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April 25, 2011

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

Re: File Reference No. 2011-175

Dear Sue:

Microsoft appreciates the opportunity to respond to the Invitation to Comment (IC), "Selected Issues about Hedge Accounting". We are supportive of many of the IASB's proposed revisions to hedge accounting, since aligning hedge accounting more closely with an entity's risk management objectives will provide users of financial statements more useful information. In particular, Microsoft strongly supports the proposal to accumulate changes in the fair value of an option's time value in other comprehensive income. For transaction related hedged items such as forecasted revenue, recognizing changes in the fair value of an option's time value in other comprehensive income rather than in profit or loss is more reflective of an entity's risk management objectives.

On the other hand, we are opposed to some of the IASB's proposed revisions. We struggled with the "other-than-accidental offset" guidance and, as indicated in our September 2010 response to the FASB Exposure Draft "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities", are supportive of an effectiveness threshold of "reasonably effective". We are also opposed to the proposed changes to the presentation of information on the face of the financial statements. For many entities that are not financial institutions, this inappropriately overemphasizes the effects of hedge accounting versus the other information that is presented on the face of the financial statements.

From a higher level perspective, Microsoft believes this IC is reflective of the sub-optimal approach that has been taken on the Financial Instruments project. One of the questions in the IC is whether the FASB should be making targeted changes to U.S. GAAP or moving towards converging its overall standards on derivatives and hedging activities with the IASB's standards. We believe neither approach is appropriate; rather, the FASB and IASB should be working on joint proposals that are then exposed for comment.

We understand the demand for action on improving the accounting for financial instruments, but it is important that a final standard(s) is reflective of a robust joint FASB/IASB project rather than a hodgepodge of various FASB/IASB preferences. With the recent announcement that the FASB/IASB will extend the timeline for completing the convergence program, Microsoft believes it is important that the Boards take a critical look at the how this project has been conducted to date and carefully plan how it should be conducted in the future. It is our opinion that, to date, the desire for speed in completing the Financial Instruments project has taken precedence over an actual robust joint project.

Our responses to the questions raised in the IC 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

### Risk Management

*Question 1— When an entity uses financial instruments to manage risk exposures in economic hedges but those instruments are not designated in hedging relationships for accounting purposes, do you believe that the proposed guidance would provide useful information about all of the effects of an entity’s risk management objectives?*

Response: In order to provide useful information about all of the effects of an entity’s risk management objectives, Microsoft believes companies should disclose instances where financial instruments are used to manage risk exposures in economic hedges but are not designated in hedging relationships for accounting purposes.

*Question 2— Do you believe that the proposed guidance and illustrative examples included in the IASB’s Exposure Draft are sufficient to understand what is meant by risk management, how to apply that notion to determine accounting at a transaction level, and how to determine the appropriate level of documentation required? Why or why not?*

Response: Except for some of the specifics noted below, we believe the proposed guidance and illustrative examples are sufficient.

*Question 3— Do you foresee an entity changing how it determines, documents, and oversees its risk management objectives as a result of this proposed guidance? If yes, what changes do you foresee? Do you foresee any significant difficulties that an entity would likely encounter in establishing the controls related to complying with the proposed guidance?*

Response: No

### Hedged Items—Overall

*Question 6— Do you believe that the proposed guidance is sufficient to understand what constraints apply when determining whether an item in its entirety or a component thereof is eligible to be designated as a hedged item (for example, equity instruments measured at fair value through profit or loss, standalone derivatives, hybrid instruments, and components of instruments measured at fair value through profit or loss that are not permitted to be bifurcated)? If not, what additional guidance should be provided?*

Response: Except for some of the specifics noted below, we believe the proposed guidance and illustrative examples are sufficient.

### Hedged Items—Risk Components

*Question 7— Do you believe that the proposed criteria are appropriate when designating a component of an item as a hedged item? If not, what criteria do you suggest? Do you*

*believe that the proposed guidance and illustrative examples are sufficient to understand how to determine when the criteria of separately identifiable and reliably measurable have been met? If not, please describe what additional guidance should be provided.*

Response: See response below.

**Question 8**— *Do you believe that “separately identifiable” should be limited to risk components that are contractually specified? Why or why not?*

Response: No, Microsoft agrees with the IASB proposal that a hedged item could be a component that is not contractually specified as long as it is separately identifiable and reliably measurable. However, we believe further application guidance in this area would be helpful.

### **Hedged Items—Layer Component**

**Question 10**— *Do you believe that the proposed guidance is sufficient to understand what constraints apply to determining a layer component from a defined, but open, population? (For example, do you believe that the sale of the last 10,000 widgets sold during a specified period could be designated a layer component in a cash flow hedge?) If not, what additional guidance should be provided?*

Response: Yes, we believe the proposed guidance is sufficient and the examples provided in paragraph B21 of the IASB’s Exposure Draft are helpful in understanding layer components that may be specified from a defined, but open, population.

### **Hedged Items—Aggregated Exposures and Groups of Items**

**Question 12**— *Do you believe that the proposed guidance on aggregated exposures will provide more transparent and consistent information about an entity’s use of derivatives? Why or why not?*

Response: Yes, Microsoft believes that an aggregated exposure that is a combination of an exposure and a derivative should be allowed to be designated as a hedged item if it is reflective of an entity’s risk management objectives.

### **Hedge Effectiveness**

**Question 14**— *Do you foresee any significant operational concerns, including auditing issues, in determining how to assess whether a hedge achieves other-than-accidental offset? If yes, what concerns do you foresee and how would you alleviate them?*

Response: We struggled with the “other-than-accidental offset” guidance and, as indicated in our September 2010 response to the FASB Exposure Draft “Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and

Hedging Activities”, are supportive of an effectiveness threshold of “reasonably effective”.

**Question 15**— *Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to analyze hedge effectiveness (for example, how to measure the change in the value of the hedged item attributable to the related hedged risk for nonfinancial items)? If not, what additional guidance is needed?*

Response: Subject to our comment above concerning “other-than-accidental offset”, we believe the proposed guidance and illustrative examples are sufficient.

### **Changes to a Hedging Relationship**

**Question 16**— *Do you foresee any significant operational concerns or constraints in determining whether (a) a change to a hedging relationship represents a rebalancing versus a discontinuation of the hedging relationship or (b) an entity’s risk management objective has changed? If yes, what concerns or constraints do you foresee and how would you alleviate them?*

**Question 17**— *Do you foresee any significant operational concerns or constraints relating to the potential need to rebalance the hedging relationship to continue to qualify for hedge accounting? If yes, what concerns or constraints do you foresee and how would you alleviate them?*

Response (Questions 16 and 17): Microsoft does not believe rebalancing should be mandated if it is inconsistent with actual risk management strategies. Accordingly, we believe the Boards should permit, but not require, rebalancing hedge relationships as this would most closely align the accounting with the risk management strategies, which is the stated objective of the IASB’s Exposure Draft.

### **Accounting for the Time Value of Options**

**Question 18**— *Do you believe that capitalizing the time value of an option as a basis adjustment of nonfinancial items (in other words, marking the asset or liability away from market) will improve the information that is provided in an entity’s statement of financial position? Why or why not?*

Response: Microsoft strongly supports the proposed accounting in the IASB Exposure Draft to accumulate changes in the fair value of an option’s time value in other comprehensive income. For transaction related hedged items such as forecasted revenue, recognizing changes in the fair value of an option’s time value in other comprehensive income rather than in profit or loss is more reflective of an entity’s risk management objectives. When reclassified out of other comprehensive income, we believe the time value of an option should be recognized as an expense, since it is a cost of obtaining protection against unfavorable changes of prices or rates.

## **Hedge Accounting and Presentation**

**Question 19**— *Do you believe that the proposed presentation of the gains and losses in other comprehensive income will provide users of financial statements with more useful information? Why or why not?*

**Question 20**— *Do you believe that the proposed presentation of a separate line item in the statement of financial position would increase the transparency and the usefulness of the information about an entity's hedging activities? Why or why not?*

**Question 21**— *Do you believe that there is sufficient guidance to specifically link the hedging adjustments to the hedged assets and liabilities that compose a hedged net position with respect to presenting a separate line item in the statement of financial position?*

Response (Questions 19, 20 and 21): No, we believe the proposed presentation would unnecessarily clutter the face of the financial statements and for many entities that are not financial institutions, inappropriately overemphasizes the effects of hedge accounting versus the other items presented on the face of the financial statements.

## **Disclosures**

**Question 22**— *Do you foresee any significant auditing issues arising from the inclusion of risk management disclosures in the notes to the financial statements? If yes, what issues do you foresee and how would you alleviate them? Do you believe that it is appropriate to include risk management disclosures in the notes to the financial statements rather than in other information in documents containing financial statements? Why or why not?*

Response: Given that the proposed guidance would rely substantially on an entity's risk management objectives as a basis for hedge accounting, Microsoft believes it is appropriate to include risk management disclosures in the notes to the financial statements.

## **Other**

**Question 23**— *Do you believe that the changes proposed by the IASB provide a superior starting point for any changes to U.S. GAAP as it relates to derivatives and hedging activities? Why or why not? Should the FASB be making targeted changes to U.S. GAAP or moving toward converging its overall standards on derivatives and hedging activities with the IASB's standards?*

Response: As indicated in our cover letter, we are supportive of many of the IASB's proposed revisions to hedge accounting. However, Microsoft believes this IC is indicative of the sub-optimal approach that has been taken on the Financial Instruments project. The FASB should neither be making targeted changes to U.S. GAAP nor

moving towards converging its overall standards on derivatives and hedging activities with the IASB's standards. Rather, the FASB and IASB should be working on joint proposals that are then exposed for comment.

We understand the demand for action on improving the accounting for financial instruments, but it is important that a final standard(s) is reflective of a robust joint FASB/IASB project rather than a hodgepodge of various FASB/IASB preferences. With the recent announcement that the FASB/IASB will extend the timeline for completing the convergence program, Microsoft believes it is important that the Boards take a critical look at the how this project has been conducted to date and carefully plan how it should be conducted in the future. It is our opinion that, to date, the desire for speed in completing the Financial Instruments project has taken precedence over an actual robust joint project.