entity to look through to the underlying pool of instruments in determining whether the tranche contains payments of solely principal and interest. Do you agree with this look-through approach? If not, why? What would you propose instead?*

Response: The ED indicates that the main objective in developing the proposed Update is to provide financial statement users with more decision-useful information about an entity's involvement in financial instruments, *while reducing the complexity in accounting for those instruments* [Emphasis Added]. Microsoft does not believe the contractual cash flow characteristics criterion in the proposed guidance reduces the complexity in accounting for financial instruments, as evidenced by the need for four questions to respondents related to the issue of complexity and the significant application guidance on the subject in the ED (including seven instrument based examples and two beneficial interests in securitized financial assets cases - 26 paragraphs, 5 pages), in order to provide illustrations of assessing whether the contractual cash flow characteristics criterion is met.

Question 10*— Do the proposed amendments appropriately convey the principle associated with the business model assessment? If not, why? What would you propose instead?*

Question 11*— Do the proposed amendments provide sufficient application guidance and illustrations on how to distinguish among the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the proposed guidance provided to describe those business models? If not, why?*

Response: Microsoft agrees with the concept that a financial asset should be classified depending on how the asset is managed together with other financial assets within a distinct business model. However, as indicated above, we believe the classification should not be dependent upon the cash flow characteristics of the financial asset. Furthermore, basing a financial asset's classification on its cash flow characteristics leads to what we believe is theoretically weak guidance that is articulated in paragraph 825-10-25-25b, which in essence bases a financial asset's classification upon a business model that has the objective of *both* holding and selling financial assets. We do not to see how guidance such as this results in the classification of financial assets based on the way in which an entity *expects* to benefit from the cash flows embedded in financial assets.

***Question 12**— Should the classification and measurement model for financial instruments contain an explicit tainting notion or should it rely on the principle and exercise of professional judgment? Why?*

Response: We agree with the Board's conclusion to not include an explicit tainting notion because the appropriate effects of an entity's sales of financial assets are best dealt with by expressing a clear objective and implementation guidance rather than by establishing detailed rules.

***Question 13**— The proposed amendments would require loan commitments, a revolving line of credit, or a commercial letter of credit (the potential creditor) to be measured on the basis of the likelihood of exercise of the commitment and the classification of the underlying loan that would be made upon exercise of the commitment. Do you agree with the proposed classification of loan commitments? If not, why? What would you propose instead?*

Response: We agree.

Initial Measurement

Questions for All Respondents

***Question 14**— Do you agree with the initial measurement principles for financial instruments? If not, why?*

Response: We agree.

Subsequent Measurement

Questions for All Respondents

***Question 16**— Should financial liabilities subsequently be measured at amortized cost, unless certain exceptions are met? If not, why?*

Response: Yes.

***Question 17**— The proposed amendments would require a nonrecourse financial liability that is settled with only the cash flows from the related financial assets (see paragraph 825-10-35-11) to be measured on the same basis as those assets. Do you agree with the proposed amendments? If not, why? What would you propose instead?*

Response: We agree.

***Question 18**— The proposed amendments would require financial assets measured at amortized cost that are subsequently identified for sale to continue to be classified and measured at amortized cost less impairment and would prohibit recognition of the gain,* *until the sale is complete. Do you agree with the proposed classification and measurement requirements? If not, why?*

Response: No, financial assets measured at amortized cost that are subsequently identified for sale should be measured at fair value, as that is consistent with the way in which an entity *expects* to benefit from the cash flows embedded in financial assets.

Question 19*— The proposed amendments would provide a practicability exception for measuring equity investments without readily determinable fair values that do not qualify for the practical expedient in paragraph 820-10-35-59 (that is, the net asset value per share expedient) and a one-step impairment model for all equity investments subject to the practicability exception. Do you agree with the proposed amendments? If not, why?*

Response: We agree.

Question 20*— Should an entity evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at fair value with qualifying changes in fair value recognized in other comprehensive income separately from the other deferred tax assets of the entity (rather than combined and analyzed together)? If not, why?*

Response: No, the need for a valuation allowance on a deferred tax asset related to the change in fair values of debt instruments recognized in other comprehensive should be determined in combination with an entity's other deferred tax assets. We found the Board's basis for conclusions on this matter opaque, indicating that a valuation allowance may not be necessary because a deferred tax asset related to such unrealized losses results from the interaction of Topic 740 and Topic 320.

Microsoft speculates that the Board's decision is based on the notion that an entity *may* hold an investment in a debt instrument until recovery of its amortized cost basis such that the recovery of the unrealized losses in other comprehensive income and the corresponding reversals of the deferred tax asset can be viewed as the realization of the entity's tax benefit. We think this is based on the Board's conclusion in paragraph 825-10-25-25b, which in essence bases a financial asset's classification upon a business model that has the objective of *both* holding and selling financial assets. As indicated previously, we do not see how guidance such as this results in the classification of financial assets based on the way in which an entity *expects* to benefit from the cash flows embedded in financial assets.

Question 21*— Under the amendments in this proposed Update, hybrid financial assets would not be required to be analyzed for bifurcation under Subtopic 815-15 and would be assessed in their entirety on the basis of the proposed classification requirements. In contrast, hybrid financial liabilities would be assessed for bifurcation and separate accounting under Subtopic 815-15, and the financial liability host contract would be subject to the proposed amendments. Do you agree with this proposal? If not, why? What would you propose instead?*

Response: No. It appears one of the motivations for the Board's conclusion is that the bifurcation requirements in Subtopic 815-15 do not work when overlaid on the contractual cash flow characteristics criterion. As indicated previously, Microsoft believes that the contractual cash flow characteristics criterion should be removed from the proposed guidance.

Question 22*— The proposed amendments would require reclassification of financial assets when a change in business model occurs and prescribes how those changes should be subsequently accounted for. Do you agree with the proposed amendment on reclassifications? If not, why?*

Response: Microsoft agrees with reclassification of financial assets when a change in business model occurs and believes that an entity should recognize the reclassification on the last day of the reporting period in which the business model changes.

Presentation

Questions for Preparers and Auditors

Question 26*— The proposed amendments would require an entity to separately recognize in net income changes in fair value attributable to foreign currency gain or loss on foreign-currency-denominated debt securities measured at fair value through other comprehensive income (see paragraphs 825-10-45-14 through 45-15). Is the proposed fair-value-based method provided for computing the foreign currency gain or loss component operable? If not, why? What would you propose instead?*

Response: Microsoft believes that the current guidance which requires that the entire change in the fair value of a foreign-currency-denominated debt security be reported in other comprehensive income should be retained.

Disclosures

Questions for All Respondents

Question 29*— Do you agree with the proposed disclosure requirements? If not, which disclosure requirement would you change and why?*

Response: Microsoft asks the Board to reconsider the proposed requirement in paragraph 825-10-50-37b, in particular, whether the information required is already captured under the requirements of the recent updates to Topic 220. More importantly, we are concerned about the interaction of paragraph 825-10-50-33, which requires information to be disclosed by *class* of financial instruments, with the requirements in paragraph 825-10-50-37. We do not believe that the information required in paragraph 825-10-50-37 should be presented by class of financial instrument.

While not specifically asked as a question for respondents, Microsoft objects to the presentation requirements in paragraphs 825-10-45-4, 825-10-45-13, 825-10-45-14, and 825-10-45-16. Microsoft believes an entity should be allowed to present this information in their footnotes to the financial statements. If the Board believes the proposed presentation is important for financial institutions, then it should only require this information be presented on the face of the financial statements for financial institutions.

Transition and Open Effective Date Information

Questions for All Respondents

Question 30*— Should an entity be permitted to early adopt only the proposed presentation requirements related to changes in instrument-specific credit risk for hybrid financial liabilities that would qualify for the fair value option under the proposed requirements? If not, why?*

Response: Microsoft does not believe it will elect the fair value option under the proposed requirements.

Question 31*— Should the effective date be the same for both public entities and nonpublic entities?*

Response: We defer to the Board on what would be the appropriate effective date for nonpublic entities.

Questions for Preparers and Auditors

Question 32*— How much time is needed to implement the proposed guidance?*

Response: While we disagree with some of the proposed guidance as articulated above, Microsoft estimates that it would take two or possibly three years to implement the proposed guidance.

Question 33*— Are the transition provisions in this proposed Update operable? If not, why?*

Response: We believe the transition provisions are operable.

Equity Method Accounting

Questions for All Respondents

Question 34*— The proposed amendments would require investments that qualify for the equity method of accounting in Subtopic 323-10, Investments—Equity Method and Joint Ventures—Overall, to be subsequently measured at fair value with changes in fair value* *recognized in net income if the investment is held for sale at initial recognition. Are the proposed indicators/conditions operable? If not, why? What would you propose instead?*

Response: We believe the proposed indicators/conditions are operable.

Question 35*— The proposed amendments would change the current two-step impairment model for equity method investments to a one-step impairment model for all equity investments. Do you agree with the proposed one-step equity impairment model? If not, why? What would you propose instead?*

Response: We agree with the change for equity method investments.

Nonfinancial Hybrid Instruments

Questions for All Respondents

Question 37*— The proposed amendments would eliminate the fair value option for hybrid nonfinancial instruments in current U.S. GAAP and would provide a new fair value option for hybrid nonfinancial liabilities. For a hybrid nonfinancial liability, an entity would apply the bifurcation and separate accounting requirements in Subtopic 815-15 and account for the embedded derivative in accordance with Topic 815. The financial liability host that results from separation of the nonfinancial embedded derivative would be subject to the proposed amendments. However, an entity would be permitted to initially and subsequently measure the entire hybrid nonfinancial liability at fair value (with changes in fair value recognized in net income) if after applying Subtopic 815-15 the entity determines that an embedded derivative that requires bifurcation and separate accounting exists. In contrast, for a hybrid nonfinancial asset the proposed amendments would require the hybrid contract to be measured at fair value (with changes in fair value recognized in net income) if the hybrid nonfinancial asset contains an embedded derivative that would have required bifurcation and separate accounting under Subtopic 815-15. Do you agree with the proposed amendments? If not, why? What would you propose instead?*

Response: Microsoft disagrees that changes in the fair value of a hybrid nonfinancial asset should always be recognized in net income, as that requirement seems to be based on the contractual cash flow characteristics criterion which we believe should be removed from the proposed guidance.