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March 29, 2002

Mr. Timothy S. Lucas Director of Research and Technical Activities Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856-5116

## Dear Tim:

Microsoft appreciates the opportunity to respond to the Proposal for a New Agenda Project: Issues Related to the Recognition of Revenues and Liabilities. We agree that issues involving revenue recognition are among the most important and most difficult that standard setters and accountants face. Accordingly, Microsoft believes that the FASB should add a project to its agenda to address revenue recognition. On the other hand, we are strongly opposed to the inclusion in this project of issues concerning the clarification of the liabilities definition in the Concepts Statements or the recognition criteria that apply to liabilities.

While Microsoft believes the conceptual framework serves as an important guide in setting accounting standards, we also believe that the FASB has failed in balancing the importance of a conceptually pure answer with the equally important need to provide timely and pragmatic guidance. If the FASB believes this project must refine and clarify the liabilities definition in Concepts Statement 6 (along with a refinement to the asset definition to the extent that it parallels the liabilities definition), as well as improve the recognition criteria in Concepts Statement 5 that apply to liabilities, Microsoft seriously questions whether the FASB will be able to complete the project in a timely matter.

With respect to addressing revenue recognition issues in a FASB project, we agree with the FASB's proposal to undertake two distinct but interrelated phases, a "top-down" approach that focuses on the conceptual guidance in Concepts Statements 5 and 6, and a "bottom-up" approach that focuses on the detailed authoritative guidance and other accepted practices for revenue recognition. Furthermore, we believe AcSEC, and to a lesser extent, the EITF, could provide valuable assistance to the FASB on certain aspects of the "bottom-up" approach.

In addition, we believe the FASB (as well as AcSEC and the EITF) needs to be sensitive to transition issues from a potential new standard or amendments to existing standards. For example, Microsoft has a significant amount of unearned revenue, some of which is due to the provisions of SOP 97-2, Software Revenue Recognition. We would find it

unconscionable if a transition provision required that unearned revenue currently recognized on a company's balance sheet be "washed away" in a cumulative effect adjustment and never be reflected as revenue in a company's income statement.

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

Sincerely,

Bob Laux Director, External Reporting Issue 1: Is there a need for the FASB or others to comprehensively address issues associated with the recognition of revenues and liabilities? If yes, should the FASB take on such an effort or defer to others? If so, to whom?

Response: There is a need for the FASB to comprehensively address issues associated with the recognition of revenues. Issues involving revenue recognition are among the most important and the most difficult that standard setters and accountants face. Microsoft believes that the FASB should add a project to its agenda that would develop a general revenue recognition standard to close the gap between the broad guidance at the concepts level and the detailed revenue recognition guidance for particular industries or transactions. On the other hand, we are strongly opposed to the inclusion in this project of issues concerning the clarification of the liabilities definition in the Concepts Statements or the recognition criteria that apply to liabilities.

Issue 2: Is the proposed scope of such a project as described in this proposal insufficient, appropriate, or too ambitious?

Response: Too ambitious. As stated above, Microsoft is strongly opposed to the inclusion in this project of issues concerning the clarification of the liabilities definition in the Concepts Statements or the recognition criteria that apply to liabilities. If the FASB believes this project must refine and clarify the liabilities definition in Concepts Statement 6 (along with a refinement to the asset definition to the extent that it parallels the liabilities definition), as well as improve the recognition criteria in Concepts Statement 5 that apply to liabilities, we seriously question whether the FASB will be able to complete the project in a timely matter.

Issue 3: Should specific issues identified above or in the appendix be excluded from the scope of the proposed project? If yes, for each specific issue, please indicate whether it should be addressed as part of another FASB project, by others, or not at all and why.

Response: What is needed is guidance that closes the gap between the broad guidance at the concepts level and the detailed revenue recognition guidance for particular industries or transactions.

Issue 4: Should specific issues *not* identified above or in the appendix be addressed as part of the proposed project? If yes, please describe the specific issue and indicate why it is sufficiently crucial that it should be addressed as part of the proposed project.

Response: No.

Issue 5: Should the proposed project, in addition to developing a new, general accounting standard on revenue recognition and revising the related guidance on revenues and liabilities in Concepts Statements 5 and 6, develop a new, general accounting standard on liability recognition?

Response: No.