UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended June 30, 2022

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period From to

Commission File Number 001-37845

MICROSOFT CORPORATION

WASHINGTON	**91-1144442**
(STATE OF INCORPORATION)	**(I.R.S. ID)**

ONE MICROSOFT WAY, REDMOND, WASHINGTON 98052-6399

(425) 882-8080

www.microsoft.com/investor

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of exchange on which registered
Common stock, $0.00000625 par value per share	**MSFT**	**NASDAQ**
3.125% Notes due 2028	**MSFT**	**NASDAQ**
2.625% Notes due 2033	**MSFT**	**NASDAQ**

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☒	Accelerated Filer ☐
Non-accelerated Filer ☐	Smaller Reporting Company ☐
	Emerging Growth Company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

As of December 31, 2021, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $2.5 trillion based on the closing sale price as reported on the NASDAQ National Market System. As of July 25, 2022, there were 7,457,891,872 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on December 13, 2022 are incorporated by reference into Part III.

MICROSOFT CORPORATION

FORM 10-K

For the Fiscal Year Ended June 30, 2022

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Note About Forward-Looking Statements

This report includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including the following sections: "Business" (Part I, Item 1 of this Form 10-K), "Risk Factors" (Part I, Item 1A of this Form 10-K), and "Management's Discussion and Analysis of Financial Condition and Results of Operations" (Part II, Item 7 of this Form 10-K). These forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "future," "opportunity," "plan," "may," "should," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. We describe risks and uncertainties that could cause actual results and events to differ materially in "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Quantitative and Qualitative Disclosures about Market Risk" (Part II, Item 7A of this Form 10-K). Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date they are made. We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

PART I

ITEM 1. BUSINESS

GENERAL

Embracing Our Future

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. We are creating the tools and platforms that deliver better, faster, and more effective solutions to support new startups, improve educational and health outcomes, and empower human ingenuity.

Microsoft is innovating and expanding our entire portfolio to help people and organizations overcome today's challenges and emerge stronger. We bring technology and products together into experiences and solutions that unlock value for our customers.

In a dynamic environment, digital technology is the key input that powers the world's economic output. Our ecosystem of customers and partners have learned that while hybrid work is complex, embracing flexibility, different work styles, and a culture of trust can help navigate the challenges the world faces today. Organizations of all sizes have digitized business-critical functions, redefining what they can expect from their business applications. Customers are looking to unlock value while simplifying security and management. From infrastructure and data, to business applications and collaboration, we provide unique, differentiated value to customers.

We are building a distributed computing fabric – across cloud and the edge – to help every organization build, run, and manage mission-critical workloads anywhere. In the next phase of innovation, artificial intelligence ("AI") capabilities are rapidly advancing, fueled by data and knowledge of the world. We are enabling metaverse experiences at all layers of our stack, so customers can more effectively model, automate, simulate, and predict changes within their industrial environments, feel a greater sense of presence in the new world of hybrid work, and create custom immersive worlds to enable new opportunities for connection and experimentation.

What We Offer

Founded in 1975, we develop and support software, services, devices, and solutions that deliver new value for customers and help people and businesses realize their full potential.

We offer an array of services, including cloud-based solutions that provide customers with software, services, platforms, and content, and we provide solution support and consulting services. We also deliver relevant online advertising to a global audience.

Our products include operating systems, cross-device productivity and collaboration applications, server applications, business solution applications, desktop and server management tools, software development tools, and video games. We also design and sell devices, including PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

The Ambitions That Drive Us

To achieve our vision, our research and development efforts focus on three interconnected ambitions:

- Reinvent productivity and business processes.
- Build the intelligent cloud and intelligent edge platform.
- Create more personal computing.

Reinvent Productivity and Business Processes

At Microsoft, we provide technology and resources to help our customers create a secure hybrid work environment. Our family of products plays a key role in the ways the world works, learns, and connects.

Our growth depends on securely delivering continuous innovation and advancing our leading productivity and collaboration tools and services, including Office 365, Dynamics 365, and LinkedIn. Microsoft 365 brings together Office 365, Windows, and Enterprise Mobility + Security to help organizations empower their employees with AI-backed tools that unlock creativity, increase collaboration, and fuel innovation, all the while enabling compliance coverage and data protection. Microsoft Teams is a comprehensive platform for work, with meetings, calls, chat, collaboration, and business process automation. Microsoft Viva is an employee experience platform that brings together communications, knowledge, learning, resources, and insights powered by Microsoft 365. Together with the Microsoft Cloud, Dynamics 365, Microsoft Teams, and Azure Synapse bring a new era of collaborative applications that transform every business function and process. Microsoft Power Platform is helping domain experts drive productivity gains with low-code/no-code tools, robotic process automation, virtual agents, and business intelligence. In a dynamic labor market, LinkedIn is helping professionals use the platform to connect, learn, grow, and get hired.

Build the Intelligent Cloud and Intelligent Edge Platform

As digital transformation accelerates, organizations in every sector across the globe can address challenges that will have a fundamental impact on their success. For enterprises, digital technology empowers employees, optimizes operations, engages customers, and in some cases, changes the very core of products and services. Microsoft has a proven track record of delivering high value to our customers across many diverse and durable growth markets.

We continue to invest in high performance and sustainable computing to meet the growing demand for fast access to Microsoft services provided by our network of cloud computing infrastructure and datacenters. Azure is a trusted cloud with comprehensive compliance coverage and AI-based security built in.

Our cloud business benefits from three economies of scale: datacenters that deploy computational resources at significantly lower cost per unit than smaller ones; datacenters that coordinate and aggregate diverse customer, geographic, and application demand patterns, improving the utilization of computing, storage, and network resources; and multi-tenancy locations that lower application maintenance labor costs.

The Microsoft Cloud is the most comprehensive and trusted cloud, providing the best integration across the technology stack while offering openness, improving time to value, reducing costs, and increasing agility. Being a global-scale cloud, Azure uniquely offers hybrid consistency, developer productivity, AI capabilities, and trusted security and compliance. We see more emerging use cases and needs for compute and security at the edge and are accelerating our innovation across the spectrum of intelligent edge devices, from Internet of Things ("IoT") sensors to gateway devices and edge hardware to build, manage, and secure edge workloads. With Azure Stack, organizations can extend Azure into their own datacenters to create a consistent stack across the public cloud and the intelligent edge.

Our hybrid infrastructure consistency spans security, compliance, identity, and management, helping to support the real-world needs and evolving regulatory requirements of commercial customers and enterprises. Our industry clouds bring together capabilities across the entire Microsoft Cloud, along with industry-specific customizations, to improve time to value, increase agility, and lower costs. Azure Arc simplifies governance and management by delivering a consistent multi-cloud and on-premises management platform. Security, compliance, identity, and management underlie our entire tech stack. We offer integrated, end-to-end capabilities to protect people and organizations.

In March 2022, we completed our acquisition of Nuance Communications, Inc. (“Nuance”). Together, Microsoft and Nuance will enable organizations across industries to accelerate their business goals with security-focused, cloud-based solutions infused with powerful, vertically optimized AI.

We are accelerating our development of mixed reality solutions with new Azure services and devices. Microsoft Mesh enables presence and shared experiences from anywhere through mixed reality applications. The opportunity to merge the physical and digital worlds, when combined with the power of Azure cloud services, unlocks new workloads and experiences to create common understanding and drive more informed decisions.

The ability to convert data into AI drives our competitive advantage. Azure SQL Database makes it possible for customers to take SQL Server from their on-premises datacenter to a fully managed instance in the cloud to utilize built-in AI. Azure Synapse brings together data integration, enterprise data warehousing, and big data analytics in a comprehensive solution. We are accelerating adoption of AI innovations from research to products. Our innovation helps every developer be an AI developer, with approachable new tools from Azure Machine Learning Studio for creating simple machine learning models, to the powerful Azure Machine Learning Workbench for the most advanced AI modeling and data science. From GitHub to Visual Studio, we provide a developer tool chain for everyone, no matter the technical experience, across all platforms, whether Azure, Windows, or any other cloud or client platform.

Additionally, we are extending our infrastructure beyond the planet, bringing cloud computing to space. Azure Orbital is a fully managed ground station as a service for fast downlinking of data.

Create More Personal Computing

We strive to make computing more personal by putting people at the core of the experience, enabling them to interact with technology in more intuitive, engaging, and dynamic ways. Microsoft 365 is empowering people and organizations to be productive and secure as they adapt to more fluid ways of working, learning, and playing. Windows also plays a critical role in fueling our cloud business with Windows 365, a desktop operating system that’s also a cloud service. From another internet-connected device, including Android or macOS devices, you can run Windows 365, just like a virtual machine.

With Windows 11, we have simplified the design and experience to empower productivity and inspire creativity. Windows 11 offers innovations focused on enhancing productivity and is designed to support hybrid work. It adds new experiences that include powerful task switching tools like new snap layouts, snap groups, and desktops; new ways to stay connected through Microsoft Teams chat; the information you want at your fingertips; and more. Windows 11 security and privacy features include operating system security, application security, and user and identity security.

Tools like search, news, and maps have given us immediate access to the world’s information. Today, through our Search, News, Mapping, and Browse services, Microsoft delivers unique trust, privacy, and safety features. Microsoft Edge is our fast and secure browser that helps protect your data, with built-in shopping tools designed to save you time and money. Organizational tools such as Collections, Vertical Tabs, and Immersive Reader help make the most of your time while browsing, streaming, searching, and sharing.

We are committed to designing and marketing first-party devices to help drive innovation, create new device categories, and stimulate demand in the Windows ecosystem. The Surface family includes Surface Laptop Studio, Surface Laptop 4, Surface Laptop Go 2, Surface Laptop Pro 8, Surface Pro X, Surface Go 3, Surface Studio 2, and Surface Duo 2.

With three billion people actively playing games today, and a new generation steeped in interactive entertainment, Microsoft continues to invest in content, community, and cloud services. We have broadened our approach to how we think about gaming end-to-end, from the way games are created and distributed to how they are played, including cloud gaming so players can stream across PC, console, and mobile. We have a strong position with our large and growing highly engaged community of gamers, including the acquisition of ZeniMax Media Inc., the parent company of Bethesda Softworks LLC. In January 2022, we announced plans to acquire Activision Blizzard, Inc., a leader in game development and an interactive entertainment content publisher. Xbox Game Pass is a community with access to a curated library of over 100 first- and third-party console and PC titles. Xbox Cloud Gaming is Microsoft's game streaming technology that is complementary to our console hardware and gives fans the ultimate choice to play the games they want, with the people they want, on the devices they want.

Our Future Opportunity

The case for digital transformation has never been more urgent. Customers are looking to us to help improve productivity and the affordability of their products and services. We continue to develop complete, intelligent solutions for our customers that empower people to stay productive and collaborate, while safeguarding businesses and simplifying IT management. Our goal is to lead the industry in several distinct areas of technology over the long term, which we expect will translate to sustained growth. We are investing significant resources in:

- Transforming the workplace to deliver new modern, modular business applications, drive deeper insights, and improve how people communicate, collaborate, learn, work, play, and interact with one another.
- Building and running cloud-based services in ways that unleash new experiences and opportunities for businesses and individuals.
- Applying AI to drive insights and act on our customer's behalf by understanding and interpreting their needs using natural methods of communication.
- Tackling security from all angles with our integrated, end-to-end solutions spanning security, compliance, identity, and management, across all clouds and platforms.
- Inventing new gaming experiences that bring people together around their shared love for games on any devices and pushing the boundaries of innovation with console and PC gaming by creating the next wave of entertainment.
- Using Windows to fuel our cloud business, grow our share of the PC market, and drive increased engagement with our services like Microsoft 365 Consumer, Teams, Edge, Bing, Xbox Game Pass, and more.

Our future growth depends on our ability to transcend current product category definitions, business models, and sales motions. We have the opportunity to redefine what customers and partners can expect and are working to deliver new solutions that reflect the best of Microsoft.

Corporate Social Responsibility

Commitment to Sustainability

We work to ensure that technology is inclusive, trusted, and increases sustainability. We are accelerating progress toward a more sustainable future by reducing our environmental footprint, advancing research, helping our customers build sustainable solutions, and advocating for policies that benefit the environment. In January 2020, we announced a bold commitment and detailed plan to be carbon negative by 2030, and to remove from the environment by 2050 all the carbon we have emitted since our founding in 1975. This included a commitment to invest $1 billion over four years in new technologies and innovative climate solutions. We built on this pledge by adding commitments to be water positive by 2030, zero waste by 2030, and to protect ecosystems by developing a Planetary Computer. We also help our suppliers and customers around the world use Microsoft technology to reduce their own carbon footprint.

Fiscal year 2021 was a year of both successes and challenges. While we continued to make progress on several of our goals, with an overall reduction in our combined Scope 1 and Scope 2 emissions, our

Scope 3 emissions increased, due in substantial part to significant global datacenter expansions and growth in Xbox sales and usage as a result of the COVID-19 pandemic. Despite these Scope 3 increases, we will continue to build the foundations and do the work to deliver on our commitments, and help our customers and partners achieve theirs. We have learned the impact of our work will not all be felt immediately, and our experience highlights how progress won’t always be linear.

While fiscal year 2021 presented us with some new learnings, we also made some great progress. A few examples that illuminate the diversity of our work include:

- We purchased the removal of 1.4 million metrics tons of carbon.
- Four of our datacenters received new or renewed Zero Waste certifications.
- We granted $100 million to Breakthrough Energy Catalyst to accelerate the development of climate solutions the world needs to reach net-zero across four key areas: direct air capture, green hydrogen, long duration energy storage, and sustainable aviation fuel.
- We joined the First Movers Coalition as an early leader and expert partner in the carbon dioxide removal sector, with a commitment of $200 million toward carbon removal by 2030.

Sustainability is an existential priority for our society and businesses today. This led us to create our Microsoft Cloud for Sustainability, an entirely new business process category to help organizations monitor their carbon footprint across their operations. We also joined with leading organizations to launch the Carbon Call – an initiative to mobilize collective action to solve carbon emissions and removal accounting challenges for a net zero future.

The investments we make in sustainability carry through to our products, services, and devices. We design our devices, from Surface to Xbox, to minimize their impact on the environment. Our cloud and AI services and datacenters help businesses cut energy consumption, reduce physical footprints, and design sustainable products.

Addressing Racial Injustice and Inequity

We are committed to addressing racial injustice and inequity in the United States for Black and African American communities and helping improve lived experiences at Microsoft, in employees' communities, and beyond. Our Racial Equity Initiative focuses on three multi-year pillars, each containing actions and progress we expect to make or exceed by 2025.

- Strengthening our communities: using data, technology, and partnerships to help improve the lives of Black and African American people in the United States, including our employees and their communities.
- Evolving our ecosystem: using our balance sheet and relationships with suppliers and partners to foster societal change and create new opportunities.
- Increasing representation and strengthening inclusion: build on our momentum, adding a $150 million investment to strengthen inclusion and double the number of Black, African American, Hispanic, and Latinx leaders in the United States by 2025.

Over the last year, we collaborated with partners and worked within neighborhoods and communities to launch and scale a number of projects and programs, including: working with 70 organizations in 145 communities on the Justice Reform Initiative, expanding access to affordable broadband and devices for Black and African American communities and key institutions that support them in major urban centers, expanding access to skills and education to support Black and African American students and adults to succeed in the digital economy, and increasing technology support for nonprofits that provide critical services to Black and African American communities.

We have made meaningful progress on representation and inclusion at Microsoft. We are 90 percent of the way to our 2025 commitment to double the number of Black and African American people managers, senior individual contributors, and senior leaders in the U.S., and 50 percent of the way for Hispanic and Latinx people managers, senior individual contributors, and senior leaders in the U.S.

We exceeded our goal on increasing the percentage of transaction volumes with Black- and African American-owned financial institutions and increased our deposits with Black- and African American-owned minority depository institutions, enabling increased funds into local communities. Additionally, we enriched our supplier pipeline, reaching more than 90 percent of our goal to spend $500 million with double the number of Black and African American-owned suppliers. We also increased the number of identified partners in the Black Partner Growth Initiative and continue to invest in the partner community through the

Black Channel Partner Alliance by supporting events focused on business growth, accelerators, and mentorship.

Progress does not undo the egregious injustices of the past or diminish those who continue to live with inequity. We are committed to leveraging our resources to help accelerate diversity and inclusion across our ecosystem and to hold ourselves accountable to accelerate change – for Microsoft, and beyond.

Investing in Digital Skills

The COVID-19 pandemic led to record unemployment, disrupting livelihoods of people around the world. After helping over 30 million people in 249 countries and territories with our global skills initiative, we introduced a new initiative to support a more skills-based labor market, with greater flexibility and accessible learning paths to develop the right skills needed for the most in-demand jobs. Our skills initiative brings together learning resources, certification opportunities, and job-seeker tools from LinkedIn, GitHub, and Microsoft Learn, and is built on data insights drawn from LinkedIn's Economic Graph. We previously invested $20 million in key non-profit partnerships through Microsoft Philanthropies to help people from underserved communities that are often excluded by the digital economy.

We also launched a national campaign with U.S. community colleges to help skill and recruit into the cybersecurity workforce 250,000 people by 2025, representing half of the country's workforce shortage. To that end, we are making curriculum available free of charge to all of the nation's public community colleges, providing training for new and existing faculty at 150 community colleges, and providing scholarships and supplemental resources to 25,000 students.

HUMAN CAPITAL RESOURCES

Overview

Microsoft aims to recruit, develop, and retain world-changing talent from a diversity of backgrounds. To foster their and our success, we seek to create an environment where people can thrive, where they can do their best work, where they can proudly be their authentic selves, guided by our values, and where they know their needs can be met. We strive to maximize the potential of our human capital resources by creating a respectful, rewarding, and inclusive work environment that enables our global employees to create products and services that further our mission to empower every person and every organization on the planet to achieve more.

As of June 30, 2022, we employed approximately 221,000 people on a full-time basis, 122,000 in the U.S. and 99,000 internationally. Of the total employed people, 85,000 were in operations, including manufacturing, distribution, product support, and consulting services; 73,000 were in product research and development; 47,000 were in sales and marketing; and 16,000 were in general and administration. Certain employees are subject to collective bargaining agreements.

Our Culture

Microsoft's culture is grounded in the growth mindset. This means everyone is on a continuous journey to learn and grow. We believe potential can be nurtured and is not pre-determined, and we should always be learning and curious – trying new things without fear of failure. We identified four attributes that allow growth mindset to flourish:

- Obsessing over what matters to our customers.
- Becoming more diverse and inclusive in everything we do.
- Operating as one company, One Microsoft, instead of multiple siloed businesses.
- Making a difference in the lives of each other, our customers, and the world around us.

Our employee listening systems enable us to gather feedback directly from our workforce to inform our programs and employee needs globally. Seventy percent of employees globally participated in our fiscal year 2022 Employee Signals survey, which covers a variety of topics such as thriving, inclusion, team culture, wellbeing, and learning and development. Throughout the fiscal year, we collect over 75,000 Daily Pulse employee survey responses. During fiscal year 2022, our Daily Pulse surveys gave us invaluable insights into ways we could support employees through the COVID-19 pandemic, addressing racial injustice, the war in Ukraine, and their general wellbeing. In addition to Employee Signals and Daily Pulse surveys, we gain insights through onboarding, internal mobility, leadership, performance and development, exit surveys, internal Yammer channels, employee Q&A sessions, and AskHR Service support.

Diversity and Inclusion

At Microsoft we have an inherently inclusive mission: to empower every person and every organization on the planet to achieve more. We think of diversity and inclusion as core to our business model, informing our actions to impact economies and people around the world. There are billions of people who want to achieve more, but have a different set of circumstances, abilities, and backgrounds that often limit access to opportunity and achievement. The better we represent that diversity inside Microsoft, the more effectively we can innovate for those we seek to empower.

We strive to include others by holding ourselves accountable for diversity, driving global systemic change in our workplace and workforce, and creating an inclusive work environment. Through this commitment we can allow everyone the chance to be their authentic selves and do their best work every day. We support multiple highly active Employee Resource Groups for women, families, racial and ethnic minorities, military, people with disabilities, and employees who identify as LGBTQIA+, where employees can go for support, networking, and community-building. As described in our 2021 Proxy Statement, annual performance and compensation reviews of our senior leadership team include an evaluation of their contributions to employee culture and diversity. To ensure accountability over time, we publicly disclose our progress on a multitude of workforce metrics including:

- Detailed breakdowns of gender, racial, and ethnic minority representation in our employee population, with data by job types, levels, and segments of our business.
- Our EEO-1 report (equal employment opportunity).
- Disability representation.
- Pay equity (see details below).

Total Rewards

We develop dynamic, sustainable, market-driven, and strategic programs with the goal of providing a highly differentiated portfolio to attract, reward, and retain top talent and enable our employees to thrive. These programs reinforce our culture and values such as collaboration and growth mindset. Managers evaluate and recommend rewards based on, for example, how well we leverage the work of others and contribute to the success of our colleagues. We monitor pay equity and career progress across multiple dimensions.

As part of our effort to promote a One Microsoft and inclusive culture, in fiscal year 2021 we expanded stock eligibility to all Microsoft employees as part of our annual rewards process. This includes all non-exempt and exempt employees and equivalents across the globe including business support professionals and datacenter and retail employees. In response to the Great Reshuffle, in fiscal year 2022 we announced a sizable investment in annual merit and annual stock award opportunity for all employees below senior executive levels. We also invested in base salary adjustments for our datacenter and retail hourly employees and hourly equivalents outside the U.S. These investments have supported retention and help to ensure that Microsoft remains an employer of choice.

Pay Equity

In our 2021 Diversity and Inclusion Report, we reported that all racial and ethnic minority employees in the U.S. combined earn $1.006 for every $1.000 earned by their white counterparts, that women in the U.S. earn $1.002 for every $1.000 earned by their counterparts in the U.S. who are men, and women in the U.S. plus our twelve other largest employee geographies representing 86.6% of our global population (Australia, Canada, China, France, Germany, India, Ireland, Israel, Japan, Romania, Singapore, and the United Kingdom) combined earn $1.001 for every $1.000 by men in these countries. Our intended result is a global performance and development approach that fosters our culture, and competitive compensation that ensures equitable pay by role while supporting pay for performance.

Wellness and Safety

Microsoft is committed to supporting our employees' well-being and safety while they are at work and in their personal lives.

We took a wide variety of measures to protect the health and well-being of our employees, suppliers, and customers during the COVID-19 pandemic and are now supporting employees in shifting to return to office and/or hybrid arrangements. We developed hybrid guidelines for managers and employees to support the transition and continue to identify ways we can support hybrid work scenarios through our employee listening systems.

We have invested significantly in holistic wellbeing, and offer a differentiated benefits package which includes many physical, emotional, and financial wellness programs including counseling through the Microsoft CARES Employee Assistance Program, mental wellbeing support, flexible fitness benefits, savings and investment tools, adoption assistance, and back-up care for children and elders. Finally, our Occupational Health and Safety program helps ensure employees can stay safe while they are working.

We continue to strive to support our Ukrainian employees and their dependents during the Ukraine crisis with emergency relocation assistance, emergency leave, and other benefits.

Learning and Development

Our growth mindset culture begins with valuing learning over knowing – seeking out new ideas, driving innovation, embracing challenges, learning from failure, and improving over time. To support this culture, we offer a wide range of learning and development opportunities. We believe learning can be more than formal instruction, and our learning philosophy focuses on providing the right learning, at the right time, in the right way. Opportunities include:

- Personalized, integrated, and relevant views of all learning opportunities on both our internal learning portal Learning (Viva Learning + LinkedIn Learning) and our external learning portal MS Learn are available to all employees worldwide.
- In-the-classroom learning, learning cohorts, our early-in-career Aspire program, and manager excellence communities.
- Required learning for all employees and managers on topics such as compliance, regulation, company culture, leadership, and management. This includes the annual Standards of Business Conduct training.
- On-the-job “stretch” and advancement opportunities.
- Managers holding conversations about employees’ career and development plans, coaching on career opportunities, and programs like mentoring and sponsorship.
- Customized manager learning to build people manager capabilities and similar learning solutions to build leadership skills for all employees including differentiated leadership development programs.
- New employee orientation covering a range of topics including company values, and culture, as well as ongoing onboarding programs.
- New tools to assist managers and employees in learning how to operate, be productive, and connect in the new flexible hybrid world of work. These include quick guides for teams to use, such as Creating Team Agreements, Reconnecting as a Team, and Running Effective Hybrid Meetings.

Our employees embrace the growth mindset and take advantage of the formal learning opportunities as well as thousands of informal and on-the-job learning opportunities. In terms of formal on-line learning solutions, in fiscal year 2022 our employees completed over 4.7 million courses, averaging over 14 hours per employee. Given our focus on understanding core company beliefs and compliance topics, all employees complete required learning programs like Standards of Business Conduct, Privacy, Unconscious Bias, and preventing harassment courses. Our corporate learning portal has over 100,000 average monthly active users. We have over 27,000 people managers, all of whom must complete between 20-33 hours of required manager capability and excellence training and are assigned ongoing required training each year. In addition, all employees complete skills training based on the profession they are in each year.

New Ways of Working

The COVID-19 pandemic accelerated our capabilities and culture with respect to flexible work. We introduced a Hybrid Workplace Flexibility Guide to better support managers and employees as they adapt to new ways of working that shift paradigms, embrace flexibility, promote inclusion, and drive innovation. Our ongoing survey data shows employees value the flexibility related to work location, work site, and work hours, and while many have begun returning to worksites as conditions have permitted, they also continue to adjust hours and/or spend some of workweeks working at home, another site, or remotely. We are focused on building capabilities to support a variety of workstyles where individuals, teams, and our business can deliver success.

OPERATING SEGMENTS

We operate our business and report our financial performance using three segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. Our segments provide management with a comprehensive financial view of our key businesses. The segments enable the alignment of strategies and objectives across the development, sales, marketing, and services organizations, and they provide a framework for timely and rational allocation of resources within businesses.

Additional information on our operating segments and geographic and product information is contained in Note 19 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Microsoft Viva.
- Office Consumer, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services.
- LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications.

Office Commercial

Office Commercial is designed to increase personal, team, and organizational productivity through a range of products and services. Growth depends on our ability to reach new users in new markets such as frontline workers, small and medium businesses, and growth markets, as well as add value to our core product and service offerings to span productivity categories such as communication, collaboration, analytics, security, and compliance. Office Commercial revenue is mainly affected by a combination of continued installed base growth and average revenue per user expansion, as well as the continued shift from Office licensed on-premises to Office 365.

Office Consumer

Office Consumer is designed to increase personal productivity through a range of products and services. Growth depends on our ability to reach new users, add value to our core product set, and continue to expand our product and service offerings into new markets. Office Consumer revenue is mainly affected by the percentage of customers that buy Office with their new devices and the continued shift from Office licensed on-premises to Microsoft 365 Consumer subscriptions. Office Consumer Services revenue is mainly affected by the demand for communication and storage through Skype, Outlook.com, and OneDrive, which is largely driven by subscriptions, advertising, and the sale of minutes.

LinkedIn

LinkedIn connects the world’s professionals to make them more productive and successful and transforms the way companies hire, market, sell, and learn. Our vision is to create economic opportunity for every member of the global workforce through the ongoing development of the world’s first Economic Graph, a digital representation of the global economy. In addition to LinkedIn’s free services, LinkedIn offers monetized solutions: Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions. Talent Solutions provide insights for workforce planning and tools to hire, nurture, and develop talent. Talent Solutions also includes Learning Solutions, which help businesses close critical skills gaps in times where companies are having to do more with existing talent. Marketing Solutions help companies reach, engage, and convert their audiences at scale. Premium Subscriptions enables professionals to manage their professional identity, grow their network, and connect with talent through additional services like premium search. Sales Solutions help companies strengthen customer relationships, empower teams with digital selling tools, and acquire new opportunities. LinkedIn has over 850 million members and has offices around the globe. Growth will depend on our ability to increase the number of LinkedIn members and our ability to continue offering services that provide value for our members and increase their engagement. LinkedIn revenue is mainly affected by demand from enterprises and professional organizations for subscriptions to Talent Solutions, Sales Solutions, and Premium Subscriptions offerings, as well as member engagement and the quality of the sponsored content delivered to those members to drive Marketing Solutions.

Dynamics

Dynamics provides cloud-based and on-premises business solutions for financial management, enterprise resource planning (“ERP”), customer relationship management (“CRM”), supply chain management, and other application development platforms for small and medium businesses, large organizations, and divisions of global enterprises. Dynamics revenue is driven by the number of users licensed and applications consumed, expansion of average revenue per user, and the continued shift to Dynamics 365, a unified set of cloud-based intelligent business applications, including Power Apps and Power Automate.

Competition

Competitors to Office include software and global application vendors, such as Apple, Cisco Systems, Meta, Google, IBM, Okta, Proofpoint, Slack, Symantec, Zoom, and numerous web-based and mobile application competitors as well as local application developers. Apple distributes versions of its pre-installed application software, such as email and calendar products, through its PCs, tablets, and phones. Cisco Systems is using its position in enterprise communications equipment to grow its unified communications business. Google provides a hosted messaging and productivity suite. Slack provides teamwork and collaboration software. Zoom offers videoconferencing and cloud phone solutions. Okta, Proofpoint, and Symantec provide security solutions across email security, information protection, identity, and governance. Web-based offerings competing with individual applications have also positioned themselves as alternatives to our products and services. We compete by providing powerful, flexible, secure, integrated industry-specific, and easy-to-use productivity and collaboration tools and services that create comprehensive solutions and work well with technologies our customers already have both on-premises or in the cloud.

LinkedIn faces competition from online professional networks, recruiting companies, talent management companies, and larger companies that are focusing on talent management and human resource services; job boards; traditional recruiting firms; and companies that provide learning and development products and services. Marketing Solutions competes with online and offline outlets that generate revenue from advertisers and marketers, and Sales Solutions competes with online and offline outlets for companies with lead generation and customer intelligence and insights.

Dynamics competes with cloud-based and on-premises business solution providers such as Oracle, Salesforce, and SAP.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business and developers. This segment primarily comprises:

- Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses ("CALs"); and Nuance and GitHub.
- Enterprise Services, including Enterprise Support Services, Microsoft Consulting Services, and Nuance professional services.

Server Products and Cloud Services

Azure is a comprehensive set of cloud services that offer developers, IT professionals, and enterprises freedom to build, deploy, and manage applications on any platform or device. Customers can use Azure through our global network of datacenters for computing, networking, storage, mobile and web application services, AI, IoT, cognitive services, and machine learning. Azure enables customers to devote more resources to development and use of applications that benefit their organizations, rather than managing on-premises hardware and software. Azure revenue is mainly affected by infrastructure-as-a-service and platform-as-a-service consumption-based services, and per user-based services such as Enterprise Mobility + Security.

Our server products are designed to make IT professionals, developers, and their systems more productive and efficient. Server software is integrated server infrastructure and middleware designed to support software applications built on the Windows Server operating system. This includes the server platform, database, business intelligence, storage, management and operations, virtualization, service-oriented architecture platform, security, and identity software. We also license standalone and software development lifecycle tools for software architects, developers, testers, and project managers. GitHub provides a collaboration platform and code hosting service for developers. Server products revenue is mainly affected by purchases through volume licensing programs, licenses sold to original equipment manufacturers ("OEM"), and retail packaged products. CALs provide access rights to certain server products, including SQL Server and Windows Server, and revenue is reported along with the associated server product.

Nuance and GitHub include both cloud and on-premises offerings. Nuance provides healthcare and enterprise AI solutions. GitHub provides a collaboration platform and code hosting service for developers.

Enterprise Services

Enterprise Services, including Enterprise Support Services, Microsoft Consulting Services, and Nuance Professional Services, assist customers in developing, deploying, and managing Microsoft server solutions, Microsoft desktop solutions, and Nuance conversational AI and ambient intelligent solutions, along with providing training and certification to developers and IT professionals on various Microsoft products.

Competition

Azure faces diverse competition from companies such as Amazon, Google, IBM, Oracle, VMware, and open source offerings. Our Enterprise Mobility + Security offerings also compete with products from a range of competitors including identity vendors, security solution vendors, and numerous other security point solution vendors. Azure's competitive advantage includes enabling a hybrid cloud, allowing deployment of existing datacenters with our public cloud into a single, cohesive infrastructure, and the ability to run at a scale that meets the needs of businesses of all sizes and complexities. We believe our cloud's global scale, coupled with our broad portfolio of identity and security solutions, allows us to effectively solve complex cybersecurity challenges for our customers and differentiates us from the competition.

Our server products face competition from a wide variety of server operating systems and applications offered by companies with a range of market approaches. Vertically integrated computer manufacturers such as Hewlett-Packard, IBM, and Oracle offer their own versions of the Unix operating system preinstalled on server hardware. Nearly all computer manufacturers offer server hardware for the Linux operating system and many contribute to Linux operating system development. The competitive position of

Linux has also benefited from the large number of compatible applications now produced by many commercial and non-commercial software developers. A number of companies, such as Red Hat, supply versions of Linux.

We compete to provide enterprise-wide computing solutions and point solutions with numerous commercial software vendors that offer solutions and middleware technology platforms, software applications for connectivity (both Internet and intranet), security, hosting, database, and e-business servers. IBM and Oracle lead a group of companies focused on the Java Platform Enterprise Edition that competes with our enterprise-wide computing solutions. Commercial competitors for our server applications for PC-based distributed client-server environments include CA Technologies, IBM, and Oracle. Our web application platform software competes with open source software such as Apache, Linux, MySQL, and PHP. In middleware, we compete against Java vendors.

Our database, business intelligence, and data warehousing solutions offerings compete with products from IBM, Oracle, SAP, Snowflake, and other companies. Our system management solutions compete with server management and server virtualization platform providers, such as BMC, CA Technologies, Hewlett-Packard, IBM, and VMware. Our products for software developers compete against offerings from Adobe, IBM, Oracle, and other companies, and also against open-source projects, including Eclipse (sponsored by CA Technologies, IBM, Oracle, and SAP), PHP, and Ruby on Rails.

We believe our server products provide customers with advantages in performance, total costs of ownership, and productivity by delivering superior applications, development tools, compatibility with a broad base of hardware and software applications, security, and manageability.

Our Enterprise Services business competes with a wide range of companies that provide strategy and business planning, application development, and infrastructure services, including multinational consulting firms and small niche businesses focused on specific technologies.

More Personal Computing

Our More Personal Computing segment consists of products and services that put customers at the center of the experience with our technology. This segment primarily comprises:

- Windows, including Windows OEM licensing (“Windows OEM”) and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; and Windows Internet of Things.
- Devices, including Surface and PC accessories.
- Gaming, including Xbox hardware and Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, third-party disc royalties, advertising, and other cloud services.
- Search and news advertising.

Windows

The Windows operating system is designed to deliver a more personal computing experience for users by enabling consistency of experience, applications, and information across their devices. Windows OEM revenue is impacted significantly by the number of Windows operating system licenses purchased by OEMs, which they pre-install on the devices they sell. In addition to computing device market volume, Windows OEM revenue is impacted by:

- The mix of computing devices based on form factor and screen size.
- Differences in device market demand between developed markets and growth markets.
- Attachment of Windows to devices shipped.
- Customer mix between consumer, small and medium businesses, and large enterprises.
- Changes in inventory levels in the OEM channel.
- Pricing changes and promotions, pricing variation that occurs when the mix of devices manufactured shifts from local and regional system builders to large multinational OEMs, and different pricing of Windows versions licensed.
- Constraints in the supply chain of device components.
- Piracy.

Windows Commercial revenue, which includes volume licensing of the Windows operating system and Windows cloud services such as Microsoft Defender for Endpoint, is affected mainly by the demand from commercial customers for volume licensing and Software Assurance ("SA"), as well as advanced security offerings. Windows Commercial revenue often reflects the number of information workers in a licensed enterprise and is relatively independent of the number of PCs sold in a given year.

Patent licensing includes our programs to license patents we own for use across a broad array of technology areas, including mobile devices and cloud offerings.

Windows IoT extends the power of Windows and the cloud to intelligent systems by delivering specialized operating systems, tools, and services for use in embedded devices.

Devices

We design and sell devices, including Surface and PC accessories. Our devices are designed to enable people and organizations to connect to the people and content that matter most using Windows and integrated Microsoft products and services. Surface is designed to help organizations, students, and consumers be more productive. Growth in Devices is dependent on total PC shipments, the ability to attract new customers, our product roadmap, and expanding into new categories.

Gaming

Our gaming platform is designed to provide a variety of entertainment through a unique combination of content, community, and cloud. Our exclusive game content is created through Xbox Game Studios, a collection of first-party studios creating iconic and differentiated gaming experiences. We continue to invest in new gaming studios and content to expand our IP roadmap and leverage new content creators. These unique gaming experiences are the cornerstone of Xbox Game Pass, a subscription service and gaming community with access to a curated library of over 100 first- and third-party console and PC titles.

The gamer remains at the heart of the Xbox ecosystem. We continue to open new opportunities for gamers to engage both on- and off-console with both the launch of Xbox Cloud Gaming, our game streaming service, and continued investment in gaming hardware. Xbox Cloud Gaming utilizes Microsoft's Azure cloud technology to allow direct and on-demand streaming of games to PCs, consoles, and mobile devices, enabling gamers to take their favorite games with them and play on the device most convenient to them.

Xbox enables people to connect and share online gaming experiences that are accessible on Xbox consoles, Windows-enabled devices, and other devices. Xbox is designed to benefit users by providing access to a network of certified applications and services and to benefit our developer and partner ecosystems by providing access to a large customer base. Xbox revenue is mainly affected by subscriptions and sales of first- and third-party content, as well as advertising. Growth of our Gaming business is determined by the overall active user base through Xbox enabled content, availability of games, providing exclusive game content that gamers seek, the computational power and reliability of the devices used to access our content and services, and the ability to create new experiences through first-party content creators.

Search and News Advertising

Our Search and news advertising business is designed to deliver relevant search, native, and display advertising to a global audience. We have several partnerships with other companies, including Yahoo, through which we provide and monetize search queries. Growth depends on our ability to attract new users, understand intent, and match intent with relevant content and advertiser offerings.

On June 6, 2022, we acquired Xandr, Inc., a technology platform with tools to accelerate the delivery of our digital advertising solutions.

Competition

Windows faces competition from various software products and from alternative platforms and devices, mainly from Apple and Google. We believe Windows competes effectively by giving customers choice, value, flexibility, security, an easy-to-use interface, and compatibility with a broad range of hardware and software applications, including those that enable productivity.

Devices face competition from various computer, tablet, and hardware manufacturers who offer a unique combination of high-quality industrial design and innovative technologies across various price points. These manufacturers, many of which are also current or potential partners and customers, include Apple and our Windows OEMs.

Xbox and our cloud gaming services face competition from various online gaming ecosystems and game streaming services, including those operated by Amazon, Apple, Meta, Google, and Tencent. We also compete with other providers of entertainment services such as video streaming platforms. Our gaming platform competes with console platforms from Nintendo and Sony, both of which have a large, established base of customers. We believe our gaming platform is effectively positioned against, and uniquely differentiated from, competitive products and services based on significant innovation in hardware architecture, user interface, developer tools, online gaming and entertainment services, and continued strong exclusive content from our own first-party game franchises as well as other digital content offerings.

Our Search and news advertising business competes with Google and a wide array of websites, social platforms like Meta, and portals that provide content and online offerings to end users.

OPERATIONS

We have operations centers that support operations in their regions, including customer contract and order processing, credit and collections, information processing, and vendor management and logistics. The regional center in Ireland supports the European, Middle Eastern, and African region; the center in Singapore supports the Japan, India, Greater China, and Asia-Pacific region; and the centers in Fargo, North Dakota, Fort Lauderdale, Florida, Puerto Rico, Redmond, Washington, and Reno, Nevada support Latin America and North America. In addition to the operations centers, we also operate datacenters throughout the Americas, Europe, Australia, and Asia, as well as in the Middle East and Africa.

To serve the needs of customers around the world and to improve the quality and usability of products in international markets, we localize many of our products to reflect local languages and conventions. Localizing a product may require modifying the user interface, altering dialog boxes, and translating text.

Our devices are primarily manufactured by third-party contract manufacturers. For the majority of our products, we have the ability to use other manufacturers if a current vendor becomes unavailable or unable to meet our requirements. However, some of our products contain certain components for which there are very few qualified suppliers. For these components, we have limited near-term flexibility to use other manufacturers if a current vendor becomes unavailable or is unable to meet our requirements. Extended disruptions at these suppliers and/or manufacturers could lead to a similar disruption in our ability to manufacture devices on time to meet consumer demand.

RESEARCH AND DEVELOPMENT

Product and Service Development, and Intellectual Property

We develop most of our products and services internally through the following engineering groups.

- *Cloud and AI*, focuses on making IT professionals, developers, and their systems more productive and efficient through development of cloud infrastructure, server, database, CRM, ERP, software development tools and services (including GitHub), AI cognitive services, and other business process applications and services for enterprises.
- *Experiences and Devices*, focuses on instilling a unifying product ethos across our end-user experiences and devices, including Office, Windows, Teams, consumer web experiences (including search and news advertising), and the Surface line of devices.
- *Security, Compliance, Identity, and Management*, focuses on cloud platform and application security, identity and network access, enterprise mobility, information protection, and managed services.
- *Technology and Research*, focuses on our AI innovations and other forward-looking research and development efforts spanning infrastructure, services, and applications.
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LinkedIn, focuses on our services that transform the way customers hire, market, sell, and learn.

- *Gaming*, focuses on developing hardware, content, and services across a large range of platforms to help grow our user base through game experiences and social interaction.

Internal development allows us to maintain competitive advantages that come from product differentiation and closer technical control over our products and services. It also gives us the freedom to decide which modifications and enhancements are most important and when they should be implemented. We strive to obtain information as early as possible about changing usage patterns and hardware advances that may affect software and hardware design. Before releasing new software platforms, and as we make significant modifications to existing platforms, we provide application vendors with a range of resources and guidelines for development, training, and testing. Generally, we also create product documentation internally.

We protect our intellectual property investments in a variety of ways. We work actively in the U.S. and internationally to ensure the enforcement of copyright, trademark, trade secret, and other protections that apply to our software and hardware products, services, business plans, and branding. We are a leader among technology companies in pursuing patents and currently have a portfolio of over 69,000 U.S. and international patents issued and over 19,000 pending worldwide. While we employ much of our internally-developed intellectual property exclusively in our products and services, we also engage in outbound licensing of specific patented technologies that are incorporated into licensees' products. From time to time, we enter into broader cross-license agreements with other technology companies covering entire groups of patents. We may also purchase or license technology that we incorporate into our products and services. At times, we make select intellectual property broadly available at no or low cost to achieve a strategic objective, such as promoting industry standards, advancing interoperability, supporting societal and/or environmental efforts, or attracting and enabling our external development community. Our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations.

While it may be necessary in the future to seek or renew licenses relating to various aspects of our products, services, and business methods, we believe, based upon past experience and industry practice, such licenses generally can be obtained on commercially reasonable terms. We believe our continuing research and product development are not materially dependent on any single license or other agreement with a third party relating to the development of our products.

Investing in the Future

Our success is based on our ability to create new and compelling products, services, and experiences for our users, to initiate and embrace disruptive technology trends, to enter new geographic and product markets, and to drive broad adoption of our products and services. We invest in a range of emerging technology trends and breakthroughs that we believe offer significant opportunities to deliver value to our customers and growth for the Company. Based on our assessment of key technology trends, we maintain our long-term commitment to research and development across a wide spectrum of technologies, tools, and platforms spanning digital work and life experiences, cloud computing, AI, devices, and operating systems.

While our main product research and development facilities are located in Redmond, Washington, we also operate research and development facilities in other parts of the U.S. and around the world. This global approach helps us remain competitive in local markets and enables us to continue to attract top talent from across the world.

We plan to continue to make significant investments in a broad range of product research and development activities, and as appropriate we will coordinate our research and development across operating segments and leverage the results across the Company.

In addition to our main research and development operations, we also operate Microsoft Research. Microsoft Research is one of the world's largest corporate research organizations and works in close collaboration with top universities around the world to advance the state-of-the-art in computer science and a broad range of other disciplines, providing us a unique perspective on future trends and contributing to our innovation.

DISTRIBUTION, SALES, AND MARKETING

We market and distribute our products and services through the following channels: OEMs, direct, and distributors and resellers. Our sales force performs a variety of functions, including working directly with commercial enterprises and public-sector organizations worldwide to identify and meet their technology and digital transformation requirements; managing OEM relationships; and supporting system integrators, independent software vendors, and other partners who engage directly with our customers to perform sales, consulting, and fulfillment functions for our products and services.

OEMs

We distribute our products and services through OEMs that pre-install our software on new devices and servers they sell. The largest component of the OEM business is the Windows operating system pre-installed on devices. OEMs also sell devices pre-installed with other Microsoft products and services, including applications such as Office and the capability to subscribe to Office 365.

There are two broad categories of OEMs. The largest category of OEMs are direct OEMs as our relationship with them is managed through a direct agreement between Microsoft and the OEM. We have distribution agreements covering one or more of our products with virtually all the multinational OEMs, including Dell, Hewlett-Packard, Lenovo, and with many regional and local OEMs. The second broad category of OEMs are system builders consisting of lower-volume PC manufacturers, which source Microsoft software for pre-installation and local redistribution primarily through the Microsoft distributor channel rather than through a direct agreement or relationship with Microsoft.

Direct

Many organizations that license our products and services transact directly with us through Enterprise Agreements and Enterprise Services contracts, with sales support from system integrators, independent software vendors, web agencies, and partners that advise organizations on licensing our products and services (“Enterprise Agreement Software Advisors” or “ESA”). Microsoft offers direct sales programs targeted to reach small, medium, and corporate customers, in addition to those offered through the reseller channel. A large network of partner advisors support many of these sales.

We also sell commercial and consumer products and services directly to customers, such as cloud services, search, and gaming, through our digital marketplaces and online stores. In fiscal year 2021, we closed our Microsoft Store physical locations and opened our Microsoft Experience Centers. Microsoft Experience Centers are designed to facilitate deeper engagement with our partners and customers across industries.

Distributors and Resellers

Organizations also license our products and services indirectly, primarily through licensing solution partners (“LSP”), distributors, value-added resellers (“VAR”), and retailers. Although each type of reselling partner may reach organizations of all sizes, LSPs are primarily engaged with large organizations, distributors resell primarily to VARs, and VARs typically reach small and medium organizations. ESAs are also typically authorized as LSPs and operate as resellers for our other volume licensing programs. Microsoft Cloud Solution Provider is our main partner program for reselling cloud services.

We distribute our retail packaged products primarily through independent non-exclusive distributors, authorized replicators, resellers, and retail outlets. Individual consumers obtain these products primarily through retail outlets. We distribute our devices through third-party retailers. We have a network of field sales representatives and field support personnel that solicit orders from distributors and resellers and provide product training and sales support.

Our Dynamics business solutions are also licensed to enterprises through a global network of channel partners providing vertical solutions and specialized services.

LICENSING OPTIONS

We offer options for organizations that want to purchase our cloud services, on-premises software, and SA. We license software to organizations under volume licensing agreements to allow the customer to acquire multiple licenses of products and services instead of having to acquire separate licenses through retail channels. We use different programs designed to provide flexibility for organizations of various sizes. While these programs may differ in various parts of the world, generally they include those discussed below.

SA conveys rights to new software and upgrades for perpetual licenses released over the contract period. It also provides support, tools, training, and other licensing benefits to help customers deploy and use software efficiently. SA is included with certain volume licensing agreements and is an optional purchase with others.

Volume Licensing Programs

Enterprise Agreement

Enterprise Agreements offer large organizations a manageable volume licensing program that gives them the flexibility to buy cloud services and software licenses under one agreement. Enterprise Agreements are designed for medium or large organizations that want to license cloud services and on-premises software organization-wide over a three-year period. Organizations can elect to purchase perpetual licenses or subscribe to licenses. SA is included.

Microsoft Customer Agreement

A Microsoft Customer Agreement is a simplified purchase agreement presented, accepted, and stored through a digital experience. A Microsoft Customer Agreement is a non-expiring agreement that is designed to support all customers over time, whether purchasing through a partner or directly from Microsoft.

Microsoft Online Subscription Agreement

A Microsoft Online Subscription Agreement is designed for small and medium organizations that want to subscribe to, activate, provision, and maintain cloud services seamlessly and directly via the web. The agreement allows customers to acquire monthly or annual subscriptions for cloud-based services.

Microsoft Products and Services Agreement

Microsoft Products and Services Agreements are designed for medium and large organizations that want to license cloud services and on-premises software as needed, with no organization-wide commitment, under a single, non-expiring agreement. Organizations purchase perpetual licenses or subscribe to licenses. SA is optional for customers that purchase perpetual licenses.

Open Value

Open Value agreements are a simple, cost-effective way to acquire the latest Microsoft technology. These agreements are designed for small and medium organizations that want to license cloud services and on-premises software over a three-year period. Under Open Value agreements, organizations can elect to purchase perpetual licenses or subscribe to licenses and SA is included.

Select Plus

A Select Plus agreement is designed for government and academic organizations to acquire on-premises licenses at any affiliate or department level, while realizing advantages as one organization. Organizations purchase perpetual licenses and SA is optional.

Partner Programs

The Microsoft Cloud Solution Provider program offers customers an easy way to license the cloud services they need in combination with the value-added services offered by their systems integrator, managed services provider, or cloud reseller partner. Partners in this program can easily package their own products and services to directly provision, manage, and support their customer subscriptions.

The Microsoft Services Provider License Agreement allows hosting service providers and independent software vendors who want to license eligible Microsoft software products to provide software services and hosted applications to their end customers. Partners license software over a three-year period and are billed monthly based on consumption.

The Independent Software Vendor Royalty program enables partners to integrate Microsoft products into other applications and then license the unified business solution to their end users.

CUSTOMERS

Our customers include individual consumers, small and medium organizations, large global enterprises, public-sector institutions, Internet service providers, application developers, and OEMs. Our practice is to ship our products promptly upon receipt of purchase orders from customers; consequently, backlog is not significant.

INFORMATION ABOUT OUR EXECUTIVE OFFICERS

Our executive officers as of July 28, 2022 were as follows:

Name	Age	Position with the Company
Satya Nadella	54	Chairman of the Board and Chief Executive Officer
Judson Althoff	49	Executive Vice President and Chief Commercial Officer
Christopher C. Capossela	52	Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer
Kathleen T. Hogan	56	Executive Vice President, Human Resources
Amy E. Hood	50	Executive Vice President, Chief Financial Officer
Bradford L. Smith	63	President and Vice Chair
Christopher D. Young	50	Executive Vice President, Business Development, Strategy, and Ventures

Mr. Nadella was appointed Chairman of the Board in June 2021 and Chief Executive Officer in February 2014. He served as Executive Vice President, Cloud and Enterprise from July 2013 until that time. From 2011 to 2013, Mr. Nadella served as President, Server and Tools. From 2009 to 2011, he was Senior Vice President, Online Services Division. From 2008 to 2009, he was Senior Vice President, Search, Portal, and Advertising. Since joining Microsoft in 1992, Mr. Nadella's roles also included Vice President of the Business Division. Mr. Nadella also serves on the Board of Directors of Starbucks Corporation.

Mr. Althoff was appointed Executive Vice President and Chief Commercial Officer in July 2021. He served as Executive Vice President, Worldwide Commercial Business from July 2017 until that time. Prior to that, Mr. Althoff served as the President of Microsoft North America. Mr. Althoff joined Microsoft in March 2013 as President of Microsoft North America.

Mr. Capossela was appointed Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer in July 2016. He had served as Executive Vice President, Chief Marketing Officer since March 2014. Previously, he served as the worldwide leader of the Consumer Channels Group, responsible for sales and marketing activities with OEMs, operators, and retail partners. In his more than 25 years at Microsoft, Mr. Capossela has held a variety of marketing leadership roles in the Microsoft Office Division. He was responsible for marketing productivity solutions including Microsoft Office, Office 365, SharePoint, Exchange, Skype for Business, Project, and Visio.

Ms. Hogan was appointed Executive Vice President, Human Resources in November 2014. Prior to that Ms. Hogan was Corporate Vice President of Microsoft Services. She also served as Corporate Vice President of Customer Service and Support. Ms. Hogan joined Microsoft in 2003. Ms. Hogan also serves on the Board of Directors of Alaska Air Group, Inc.

Ms. Hood was appointed Executive Vice President and Chief Financial Officer in July 2013, subsequent to her appointment as Chief Financial Officer in May 2013. From 2010 to 2013, Ms. Hood was Chief Financial Officer of the Microsoft Business Division. From 2006 through 2009, Ms. Hood was General Manager, Microsoft Business Division Strategy. Since joining Microsoft in 2002, Ms. Hood has also held finance-related positions in the Server and Tools Business and the corporate finance organization. Ms. Hood also serves on the Board of Directors of 3M Corporation.

Mr. Smith was appointed President and Vice Chair in September 2021. Prior to that, he served as President and Chief Legal Officer since September 2015. He served as Executive Vice President, General Counsel, and Secretary from 2011 to 2015, and served as Senior Vice President, General Counsel, and Secretary from 2001 to 2011. Mr. Smith was also named Chief Compliance Officer in 2002. Since joining Microsoft in 1993, he was Deputy General Counsel for Worldwide Sales and previously was responsible for managing the European Law and Corporate Affairs Group, based in Paris. Mr. Smith also serves on the Board of Directors of Netflix, Inc.

Mr. Young has served as Executive Vice President, Business Development, Strategy, and Ventures since joining Microsoft in November 2020. Prior to Microsoft, he served as the Chief Executive Officer of McAfee, LLC from 2017 to 2020, and served as a Senior Vice President and General Manager of Intel Security Group from 2014 until 2017, when he led the initiative to spin out McAfee into a standalone company. Mr. Young also serves on the Board of Directors of American Express Company.

AVAILABLE INFORMATION

Our Internet address is www.microsoft.com. At our Investor Relations website, www.microsoft.com/investor, we make available free of charge a variety of information for investors. Our goal is to maintain the Investor Relations website as a portal through which investors can easily find or navigate to pertinent information about us, including:

- Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file that material with or furnish it to the Securities and Exchange Commission ("SEC") at www.sec.gov.
- Information on our business strategies, financial results, and metrics for investors.
- Announcements of investor conferences, speeches, and events at which our executives talk about our product, service, and competitive strategies. Archives of these events are also available.
- Press releases on quarterly earnings, product and service announcements, legal developments, and international news.
- Corporate governance information including our articles of incorporation, bylaws, governance guidelines, committee charters, codes of conduct and ethics, global corporate social responsibility initiatives, and other governance-related policies.
- Other news and announcements that we may post from time to time that investors might find useful or interesting.
- Opportunities to sign up for email alerts to have information pushed in real time.

We publish a variety of reports and resources related to our Corporate Social Responsibility programs and progress on our Reports Hub website, www.microsoft.com/corporate-responsibility/reports-hub, including reports on sustainability, responsible sourcing, accessibility, digital trust, and public policy engagement.

The information found on these websites is not part of, or incorporated by reference into, this or any other report we file with, or furnish to, the SEC. In addition to these channels, we use social media to communicate to the public. It is possible that the information we post on social media could be deemed to be material to investors. We encourage investors, the media, and others interested in Microsoft to review the information we post on the social media channels listed on our Investor Relations website.

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described below, that could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock.

STRATEGIC AND COMPETITIVE RISKS

We face intense competition across all markets for our products and services, which may lead to lower revenue or operating margins.

Competition in the technology sector

Our competitors range in size from diversified global companies with significant research and development resources to small, specialized firms whose narrower product lines may let them be more effective in deploying technical, marketing, and financial resources. Barriers to entry in many of our businesses are low and many of the areas in which we compete evolve rapidly with changing and disruptive technologies, shifting user needs, and frequent introductions of new products and services. Our ability to remain competitive depends on our success in making innovative products, devices, and services that appeal to businesses and consumers.

Competition among platform-based ecosystems

An important element of our business model has been to create platform-based ecosystems on which many participants can build diverse solutions. A well-established ecosystem creates beneficial network effects among users, application developers, and the platform provider that can accelerate growth. Establishing significant scale in the marketplace is necessary to achieve and maintain attractive margins. We face significant competition from firms that provide competing platforms.

- A competing vertically-integrated model, in which a single firm controls the software and hardware elements of a product and related services, has succeeded with some consumer products such as personal computers, tablets, phones, gaming consoles, wearables, and other endpoint devices. Competitors pursuing this model also earn revenue from services integrated with the hardware and software platform, including applications and content sold through their integrated marketplaces. They may also be able to claim security and performance benefits from their vertically integrated offer. We also offer some vertically-integrated hardware and software products and services. To the extent we shift a portion of our business to a vertically integrated model we increase our cost of revenue and reduce our operating margins.
- We derive substantial revenue from licenses of Windows operating systems on PCs. We face significant competition from competing platforms developed for new devices and form factors such as smartphones and tablet computers. These devices compete on multiple bases including price and the perceived utility of the device and its platform. Users are increasingly turning to these devices to perform functions that in the past were performed by personal computers. Even if many users view these devices as complementary to a personal computer, the prevalence of these devices may make it more difficult to attract application developers to our PC operating system platforms. Competing with operating systems licensed at low or no cost may decrease our PC operating system margins. Popular products or services offered on competing platforms could increase their competitive strength. In addition, some of our devices compete with products made by our original equipment manufacturer ("OEM") partners, which may affect their commitment to our platform.
- Competing platforms have content and application marketplaces with scale and significant installed bases. The variety and utility of content and applications available on a platform are important to device purchasing decisions. Users may incur costs to move data and buy new content and applications when switching platforms. To compete, we must successfully enlist developers to write applications for our platform and ensure that these applications have high quality, security, customer appeal, and value. Efforts to compete with competitors' content and

application marketplaces may increase our cost of revenue and lower our operating margins. Competitors' rules governing their content and applications marketplaces may restrict our ability to distribute products and services through them in accordance with our technical and business model objectives.

Business model competition

Companies compete with us based on a growing variety of business models.

- Even as we transition more of our business to infrastructure-, platform-, and software-as-a-service business model, the license-based proprietary software model generates a substantial portion of our software revenue. We bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from licensing our products. Many of our competitors also develop and sell software to businesses and consumers under this model.
- Other competitors develop and offer free applications, online services and content, and make money by selling third-party advertising. Advertising revenue funds development of products and services these competitors provide to users at no or little cost, competing directly with our revenue-generating products.
- Some companies compete with us by modifying and then distributing open source software at little or no cost to end users, and earning revenue on advertising or integrated products and services. These firms do not bear the full costs of research and development for the open source software. Some open source software mimics the features and functionality of our products.

The competitive pressures described above may cause decreased sales volumes, price reductions, and/or increased operating costs, such as for research and development, marketing, and sales incentives. This may lead to lower revenue, gross margins, and operating income.

Our increasing focus on cloud-based services presents execution and competitive risks. A growing part of our business involves cloud-based services available across the spectrum of computing devices. Our strategic vision is to compete and grow by building best-in-class platforms and productivity services for an intelligent cloud and an intelligent edge infused with artificial intelligence (“AI”). At the same time, our competitors are rapidly developing and deploying cloud-based services for consumers and business customers. Pricing and delivery models are evolving. Devices and form factors influence how users access services in the cloud and sometimes the user’s choice of which cloud-based services to use. We are devoting significant resources to develop and deploy our cloud-based strategies. The Windows ecosystem must continue to evolve with this changing environment. We embrace cultural and organizational changes to drive accountability and eliminate obstacles to innovation. Our intelligent cloud and intelligent edge worldview is connected with the growth of the Internet of Things (“IoT”). Our success in the IoT will depend on the level of adoption of our offerings such as Azure, Azure Stack, Azure IoT Edge, and Azure Sphere. We may not establish market share sufficient to achieve scale necessary to meet our business objectives.

Besides software development costs, we are incurring costs to build and maintain infrastructure to support cloud computing services. These costs will reduce the operating margins we have previously achieved. Whether we succeed in cloud-based services depends on our execution in several areas, including:

- Continuing to bring to market compelling cloud-based experiences that generate increasing traffic and market share.
- Maintaining the utility, compatibility, and performance of our cloud-based services on the growing array of computing devices, including PCs, smartphones, tablets, gaming consoles, and other devices, as well as sensors and other IoT endpoints.
- Continuing to enhance the attractiveness of our cloud platforms to third-party developers.
- Ensuring our cloud-based services meet the reliability expectations of our customers and maintain the security of their data as well as help them meet their own compliance needs.
- Making our suite of cloud-based services platform-agnostic, available on a wide range of devices and ecosystems, including those of our competitors.

It is uncertain whether our strategies will attract the users or generate the revenue required to succeed. If we are not effective in executing organizational and technical changes to increase efficiency and accelerate innovation, or if we fail to generate sufficient usage of our new products and services, we may not grow revenue in line with the infrastructure and development investments described above. This may negatively impact gross margins and operating income.

RISKS RELATING TO THE EVOLUTION OF OUR BUSINESS

We make significant investments in products and services that may not achieve expected returns. We will continue to make significant investments in research, development, and marketing for existing products, services, and technologies, including the Windows operating system, Microsoft 365, Office, Bing, SQL Server, Windows Server, Azure, Office 365, Xbox, LinkedIn, and other products and services. We also invest in the development and acquisition of a variety of hardware for productivity, communication, and entertainment including PCs, tablets, gaming devices, and HoloLens. Investments in new technology are speculative. Commercial success depends on many factors, including innovativeness, developer support, and effective distribution and marketing. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of new software and hardware products or upgrades, unfavorably affecting revenue. We may not achieve significant revenue from new product, service, and distribution channel investments for several years, if at all. New products and services may not be profitable, and even if they are profitable, operating margins for some new products and businesses will not be as high as the margins we have experienced historically. We may not get engagement in certain features, like Edge and Bing, that drive post-sale monetization opportunities. Our data handling practices across our products and services will continue to be under scrutiny and perceptions of mismanagement, driven by regulatory activity or negative public reaction to our practices or product experiences, could negatively impact product and feature adoption, product design, and product quality.

Developing new technologies is complex. It can require long development and testing periods. Significant delays in new releases or significant problems in creating new products or services could adversely affect our revenue.

Acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business. We expect to continue making acquisitions and entering into joint ventures and strategic alliances as part of our long-term business strategy. For example, in March 2021 we completed our acquisition of ZeniMax Media Inc. for $8.1 billion, and in March 2022 we completed our acquisition of Nuance Communications, Inc. for $18.8 billion. In January 2022 we announced a definitive agreement to acquire Activision Blizzard, Inc. for $68.7 billion. These acquisitions and other transactions and arrangements involve significant challenges and risks, including that they do not advance our business strategy, that we get an unsatisfactory return on our investment, that they raise new compliance-related obligations and challenges, that we have difficulty integrating and retaining new employees, business systems, and technology, that they distract management from our other businesses, or that announced transactions may not be completed. If an arrangement fails to adequately anticipate changing circumstances and interests of a party, it may result in early termination or renegotiation of the arrangement. The success of these transactions and arrangements will depend in part on our ability to leverage them to enhance our existing products and services or develop compelling new ones, as well as acquired companies' ability to meet our policies and processes in areas such as data governance, privacy, and cybersecurity. It may take longer than expected to realize the full benefits from these transactions and arrangements such as increased revenue or enhanced efficiencies, or the benefits may ultimately be smaller than we expected. These events could adversely affect our consolidated financial statements.

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings. We acquire other companies and intangible assets and may not realize all the economic benefit from those acquisitions, which could cause an impairment of goodwill or intangibles. We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment at least annually. Factors that may be a change in circumstances, indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable, include a decline in our stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in industry segments in which we participate. We have in the past recorded, and may in the future be required to record, a significant charge in our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively affecting our results of operations.

CYBERSECURITY, DATA PRIVACY, AND PLATFORM ABUSE RISKS

Cyberattacks and security vulnerabilities could lead to reduced revenue, increased costs, liability claims, or harm to our reputation or competitive position.

Security of our information technology

Threats to IT security can take a variety of forms. Individual and groups of hackers and sophisticated organizations, including state-sponsored organizations or nation-states, continuously undertake attacks that pose threats to our customers and our IT. These actors may use a wide variety of methods, which may include developing and deploying malicious software or exploiting vulnerabilities in hardware, software, or other infrastructure in order to attack our products and services or gain access to our networks and datacenters, using social engineering techniques to induce our employees, users, partners, or customers to disclose passwords or other sensitive information or take other actions to gain access to our data or our users' or customers' data, or acting in a coordinated manner to launch distributed denial of service or other coordinated attacks. Nation-state and state-sponsored actors can deploy significant resources to plan and carry out exploits. Nation-state attacks against us or our customers may intensify during periods of intense diplomatic or armed conflict, such as the ongoing conflict in Ukraine. Inadequate account security practices may also result in unauthorized access to confidential data. For example, system administrators may fail to timely remove employee account access when no longer appropriate. Employees or third parties may intentionally compromise our or our users' security or systems or reveal confidential information. Malicious actors may employ the IT supply chain to introduce malware through software updates or compromised supplier accounts or hardware.

Cyberthreats are constantly evolving and becoming increasingly sophisticated and complex, increasing the difficulty of detecting and successfully defending against them. We may have no current capability to detect certain vulnerabilities, which may allow them to persist in the environment over long periods of time. Cyberthreats can have cascading impacts that unfold with increasing speed across our internal networks and systems and those of our partners and customers. Breaches of our facilities, network, or data security could disrupt the security of our systems and business applications, impair our ability to provide services to our customers and protect the privacy of their data, result in product development delays, compromise confidential or technical business information harming our reputation or competitive position, result in theft or misuse of our intellectual property or other assets, subject us to ransomware attacks, require us to allocate more resources to improve technologies or remediate the impacts of attacks, or otherwise adversely affect our business.

The cyberattacks uncovered in late 2020 known as "Solorigate" or "Nobelium" are an example of a supply chain attack where malware was introduced to a software provider's customers, including us, through software updates. The attackers were later able to create false credentials that appeared legitimate to certain customers' systems. We may be targets of further attacks similar to Solorigate/Nobelium as both a supplier and consumer of IT.

In addition, our internal IT environment continues to evolve. Often, we are early adopters of new devices and technologies. We embrace new ways of sharing data and communicating internally and with partners and customers using methods such as social networking and other consumer-oriented technologies. Our business policies and internal security controls may not keep pace with these changes as new threats emerge, or emerging cybersecurity regulations in jurisdictions worldwide.

Security of our products, services, devices, and customers' data

The security of our products and services is important in our customers' decisions to purchase or use our products or services across cloud and on-premises environments. Security threats are a significant challenge to companies like us whose business is providing technology products and services to others. Threats to our own IT infrastructure can also affect our customers. Customers using our cloud-based services rely on the security of our infrastructure, including hardware and other elements provided by third parties, to ensure the reliability of our services and the protection of their data. Adversaries tend to focus their efforts on the most popular operating systems, programs, and services, including many of ours, and we expect that to continue. In addition, adversaries can attack our customers' on-premises or cloud environments, sometimes exploiting previously unknown ("zero day") vulnerabilities, such as occurred in early calendar year 2021 with several of our Exchange Server on-premises products. Vulnerabilities in these or any product can persist even after we have issued security patches if customers have not installed the most recent updates, or if the attackers exploited the vulnerabilities before patching to install additional malware to further compromise customers' systems. Adversaries will continue to attack customers using our cloud services as customers embrace digital transformation. Adversaries that acquire user account information can use that information to compromise our users' accounts, including where accounts share the same attributes such as passwords. Inadequate account security practices may also result in unauthorized access, and user activity may result in ransomware or other malicious software impacting a customer's use of our products or services. We are increasingly incorporating open source software into our products. There may be vulnerabilities in open source software that may make our products susceptible to cyberattacks.

Our customers operate complex IT systems with third-party hardware and software from multiple vendors that may include systems acquired over many years. They expect our products and services to support all these systems and products, including those that no longer incorporate the strongest current security advances or standards. As a result, we may not be able to discontinue support in our services for a product, service, standard, or feature solely because a more secure alternative is available. Failure to utilize the most current security advances and standards can increase our customers' vulnerability to attack. Further, customers of widely varied size and technical sophistication use our technology, and consequently may have limited capabilities and resources to help them adopt and implement state of the art cybersecurity practices and technologies. In addition, we must account for this wide variation of technical sophistication when defining default settings for our products and services, including security default settings, as these settings may limit or otherwise impact other aspects of IT operations and some customers may have limited capability to review and reset these defaults.

Cyberattacks such as Solorigate/Nobelium may adversely impact our customers even if our production services are not directly compromised. We are committed to notifying our customers whose systems have been impacted as we become aware and have available information and actions for customers to help protect themselves. We are also committed to providing guidance and support on detection, tracking, and remediation. We may not be able to detect the existence or extent of these attacks for all of our customers or have information on how to detect or track an attack, especially where an attack involves on-premises software such as Exchange Server where we may have no or limited visibility into our customers' computing environments.

Development and deployment of defensive measures

To defend against security threats to our internal IT systems, our cloud-based services, and our customers' systems, we must continuously engineer more secure products and services, enhance security and reliability features, improve the deployment of software updates to address security vulnerabilities in our own products as well as those provided by others, develop mitigation technologies that help to secure customers from attacks even when software updates are not deployed, maintain the digital security infrastructure that protects the integrity of our network, products, and services, and provide security tools such as firewalls, anti-virus software, and advanced security and information about the need to deploy security measures and the impact of doing so. Customers in certain industries such as financial services, health care, and government may have enhanced or specialized requirements to which we must engineer our products and services.

The cost of measures to protect products and customer-facing services could reduce our operating margins. If we fail to do these things well, actual or perceived security vulnerabilities in our products and services, data corruption issues, or reduced performance could harm our reputation and lead customers to reduce or delay future purchases of products or subscriptions to services, or to use competing products or services. Customers may also spend more on protecting their existing computer systems from attack, which could delay adoption of additional products or services. Customers, and third parties granted access to their systems, may fail to update their systems, continue to run software or operating systems we no longer support, or may fail timely to install or enable security patches, or may otherwise fail to adopt adequate security practices. Any of these could adversely affect our reputation and revenue. Actual or perceived vulnerabilities may lead to claims against us. Our license agreements typically contain provisions that eliminate or limit our exposure to liability, but there is no assurance these provisions will withstand legal challenges. At times, to achieve commercial objectives, we may enter into agreements with larger liability exposure to customers.

Our products operate in conjunction with and are dependent on products and components across a broad ecosystem of third parties. If there is a security vulnerability in one of these components, and if there is a security exploit targeting it, we could face increased costs, liability claims, reduced revenue, or harm to our reputation or competitive position.

Disclosure and misuse of personal data could result in liability and harm our reputation. As we continue to grow the number, breadth, and scale of our cloud-based offerings, we store and process increasingly large amounts of personal data of our customers and users. The continued occurrence of high-profile data breaches provides evidence of an external environment increasingly hostile to information security. Despite our efforts to improve the security controls across our business groups and geographies, it is possible our security controls over personal data, our training of employees and third parties on data security, and other practices we follow may not prevent the improper disclosure or misuse of customer or user data we or our vendors store and manage. In addition, third parties who have limited access to our customer or user data may use this data in unauthorized ways. Improper disclosure or misuse could harm our reputation, lead to legal exposure to customers or users, or subject us to liability under laws that protect personal data, resulting in increased costs or loss of revenue. Our software products and services also enable our customers and users to store and process personal data on-premises or, increasingly, in a cloud-based environment we host. Government authorities can sometimes require us to produce customer or user data in response to valid legal orders. In the U.S. and elsewhere, we advocate for transparency concerning these requests and appropriate limitations on government authority to compel disclosure. Despite our efforts to protect customer and user data, perceptions that the collection, use, and retention of personal information is not satisfactorily protected could inhibit sales of our products or services and could limit adoption of our cloud-based solutions by consumers, businesses, and government entities. Additional security measures we may take to address customer or user concerns, or constraints on our flexibility to determine where and how to operate datacenters in response to customer or user expectations or governmental rules or actions, may cause higher operating expenses or hinder growth of our products and services.

We may not be able to protect information in our products and services from use by others. LinkedIn and other Microsoft products and services contain valuable information and content protected by contractual restrictions or technical measures. In certain cases, we have made commitments to our members and users to limit access to or use of this information. Changes in the law or interpretations of the law may weaken our ability to prevent third parties from scraping or gathering information or content through use of bots or other measures and using it for their own benefit, thus diminishing the value of our products and services.

Abuse of our platforms may harm our reputation or user engagement.

Advertising, professional, marketplace, and gaming platform abuses

For platform products and services that provide content or host ads that come from or can be influenced by third parties, including GitHub, LinkedIn, Microsoft Advertising, Microsoft News, Microsoft Store, Bing, and Xbox, our reputation or user engagement may be negatively affected by activity that is hostile or inappropriate. This activity may come from users impersonating other people or organizations, dissemination of information that may be viewed as misleading or intended to manipulate the opinions of our users, or the use of our products or services that violates our terms of service or otherwise for objectionable or illegal ends. Preventing or responding to these actions may require us to make substantial investments in people and technology and these investments may not be successful, adversely affecting our business and consolidated financial statements.

Other digital safety abuses

Our hosted consumer services as well as our enterprise services may be used to disseminate harmful or illegal content in violation of our terms or applicable law. We may not proactively discover such content due to scale, the limitations of existing technologies, and conflicting legal frameworks. When discovered by users, such content may negatively affect our reputation, our brands, and user engagement. Regulations and other initiatives to make platforms responsible for preventing or eliminating harmful content online have been enacted, and we expect this to continue. We may be subject to enhanced regulatory oversight, civil or criminal liability, or reputational damage if we fail to comply with content moderation regulations, adversely affecting our business and consolidated financial statements.

The development of the IoT presents security, privacy, and execution risks. To support the growth of the intelligent cloud and the intelligent edge, we are developing products, services, and technologies to power the IoT, a network of distributed and interconnected devices employing sensors, data, and computing capabilities including AI. The IoT's great potential also carries substantial risks. IoT products and services may contain defects in design, manufacture, or operation that make them insecure or ineffective for their intended purposes. An IoT solution has multiple layers of hardware, sensors, processors, software, and firmware, several of which we may not develop or control. Each layer, including the weakest layer, can impact the security of the whole system. Many IoT devices have limited interfaces and ability to be updated or patched. IoT solutions may collect large amounts of data, and our handling of IoT data may not satisfy customers or regulatory requirements. IoT scenarios may increasingly affect personal health and safety. If IoT solutions that include our technologies do not work as intended, violate the law, or harm individuals or businesses, we may be subject to legal claims or enforcement actions. These risks, if realized, may increase our costs, damage our reputation or brands, or negatively impact our revenues or margins.

Issues in the development and use of AI may result in reputational harm or liability. We are building AI into many of our offerings, including our productivity services, and we are also making first- and third-party AI available for our customers to use in solutions that they build. We expect these elements of our business to grow. We envision a future in which AI operating in our devices, applications, and the cloud helps our customers be more productive in their work and personal lives. As with many innovations, AI presents risks and challenges that could affect its adoption, and therefore our business. AI algorithms may be flawed. Datasets may be insufficient or contain biased information. Ineffective or inadequate AI development or deployment practices by Microsoft or others could result in incidents that impair the acceptance of AI solutions or cause harm to individuals or society. These deficiencies and other failures of AI systems could subject us to competitive harm, regulatory action, legal liability, including under new proposed legislation regulating AI in jurisdictions such as the European Union ("EU"), and brand or reputational harm. Some AI scenarios present ethical issues. If we enable or offer AI solutions that are controversial because of their impact on human rights, privacy, employment, or other social, economic, or political issues, we may experience brand or reputational harm.

OPERATIONAL RISKS

We may have excessive outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure. Our increasing user traffic, growth in services, and the complexity of our products and services demand more computing power. We spend substantial amounts to build, purchase, or lease datacenters and equipment and to upgrade our technology and network infrastructure to handle more traffic on our websites and in our datacenters. Our datacenters depend on predictable energy and networking supplies, the cost or availability of which could be adversely affected by a variety of factors, including the transition to a clean energy economy and geopolitical disruptions. These demands continue to increase as we introduce new products and services and support the growth of existing services such as Bing, Azure, Microsoft Account services, Microsoft 365, Microsoft Teams, Dynamics 365, OneDrive, SharePoint Online, Skype, Xbox, and Outlook.com. We are rapidly growing our business of providing a platform and back-end hosting for services provided by third parties to their end users. Maintaining, securing, and expanding this infrastructure is expensive and complex, and requires development of principles for datacenter builds in geographies with higher safety risks. It requires that we maintain an Internet connectivity infrastructure and storage and compute capacity that is robust and reliable within competitive and regulatory constraints that continue to evolve. Inefficiencies or operational failures, including temporary or permanent loss of customer data, insufficient Internet connectivity, or inadequate storage and compute capacity, could diminish the quality of our products, services, and user experience resulting in contractual liability, claims by customers and other third parties, regulatory actions, damage to our reputation, and loss of current and potential users, subscribers, and advertisers, each of which may adversely impact our consolidated financial statements.

We may experience quality or supply problems. Our hardware products such as Xbox consoles, Surface devices, and other devices we design and market are highly complex and can have defects in design, manufacture, or associated software. We could incur significant expenses, lost revenue, and reputational harm as a result of recalls, safety alerts, or product liability claims if we fail to prevent, detect, or address such issues through design, testing, or warranty repairs.

Our software products and services also may experience quality or reliability problems. The highly sophisticated software we develop may contain bugs and other defects that interfere with their intended operation. Our customers increasingly rely on us for critical business functions and multiple workloads. Many of our products and services are interdependent with one another. Each of these circumstances potentially magnifies the impact of quality or reliability issues. Any defects we do not detect and fix in pre-release testing could cause reduced sales and revenue, damage to our reputation, repair or remediation costs, delays in the release of new products or versions, or legal liability. Although our license agreements typically contain provisions that eliminate or limit our exposure to liability, there is no assurance these provisions will withstand legal challenge.

There are limited suppliers for certain device and datacenter components. Our competitors use some of the same suppliers and their demand for hardware components can affect the capacity available to us. If components are delayed or become unavailable, whether because of supplier capacity constraint, industry shortages, legal or regulatory changes that restrict supply sources, or other reasons, we may not obtain timely replacement supplies, resulting in reduced sales or inadequate datacenter capacity. Component shortages, excess or obsolete inventory, or price reductions resulting in inventory adjustments may increase our cost of revenue. Xbox consoles, Surface devices, datacenter servers, and other hardware are assembled in Asia and other geographies that may be subject to disruptions in the supply chain, resulting in shortages that would affect our revenue and operating margins.

LEGAL, REGULATORY, AND LITIGATION RISKS

Government litigation and regulatory activity relating to competition rules may limit how we design and market our products. As a leading global software and device maker, government agencies closely scrutinize us under U.S. and foreign competition laws. Governments are actively enforcing competition laws and regulations, and this includes scrutiny in potentially large markets such as the EU, the U.S., and China. Some jurisdictions also allow competitors or consumers to assert claims of anti-competitive conduct. U.S. federal and state antitrust authorities have previously brought enforcement actions and continue to scrutinize our business.

The European Commission (“the Commission”) closely scrutinizes the design of high-volume Microsoft products and the terms on which we make certain technologies used in these products, such as file formats, programming interfaces, and protocols, available to other companies. Flagship product releases such as Windows can receive significant scrutiny under competition laws. For example, in 2004, the Commission ordered us to create new versions of our Windows operating system that do not include certain multimedia technologies and to provide our competitors with specifications for how to implement certain proprietary Windows communications protocols in their own products. In 2009, the Commission accepted a set of commitments we offered to address the Commission’s concerns relating to competition in web browsing software, including an undertaking to address Commission concerns relating to interoperability. The web browsing commitments expired in 2014. The remaining obligations may limit our ability to innovate in Windows or other products in the future, diminish the developer appeal of the Windows platform, and increase our product development costs. The availability of licenses related to protocols and file formats may enable competitors to develop software products that better mimic the functionality of our products, which could hamper sales of our products.

Our portfolio of first-party devices continues to grow; at the same time our OEM partners offer a large variety of devices for our platforms. As a result, increasingly we both cooperate and compete with our OEM partners, creating a risk that we fail to do so in compliance with competition rules. Regulatory scrutiny in this area may increase. Certain foreign governments, particularly in China and other countries in Asia, have advanced arguments under their competition laws that exert downward pressure on royalties for our intellectual property.

Government regulatory actions and court decisions such as these may result in fines or hinder our ability to provide the benefits of our software to consumers and businesses, reducing the attractiveness of our products and the revenue that comes from them. New competition law actions could be initiated, potentially using previous actions as precedent. The outcome of such actions, or steps taken to avoid them, could adversely affect us in a variety of ways, including:

- We may have to choose between withdrawing products from certain geographies to avoid fines or designing and developing alternative versions of those products to comply with government rulings, which may entail a delay in a product release and removing functionality that customers want or on which developers rely.
- We may be required to make available licenses to our proprietary technologies on terms that do not reflect their fair market value or do not protect our associated intellectual property.
- We are subject to a variety of ongoing commitments because of court or administrative orders, consent decrees, or other voluntary actions we have taken. If we fail to comply with these commitments, we may incur litigation costs and be subject to substantial fines or other remedial actions.
- Our ability to realize anticipated Windows post-sale monetization opportunities may be limited.
- Regulatory scrutiny may inhibit our ability to consummate acquisitions or impose conditions that reduce the ultimate value of such transactions.

Our global operations subject us to potential consequences under anti-corruption, trade, and other laws and regulations. The Foreign Corrupt Practices Act ("FCPA") and other anti-corruption laws and regulations ("Anti-Corruption Laws") prohibit corrupt payments by our employees, vendors, or agents, and the accounting provisions of the FCPA require us to maintain accurate books and records and adequate internal controls. From time to time, we receive inquiries from authorities in the U.S. and elsewhere which may be based on reports from employees and others about our business activities outside the U.S. and our compliance with Anti-Corruption Laws. Periodically, we receive such reports directly and investigate them, and also cooperate with investigations by U.S. and foreign law enforcement authorities. An example of increasing international regulatory complexity is the EU Whistleblower Directive, initiated in 2021, which may present compliance challenges to the extent it is implemented in different forms by EU member states. Most countries in which we operate also have competition laws that prohibit competitors from colluding or otherwise attempting to reduce competition between themselves. While we devote substantial resources to our U.S. and international compliance programs and have implemented policies, training, and internal controls designed to reduce the risk of corrupt payments and collusive activity, our employees, vendors, or agents may violate our policies. Our failure to comply with Anti-Corruption Laws or competition laws could result in significant fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation.

Increasing trade laws, policies, sanctions, and other regulatory requirements also affect our operations in and outside the U.S. relating to trade and investment. Economic sanctions in the U.S., the EU, and other countries prohibit most business with restricted entities or countries such as Crimea, Cuba, Iran, North Korea, and Syria. U.S. export controls restrict Microsoft from offering many of its products and services to, or making investments in, certain entities in specified countries. U.S. import controls restrict us from integrating certain information and communication technologies into our supply chain and allow for government review of transactions involving information and communications technology from countries determined to be foreign adversaries. Periods of intense diplomatic or armed conflict, such as the ongoing conflict in Ukraine, may result in (1) new and rapidly evolving sanctions and trade restrictions, which may impair trade with sanctioned individuals and countries, and (2) negative impacts to regional trade ecosystems among our customers, partners, and us. Non-compliance with sanctions as well as general ecosystem disruptions could result in reputational harm, operational delays, monetary fines, loss of revenues, increased costs, loss of export privileges, or criminal sanctions.

Other regulatory areas that may apply to our products and online services offerings include requirements related to user privacy, telecommunications, data storage and protection, advertising, and online content. For example, some regulators are taking the position that our offerings such as Microsoft Teams and Skype are covered by existing laws regulating telecommunications services, and some new laws, including EU Member State laws under the European Electronic Communications Code, are defining more of our services as regulated telecommunications services. This trend may continue and will result in these offerings being subjected to additional data protection, security, and law enforcement surveillance obligations. Regulators may assert that our collection, use, and management of customer data and other information is inconsistent with their laws and regulations, including laws that apply to the tracking of users via technology such as cookies. Legislative or regulatory action relating to cybersecurity requirements may increase the costs to develop, implement, or secure our products and services. Legislative and regulatory action is emerging in the areas of AI and content moderation, which could increase costs or restrict opportunity. Applying these laws and regulations to our business is often unclear, subject to change over time, and sometimes may conflict from jurisdiction to jurisdiction. Additionally, these laws and governments' approach to their enforcement, and our products and services, are continuing to evolve. Compliance with these types of regulation may involve significant costs or require changes in products or business practices that result in reduced revenue. Noncompliance could result in the imposition of penalties or orders we stop the alleged noncompliant activity.

We strive to empower all people and organizations to achieve more, and accessibility of our products is an important aspect of this goal. There is increasing pressure from advocacy groups, regulators, competitors, customers, and other stakeholders to make technology more accessible. If our products do not meet customer expectations or global accessibility requirements, we could lose sales opportunities or face regulatory or legal actions.

Laws and regulations relating to the handling of personal data may impede the adoption of our services or result in increased costs, legal claims, fines against us, or reputational damage. The growth of our Internet- and cloud-based services internationally relies increasingly on the movement of data across national boundaries. Legal requirements relating to the collection, storage, handling, and transfer of personal data continue to evolve. For example, in July 2020 the Court of Justice of the EU invalidated a framework called Privacy Shield for companies to transfer data from EU member states to the United States. This ruling continues to generate uncertainty about the legal requirements for data transfers from the EU under other legal mechanisms and has resulted in some EU data protection authorities blocking the use of U.S.-based services that involve the transfer of data to the U.S. The U.S. and the EU in March 2022 agreed in principle on a replacement framework for the Privacy Shield, called the Trans-Atlantic Data Privacy Framework. A failure of the U.S. and EU to finalize the Trans-Atlantic Data Privacy Framework could compound that uncertainty and result in additional blockages of data transfers. Potential new rules and restrictions on the flow of data across borders could increase the cost and complexity of delivering our products and services in some markets. For example, the EU General Data Protection Regulation ("GDPR") applies to all of our activities conducted from an establishment in the EU or related to products and services offered in the EU, imposes a range of compliance obligations regarding the handling of personal data. More recently, the EU has been developing new requirements related to the use of data, including in the Digital Markets Act, the Digital Services Act, and the Data Act, that will add additional rules and restriction on the use of data in our products and services. Engineering efforts to build and maintain capabilities to facilitate compliance with these laws involve substantial expense and the diversion of engineering resources from other projects. We might experience reduced demand for our offerings if we are unable to engineer products that meet our legal duties or help our customers meet their obligations under the GDPR and other data regulations, or if our implementation to comply with the GDPR makes our offerings less attractive. Compliance with these obligations depends in part on how particular regulators interpret and apply them. If we fail to comply, or if regulators assert we have failed to comply (including in response to complaints made by customers), it may lead to regulatory enforcement actions, which can result in monetary penalties (of up to 4% of worldwide revenue in the case of GDPR), private lawsuits, reputational damage, blockage of international data transfers, and loss of customers. The highest fines assessed under GDPR have recently been increasing, especially against large technology companies. Jurisdictions around the world, such as China, India, and states in the U.S. have adopted, or are considering adopting or expanding, laws and regulations imposing obligations regarding the handling or transfer of personal data.

The Company's investment in gaining insights from data is becoming central to the value of the services we deliver to customers, to our operational efficiency and key opportunities in monetization, customer perceptions of quality, and operational efficiency. Our ability to use data in this way may be constrained by regulatory developments that impede realizing the expected return from this investment. Ongoing legal analyses, reviews, and inquiries by regulators of Microsoft practices, or relevant practices of other organizations, may result in burdensome or inconsistent requirements, including data sovereignty and localization requirements, affecting the location, movement, collection, and use of our customer and internal employee data as well as the management of that data. Compliance with applicable laws and regulations regarding personal data may require changes in services, business practices, or internal systems that result in increased costs, lower revenue, reduced efficiency, or greater difficulty in competing with foreign-based firms. Compliance with data regulations might limit our ability to innovate or offer certain features and functionality in some jurisdictions where we operate. Failure to comply with existing or new rules may result in significant penalties or orders to stop the alleged noncompliant activity, as well as negative publicity and diversion of management time and effort.

We have claims and lawsuits against us that may result in adverse outcomes. We are subject to a variety of claims and lawsuits. These claims may arise from a wide variety of business practices and initiatives, including major new product releases such as Windows, significant business transactions, warranty or product claims, and employment practices. Adverse outcomes in some or all of these claims may result in significant monetary damages or injunctive relief that could adversely affect our ability to conduct our business. The litigation and other claims are subject to inherent uncertainties and management's view of these matters may change in the future. A material adverse impact in our consolidated financial statements could occur for the period in which the effect of an unfavorable outcome becomes probable and reasonably estimable.

Our business with government customers may present additional uncertainties. We derive substantial revenue from government contracts. Government contracts generally can present risks and challenges not present in private commercial agreements. For instance, we may be subject to government audits and investigations relating to these contracts, we could be suspended or debarred as a governmental contractor, we could incur civil and criminal fines and penalties, and under certain circumstances contracts may be rescinded. Some agreements may allow a government to terminate without cause and provide for higher liability limits for certain losses. Some contracts may be subject to periodic funding approval, reductions, or delays which could adversely impact public-sector demand for our products and services. These events could negatively impact our results of operations, financial condition, and reputation.

We may have additional tax liabilities. We are subject to income taxes in the U.S. and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. For example, compliance with the 2017 United States Tax Cuts and Jobs Act ("TCJA") and possible future legislative changes may require the collection of information not regularly produced within the Company, the use of estimates in our consolidated financial statements, and the exercise of significant judgment in accounting for its provisions. As regulations and guidance evolve with respect to the TCJA or possible future legislative changes, and as we gather more information and perform more analysis, our results may differ from previous estimates and may materially affect our consolidated financial statements.

We regularly are under audit by tax authorities in different jurisdictions. Although we believe that our provision for income taxes and our tax estimates are reasonable, tax authorities may disagree with certain positions we have taken. In addition, economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes favorably more difficult. We are currently under Internal Revenue Service audit for prior tax years, with the primary unresolved issues relating to transfer pricing. The final resolution of those audits, and other audits or litigation, may differ from the amounts recorded in our consolidated financial statements and may materially affect our consolidated financial statements in the period or periods in which that determination is made.

We earn a significant amount of our operating income outside the U.S. A change in the mix of earnings and losses in countries with differing statutory tax rates, changes in our business or structure, or the expiration of or disputes about certain tax agreements in a particular country may result in higher effective tax rates for the Company. In addition, changes in U.S. federal and state or international tax laws applicable to corporate multinationals, other fundamental law changes currently being considered by many countries, including in the U.S., and changes in taxing jurisdictions' administrative interpretations, decisions, policies, and positions may materially adversely impact our consolidated financial statements.

INTELLECTUAL PROPERTY RISKS

We may not be able to protect our source code from copying if there is an unauthorized disclosure. Source code, the detailed program commands for our operating systems and other software programs, is critical to our business. Although we license portions of our application and operating system source code to several licensees, we take significant measures to protect the secrecy of large portions of our source code. If our source code leaks, we might lose future trade secret protection for that code. It may then become easier for third parties to compete with our products by copying functionality, which could adversely affect our revenue and operating margins. Unauthorized disclosure of source code also could increase the security risks described elsewhere in these risk factors.

Legal changes, our evolving business model, piracy, and other factors may decrease the value of our intellectual property. Protecting our intellectual property rights and combating unlicensed copying and use of our software and other intellectual property on a global basis is difficult. While piracy adversely affects U.S. revenue, the impact on revenue from outside the U.S. is more significant, particularly countries in which the legal system provides less protection for intellectual property rights. Our revenue in these markets may grow more slowly than the underlying device market. Similarly, the absence of harmonized patent laws makes it more difficult to ensure consistent respect for patent rights. Throughout the world, we educate users about the benefits of licensing genuine products and obtaining indemnification benefits for intellectual property risks, and we educate lawmakers about the advantages of a business climate where intellectual property rights are protected. Reductions in the legal protection for software intellectual property rights could adversely affect revenue.

We expend significant resources to patent the intellectual property we create with the expectation that we will generate revenues by incorporating that intellectual property in our products or services or, in some instances, by licensing or cross-licensing our patents to others in return for a royalty and/or increased freedom to operate. Changes in the law may continue to weaken our ability to prevent the use of patented technology or collect revenue for licensing our patents. These include legislative changes and regulatory actions that make it more difficult to obtain injunctions, and the increasing use of legal process to challenge issued patents. Similarly, licensees of our patents may fail to satisfy their obligations to pay us royalties or may contest the scope and extent of their obligations. The royalties we can obtain to monetize our intellectual property may decline because of the evolution of technology, price changes in products using licensed patents, greater value from cross-licensing, or the difficulty of discovering infringements. Finally, our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations and may negatively impact revenue.

Third parties may claim we infringe their intellectual property rights. From time to time, others claim we infringe their intellectual property rights. The number of these claims may grow because of constant technological change in the markets in which we compete, the extensive patent coverage of existing technologies, the rapid rate of issuance of new patents, and our offering of first-party devices, such as Surface. To resolve these claims, we may enter into royalty and licensing agreements on terms that are less favorable than currently available, stop selling or redesign affected products or services, or pay damages to satisfy indemnification commitments with our customers. These outcomes may cause operating margins to decline. Besides money damages, in some jurisdictions plaintiffs can seek injunctive relief that may limit or prevent importing, marketing, and selling our products or services that have infringing technologies. In some countries, such as Germany, an injunction can be issued before the parties have fully litigated the validity of the underlying patents. We have paid significant amounts to settle claims related to the use of technology and intellectual property rights and to procure intellectual property rights as part of our strategy to manage this risk, and may continue to do so.

GENERAL RISKS

If our reputation or our brands are damaged, our business and operating results may be harmed. Our reputation and brands are globally recognized and are important to our business. Our reputation and brands affect our ability to attract and retain consumer, business, and public-sector customers. There are numerous ways our reputation or brands could be damaged. These include product safety or quality issues, our environmental impact and sustainability, supply chain practices, or human rights record. We may experience backlash from customers, government entities, advocacy groups, employees, and other stakeholders that disagree with our product offering decisions or public policy positions. Damage to our reputation or our brands may occur from, among other things:

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The introduction of new features, products, services, or terms of service that customers, users, or partners do not like.

- Public scrutiny of our decisions regarding user privacy, data practices, or content.
- Data security breaches, compliance failures, or actions of partners or individual employees.

The proliferation of social media may increase the likelihood, speed, and magnitude of negative brand events. If our brands or reputation are damaged, it could negatively impact our revenues or margins, or ability to attract the most highly qualified employees.

Adverse economic or market conditions may harm our business. Worsening economic conditions, including inflation, recession, pandemic, or other changes in economic conditions, may cause lower IT spending and adversely affect our revenue. If demand for PCs, servers, and other computing devices declines, or consumer or business spending for those products declines, our revenue will be adversely affected.

Our product distribution system relies on an extensive partner and retail network. OEMs building devices that run our software have also been a significant means of distribution. The impact of economic conditions on our partners, such as the bankruptcy of a major distributor, OEM, or retailer, could cause sales channel disruption.

Challenging economic conditions also may impair the ability of our customers to pay for products and services they have purchased. As a result, allowances for doubtful accounts and write-offs of accounts receivable may increase.

We maintain an investment portfolio of various holdings, types, and maturities. These investments are subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by market downturns or events that affect global financial markets. A significant part of our investment portfolio comprises U.S. government securities. If global financial markets decline for long periods, or if there is a downgrade of the U.S. government credit rating due to an actual or threatened default on government debt, our investment portfolio may be adversely affected and we could determine that more of our investments have experienced a decline in fair value, requiring impairment charges that could adversely affect our consolidated financial statements.

Catastrophic events or geopolitical conditions may disrupt our business. A disruption or failure of our systems or operations because of a major earthquake, weather event, cyberattack, terrorist attack, pandemic, or other catastrophic event could cause delays in completing sales, providing services, or performing other critical functions. Our corporate headquarters, a significant portion of our research and development activities, and certain other essential business operations are in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are seismically active regions. A catastrophic event that results in the destruction or disruption of any of our critical business or IT systems, or the infrastructure or systems they rely on, such as power grids, could harm our ability to conduct normal business operations. Providing our customers with more services and solutions in the cloud puts a premium on the resilience of our systems and strength of our business continuity management plans and magnifies the potential impact of prolonged service outages in our consolidated financial statements.

Abrupt political change, terrorist activity, and armed conflict, such as the ongoing conflict in Ukraine, pose a risk of general economic disruption in affected countries, which may increase our operating costs and negatively impact our ability to sell to and collect from customers in affected markets. These conditions also may add uncertainty to the timing and budget for technology investment decisions by our customers and may cause supply chain disruptions for hardware manufacturers. Geopolitical change may result in changing regulatory systems and requirements and market interventions that could impact our operating strategies, access to national, regional, and global markets, hiring, and profitability. Geopolitical instability may lead to sanctions and impact our ability to do business in some markets or with some public-sector customers. Any of these changes may negatively impact our revenues.

The occurrence of regional epidemics or a global pandemic such as COVID-19 may adversely affect our operations, financial condition, and results of operations. The COVID-19 pandemic has had widespread, rapidly evolving, and unpredictable impacts on global society, economies, financial markets, and business practices. The extent to which global pandemics impact our business going forward will depend on factors such as the duration and scope of the pandemic; governmental, business, and individuals' actions in response to the pandemic; and the impact on economic activity including the possibility of recession or financial market instability.

Measures to contain a global pandemic may intensify other risks described in these Risk Factors. Any of these measures may adversely impact our ability to:

- Maintain our operations infrastructure, including the reliability and adequate capacity of cloud services.
- Satisfy our contractual and regulatory compliance obligations as we adapt to changing usage patterns, such as through datacenter load balancing.
- Ensure a high-quality and consistent supply chain and manufacturing operations for our hardware devices and datacenter operations.
- Effectively manage our international operations through changes in trade practices and policies.
- Hire and deploy people where we most need them.
- Sustain the effectiveness and productivity of our operations including our sales, marketing, engineering, and distribution functions.

We may incur increased costs to effectively manage these aspects of our business. If we are unsuccessful it may adversely impact our revenues, cash flows, market share growth, and reputation.

The long-term effects of climate change on the global economy and the IT industry in particular are unclear. Environmental regulations or changes in the supply, demand or available sources of energy or other resources may affect the availability or cost of goods and services, including natural resources, necessary to run our business. Changes in climate where we operate may increase the costs of powering and cooling computer hardware we use to develop software and provide cloud-based services.

Our global business exposes us to operational and economic risks. Our customers are located throughout the world and a significant part of our revenue comes from international sales. The global nature of our business creates operational, economic, and geopolitical risks. Our results of operations may be affected by global, regional, and local economic developments, monetary policy, inflation, and recession, as well as political and military disputes. In addition, our international growth strategy includes certain markets, the developing nature of which presents several risks, including deterioration of social, political, labor, or economic conditions in a country or region, and difficulties in staffing and managing foreign operations. Emerging nationalist and protectionist trends and concerns about human rights and political expression in specific countries may significantly alter the trade and commercial environments. Changes to trade policy or agreements as a result of populism, protectionism, or economic nationalism may result in higher tariffs, local sourcing initiatives, and non-local sourcing restrictions, export controls, investment restrictions, or other developments that make it more difficult to sell our products in foreign countries. Disruptions of these kinds in developed or emerging markets could negatively impact demand for our products and services or increase operating costs. Although we hedge a portion of our international currency exposure, significant fluctuations in foreign exchange rates between the U.S. dollar and foreign currencies may adversely affect our results of operations.

Our business depends on our ability to attract and retain talented employees. Our business is based on successfully attracting and retaining talented employees representing diverse backgrounds, experiences, and skill sets. The market for highly skilled workers and leaders in our industry is extremely competitive. Maintaining our brand and reputation, as well as a diverse and inclusive work environment that enables all our employees to thrive, are important to our ability to recruit and retain employees. We are also limited in our ability to recruit internationally by restrictive domestic immigration laws. Changes to U.S. immigration policies that restrain the flow of technical and professional talent may inhibit our ability to adequately staff our research and development efforts. If we are less successful in our recruiting efforts, or if we cannot retain highly skilled workers and key leaders, our ability to develop and deliver successful products and services may be adversely affected. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees could hinder our strategic planning and execution. How employment-related laws are interpreted and applied to our workforce practices may result in increased operating costs and less flexibility in how we meet our workforce needs. Our global workforce is primarily non-unionized, but we have several unions and works councils outside of the United States. In the U.S., there has been a general increase in workers exercising their right to form or join a union. While Microsoft has not received such petitions in the U.S., the unionization of significant employee populations could result in higher costs and other operational changes necessary to respond to changing conditions and to establish new relationships with worker representatives.

ITEM 1B. UNRESOLVED STAFF COMMENTS

We have received no written comments regarding our periodic or current reports from the staff of the Securities and Exchange Commission that were issued 180 days or more preceding the end of our fiscal year 2022 that remain unresolved.

ITEM 2. PROPERTIES

Our corporate headquarters are located in Redmond, Washington. We have approximately 15 million square feet of space located in King County, Washington that is used for engineering, sales, marketing, and operations, among other general and administrative purposes. These facilities include approximately 10 million square feet of owned space situated on approximately 520 acres of land we own at our corporate headquarters, and approximately 5 million square feet of space we lease. In addition, we own and lease space domestically that includes office and datacenter space.

We also own and lease facilities internationally for datacenters, research and development, and other operations. The largest owned properties include space in the following locations: China, India, Ireland, the Netherlands, and Singapore. The largest leased properties include space in the following locations: Australia, Canada, China, France, Germany, India, Ireland, Israel, Japan, the Netherlands, and the United Kingdom.

In addition to the above locations, we have various product development facilities, both domestically and internationally, as described under Research and Development (Part I, Item 1 of this Form 10-K).

The table below shows a summary of the square footage of our office, datacenter, and other facilities owned and leased domestically and internationally as of June 30, 2022:

(Square feet in millions)

Location	Owned	Leased	Total
U.S.	**25**	**19**	**44**
International	**8**	**21**	**29**
Total	**33**	**40**	**73**

ITEM 3. LEGAL PROCEEDINGS

Refer to Note 15 – Contingencies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for information regarding legal proceedings in which we are involved.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

MARKET AND STOCKHOLDERS

Our common stock is traded on the NASDAQ Stock Market under the symbol MSFT. On July 25, 2022, there were 86,465 registered holders of record of our common stock.

SHARE REPURCHASES AND DIVIDENDS

Following are our monthly share repurchases for the fourth quarter of fiscal year 2022:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
				(In millions)
April 1, 2022 – April 30, 2022	**9,124,963**	**$ 289.34**	**9,124,963**	**$ 45,869**
May 1, 2022 – May 31, 2022	**9,809,727**	**265.95**	**9,809,727**	**43,260**
June 1, 2022 – June 30, 2022	**9,832,841**	**259.42**	**9,832,841**	**40,709**
	28,767,531		**28,767,531**	

All share repurchases were made using cash resources. Our share repurchases may occur through open market purchases or pursuant to a Rule 10b5-1 trading plan. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards.

Our Board of Directors declared the following dividends during the fourth quarter of fiscal year 2022:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
June 14, 2022	**August 18, 2022**	**September 8, 2022**	**$ 0.62**	**$ 4,627**

We returned $12.4 billion to shareholders in the form of share repurchases and dividends in the fourth quarter of fiscal year 2022. Refer to Note 16 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion regarding share repurchases and dividends.

ITEM 6. [RESERVED]

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the results of operations and financial condition of Microsoft Corporation. MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying Notes to Financial Statements (Part II, Item 8 of this Form 10-K). This section generally discusses the results of our operations for the year ended June 30, 2022 compared to the year ended June 30, 2021. For a discussion of the year ended June 30, 2021 compared to the year ended June 30, 2020, please refer to Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended June 30, 2021.

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity.

We generate revenue by offering a wide range of cloud-based and other services to people and businesses; licensing and supporting an array of software products; designing, manufacturing, and selling devices; and delivering relevant online advertising to a global audience. Our most significant expenses are related to compensating employees; designing, manufacturing, marketing, and selling our products and services; datacenter costs in support of our cloud-based services; and income taxes.

Highlights from fiscal year 2022 compared with fiscal year 2021 included:

- Microsoft Cloud (formerly commercial cloud) revenue increased 32% to $91.2 billion.
- Office Commercial products and cloud services revenue increased 13% driven by Office 365 Commercial growth of 18%.
- Office Consumer products and cloud services revenue increased 11% and Microsoft 365 Consumer subscribers grew to 59.7 million.
- LinkedIn revenue increased 34%.
- Dynamics products and cloud services revenue increased 25% driven by Dynamics 365 growth of 39%.
- Server products and cloud services revenue increased 28% driven by Azure and other cloud services growth of 45%.
- Windows original equipment manufacturer licensing ("Windows OEM") revenue increased 11%.
- Windows Commercial products and cloud services revenue increased 11%.
- Xbox content and services revenue increased 3%.
- Search and news advertising revenue excluding traffic acquisition costs increased 27%.
- Surface revenue increased 3%.

On March 4, 2022, we completed our acquisition of Nuance Communications, Inc. ("Nuance") for a total purchase price of $18.8 billion, consisting primarily of cash. Nuance is a cloud and artificial intelligence ("AI") software provider with healthcare and enterprise AI experience, and the acquisition will build on our industry-specific cloud offerings. The financial results of Nuance have been included in our consolidated financial statements since the date of the acquisition. Nuance is reported as part of our Intelligent Cloud segment. Refer to Note 8 – Business Combinations of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Industry Trends

Our industry is dynamic and highly competitive, with frequent changes in both technologies and business models. Each industry shift is an opportunity to conceive new products, new technologies, or new ideas that can further transform the industry and our business. At Microsoft, we push the boundaries of what is possible through a broad range of research and development activities that seek to identify and address the changing demands of customers and users, industry trends, and competitive forces.

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, and influence how users access services in the cloud, and in some cases, the user's choice of which suite of cloud-based services to use. We must continue to evolve and adapt over an extended time in pace with this changing environment. The investments we are making in infrastructure and devices will continue to increase our operating costs and may decrease our operating margins.

Our success is highly dependent on our ability to attract and retain qualified employees. We hire a mix of university and industry talent worldwide. We compete for talented individuals globally by offering an exceptional working environment, broad customer reach, scale in resources, the ability to grow one's career across many different products and businesses, and competitive compensation and benefits. Aggregate demand for our software, services, and devices is correlated to global macroeconomic and geopolitical factors, which remain dynamic.

Our devices are primarily manufactured by third-party contract manufacturers, some of which contain certain components for which there are very few qualified suppliers. For these components, we have limited near-term flexibility to use other manufacturers if a current vendor becomes unavailable or is unable to meet our requirements. Extended disruptions at these suppliers and/or manufacturers could lead to a similar disruption in our ability to manufacture devices on time to meet consumer demand.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. Fluctuations in the U.S. dollar relative to certain foreign currencies did not have a material impact on reported revenue or expenses from our international operations in fiscal year 2022.

Refer to Risk Factors (Part I, Item 1A of this Form 10-K) for a discussion of these factors and other risks.

Seasonality

Our revenue fluctuates quarterly and is generally higher in the second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.

Reportable Segments

We report our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. The segment amounts included in MD&A are presented on a basis consistent with our internal management reporting. Additional information on our reportable segments is contained in Note 19 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

Metrics

We use metrics in assessing the performance of our business and to make informed decisions regarding the allocation of resources. We disclose metrics to enable investors to evaluate progress against our ambitions, provide transparency into performance trends, and reflect the continued evolution of our products and services. Our commercial and other business metrics are fundamentally connected based on how customers use our products and services. The metrics are disclosed in the MD&A or the Notes to Financial Statements (Part II, Item 8 of this Form 10-K). Financial metrics are calculated based on financial results prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), and growth comparisons relate to the corresponding period of last fiscal year.

In the first quarter of fiscal year 2022, we made updates to the presentation and method of calculation for certain metrics, most notably changes to incorporate all current and anticipated revenue streams within our Office Consumer and Server products and cloud services metrics and changes to align with how we manage our Windows OEM and Search and news advertising businesses. None of these changes had a material impact on previously reported amounts in our MD&A.

In the third quarter of fiscal year 2022, we completed our acquisition of Nuance. Nuance is included in all commercial metrics and our Server products and cloud services revenue growth metric. Azure and other cloud services revenue includes Nuance cloud services, and Server products revenue includes Nuance on-premises offerings.

Commercial

Our commercial business primarily consists of Server products and cloud services, Office Commercial, Windows Commercial, the commercial portion of LinkedIn, Enterprise Services, and Dynamics. Our commercial metrics allow management and investors to assess the overall health of our commercial business and include leading indicators of future performance.

Commercial remaining performance obligation	Commercial portion of revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods
Microsoft Cloud revenue	Revenue from Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties
Microsoft Cloud gross margin percentage	Gross margin percentage for our Microsoft Cloud business

Productivity and Business Processes and Intelligent Cloud

Metrics related to our Productivity and Business Processes and Intelligent Cloud segments assess the health of our core businesses within these segments. The metrics reflect our cloud and on-premises product strategies and trends.

Office Commercial products and cloud services revenue growth	Revenue from Office Commercial products and cloud services (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Microsoft Viva
Office Consumer products and cloud services revenue growth	Revenue from Office Consumer products and cloud services, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services
Office 365 Commercial seat growth	The number of Office 365 Commercial seats at end of period where seats are paid users covered by an Office 365 Commercial subscription
Microsoft 365 Consumer subscribers	The number of Microsoft 365 Consumer subscribers at end of period
Dynamics products and cloud services revenue growth	Revenue from Dynamics products and cloud services, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications
LinkedIn revenue growth	Revenue from LinkedIn, including Talent Solutions, Marketing Solutions,

	Premium Subscriptions, and Sales Solutions
Server products and cloud services revenue growth	Revenue from Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and Nuance and GitHub

More Personal Computing

Metrics related to our More Personal Computing segment assess the performance of key lines of business within this segment. These metrics provide strategic product insights which allow us to assess the performance across our commercial and consumer businesses. As we have diversity of target audiences and sales motions within the Windows business, we monitor metrics that are reflective of those varying motions.

Windows OEM revenue growth	Revenue from sales of Windows Pro and non-Pro licenses sold through the OEM channel
Windows Commercial products and cloud services revenue growth	Revenue from Windows Commercial products and cloud services, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings
Surface revenue growth	Revenue from Surface devices and accessories
Xbox content and services revenue growth	Revenue from Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, third-party disc royalties, advertising, and other cloud services
Search and news advertising revenue, excluding TAC, growth	Revenue from search and news advertising excluding traffic acquisition costs (“TAC”) paid to Bing Ads network publishers and news partners

SUMMARY RESULTS OF OPERATIONS

(In millions, except percentages and per share amounts)	2022	2021	Percentage Change
Revenue	**$ 198,270**	$ 168,088	18%
Gross margin	**135,620**	115,856	17%
Operating income	**83,383**	69,916	19%
Net income	**72,738**	61,271	19%
Diluted earnings per share	**9.65**	8.05	20%
Adjusted net income (non-GAAP)	**69,447**	60,651	15%
Adjusted diluted earnings per share (non-GAAP)	**9.21**	7.97	16%

Adjusted net income and adjusted diluted earnings per share (“EPS”) are non-GAAP financial measures which exclude the net income tax benefit related to transfer of intangible properties in the first quarter of fiscal year 2022 and the net income tax benefit related to an India Supreme Court decision on withholding taxes in the third quarter of fiscal year 2021. Refer to the Non-GAAP Financial Measures section below for a reconciliation of our financial results reported in accordance with GAAP to non-GAAP financial results. See Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Fiscal Year 2022 Compared with Fiscal Year 2021

Revenue increased $30.2 billion or 18% driven by growth across each of our segments. Intelligent Cloud revenue increased driven by Azure and other cloud services. Productivity and Business Processes revenue increased driven by Office 365 Commercial and LinkedIn. More Personal Computing revenue increased driven by Search and news advertising and Windows.

Cost of revenue increased $10.4 billion or 20% driven by growth in Microsoft Cloud.

Gross margin increased $19.8 billion or 17% driven by growth across each of our segments.

- Gross margin percentage decreased slightly. Excluding the impact of the fiscal year 2021 change in accounting estimate for the useful lives of our server and network equipment, gross margin percentage increased 1 point driven by improvement in Productivity and Business Processes.
- Microsoft Cloud gross margin percentage decreased slightly to 70%. Excluding the impact of the change in accounting estimate, Microsoft Cloud gross margin percentage increased 3 points driven by improvement across our cloud services, offset in part by sales mix shift to Azure and other cloud services.

Operating expenses increased $6.3 billion or 14% driven by investments in cloud engineering, LinkedIn, Gaming, and commercial sales.

Key changes in operating expenses were:

- Research and development expenses increased $3.8 billion or 18% driven by investments in cloud engineering, Gaming, and LinkedIn.
- Sales and marketing expenses increased $1.7 billion or 8% driven by investments in commercial sales and LinkedIn. Sales and marketing included a favorable foreign currency impact of 2%.
- General and administrative expenses increased $793 million or 16% driven by investments in corporate functions.

Operating income increased $13.5 billion or 19% driven by growth across each of our segments.

Current year net income and diluted EPS were positively impacted by the net tax benefit related to the transfer of intangible properties, which resulted in an increase to net income and diluted EPS of $3.3 billion and $0.44, respectively. Prior year net income and diluted EPS were positively impacted by the net tax benefit related to the India Supreme Court decision on withholding taxes, which resulted in an increase to net income and diluted EPS of $620 million and $0.08, respectively.

Gross margin and operating income both included an unfavorable foreign currency impact of 2%.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	2022	2021	Percentage Change
Revenue			
Productivity and Business Processes	**$ 63,364**	$ 53,915	18%
Intelligent Cloud	**75,251**	60,080	25%
More Personal Computing	**59,655**	54,093	10%
Total	**$ 198,270**	$ 168,088	18%
Operating Income			
Productivity and Business Processes	**$ 29,687**	$ 24,351	22%
Intelligent Cloud	**32,721**	26,126	25%
More Personal Computing	**20,975**	19,439	8%
Total	**$ 83,383**	$ 69,916	19%

Reportable Segments

Fiscal Year 2022 Compared with Fiscal Year 2021

Productivity and Business Processes

Revenue increased $9.4 billion or 18%.

- Office Commercial products and cloud services revenue increased $4.4 billion or 13%. Office 365 Commercial revenue grew 18% driven by seat growth of 14%, with continued momentum in small and medium business and frontline worker offerings, as well as growth in revenue per user. Office Commercial products revenue declined 22% driven by continued customer shift to cloud offerings.
- Office Consumer products and cloud services revenue increased $641 million or 11% driven by Microsoft 365 Consumer subscription revenue. Microsoft 365 Consumer subscribers grew 15% to 59.7 million.
- LinkedIn revenue increased $3.5 billion or 34% driven by a strong job market in our Talent Solutions business and advertising demand in our Marketing Solutions business.
- Dynamics products and cloud services revenue increased 25% driven by Dynamics 365 growth of 39%.

Operating income increased $5.3 billion or 22%.

- Gross margin increased $7.3 billion or 17% driven by growth in Office 365 Commercial and LinkedIn. Gross margin percentage was relatively unchanged. Excluding the impact of the change in accounting estimate, gross margin percentage increased 2 points driven by improvement across all cloud services.
- Operating expenses increased $2.0 billion or 11% driven by investments in LinkedIn and cloud engineering.

Gross margin and operating income both included an unfavorable foreign currency impact of 2%.

Intelligent Cloud

Revenue increased $15.2 billion or 25%.

- Server products and cloud services revenue increased $14.7 billion or 28% driven by Azure and other cloud services. Azure and other cloud services revenue grew 45% driven by growth in our consumption-based services. Server products revenue increased 5% driven by hybrid solutions, including Windows Server and SQL Server running in multi-cloud environments.
- Enterprise Services revenue increased $464 million or 7% driven by growth in Enterprise Support Services.

Operating income increased $6.6 billion or 25%.

- Gross margin increased $9.4 billion or 22% driven by growth in Azure and other cloud services. Gross margin percentage decreased. Excluding the impact of the change in accounting estimate, gross margin percentage was relatively unchanged driven by improvement in Azure and other cloud services, offset in part by sales mix shift to Azure and other cloud services.
- Operating expenses increased $2.8 billion or 16% driven by investments in Azure and other cloud services.

Revenue and operating income included an unfavorable foreign currency impact of 2% and 3%, respectively.

More Personal Computing

Revenue increased $5.6 billion or 10%.

- Windows revenue increased $2.3 billion or 10% driven by growth in Windows OEM and Windows Commercial. Windows OEM revenue increased 11% driven by continued strength in the commercial PC market, which has higher revenue per license. Windows Commercial products and cloud services revenue increased 11% driven by demand for Microsoft 365.
- Search and news advertising revenue increased $2.3 billion or 25%. Search and news advertising revenue excluding traffic acquisition costs increased 27% driven by higher revenue per search and search volume.
- Gaming revenue increased $860 million or 6% on a strong prior year comparable that benefited from Xbox Series X|S launches and stay-at-home scenarios, driven by growth in Xbox hardware and Xbox content and services. Xbox hardware revenue increased 16% due to continued demand for Xbox Series X|S. Xbox content and services revenue increased 3% driven by growth in Xbox Game Pass subscriptions and first-party content, offset in part by a decline in third-party content.
- Surface revenue increased $226 million or 3%.

Operating income increased $1.5 billion or 8%.

- Gross margin increased $3.1 billion or 10% driven by growth in Windows and Search and news advertising. Gross margin percentage was relatively unchanged.
- Operating expenses increased $1.5 billion or 14% driven by investments in Gaming, Search and news advertising, and Windows marketing.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)		2022		2021	Percentage Change
Research and development	$	**24,512**	$	20,716	18%
As a percent of revenue		**12%**		12%	0ppt

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content.

Research and development expenses increased $3.8 billion or 18% driven by investments in cloud engineering, Gaming, and LinkedIn.

Sales and Marketing

(In millions, except percentages)		2022		2021	Percentage Change
Sales and marketing	$	**21,825**	$	20,117	8%
As a percent of revenue		**11%**		12%	(1)ppt

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs.

Sales and marketing expenses increased $1.7 billion or 8% driven by investments in commercial sales and LinkedIn. Sales and marketing included a favorable foreign currency impact of 2%.

General and Administrative

(In millions, except percentages)		2022		2021	Percentage Change
General and administrative	$	**5,900**	$	5,107	16%
As a percent of revenue		**3%**		3%	0ppt

General and administrative expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with finance, legal, facilities, certain human resources and other administrative personnel, certain taxes, and legal and other administrative fees.

General and administrative expenses increased $793 million or 16% driven by investments in corporate functions.

OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**
Interest and dividends income	**$ 2,094**	$ 2,131
Interest expense	**(2,063)**	(2,346)
Net recognized gains on investments	**461**	1,232
Net gains (losses) on derivatives	**(52)**	17
Net gains (losses) on foreign currency remeasurements	**(75)**	54
Other, net	**(32)**	98
Total	**$ 333**	$ 1,186

We use derivative instruments to manage risks related to foreign currencies, equity prices, interest rates, and credit; enhance investment returns; and facilitate portfolio diversification. Gains and losses from changes in fair values of derivatives that are not designated as hedging instruments are primarily recognized in other income (expense), net.

Interest and dividends income decreased due to lower portfolio balances. Interest expense decreased due to a decrease in outstanding long-term debt due to debt maturities. Net recognized gains on investments decreased primarily due to lower gains on equity securities.

INCOME TAXES

Effective Tax Rate

Our effective tax rate for fiscal years 2022 and 2021 was 13% and 14%, respectively. The decrease in our effective tax rate was primarily due to a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022 related to the transfer of intangible properties, offset in part by changes in the mix of our income before income taxes between the U.S. and foreign countries, as well as tax benefits in the prior year from the India Supreme Court decision on withholding taxes in the case of Engineering Analysis Centre of Excellent Private Limited vs The Commissioner of Income Tax, an agreement between the U.S. and India tax authorities related to transfer pricing, and final Tax Cuts and Jobs Act (“TCJA”) regulations.

In the first quarter of fiscal year 2022, we transferred certain intangible properties from our Puerto Rico subsidiary to the U.S. The transfer of intangible properties resulted in a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022, as the value of future U.S. tax deductions exceeds the current tax liability from the U.S. global intangible low-taxed income tax.

We have historically paid India withholding taxes on software sales through distributor withholding and tax audit assessments in India. In March 2021, the India Supreme Court ruled favorably for companies in 86 separate appeals, some dating back to 2012, holding that software sales are not subject to India withholding taxes. Although we were not a party to the appeals, our software sales in India were determined to be not subject to withholding taxes. Therefore, we recorded a net income tax benefit of $620 million in the third quarter of fiscal year 2021 to reflect the results of the India Supreme Court decision impacting fiscal year 1996 through fiscal year 2016.

Our effective tax rate was lower than the U.S. federal statutory rate, primarily due to the net income tax benefit related to the transfer of intangible properties, earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations center in Ireland, and tax benefits relating to stock-based compensation.

The mix of income before income taxes between the U.S. and foreign countries impacted our effective tax rate as a result of the geographic distribution of, and customer demand for, our products and services. In fiscal year 2022, our U.S. income before income taxes was $47.8 billion and our foreign income before income taxes was $35.9 billion. In fiscal year 2021, our U.S. income before income taxes was $35.0 billion and our foreign income before income taxes was $36.1 billion.

Uncertain Tax Positions

We settled a portion of the Internal Revenue Service ("IRS") audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. In the second quarter of fiscal year 2021, we settled an additional portion of the IRS audits for tax years 2004 to 2013 and made a payment of $1.7 billion, including tax and interest. We remain under audit for tax years 2004 to 2017.

As of June 30, 2022, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved key transfer pricing issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2021, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NON-GAAP FINANCIAL MEASURES

Adjusted net income and adjusted diluted EPS are non-GAAP financial measures which exclude the net tax benefit related to the transfer of intangible properties in the first quarter of fiscal year 2022 and the net income tax benefit related to an India Supreme Court decision on withholding taxes in the third quarter of fiscal year 2021. We believe these non-GAAP measures aid investors by providing additional insight into our operational performance and help clarify trends affecting our business. For comparability of reporting, management considers non-GAAP measures in conjunction with GAAP financial results in evaluating business performance. These non-GAAP financial measures presented should not be considered a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP.

The following table reconciles our financial results reported in accordance with GAAP to non-GAAP financial results:

(In millions, except percentages and per share amounts)	**2022**	**2021**	**Percentage Change**
Net income	**$ 72,738**	$ 61,271	19%
Net income tax benefit related to transfer of intangible properties	**(3,291)**	0	*
Net income tax benefit related to India Supreme Court decision on withholding taxes	**0**	(620)	*
Adjusted net income (non-GAAP)	**$ 69,447**	$ 60,651	15%
Diluted earnings per share	**$ 9.65**	$ 8.05	20%
Net income tax benefit related to transfer of intangible properties	**(0.44)**	0	*
Net income tax benefit related to India Supreme Court decision on withholding taxes	**0**	(0.08)	*
Adjusted diluted earnings per share (non-GAAP)	**$ 9.21**	$ 7.97	16%

* *Not meaningful.*

LIQUIDITY AND CAPITAL RESOURCES

We expect existing cash, cash equivalents, short-term investments, cash flows from operations, and access to capital markets to continue to be sufficient to fund our operating activities and cash commitments for investing and financing activities, such as dividends, share repurchases, debt maturities, material capital expenditures, and the transition tax related to the TCJA, for at least the next 12 months and thereafter for the foreseeable future.

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $104.8 billion and $130.3 billion as of June 30, 2022 and 2021, respectively. Equity investments were $6.9 billion and $6.0 billion as of June 30, 2022 and 2021, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Valuation

In general, and where applicable, we use quoted prices in active markets for identical assets or liabilities to determine the fair value of our financial instruments. This pricing methodology applies to our Level 1 investments, such as U.S. government securities, common and preferred stock, and mutual funds. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then we use quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. This pricing methodology applies to our Level 2 investments, such as commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Level 3 investments are valued using internally-developed models with unobservable inputs. Assets and liabilities measured at fair value on a recurring basis using unobservable inputs are an immaterial portion of our portfolio.

A majority of our investments are priced by pricing vendors and are generally Level 1 or Level 2 investments as these vendors either provide a quoted market price in an active market or use observable inputs for their pricing without applying significant adjustments. Broker pricing is used mainly when a quoted price is not available, the investment is not priced by our pricing vendors, or when a broker price is more reflective of fair values in the market in which the investment trades. Our broker-priced investments are generally classified as Level 2 investments because the broker prices these investments based on similar assets without applying significant adjustments. In addition, all our broker-priced investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments. Our fair value processes include controls that are designed to ensure appropriate fair values are recorded. These controls include model validation, review of key model inputs, analysis of period-over-period fluctuations, and independent recalculation of prices where appropriate.

Cash Flows

Cash from operations increased $12.3 billion to $89.0 billion for fiscal year 2022, mainly due to an increase in cash received from customers, offset in part by an increase in cash paid to suppliers and employees. Cash used in financing increased $10.4 billion to $58.9 billion for fiscal year 2022, mainly due to a $5.3 billion increase in common stock repurchases and a $5.3 billion increase in repayments of debt. Cash used in investing increased $2.7 billion to $30.3 billion for fiscal year 2022, mainly due to a $13.1 billion increase in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets, and a $3.3 billion increase in additions to property and equipment, offset in part by a $15.6 billion increase in cash from net investment purchases, sales, and maturities.

Debt Proceeds

We issue debt to take advantage of favorable pricing and liquidity in the debt markets, reflecting our credit rating and the low interest rate environment. The proceeds of these issuances were or will be used for general corporate purposes, which may include, among other things, funding for working capital, capital expenditures, repurchases of capital stock, acquisitions, and repayment of existing debt. In March 2021 and June 2020, we exchanged a portion of our existing debt at a premium for cash and new debt with longer maturities to take advantage of favorable financing rates in the debt markets, reflecting our credit rating and the low interest rate environment. Refer to Note 11 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Unearned Revenue

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include Software Assurance (“SA”) and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service. Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

The following table outlines the expected future recognition of unearned revenue as of June 30, 2022:

(In millions)

Three Months Ending	
September 30, 2022	**$ 17,691**
December 31, 2022	**13,923**
March 31, 2023	**9,491**
June 30, 2023	**4,433**
Thereafter	**2,870**
Total	**$ 48,408**

If our customers choose to license cloud-based versions of our products and services rather than licensing transaction-based products and services, the associated revenue will shift from being recognized at the time of the transaction to being recognized over the subscription period or upon consumption, as applicable.

Material Cash Requirements and Other Obligations

Contractual Obligations

The following table summarizes the payments due by fiscal year for our outstanding contractual obligations as of June 30, 2022:

(In millions)	2023	Thereafter	Total
Long-term debt: (a)			
Principal payments	$ 2,750	$ 52,761	$ 55,511
Interest payments	1,468	21,139	22,607
Construction commitments (b)	7,942	576	8,518
Operating and finance leases, including imputed interest (c)	4,609	44,045	48,654
Purchase commitments (d)	42,669	2,985	45,654
Total	$ 59,438	$ 121,506	$ 180,944

(a) *Refer to Note 11 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(b) *Refer to Note 7 – Property and Equipment of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(c) *Refer to Note 14 – Leases of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(d) *Purchase commitments primarily relate to datacenters and include open purchase orders and take-or-pay contracts that are not presented as construction commitments above.*

Income Taxes

As a result of the TCJA, we are required to pay a one-time transition tax on deferred foreign income not previously subject to U.S. income tax. Under the TCJA, the transition tax is payable in interest-free installments over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. We have paid transition tax of $6.2 billion, which included $1.5 billion for fiscal year 2022. The remaining transition tax of $12.0 billion is payable over the next four years, with $1.3 billion payable within 12 months.

Provisions enacted in the TCJA related to the capitalization for tax purposes of research and experimental expenditures became effective on July 1, 2022. These provisions require us to capitalize research and experimental expenditures and amortize them on the U.S. tax return over five or fifteen years, depending on where research is conducted. The final foreign tax credit regulations, also effective on July 1, 2022, introduced significant changes to foreign tax credit calculations in the U.S. tax return. While these provisions are not expected to have a material impact on our fiscal year 2023 effective tax rate on a net basis, our cash paid for taxes would increase unless these provisions are postponed or modified through legislative processes.

Share Repurchases

During fiscal years 2022 and 2021, we repurchased 95 million shares and 101 million shares of our common stock for $28.0 billion and $23.0 billion, respectively, through our share repurchase programs. All repurchases were made using cash resources. As of June 30, 2022, $40.7 billion remained of our $60 billion share repurchase program. Refer to Note 16 – Stockholders’ Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Dividends

During fiscal year 2022, our Board of Directors declared quarterly dividends of $0.62 per share. We intend to continue returning capital to shareholders in the form of dividends, subject to declaration by our Board of Directors. Refer to Note 16 – Stockholders’ Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Other Planned Uses of Capital

On January 18, 2022, we entered into a definitive agreement to acquire Activision Blizzard, Inc. (“Activision Blizzard”) for $95.00 per share in an all-cash transaction valued at $68.7 billion, inclusive of Activision Blizzard’s net cash. The acquisition has been approved by Activision Blizzard’s shareholders, and we expect it to close in fiscal year 2023, subject to the satisfaction of certain regulatory approvals and other customary closing conditions.

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as continue making acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings. We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. We have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of capital resources.

RECENT ACCOUNTING GUIDANCE

Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

CRITICAL ACCOUNTING ESTIMATES

Our consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Critical accounting estimates are those estimates that involve a significant level of estimation uncertainty and could have a material impact on our financial condition or results of operations. We have critical accounting estimates in the areas of revenue recognition, impairment of investment securities, goodwill, research and development costs, legal and other contingencies, income taxes, and inventories.

Revenue Recognition

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the stand-alone selling price (“SSP") for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Impairment of Investment Securities

We review debt investments quarterly for credit losses and impairment. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the extent to which the fair value is less than cost. This determination requires significant judgment. In making this judgment, we employ a systematic methodology that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. In addition, we consider specific adverse conditions related to the financial health of, and business outlook for, the investee. If we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery, then a decline in fair value below cost is recorded as an impairment charge in other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Equity investments without readily determinable fair values are written down to fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than carrying value. We perform a qualitative assessment on a periodic basis. We are required to estimate the fair value of the investment to determine the amount of the impairment loss. Once an investment is determined to be impaired, an impairment charge is recorded in other income (expense), net.

Goodwill

We allocate goodwill to reporting units based on the reporting unit expected to benefit from the business combination. We evaluate our reporting units on an annual basis and, if necessary, reassign goodwill using a relative fair value allocation approach. Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated primarily through the use of a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur, and determination of our weighted average cost of capital.

The estimates used to calculate the fair value of a reporting unit change from year to year based on operating results, market conditions, and other factors. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit.

Research and Development Costs

Costs incurred internally in researching and developing a computer software product are charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, software costs are capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our software products is reached after all high-risk development issues have been resolved through coding and testing. Generally, this occurs shortly before the products are released to production. The amortization of these costs is included in cost of revenue over the estimated life of the products.

Legal and Other Contingencies

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our consolidated financial statements.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year, and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting literature also provides guidance on derecognition of income tax assets and liabilities, classification of deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our consolidated financial statements.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

CHANGE IN ACCOUNTING ESTIMATE

In July 2022, we completed an assessment of the useful lives of our server and network equipment. Due to investments in software that increased efficiencies in how we operate our server and network equipment, as well as advances in technology, we determined we should increase the estimated useful lives of both server and network equipment from four years to six years. This change in accounting estimate will be effective beginning fiscal year 2023. Based on the carrying amount of server and network equipment included in property and equipment, net as of June 30, 2022, it is estimated this change will increase our fiscal year 2023 operating income by $3.7 billion. We had previously increased the estimated useful lives of both server and network equipment in July 2020.

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

Management is responsible for the preparation of the consolidated financial statements and related information that are presented in this report. The consolidated financial statements, which include amounts based on management's estimates and judgments, have been prepared in conformity with accounting principles generally accepted in the United States of America.

The Company designs and maintains accounting and internal control systems to provide reasonable assurance at reasonable cost that assets are safeguarded against loss from unauthorized use or disposition, and that the financial records are reliable for preparing consolidated financial statements and maintaining accountability for assets. These systems are augmented by written policies, an organizational structure providing division of responsibilities, careful selection and training of qualified personnel, and a program of internal audits.

The Company engaged Deloitte & Touche LLP, an independent registered public accounting firm, to audit and render an opinion on the consolidated financial statements and internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Board of Directors, through its Audit Committee, consisting solely of independent directors of the Company, meets periodically with management, internal auditors, and our independent registered public accounting firm to ensure that each is meeting its responsibilities and to discuss matters concerning internal controls and financial reporting. Deloitte & Touche LLP and the internal auditors each have full and free access to the Audit Committee.

Satya Nadella
Chief Executive Officer

Amy E. Hood
Executive Vice President and Chief Financial Officer

Alice L. Jolla
Corporate Vice President and Chief Accounting Officer

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

RISKS

We are exposed to economic risk from foreign exchange rates, interest rates, credit risk, and equity prices. We use derivatives instruments to manage these risks, however, they may still impact our consolidated financial statements.

Foreign Currencies

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency positions, including hedges. Principal currency exposures include the Euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of the fixed-income portfolio to achieve economic returns that correlate to certain global fixed-income indices.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We manage credit exposures relative to broad-based indices and to facilitate portfolio diversification.

Equity

Securities held in our equity investments portfolio are subject to price risk.

SENSITIVITY ANALYSIS

The following table sets forth the potential loss in future earnings or fair values, including associated derivatives, resulting from hypothetical changes in relevant market rates or prices:

(In millions)

Risk Categories	**Hypothetical Change**	**June 30, 2022**	**Impact**
Foreign currency — Revenue	10% decrease in foreign exchange rates	**$ (6,822)**	Earnings
Foreign currency — Investments	10% decrease in foreign exchange rates	**(94)**	Fair Value
Interest rate	100 basis point increase in U.S. treasury interest rates	**(2,536)**	Fair Value
Credit	100 basis point increase in credit spreads	**(350)**	Fair Value
Equity	10% decrease in equity market prices	**(637)**	Earnings

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INCOME STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	2022	2021	2020
Revenue:			
Product	**$ 72,732**	$ 71,074	$ 68,041
Service and other	**125,538**	97,014	74,974
Total revenue	**198,270**	168,088	143,015
Cost of revenue:			
Product	**19,064**	18,219	16,017
Service and other	**43,586**	34,013	30,061
Total cost of revenue	**62,650**	52,232	46,078
Gross margin	**135,620**	115,856	96,937
Research and development	**24,512**	20,716	19,269
Sales and marketing	**21,825**	20,117	19,598
General and administrative	**5,900**	5,107	5,111
Operating income	**83,383**	69,916	52,959
Other income, net	**333**	1,186	77
Income before income taxes	**83,716**	71,102	53,036
Provision for income taxes	**10,978**	9,831	8,755
Net income	**$ 72,738**	$ 61,271	$ 44,281
Earnings per share:			
Basic	**$ 9.70**	$ 8.12	$ 5.82
Diluted	**$ 9.65**	$ 8.05	$ 5.76
Weighted average shares outstanding:			
Basic	**7,496**	7,547	7,610
Diluted	**7,540**	7,608	7,683

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Net income	**$ 72,738**	$ 61,271	$ 44,281
Other comprehensive income (loss), net of tax:			
Net change related to derivatives	**6**	19	(38)
Net change related to investments	**(5,360)**	(2,266)	3,990
Translation adjustments and other	**(1,146)**	873	(426)
Other comprehensive income (loss)	**(6,500)**	(1,374)	3,526
Comprehensive income	**$ 66,238**	$ 59,897	$ 47,807

Refer to accompanying notes.

BALANCE SHEETS

(In millions)

June 30,	**2022**	**2021**
Assets		
Current assets:		
Cash and cash equivalents	**$ 13,931**	$ 14,224
Short-term investments	**90,826**	116,110
Total cash, cash equivalents, and short-term investments	**104,757**	130,334
Accounts receivable, net of allowance for doubtful accounts of **$633** and $751	**44,261**	38,043
Inventories	**3,742**	2,636
Other current assets	**16,924**	13,393
Total current assets	**169,684**	184,406
Property and equipment, net of accumulated depreciation of **$59,660** and $51,351	**74,398**	59,715
Operating lease right-of-use assets	**13,148**	11,088
Equity investments	**6,891**	5,984
Goodwill	**67,524**	49,711
Intangible assets, net	**11,298**	7,800
Other long-term assets	**21,897**	15,075
Total assets	**$ 364,840**	$ 333,779
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**$ 19,000**	$ 15,163
Current portion of long-term debt	**2,749**	8,072
Accrued compensation	**10,661**	10,057
Short-term income taxes	**4,067**	2,174
Short-term unearned revenue	**45,538**	41,525
Other current liabilities	**13,067**	11,666
Total current liabilities	**95,082**	88,657
Long-term debt	**47,032**	50,074
Long-term income taxes	**26,069**	27,190
Long-term unearned revenue	**2,870**	2,616
Deferred income taxes	**230**	198
Operating lease liabilities	**11,489**	9,629
Other long-term liabilities	**15,526**	13,427
Total liabilities	**198,298**	191,791
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,464** and 7,519	**86,939**	83,111
Retained earnings	**84,281**	57,055
Accumulated other comprehensive income (loss)	**(4,678)**	1,822
Total stockholders' equity	**166,542**	141,988
Total liabilities and stockholders' equity	**$ 364,840**	$ 333,779

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions)

Year Ended June 30,	2022	2021	2020
Operations			
Net income	**$ 72,738**	$ 61,271	$ 44,281
Adjustments to reconcile net income to net cash from operations:			
Depreciation, amortization, and other	**14,460**	11,686	12,796
Stock-based compensation expense	**7,502**	6,118	5,289
Net recognized gains on investments and derivatives	**(409)**	(1,249)	(219)
Deferred income taxes	**(5,702)**	(150)	11
Changes in operating assets and liabilities:			
Accounts receivable	**(6,834)**	(6,481)	(2,577)
Inventories	**(1,123)**	(737)	168
Other current assets	**(709)**	(932)	(2,330)
Other long-term assets	**(2,805)**	(3,459)	(1,037)
Accounts payable	**2,943**	2,798	3,018
Unearned revenue	**5,109**	4,633	2,212
Income taxes	**696**	(2,309)	(3,631)
Other current liabilities	**2,344**	4,149	1,346
Other long-term liabilities	**825**	1,402	1,348
Net cash from operations	**89,035**	76,740	60,675
Financing			
Cash premium on debt exchange	**0**	(1,754)	(3,417)
Repayments of debt	**(9,023)**	(3,750)	(5,518)
Common stock issued	**1,841**	1,693	1,343
Common stock repurchased	**(32,696)**	(27,385)	(22,968)
Common stock cash dividends paid	**(18,135)**	(16,521)	(15,137)
Other, net	**(863)**	(769)	(334)
Net cash used in financing	**(58,876)**	(48,486)	(46,031)
Investing			
Additions to property and equipment	**(23,886)**	(20,622)	(15,441)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(22,038)**	(8,909)	(2,521)
Purchases of investments	**(26,456)**	(62,924)	(77,190)
Maturities of investments	**16,451**	51,792	66,449
Sales of investments	**28,443**	14,008	17,721
Other, net	**(2,825)**	(922)	(1,241)
Net cash used in investing	**(30,311)**	(27,577)	(12,223)
Effect of foreign exchange rates on cash and cash equivalents	**(141)**	(29)	(201)
Net change in cash and cash equivalents	**(293)**	648	2,220
Cash and cash equivalents, beginning of period	**14,224**	13,576	11,356
Cash and cash equivalents, end of period	**$ 13,931**	$ 14,224	$ 13,576

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	2022	2021	2020
Common stock and paid-in capital			
Balance, beginning of period	**$ 83,111**	$ 80,552	$ 78,520
Common stock issued	**1,841**	1,963	1,343
Common stock repurchased	**(5,688)**	(5,539)	(4,599)
Stock-based compensation expense	**7,502**	6,118	5,289
Other, net	**173**	17	(1)
Balance, end of period	**86,939**	83,111	80,552
Retained earnings			
Balance, beginning of period	**57,055**	34,566	24,150
Net income	**72,738**	61,271	44,281
Common stock cash dividends	**(18,552)**	(16,871)	(15,483)
Common stock repurchased	**(26,960)**	(21,879)	(18,382)
Cumulative effect of accounting changes	**0**	(32)	0
Balance, end of period	**84,281**	57,055	34,566
Accumulated other comprehensive income (loss)			
Balance, beginning of period	**1,822**	3,186	(340)
Other comprehensive income (loss)	**(6,500)**	(1,374)	3,526
Cumulative effect of accounting changes	**0**	10	0
Balance, end of period	**(4,678)**	1,822	3,186
Total stockholders' equity	**$ 166,542**	$ 141,988	$ 118,304
Cash dividends declared per common share	**$ 2.48**	$ 2.24	$ 2.04

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP").

We have recast certain prior period amounts to conform to the current period presentation. The recast of these prior period amounts had no impact on our consolidated balance sheets, consolidated income statements, or consolidated cash flows statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Microsoft Corporation and its subsidiaries. Intercompany transactions and balances have been eliminated.

Estimates and Assumptions

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates and assumptions include: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price ("SSP") of performance obligations, variable consideration, and other obligations such as product returns and refunds; loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized in our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management's estimates and assumptions due to risks and uncertainties.

In July 2022, we completed an assessment of the useful lives of our server and network equipment. Due to investments in software that increased efficiencies in how we operate our server and network equipment, as well as advances in technology, we determined we should increase the estimated useful lives of both server and network equipment from four years to six years. This change in accounting estimate will be effective beginning fiscal year 2023. We had previously increased the estimated useful lives of both server and network equipment in July 2020.

Foreign Currencies

Assets and liabilities recorded in foreign currencies are translated at the exchange rate on the balance sheet date. Revenue and expenses are translated at average rates of exchange prevailing during the year. Translation adjustments resulting from this process are recorded to other comprehensive income.

Revenue

Product Revenue and Service and Other Revenue

Product revenue includes sales from operating systems, cross-device productivity applications, server applications, business solution applications, desktop and server management tools, software development tools, video games, and hardware such as PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

Service and other revenue includes sales from cloud-based solutions that provide customers with software, services, platforms, and content such as Office 365, Azure, Dynamics 365, and Xbox; solution support; and consulting services. Service and other revenue also includes sales from online advertising and LinkedIn.

Revenue Recognition

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Nature of Products and Services

Licenses for on-premises software provide the customer with a right to use the software as it exists when made available to the customer. Customers may purchase perpetual licenses or subscribe to licenses, which provide customers with the same functionality and differ mainly in the duration over which the customer benefits from the software. Revenue from distinct on-premises licenses is recognized upfront at the point in time when the software is made available to the customer. In cases where we allocate revenue to software updates, primarily because the updates are provided at no additional charge, revenue is recognized as the updates are provided, which is generally ratably over the estimated life of the related device or license.

Certain volume licensing programs, including Enterprise Agreements, include on-premises licenses combined with Software Assurance (“SA”). SA conveys rights to new software and upgrades released over the contract period and provides support, tools, and training to help customers deploy and use products more efficiently. On-premises licenses are considered distinct performance obligations when sold with SA. Revenue allocated to SA is generally recognized ratably over the contract period as customers simultaneously consume and receive benefits, given that SA comprises distinct performance obligations that are satisfied over time.

Cloud services, which allow customers to use hosted software over the contract period without taking possession of the software, are provided on either a subscription or consumption basis. Revenue related to cloud services provided on a subscription basis is recognized ratably over the contract period. Revenue related to cloud services provided on a consumption basis, such as the amount of storage used in a period, is recognized based on the customer utilization of such resources. When cloud services require a significant level of integration and interdependency with software and the individual components are not considered distinct, all revenue is recognized over the period in which the cloud services are provided.

Revenue from search advertising is recognized when the advertisement appears in the search results or when the action necessary to earn the revenue has been completed. Revenue from consulting services is recognized as services are provided.

Our hardware is generally highly dependent on, and interrelated with, the underlying operating system and cannot function without the operating system. In these cases, the hardware and software license are accounted for as a single performance obligation and revenue is recognized at the point in time when ownership is transferred to resellers or directly to end customers through retail stores and online marketplaces.

Refer to Note 19 – Segment Information and Geographic Data for further information, including revenue by significant product and service offering.

Significant Judgments

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the SSP for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Contract Balances and Other Receivables

Timing of revenue recognition may differ from the timing of invoicing to customers. We record a receivable when revenue is recognized prior to invoicing, or unearned revenue when revenue is recognized subsequent to invoicing. For multi-year agreements, we generally invoice customers annually at the beginning of each annual coverage period. We record a receivable related to revenue recognized for multi-year on-premises licenses as we have an unconditional right to invoice and receive payment in the future related to those licenses.

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include SA and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for consulting services to be performed in the future, LinkedIn subscriptions, Office 365 subscriptions, Xbox subscriptions, Windows post-delivery support, Dynamics business solutions, and other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service.

Refer to Note 13 – Unearned Revenue for further information, including unearned revenue by segment and changes in unearned revenue during the period.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers or to provide customers with financing. Examples include invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and multi-year on-premises licenses that are invoiced annually with revenue recognized upfront.

As of June 30, 2022 and 2021, other receivables due from suppliers were $1.0 billion and $965 million, respectively, and are included in accounts receivable, net in our consolidated balance sheets.

As of June 30, 2022 and 2021, long-term accounts receivable, net of allowance for doubtful accounts, was $3.8 billion and $3.4 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

Activity in the allowance for doubtful accounts was as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Balance, beginning of period	**$ 798**	$ 816	$ 434
Charged to costs and other	**157**	234	560
Write-offs	**(245)**	(252)	(178)
Balance, end of period	**$ 710**	$ 798	$ 816

Allowance for doubtful accounts included in our consolidated balance sheets:

(In millions)

June 30,	**2022**	**2021**	**2020**
Accounts receivable, net of allowance for doubtful accounts	**$ 633**	$ 751	$ 788
Other long-term assets	**77**	47	28
Total	**$ 710**	$ 798	$ 816

We record financing receivables when we offer certain of our customers the option to acquire our software products and services offerings through a financing program in a limited number of countries. As of June 30, 2022 and 2021, our financing receivables, net were $4.1 billion and $4.4 billion, respectively, for short-term and long-term financing receivables, which are included in other current assets and other long-term assets in our consolidated balance sheets. We record an allowance to cover expected losses based on troubled accounts, historical experience, and other currently available evidence.

Assets Recognized from Costs to Obtain a Contract with a Customer

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We have determined that certain sales incentive programs meet the requirements to be capitalized. Total capitalized costs to obtain a contract were immaterial during the periods presented and are included in other current and long-term assets in our consolidated balance sheets.

We apply a practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less. These costs include our internal sales force compensation program and certain partner sales incentive programs as we have determined annual compensation is commensurate with annual sales activities.

Cost of Revenue

Cost of revenue includes: manufacturing and distribution costs for products sold and programs licensed; operating costs related to product support service centers and product distribution centers; costs incurred to include software on PCs sold by original equipment manufacturers (“OEM”), to drive traffic to our websites, and to acquire online advertising space; costs incurred to support and maintain online products and services, including datacenter costs and royalties; warranty costs; inventory valuation adjustments; costs associated with the delivery of consulting services; and the amortization of capitalized software development costs. Capitalized software development costs are amortized over the estimated lives of the products.

Product Warranty

We provide for the estimated costs of fulfilling our obligations under hardware and software warranties at the time the related revenue is recognized. For hardware warranties, we estimate the costs based on historical and projected product failure rates, historical and projected repair costs, and knowledge of specific product failures (if any). The specific hardware warranty terms and conditions vary depending upon the product sold and the country in which we do business, but generally include parts and labor over a period generally ranging from 90 days to three years. For software warranties, we estimate the costs to provide bug fixes, such as security patches, over the estimated life of the software. We regularly reevaluate our estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

Research and Development

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content. Such costs related to software development are included in research and development expense until the point that technological feasibility is reached, which for our software products, is generally shortly before the products are released to production. Once technological feasibility is reached, such costs are capitalized and amortized to cost of revenue over the estimated lives of the products.

Sales and Marketing

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs. Advertising costs are expensed as incurred. Advertising expense was $1.5 billion, $1.5 billion, and $1.6 billion in fiscal years 2022, 2021, and 2020, respectively.

Stock-Based Compensation

Compensation cost for stock awards, which include restricted stock units ("RSUs") and performance stock units ("PSUs"), is measured at the fair value on the grant date and recognized as expense, net of estimated forfeitures, over the related service or performance period. The fair value of stock awards is based on the quoted price of our common stock on the grant date less the present value of expected dividends not received during the vesting period. We measure the fair value of PSUs using a Monte Carlo valuation model. Compensation cost for RSUs is recognized using the straight-line method and for PSUs is recognized using the accelerated method.

Compensation expense for the employee stock purchase plan ("ESPP") is measured as the discount the employee is entitled to upon purchase and is recognized in the period of purchase.

Income Taxes

Income tax expense includes U.S. and international income taxes, and interest and penalties on uncertain tax positions. Certain income and expenses are not reported in tax returns and financial statements in the same year. The tax effect of such temporary differences is reported as deferred income taxes. Deferred tax assets are reported net of a valuation allowance when it is more likely than not that a tax benefit will not be realized. All deferred income taxes are classified as long-term in our consolidated balance sheets.

Financial Instruments

Investments

We consider all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. The fair values of these investments approximate their carrying values. In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations.

Debt investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in fair value, excluding credit losses and impairments, are recorded in other comprehensive income. Fair value is calculated based on publicly available market information or other estimates determined by management. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the extent to which the fair value is less than cost. To determine credit losses, we employ a systematic methodology that considers available quantitative and qualitative evidence. In addition, we consider specific adverse conditions related to the financial health of, and business outlook for, the investee. If we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery, then a decline in fair value below cost is recorded as an impairment charge in other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Equity investments with readily determinable fair values are measured at fair value. Equity investments without readily determinable fair values are measured using the equity method or measured at cost with adjustments for observable changes in price or impairments (referred to as the measurement alternative). We perform a qualitative assessment on a periodic basis and recognize an impairment if there are sufficient indicators that the fair value of the investment is less than carrying value. Changes in value are recorded in other income (expense), net.

Derivatives

Derivative instruments are recognized as either assets or liabilities and measured at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

For derivative instruments designated as fair value hedges, gains and losses are recognized in other income (expense), net with offsetting gains and losses on the hedged items. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in other income (expense), net.

For derivative instruments designated as cash flow hedges, gains and losses are initially reported as a component of other comprehensive income and subsequently recognized in other income (expense), net with the corresponding hedged item. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in other income (expense), net.

For derivative instruments that are not designated as hedges, gains and losses from changes in fair values are primarily recognized in other income (expense), net.

Fair Value Measurements

We account for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. We categorize each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 investments include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.
- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 investments include commercial paper, certificates of deposit,

U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Our Level 2 derivative assets and liabilities include certain over-the-counter forward, option, and swap contracts.

- *Level 3* – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 assets and liabilities include investments in corporate notes and bonds, municipal securities, and goodwill and intangible assets, when they are recorded at fair value due to an impairment charge. Unobservable inputs used in the models are significant to the fair values of the assets and liabilities.

We measure equity investments without readily determinable fair values on a nonrecurring basis. The fair values of these investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections.

Our other current financial assets and current financial liabilities have fair values that approximate their carrying values.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation, and depreciated using the straight-line method over the shorter of the estimated useful life of the asset or the lease term. The estimated useful lives of our property and equipment are generally as follows: computer software developed or acquired for internal use, three to seven years; computer equipment, two to four years; buildings and improvements, five to 15 years; leasehold improvements, three to 20 years; and furniture and equipment, one to 10 years. Land is not depreciated.

Leases

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities in our consolidated balance sheets. Finance leases are included in property and equipment, other current liabilities, and other long-term liabilities in our consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we generally use our incremental borrowing rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

We have lease agreements with lease and non-lease components, which are generally accounted for separately. For certain equipment leases, such as vehicles, we account for the lease and non-lease components as a single lease component. Additionally, for certain equipment leases, we apply a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Goodwill

Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value.

Intangible Assets

Our intangible assets are subject to amortization and are amortized using the straight-line method over their estimated period of benefit, ranging from one to 20 years. We evaluate the recoverability of intangible assets periodically by taking into account events or circumstances that may warrant revised estimates of useful lives or that indicate the asset may be impaired.

Recent Accounting Guidance

Accounting for Income Taxes

In December 2019, the Financial Accounting Standards Board issued a new standard to simplify the accounting for income taxes. The guidance eliminates certain exceptions related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period, and the recognition of deferred tax liabilities for outside basis differences related to changes in ownership of equity method investments and foreign subsidiaries. The guidance also simplifies aspects of accounting for franchise taxes and enacted changes in tax laws or rates and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. We adopted the standard effective July 1, 2021. Adoption of the standard did not have a material impact on our consolidated financial statements.

NOTE 2 — EARNINGS PER SHARE

Basic earnings per share (“EPS”) is computed based on the weighted average number of shares of common stock outstanding during the period. Diluted EPS is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and stock awards.

The components of basic and diluted EPS were as follows:

(In millions, except earnings per share)

Year Ended June 30,	**2022**	**2021**	**2020**
Net income available for common shareholders (A)	**$ 72,738**	$ 61,271	$ 44,281
Weighted average outstanding shares of common stock (B)	**7,496**	7,547	7,610
Dilutive effect of stock-based awards	**44**	61	73
Common stock and common stock equivalents (C)	**7,540**	7,608	7,683
Earnings Per Share			
Basic (A/B)	**$ 9.70**	$ 8.12	$ 5.82
Diluted (A/C)	**$ 9.65**	$ 8.05	$ 5.76

Anti-dilutive stock-based awards excluded from the calculations of diluted EPS were immaterial during the periods presented.

NOTE 3 — OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Interest and dividends income	**$ 2,094**	$ 2,131	$ 2,680

Interest expense	**(2,063)**	(2,346)	(2,591)
Net recognized gains on investments	**461**	1,232	32
Net gains (losses) on derivatives	**(52)**	17	187
Net gains (losses) on foreign currency remeasurements	**(75)**	54	(191)
Other, net	**(32)**	98	(40)
Total	**$ 333**	$ 1,186	$ 77

Net Recognized Gains (Losses) on Investments

Net recognized gains (losses) on debt investments were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Realized gains from sales of available-for-sale securities	**$ 162**	$ 105	$ 50
Realized losses from sales of available-for-sale securities	**(138)**	(40)	(37)
Impairments and allowance for credit losses	**(81)**	(2)	(17)
Total	**$ (57)**	$ 63	$ (4)

Net recognized gains (losses) on equity investments were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Net realized gains on investments sold	**$ 29**	$ 123	$ 83
Net unrealized gains on investments still held	**509**	1,057	69
Impairments of investments	**(20)**	(11)	(116)
Total	**$ 518**	$ 1,169	$ 36

NOTE 4 — INVESTMENTS

Investment Components

The components of investments were as follows:

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2022								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 2,500	$ 0	$ 0	$ 2,500	$ 2,498	$ 2	$ 0
Certificates of deposit	Level 2	2,071	0	0	2,071	2,032	39	0
U.S. government securities	Level 1	79,696	29	(2,178)	77,547	9	77,538	0
U.S. agency securities	Level 2	419	0	(9)	410	0	410	0
Foreign government bonds	Level 2	506	0	(24)	482	0	482	0
Mortgage- and asset-backed securities	Level 2	727	1	(30)	698	0	698	0
Corporate notes and bonds	Level 2	11,661	4	(554)	11,111	0	11,111	0
Corporate notes and bonds	Level 3	67	0	0	67	0	67	0
Municipal securities	Level 2	368	19	(13)	374	0	374	0
Municipal securities	Level 3	103	0	(6)	97	0	97	0
Total debt investments		$ 98,118	$ 53	$ (2,814)	$ 95,357	$ 4,539	$ 90,818	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 1,590	$ 1,134	$ 0	$ 456
Equity investments	Other				6,435	0	0	6,435
Total equity investments					$ 8,025	$ 1,134	$ 0	$ 6,891
Cash					$ 8,258	$ 8,258	$ 0	$ 0
Derivatives, net (a)					8	0	8	0
Total					$ 111,648	$ 13,931	$ 90,826	$ 6,891

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-Investm
June 30, 2021							
Changes in Fair Value Recorded in Other Comprehensive Income							
Commercial paper	Level 2	$ 4,316	$ 0	$ 0	$ 4,316	$ 1,331	$ 2,
Certificates of deposit	Level 2	3,615	0	0	3,615	2,920	
U.S. government securities	Level 1	90,664	3,832	(111)	94,385	1,500	92,
U.S. agency securities	Level 2	807	2	0	809	0	
Foreign government bonds	Level 2	6,213	9	(2)	6,220	225	5,
Mortgage- and asset-backed securities	Level 2	3,442	22	(6)	3,458	0	3,
Corporate notes and bonds	Level 2	8,443	249	(9)	8,683	0	8,
Corporate notes and bonds	Level 3	63	0	0	63	0	
Municipal securities	Level 2	308	63	0	371	0	
Municipal securities	Level 3	95	0	(7)	88	0	
Total debt investments		$ 117,966	$ 4,177	$ (135)	$ 122,008	$ 5,976	$ 116,
Changes in Fair Value Recorded in Net Income							
Equity investments	Level 1				$ 1,582	$ 976	$
Equity investments	Other				5,378	0	
Total equity investments					$ 6,960	$ 976	$
Cash					$ 7,272	$ 7,272	$
Derivatives, net (a)					78	0	
Total					$ 136,318	$ 14,224	$ 116

(a) *Refer to Note 5 – Derivatives for further information on the fair value of our derivative instruments.*

Equity investments presented as “Other” in the tables above include investments without readily determinable fair values measured using the equity method or measured at cost with adjustments for observable changes in price or impairments, and investments measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of June 30, 2022 and 2021, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $3.8 billion and $3.3 billion, respectively.

Unrealized Losses on Debt Investments

Debt investments with continuous unrealized losses for less than 12 months and 12 months or greater and their related fair values were as follows:

	Less than 12 Months		12 Months or Greater			
(In millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2022						
U.S. government and agency securities	$ 59,092	$ (1,835)	$ 2,210	$ (352)	$ 61,302	$ (2,187)
Foreign government bonds	418	(18)	27	(6)	445	(24)
Mortgage- and asset-backed securities	510	(26)	41	(4)	551	(30)
Corporate notes and bonds	9,443	(477)	786	(77)	10,229	(554)
Municipal securities	178	(12)	74	(7)	252	(19)
Total	$ 69,641	$ (2,368)	$ 3,138	$ (446)	$ 72,779	$ (2,814)

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2021						
U.S. government and agency securities	$ 5,294	$ (111)	$ 0	$ 0	$ 5,294	$ (111)
Foreign government bonds	3,148	(1)	5	(1)	3,153	(2)
Mortgage- and asset-backed securities	1,211	(5)	87	(1)	1,298	(6)
Corporate notes and bonds	1,678	(8)	34	(1)	1,712	(9)
Municipal securities	58	(7)	1	0	59	(7)
Total	$ 11,389	$ (132)	$ 127	$ (3)	$ 11,516	$ (135)

Unrealized losses from fixed-income securities are primarily attributable to changes in interest rates. Management does not believe any remaining unrealized losses represent impairments based on our evaluation of available evidence.

Debt Investment Maturities

(In millions)	Adjusted Cost Basis	Estimated Fair Value
June 30, 2022		
Due in one year or less	**$ 26,480**	**$ 26,470**
Due after one year through five years	**52,006**	**50,748**
Due after five years through 10 years	**18,274**	**16,880**
Due after 10 years	**1,358**	**1,259**
Total	**$ 98,118**	**$ 95,357**

NOTE 5 — DERIVATIVES

We use derivative instruments to manage risks related to foreign currencies, interest rates, equity prices, and credit; to enhance investment returns; and to facilitate portfolio diversification. Our objectives for holding derivatives include reducing, eliminating, and efficiently managing the economic impact of these exposures as effectively as possible. Our derivative programs include strategies that both qualify and do not qualify for hedge accounting treatment.

Foreign Currencies

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions.

Foreign currency risks related to certain non-U.S. dollar-denominated investments are hedged using foreign exchange forward contracts that are designated as fair value hedging instruments. Foreign currency risks related to certain Euro-denominated debt are hedged using foreign exchange forward contracts that are designated as cash flow hedging instruments.

Certain options and forwards not designated as hedging instruments are also used to manage the variability in foreign exchange rates on certain balance sheet amounts and to manage other foreign currency exposures.

Interest Rate

Interest rate risks related to certain fixed-rate debt are hedged using interest rate swaps that are designated as fair value hedging instruments to effectively convert the fixed interest rates to floating interest rates.

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using exchange-traded option and futures contracts and over-the-counter swap and option contracts. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Equity

Securities held in our equity investments portfolio are subject to market price risk. At times, we may hold options, futures, and swap contracts. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Credit-Risk-Related Contingent Features

Certain of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of June 30, 2022, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

The following table presents the notional amounts of our outstanding derivative instruments measured in U.S. dollar equivalents:

(In millions)	June 30, 2022	June 30, 2021
Designated as Hedging Instruments		
Foreign exchange contracts purchased	**$ 635**	$ 635
Foreign exchange contracts sold	**0**	6,081
Interest rate contracts purchased	**1,139**	1,247
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**10,322**	14,223
Foreign exchange contracts sold	**21,606**	23,391
Other contracts purchased	**2,773**	2,456
Other contracts sold	**544**	763

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		June 30, 2022		June 30, 2021
Designated as Hedging Instruments				
Foreign exchange contracts	**$ 0**	**$ (77)**	$ 76	$ (8)
Interest rate contracts	**3**	**0**	40	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**333**	**(362)**	227	(291)
Other contracts	**20**	**(112)**	56	(36)
Gross amounts of derivatives	**356**	**(551)**	399	(335)
Gross amounts of derivatives offset in the balance sheet	**(130)**	**133**	(141)	142
Cash collateral received	**0**	**(75)**	0	(42)
Net amounts of derivatives	**$ 226**	**$ (493)**	$ 258	$ (235)
Reported as				
Short-term investments	**$ 8**	**$ 0**	$ 78	$ 0
Other current assets	**218**	**0**	137	0
Other long-term assets	**0**	**0**	43	0
Other current liabilities	**0**	**(298)**	0	(182)
Other long-term liabilities	**0**	**(195)**	0	(53)
Total	**$ 226**	**$ (493)**	$ 258	$ (235)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $343 million and $550 million, respectively, as of June 30, 2022, and $395 million and $335 million, respectively, as of June 30, 2021.

The following table presents the fair value of our derivatives instruments on a gross basis:

(In millions)	Level 1	Level 2	Level 3	Total
June 30, 2022				
Derivative assets	**$ 1**	**$ 349**	**$ 6**	**$ 356**
Derivative liabilities	**0**	**(551)**	**0**	**(551)**
June 30, 2021				
Derivative assets	0	396	3	399
Derivative liabilities	0	(335)	0	(335)

Gains (losses) on derivative instruments recognized in other income (expense), net were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Designated as Fair Value Hedging Instruments			
Foreign exchange contracts			
Derivatives	**$ 49**	$ 193	$ 1
Hedged items	**(50)**	(188)	3
Excluded from effectiveness assessment	**4**	30	139
Interest rate contracts			
Derivatives	**(92)**	(37)	93
Hedged items	**108**	53	(93)
Designated as Cash Flow Hedging Instruments			
Foreign exchange contracts			
Amount reclassified from accumulated other comprehensive income	**(79)**	17	0
Not Designated as Hedging Instruments			
Foreign exchange contracts	**383**	27	(123)
Other contracts	**(72)**	9	50

Gains (losses), net of tax, on derivative instruments recognized in our consolidated comprehensive income statements were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Designated as Cash Flow Hedging Instruments			
Foreign exchange contracts			
Included in effectiveness assessment	**$ (57)**	$ 34	$ (38)

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)

June 30,	**2022**	**2021**
Raw materials	**$ 1,144**	$ 1,190
Work in process	**82**	79
Finished goods	**2,516**	1,367
Total	**$ 3,742**	$ 2,636

NOTE 7 — PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

(In millions)

June 30,	2022	2021
Land	**$ 4,734**	$ 3,660
Buildings and improvements	**55,014**	43,928
Leasehold improvements	**7,819**	6,884
Computer equipment and software	**60,631**	51,250
Furniture and equipment	**5,860**	5,344
Total, at cost	**134,058**	111,066
Accumulated depreciation	**(59,660)**	(51,351)
Total, net	**$ 74,398**	$ 59,715

During fiscal years 2022, 2021, and 2020, depreciation expense was $12.6 billion, $9.3 billion, and $10.7 billion, respectively. We have committed $8.5 billion, primarily related to datacenters, for the construction of new buildings, building improvements, and leasehold improvements as of June 30, 2022.

NOTE 8 — BUSINESS COMBINATIONS

Nuance Communications, Inc.

On March 4, 2022, we completed our acquisition of Nuance Communications, Inc. ("Nuance") for a total purchase price of $18.8 billion, consisting primarily of cash. Nuance is a cloud and artificial intelligence ("AI") software provider with healthcare and enterprise AI experience, and the acquisition will build on our industry-specific cloud offerings. The financial results of Nuance have been included in our consolidated financial statements since the date of the acquisition. Nuance is reported as part of our Intelligent Cloud segment.

The purchase price allocation as of the date of acquisition was based on a preliminary valuation and is subject to revision as more detailed analyses are completed and additional information about the fair value of assets acquired and liabilities assumed becomes available.

The major classes of assets and liabilities to which we have preliminarily allocated the purchase price were as follows:

(In millions)

Goodwill (a)	$ 16,308
Intangible assets	4,365
Other assets	59
Other liabilities (b)	(1,971)
Total	$ 18,761

(a) *Goodwill was assigned to our Intelligent Cloud segment and was primarily attributed to increased synergies that are expected to be achieved from the integration of Nuance. None of the goodwill is expected to be deductible for income tax purposes.*

(b) *Includes $986 million of convertible senior notes issued by Nuance in 2015 and 2017, of which $985 million was redeemed prior to June 30, 2022. The remaining $1 million of notes are redeemable* *through their respective maturity dates and are included in other current liabilities on our consolidated balance sheets as of June 30, 2022.*

Following are the details of the purchase price allocated to the intangible assets acquired:

(In millions, except average life)		Amount	Weighted Average Life
Customer-related	$	2,610	9 years
Technology-based		1,540	5 years
Marketing-related		215	4 years
Total	$	4,365	7 years

ZeniMax Media Inc.

On March 9, 2021, we completed our acquisition of ZeniMax Media Inc. (“ZeniMax”), the parent company of Bethesda Softworks LLC (“Bethesda”), for a total purchase price of $8.1 billion, consisting primarily of cash. The purchase price included $766 million of cash and cash equivalents acquired. Bethesda is one of the largest, privately held game developers and publishers in the world, and brings a broad portfolio of games, technology, and talent to Xbox. The financial results of ZeniMax have been included in our consolidated financial statements since the date of the acquisition. ZeniMax is reported as part of our More Personal Computing segment.

The allocation of the purchase price to goodwill was completed as of December 31, 2021. The major classes of assets and liabilities to which we have allocated the purchase price were as follows:

(In millions)		
Cash and cash equivalents	$	766
Goodwill		5,510
Intangible assets		1,968
Other assets		121
Other liabilities		(244)
Total	$	8,121

Goodwill was assigned to our More Personal Computing segment. The goodwill was primarily attributed to increased synergies that are expected to be achieved from the integration of ZeniMax. None of the goodwill is expected to be deductible for income tax purposes.

Following are details of the purchase price allocated to the intangible assets acquired:

(In millions, except average life)		Amount	Weighted Average Life
Technology-based	$	1,341	4 years
Marketing-related		627	11 years
Total	$	1,968	6 years

Activision Blizzard, Inc.

On January 18, 2022, we entered into a definitive agreement to acquire Activision Blizzard, Inc. (“Activision Blizzard”) for $95.00 per share in an all-cash transaction valued at $68.7 billion, inclusive of Activision Blizzard’s net cash. Activision Blizzard is a leader in game development and an interactive entertainment content publisher. The acquisition will accelerate the growth in our gaming business across mobile, PC, console, and cloud and will provide building blocks for the metaverse. The acquisition has been approved by Activision Blizzard’s shareholders, and we expect it to close in fiscal year 2023, subject to the satisfaction of certain regulatory approvals and other customary closing conditions.

NOTE 9 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	June 30, 2020	Acquisitions		Other		June 30, 2021	Acquisitions		Other		June 30, 2022
Productivity and Business Processes	$ 24,190	$ 0		$ 127		**$ 24,317**	**$ 599**		**$ (105)**		**$ 24,811**
Intelligent Cloud	12,697	505		54		**13,256**	**16,879**	**(b)**	**47**	**(b)**	**30,182**
More Personal Computing	6,464	5,556	(a)	118	(a)	**12,138**	**648**		**(255)**		**12,531**
Total	$ 43,351	$ 6,061		$ 299		**$ 49,711**	**$ 18,126**		**$ (313)**		**$ 67,524**

(a) *Includes goodwill of $5.5 billion related to ZeniMax. See Note 8 – Business Combinations for further information*.

(b) *Includes goodwill of $16.3 billion related to Nuance. See Note 8 – Business Combinations for further information.*

The measurement periods for the valuation of assets acquired and liabilities assumed end as soon as information on the facts and circumstances that existed as of the acquisition dates becomes available, but do not exceed 12 months. Adjustments in purchase price allocations may require a change in the amounts allocated to goodwill during the periods in which the adjustments are determined.

Any change in the goodwill amounts resulting from foreign currency translations and purchase accounting adjustments are presented as "Other" in the table above. Also included in "Other" are business dispositions and transfers between segments due to reorganizations, as applicable.

Goodwill Impairment

We test goodwill for impairment annually on May 1 at the reporting unit level, primarily using a discounted cash flow methodology with a peer-based, risk-adjusted weighted average cost of capital. We believe use of a discounted cash flow approach is the most reliable indicator of the fair values of the businesses.

No instances of impairment were identified in our May 1, 2022, May 1, 2021, or May 1, 2020 tests. As of June 30, 2022 and 2021, accumulated goodwill impairment was $11.3 billion.

NOTE 10 — INTANGIBLE ASSETS

The components of intangible assets, all of which are finite-lived, were as follows:

(In millions)	Gross Carrying Amount		Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount		Accumulated Amortization	Net Carrying Amount
June 30,				**2022**				**2021**
Technology-based	**$ 11,277**		**$ (6,958)**	**$ 4,319**	$ 9,779		$ (7,007)	$ 2,772
Customer-related	**7,342**		**(3,171)**	**4,171**	4,958		(2,859)	2,099
Marketing-related	**4,942**		**(2,143)**	**2,799**	4,792		(1,878)	2,914
Contract-based	**16**		**(7)**	**9**	446		(431)	15
Total	**$ 23,577**	**(a)**	**$ (12,279)**	**$ 11,298**	$ 19,975	(b)	$ (12,175)	$ 7,800

(a) *Includes intangible assets of $4.4 billion related to Nuance. See Note 8 – Business Combinations for further information.*

(b)

Includes intangible assets of $2.0 billion related to ZeniMax. See Note 8 – Business Combinations for further information.

No material impairments of intangible assets were identified during fiscal years 2022, 2021, or 2020. We estimate that we have no significant residual value related to our intangible assets.

The components of intangible assets acquired during the periods presented were as follows:

(In millions)	Amount	Weighted Average Life	Amount	Weighted Average Life
Year Ended June 30,	2022		2021	
Technology-based	$ **2,611**	**4 years**	$ 1,628	4 years
Customer-related	**2,837**	**9 years**	96	4 years
Marketing-related	**233**	**4 years**	625	6 years
Contract-based	**0**	**0 years**	10	3 years
Total	$ **5,681**	**7 years**	$ 2,359	5 years

Intangible assets amortization expense was $2.0 billion, $1.6 billion, and $1.6 billion for fiscal years 2022, 2021, and 2020, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of June 30, 2022:

(In millions)	
Year Ending June 30,	
2023	$ **2,654**
2024	**2,385**
2025	**1,631**
2026	**1,227**
2027	**809**
Thereafter	**2,592**
Total	$ **11,298**

NOTE 11 — DEBT

The components of debt were as follows:

(In millions, issuance by calendar year)	Maturities (calendar year)	Stated Interest Rate	Effective Interest Rate	June 30, 2022	June 30, 2021
2009 issuance of $3.8 billion (a)	**2039**	**5.20%**	**5.24%**	**$ 520**	$ 520
2010 issuance of $4.8 billion (a)	**2040**	**4.50%**	**4.57%**	**486**	486
2011 issuance of $2.3 billion (a)	**2041**	**5.30%**	**5.36%**	**718**	718
2012 issuance of $2.3 billion (a)	**2022 – 2042**	**2.13% – 3.50%**	**2.24% – 3.57%**	**1,204**	1,204
2013 issuance of $5.2 billion (a)	**2023 – 2043**	**2.38% – 4.88%**	**2.47% – 4.92%**	**2,814**	2,814
2013 issuance of €4.1 billion	**2028 – 2033**	**2.63% – 3.13%**	**2.69% – 3.22%**	**2,404**	4,803
2015 issuance of $23.8 billion (a)	**2022 – 2055**	**2.65% – 4.75%**	**2.72% – 4.78%**	**10,805**	12,305
2016 issuance of $19.8 billion (a)	**2023 – 2056**	**2.00% – 3.95%**	**2.10% – 4.03%**	**9,430**	12,180
2017 issuance of $17.0 billion (a)	**2024 – 2057**	**2.88% – 4.50%**	**3.04% – 4.53%**	**8,945**	10,695
2020 issuance of $10.0 billion (a)	**2050 – 2060**	**2.53% – 2.68%**	**2.53% – 2.68%**	**10,000**	10,000
2021 issuance of $8.2 billion (a)	**2052 – 2062**	**2.92% – 3.04%**	**2.92% – 3.04%**	**8,185**	8,185
Total face value				**55,511**	63,910
Unamortized discount and issuance costs				**(471)**	(511)
Hedge fair value adjustments (b)				**(68)**	40
Premium on debt exchange (a)				**(5,191)**	(5,293)
Total debt				**49,781**	58,146
Current portion of long-term debt				**(2,749)**	(8,072)
Long-term debt				**$ 47,032**	$ 50,074

(a) *In March 2021 and June 2020, we exchanged a portion of our existing debt at a premium for cash and new debt with longer maturities. The premiums are amortized over the terms of the new debt.*

(b) *Refer to Note 5 – Derivatives for further information on the interest rate swaps related to fixed-rate debt.*

As of June 30, 2022 and 2021, the estimated fair value of long-term debt, including the current portion, was $50.9 billion and $70.0 billion, respectively. The estimated fair values are based on Level 2 inputs.

Debt in the table above is comprised of senior unsecured obligations and ranks equally with our other outstanding obligations. Interest is paid semi-annually, except for the Euro-denominated debt, which is paid annually. Cash paid for interest on our debt for fiscal years 2022, 2021, and 2020 was $1.9 billion, $2.0 billion, and $2.4 billion, respectively.

The following table outlines maturities of our long-term debt, including the current portion, as of June 30, 2022:

(In millions)

Year Ending June 30,		
2023	$	**2,750**
2024		**5,250**
2025		**2,250**
2026		**3,000**
2027		**8,000**
Thereafter		**34,261**
Total	$	**55,511**

NOTE 12 — INCOME TAXES

Provision for Income Taxes

The components of the provision for income taxes were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Current Taxes			
U.S. federal	**$ 8,329**	$ 3,285	$ 3,537
U.S. state and local	**1,679**	1,229	763
Foreign	**6,672**	5,467	4,444
Current taxes	**$ 16,680**	$ 9,981	$ 8,744
Deferred Taxes			
U.S. federal	**$ (4,815)**	$ 25	$ 58
U.S. state and local	**(1,062)**	(204)	(6)
Foreign	**175**	29	(41)
Deferred taxes	**$ (5,702)**	$ (150)	$ 11
Provision for income taxes	**$ 10,978**	$ 9,831	$ 8,755

U.S. and foreign components of income before income taxes were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
U.S.	**$ 47,837**	$ 34,972	$ 24,116
Foreign	**35,879**	36,130	28,920
Income before income taxes	**$ 83,716**	$ 71,102	$ 53,036

Effective Tax Rate

The items accounting for the difference between income taxes computed at the U.S. federal statutory rate and our effective rate were as follows:

Year Ended June 30,	**2022**	**2021**	**2020**
Federal statutory rate	**21.0%**	21.0%	21.0%
Effect of:			
Foreign earnings taxed at lower rates	**(1.3)%**	(2.7)%	(3.7)%
Impact of intangible property transfers	**(3.9)%**	0%	0%
Foreign-derived intangible income deduction	**(1.1)%**	(1.3)%	(1.1)%
State income taxes, net of federal benefit	**1.4%**	1.4%	1.3%
Research and development credit	**(0.9)%**	(0.9)%	(1.1)%
Excess tax benefits relating to stock-based compensation	**(1.9)%**	(2.4)%	(2.2)%
Interest, net	**0.5%**	0.5%	1.0%
Other reconciling items, net	**(0.7)%**	(1.8)%	1.3%

Effective rate	**13.1 %**	13.8 %	16.5 %

In the first quarter of fiscal year 2022, we transferred certain intangible properties from our Puerto Rico subsidiary to the U.S. The transfer of intangible properties resulted in a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022, as the value of future U.S. tax deductions exceeds the current tax liability from the U.S. global intangible low-taxed income (“GILTI”) tax.

We have historically paid India withholding taxes on software sales through distributor withholding and tax audit assessments in India. In March 2021, the India Supreme Court ruled favorably in the case of Engineering Analysis Centre of Excellence Private Limited vs The Commissioner of Income Tax for companies in 86 separate appeals, some dating back to 2012, holding that software sales are not subject to India withholding taxes. Although we were not a party to the appeals, our software sales in India were determined to be not subject to withholding taxes. Therefore, we recorded a net income tax benefit of $620 million in the third quarter of fiscal year 2021 to reflect the results of the India Supreme Court decision impacting fiscal year 1996 through fiscal year 2016.

The decrease from the federal statutory rate in fiscal year 2022 is primarily due to the net income tax benefit related to the transfer of intangible properties, earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations center in Ireland, and tax benefits relating to stock-based compensation. The decrease from the federal statutory rate in fiscal year 2021 is primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland and Puerto Rico, tax benefits relating to stock-based compensation, and tax benefits from the India Supreme Court decision on withholding taxes. The decrease from the federal statutory rate in fiscal year 2020 is primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland and Puerto Rico, and tax benefits relating to stock-based compensation. In fiscal years 2022, 2021, and 2020, our foreign regional operating centers in Ireland and Puerto Rico, which are taxed at rates lower than the U.S. rate, generated 71%, 82%, and 86% of our foreign income before tax. Other reconciling items, net consists primarily of tax credits and GILTI tax, and in fiscal year 2021, includes tax benefits from the India Supreme Court decision on withholding taxes. In fiscal years 2022, 2021, and 2020, there were no individually significant other reconciling items.

The decrease in our effective tax rate for fiscal year 2022 compared to fiscal year 2021 was primarily due to a $3.3 billion net income tax benefit in the first quarter of fiscal year 2022 related to the transfer of intangible properties, offset in part by changes in the mix of our income before income taxes between the U.S. and foreign countries, as well as tax benefits in the prior year from the India Supreme Court decision on withholding taxes, an agreement between the U.S. and India tax authorities related to transfer pricing, and final Tax Cuts and Jobs Act (“TCJA”) regulations. The decrease in our effective tax rate for fiscal year 2021 compared to fiscal year 2020 was primarily due to tax benefits from the India Supreme Court decision on withholding taxes, an agreement between the U.S. and India tax authorities related to transfer pricing, final TCJA regulations, and an increase in tax benefits relating to stock-based compensation.

The components of the deferred income tax assets and liabilities were as follows:

(In millions)

June 30,	**2022**	**2021**
Deferred Income Tax Assets		
Stock-based compensation expense	**$ 601**	$ 502
Accruals, reserves, and other expenses	**2,874**	2,960
Loss and credit carryforwards	**1,546**	1,090
Amortization	**10,656**	6,346
Leasing liabilities	**4,557**	4,060
Unearned revenue	**2,876**	2,659
Other	**461**	319
Deferred income tax assets	**23,571**	17,936
Less valuation allowance	**(1,012)**	(769)
Deferred income tax assets, net of valuation allowance	**$ 22,559**	$ 17,167
Deferred Income Tax Liabilities		
Book/tax basis differences in investments and debt	**$ (174)**	$ (2,381)
Leasing assets	**(4,291)**	(3,834)
Depreciation	**(1,602)**	(1,010)
Deferred tax on foreign earnings	**(3,104)**	(2,815)
Other	**(103)**	(144)
Deferred income tax liabilities	**$ (9,274)**	$ (10,184)
Net deferred income tax assets	**$ 13,285**	$ 6,983
Reported As		
Other long-term assets	**$ 13,515**	$ 7,181
Long-term deferred income tax liabilities	**(230)**	(198)
Net deferred income tax assets	**$ 13,285**	$ 6,983

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when the taxes are paid or recovered.

As of June 30, 2022, we had federal, state, and foreign net operating loss carryforwards of $318 million, $1.3 billion, and $2.1 billion, respectively. The federal and state net operating loss carryforwards will expire in various years from fiscal 2023 through 2042, if not utilized. The majority of our foreign net operating loss carryforwards do not expire. Certain acquired net operating loss carryforwards are subject to an annual limitation but are expected to be realized with the exception of those which have a valuation allowance. As of June 30, 2022, we had $1.3 billion federal capital loss carryforwards for U.S. tax purposes from our acquisition of Nuance. The federal capital loss carryforwards are subject to an annual limitation and will expire in various years from fiscal 2023 through 2025.

The valuation allowance disclosed in the table above relates to the foreign net operating loss carryforwards, federal capital loss carryforwards, and other net deferred tax assets that may not be realized.

Income taxes paid, net of refunds, were $16.0 billion, $13.4 billion, and $12.5 billion in fiscal years 2022, 2021, and 2020, respectively.

Uncertain Tax Positions

Gross unrecognized tax benefits related to uncertain tax positions as of June 30, 2022, 2021, and 2020, were $15.6 billion, $14.6 billion, and $13.8 billion, respectively, which were primarily included in long-term income taxes in our consolidated balance sheets. If recognized, the resulting tax benefit would affect our effective tax rates for fiscal years 2022, 2021, and 2020 by $13.3 billion, $12.5 billion, and $12.1 billion, respectively.

As of June 30, 2022, 2021, and 2020, we had accrued interest expense related to uncertain tax positions of $4.3 billion, $4.3 billion, and $4.0 billion, respectively, net of income tax benefits. The provision for income taxes for fiscal years 2022, 2021, and 2020 included interest expense related to uncertain tax positions of $36 million, $274 million, and $579 million, respectively, net of income tax benefits.

The aggregate changes in the gross unrecognized tax benefits related to uncertain tax positions were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Beginning unrecognized tax benefits	**$ 14,550**	$ 13,792	$ 13,146
Decreases related to settlements	**(317)**	(195)	(31)
Increases for tax positions related to the current year	**1,145**	790	647
Increases for tax positions related to prior years	**461**	461	366
Decreases for tax positions related to prior years	**(246)**	(297)	(331)
Decreases due to lapsed statutes of limitations	**0**	(1)	(5)
Ending unrecognized tax benefits	**$ 15,593**	$ 14,550	$ 13,792

We settled a portion of the Internal Revenue Service ("IRS") audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. In the second quarter of fiscal year 2021, we settled an additional portion of the IRS audits for tax years 2004 to 2013 and made a payment of $1.7 billion, including tax and interest. We remain under audit for tax years 2004 to 2017.

As of June 30, 2022, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved key transfer pricing issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2021, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 13 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

June 30,	**2022**	**2021**
Productivity and Business Processes	**$ 24,558**	$ 22,120
Intelligent Cloud	**19,371**	17,710
More Personal Computing	**4,479**	4,311
Total	**$ 48,408**	$ 44,141

Changes in unearned revenue were as follows:

(In millions)

Year Ended June 30, 2022

Balance, beginning of period	$ 44,141
Deferral of revenue	110,455
Recognition of unearned revenue	(106,188)
Balance, end of period	$ 48,408

Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was $193 billion as of June 30, 2022, of which $189 billion is related to the commercial portion of revenue. We expect to recognize approximately 45% of this revenue over the next 12 months and the remainder thereafter.

NOTE 14 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. Our leases have remaining lease terms of 1 year to 19 years, some of which include options to extend the leases for up to 5 years, and some of which include options to terminate the leases within 1 year.

The components of lease expense were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Operating lease cost	**$ 2,461**	$ 2,127	$ 2,043
Finance lease cost:			
Amortization of right-of-use assets	**$ 980**	$ 921	$ 611
Interest on lease liabilities	**429**	386	336
Total finance lease cost	**$ 1,409**	$ 1,307	$ 947

Supplemental cash flow information related to leases was as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Cash paid for amounts included in the measurement of lease liabilities:			
Operating cash flows from operating leases	**$ 2,368**	$ 2,052	$ 1,829
Operating cash flows from finance leases	**429**	386	336
Financing cash flows from finance leases	**896**	648	409
Right-of-use assets obtained in exchange for lease obligations:			
Operating leases	**5,268**	4,380	3,677
Finance leases	**4,234**	3,290	3,467

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

June 30,	2022	2021
Operating Leases		
Operating lease right-of-use assets	**$ 13,148**	$ 11,088
Other current liabilities	**$ 2,228**	$ 1,962
Operating lease liabilities	**11,489**	9,629
Total operating lease liabilities	**$ 13,717**	$ 11,591
Finance Leases		
Property and equipment, at cost	**$ 17,388**	$ 14,107
Accumulated depreciation	**(3,285)**	(2,306)
Property and equipment, net	**$ 14,103**	$ 11,801
Other current liabilities	**$ 1,060**	$ 791
Other long-term liabilities	**13,842**	11,750
Total finance lease liabilities	**$ 14,902**	$ 12,541
Weighted Average Remaining Lease Term		
Operating leases	**8 years**	8 years
Finance leases	**12 years**	12 years
Weighted Average Discount Rate		
Operating leases	**2.1%**	2.2%
Finance leases	**3.1%**	3.4%

The following table outlines maturities of our lease liabilities as of June 30, 2022:

(In millions)

Year Ending June 30,	Operating Leases	Finance Leases
2023	**$ 2,456**	**$ 1,477**
2024	**2,278**	**1,487**
2025	**1,985**	**1,801**
2026	**1,625**	**1,483**
2027	**1,328**	**1,489**
Thereafter	**5,332**	**9,931**
Total lease payments	**15,004**	**17,668**
Less imputed interest	**(1,287)**	**(2,766)**
Total	**$ 13,717**	**$ 14,902**

As of June 30, 2022, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $7.2 billion and $8.8 billion, respectively. These operating and finance leases will commence between fiscal year 2023 and fiscal year 2028 with lease terms of 1 year to 18 years.

NOTE 15 — CONTINGENCIES

Antitrust Litigation and Claims

China State Administration for Market Regulation Investigation

In 2014, Microsoft was informed that China's State Agency for Market Regulation ("SAMR") (formerly State Administration for Industry and Commerce) had begun a formal investigation relating to China's Anti-Monopoly Law, and the SAMR conducted onsite inspections of Microsoft offices in Beijing, Shanghai, Guangzhou, and Chengdu. In 2019, the SAMR presented preliminary views as to certain possible violations of China's Anti-Monopoly Law.

Product-Related Litigation

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 46 lawsuits, including 45 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which the defendants have moved to strike. In August 2018, the trial court issued an order striking portions of the plaintiffs' expert reports. A hearing on general causation is scheduled for September of 2022.

Other Contingencies

We also are subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in aggregate, will not have a material adverse impact in our consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future.

As of June 30, 2022, we accrued aggregate legal liabilities of $364 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $600 million in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

NOTE 16 — STOCKHOLDERS' EQUITY

Shares Outstanding

Shares of common stock outstanding were as follows:

(In millions)			
Year Ended June 30,	2022	2021	2020
Balance, beginning of year	**7,519**	7,571	7,643
Issued	**40**	49	54
Repurchased	**(95)**	(101)	(126)
Balance, end of year	**7,464**	7,519	7,571

Share Repurchases

On September 20, 2016, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program commenced in December 2016 and was completed in February 2020.

On September 18, 2019, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program commenced in February 2020 and was completed in November 2021.

On September 14, 2021, our Board of Directors approved a share repurchase program authorizing up to $60.0 billion in share repurchases. This share repurchase program commenced in November 2021, following completion of the program approved on September 18, 2019, has no expiration date, and may be terminated at any time. As of June 30, 2022, $40.7 billion remained of this $60.0 billion share repurchase program.

We repurchased the following shares of common stock under the share repurchase programs:

(In millions)	Shares	Amount	Shares	Amount	Shares	Amount
Year Ended June 30,		2022		2021		2020
First Quarter	**21**	**$ 6,200**	25	$ 5,270	29	$ 4,000
Second Quarter	**20**	**6,233**	27	5,750	32	4,600
Third Quarter	**26**	**7,800**	25	5,750	37	6,000
Fourth Quarter	**28**	**7,800**	24	6,200	28	5,088
Total	**95**	**$ 28,033**	101	$ 22,970	126	$ 19,688

All repurchases were made using cash resources. Shares repurchased during the fourth and third quarters of fiscal year 2022 were under the share repurchase program approved on September 14, 2021. Shares repurchased during the second quarter of fiscal year 2022 were under the share repurchase programs approved on both September 14, 2021 and September 18, 2019. Shares repurchased during the first quarter of fiscal year 2022, fiscal year 2021, and the fourth quarter of fiscal year 2020 were under the share repurchase program approved on September 18, 2019. Shares repurchased during the third quarter of fiscal year 2020 were under the share repurchase programs approved on both September 20, 2016 and September 18, 2019. All other shares repurchased were under the share repurchase program approved on September 20, 2016. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $4.7 billion, $4.4 billion, and $3.3 billion for fiscal years 2022, 2021, and 2020, respectively.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2022				**(In millions)**
September 14, 2021	**November 18, 2021**	**December 9, 2021**	**$ 0.62**	**$ 4,652**
December 7, 2021	**February 17, 2022**	**March 10, 2022**	**0.62**	**4,645**
March 14, 2022	**May 19, 2022**	**June 9, 2022**	**0.62**	**4,632**
June 14, 2022	**August 18, 2022**	**September 8, 2022**	**0.62**	**4,627**
Total			**$ 2.48**	**$ 18,556**
Fiscal Year 2021				
September 15, 2020	November 19, 2020	December 10, 2020	$ 0.56	$ 4,230
December 2, 2020	February 18, 2021	March 11, 2021	0.56	4,221
March 16, 2021	May 20, 2021	June 10, 2021	0.56	4,214
June 16, 2021	August 19, 2021	September 9, 2021	0.56	4,206
Total			$ 2.24	$ 16,871

The dividend declared on June 14, 2022 was included in other current liabilities as of June 30, 2022.

NOTE 17 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes in accumulated other comprehensive income (loss) by component:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Derivatives			
Balance, beginning of period	**$ (19)**	$ (38)	$ 0
Unrealized gains (losses), net of tax of **$(15)**, $9, and $(10)	**(57)**	34	(38)
Reclassification adjustments for (gains) losses included in other income (expense), net	**79**	(17)	0
Tax expense (benefit) included in provision for income taxes	**(16)**	2	0
Amounts reclassified from accumulated other comprehensive income (loss)	**63**	(15)	0
Net change related to derivatives, net of tax of **$1**, $7, and $(10)	**6**	19	(38)
Balance, end of period	**$ (13)**	$ (19)	$ (38)
Investments			
Balance, beginning of period	**$ 3,222**	$ 5,478	$ 1,488
Unrealized gains (losses), net of tax of **$(1,440)**, $(589), and $1,057	**(5,405)**	(2,216)	3,987
Reclassification adjustments for (gains) losses included in other income (expense), net	**57**	(63)	4
Tax expense (benefit) included in provision for income taxes	**(12)**	13	(1)
Amounts reclassified from accumulated other comprehensive income (loss)	**45**	(50)	3
Net change related to investments, net of tax of **$(1,428)**, $(602), and $1,058	**(5,360)**	(2,266)	3,990
Cumulative effect of accounting changes	**0**	10	0
Balance, end of period	**$ (2,138)**	$ 3,222	$ 5,478
Translation Adjustments and Other			
Balance, beginning of period	**$ (1,381)**	$ (2,254)	$ (1,828)
Translation adjustments and other, net of tax of **$0**, $(9), and $1	**(1,146)**	873	(426)
Balance, end of period	**$ (2,527)**	$ (1,381)	$ (2,254)
Accumulated other comprehensive income (loss), end of period	**$ (4,678)**	$ 1,822	$ 3,186

NOTE 18 — EMPLOYEE STOCK AND SAVINGS PLANS

We grant stock-based compensation to employees and directors. Awards that expire or are canceled without delivery of shares generally become available for issuance under the plans. We issue new shares of Microsoft common stock to satisfy vesting of awards granted under our stock plans. We also have an ESPP for all eligible employees.

Stock-based compensation expense and related income tax benefits were as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Stock-based compensation expense	**$ 7,502**	$ 6,118	$ 5,289
Income tax benefits related to stock-based compensation	**1,293**	1,065	938

Stock Plans

Stock awards entitle the holder to receive shares of Microsoft common stock as the award vests. Stock awards generally vest over a service period of four years or five years.

Executive Incentive Plan

Under the Executive Incentive Plan, the Compensation Committee approves stock awards to executive officers and certain senior executives. RSUs generally vest ratably over a service period of four years. PSUs generally vest over a performance period of three years. The number of shares the PSU holder receives is based on the extent to which the corresponding performance goals have been achieved.

Activity for All Stock Plans

The fair value of stock awards was estimated on the date of grant using the following assumptions:

Year ended June 30,	**2022**	**2021**	**2020**
Dividends per share (quarterly amounts)	**$ 0.56 – 0.62**	$ 0.51 – 0.56	$ 0.46 – 0.51
Interest rates	**0.03% – 3.6%**	0.01% – 1.5%	0.1% – 2.2%

During fiscal year 2022, the following activity occurred under our stock plans:

	Shares	**Weighted Average Grant-Date Fair Value**
	(In millions)	
Stock Awards		
Nonvested balance, beginning of year	**100**	**$ 152.51**
Granted (a)	**50**	**291.22**
Vested	**(47)**	**143.10**
Forfeited	**(10)**	**189.88**
Nonvested balance, end of year	**93**	**$ 227.59**

(a) *Includes 1 million, 2 million, and 2 million of PSUs granted at target and performance adjustments above target levels for fiscal years 2022, 2021, and 2020, respectively.*

As of June 30, 2022, there was approximately $16.7 billion of total unrecognized compensation costs related to stock awards. These costs are expected to be recognized over a weighted average period of three years. The weighted average grant-date fair value of stock awards granted was $291.22, $221.13, and $140.49 for fiscal years 2022, 2021, and 2020, respectively. The fair value of stock awards vested was $14.1 billion, $13.4 billion, and $10.1 billion, for fiscal years 2022, 2021, and 2020, respectively. As of June 30, 2022, an aggregate of 211 million shares were authorized for future grant under our stock plans.

Employee Stock Purchase Plan

We have an ESPP for all eligible employees. Shares of our common stock may be purchased by employees at three-month intervals at 90% of the fair market value on the last trading day of each three-month period. Employees may purchase shares having a value not exceeding 15% of their gross compensation during an offering period. Under the terms of the ESPP that were approved in 2012, the plan was set to terminate on December 31, 2022. At our 2021 Annual Shareholders Meeting, our shareholders approved a successor ESPP with a January 1, 2022 effective date and ten-year expiration of December 31, 2031. No additional shares were requested at this meeting.

Employees purchased the following shares during the periods presented:

(Shares in millions)

Year Ended June 30,	**2022**	**2021**	**2020**

Shares purchased	**7**	8	9
Average price per share	**$ 259.55**	$ 207.88	$ 142.22

As of June 30, 2022, 81 million shares of our common stock were reserved for future issuance through the ESPP.

Savings Plans

We have savings plans in the U.S. that qualify under Section 401(k) of the Internal Revenue Code, and a number of savings plans in international locations. Eligible U.S. employees may contribute a portion of their salary into the savings plans, subject to certain limitations. We match a portion of each dollar a participant contributes into the plans. Employer-funded retirement benefits for all plans were $1.4 billion, $1.2 billion, and $1.0 billion in fiscal years 2022, 2021, and 2020, respectively, and were expensed as contributed.

NOTE 19 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

In its operation of the business, management, including our chief operating decision maker, who is also our Chief Executive Officer, reviews certain financial information, including segmented internal profit and loss statements prepared on a basis not consistent with GAAP. During the periods presented, we reported our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing.

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Microsoft Viva.
- Office Consumer, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services.
- LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.
- Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business and developers. This segment primarily comprises:

- Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and Nuance and GitHub.
- Enterprise Services, including Enterprise Support Services, Microsoft Consulting Services, and Nuance professional services.

More Personal Computing

Our More Personal Computing segment consists of products and services that put customers at the center of the experience with our technology. This segment primarily comprises:

- Windows, including Windows OEM licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; and Windows Internet of Things.
- Devices, including Surface and PC accessories.
- Gaming, including Xbox hardware and Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other

subscriptions, Xbox Cloud Gaming, third-party disc royalties, advertising, and other cloud services.

- Search and news advertising.

Revenue and costs are generally directly attributed to our segments. However, due to the integrated structure of our business, certain revenue recognized and costs incurred by one segment may benefit other segments. Revenue from certain contracts is allocated among the segments based on the relative value of the underlying products and services, which can include allocation based on actual prices charged, prices when sold separately, or estimated costs plus a profit margin. Cost of revenue is allocated in certain cases based on a relative revenue methodology. Operating expenses that are allocated primarily include those relating to marketing of products and services from which multiple segments benefit and are generally allocated based on relative gross margin.

In addition, certain costs incurred at a corporate level that are identifiable and that benefit our segments are allocated to them. These allocated costs include legal, including settlements and fines, information technology, human resources, finance, excise taxes, field selling, shared facilities services, and customer service and support. Each allocation is measured differently based on the specific facts and circumstances of the costs being allocated.

Segment revenue and operating income were as follows during the periods presented:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Revenue			
Productivity and Business Processes	**$ 63,364**	$ 53,915	$ 46,398
Intelligent Cloud	**75,251**	60,080	48,366
More Personal Computing	**59,655**	54,093	48,251
Total	**$ 198,270**	$ 168,088	$ 143,015
Operating Income			
Productivity and Business Processes	**$ 29,687**	$ 24,351	$ 18,724
Intelligent Cloud	**32,721**	26,126	18,324
More Personal Computing	**20,975**	19,439	15,911
Total	**$ 83,383**	$ 69,916	$ 52,959

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for fiscal years 2022, 2021, or 2020. Revenue, classified by the major geographic areas in which our customers were located, was as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
United States (a)	**$ 100,218**	$ 83,953	$ 73,160
Other countries	**98,052**	84,135	69,855
Total	**$ 198,270**	$ 168,088	$ 143,015

(a) *Includes billings to OEMs and certain multinational organizations because of the nature of these businesses and the impracticability of determining the geographic source of the revenue.*

Revenue, classified by significant product and service offerings, was as follows:

(In millions)

Year Ended June 30,	**2022**	**2021**	**2020**
Server products and cloud services	**$ 67,321**	$ 52,589	$ 41,379
Office products and cloud services	**44,862**	39,872	35,316
Windows	**24,761**	22,488	21,510
Gaming	**16,230**	15,370	11,575
LinkedIn	**13,816**	10,289	8,077
Search and news advertising	**11,591**	9,267	8,524
Enterprise Services	**7,407**	6,943	6,409
Devices	**6,991**	6,791	6,457
Other	**5,291**	4,479	3,768
Total	**$ 198,270**	$ 168,088	$ 143,015

We have recast certain previously reported amounts in the table above to conform to the way we internally manage and monitor our business.

Our Microsoft Cloud (formerly commercial cloud) revenue, which includes Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was $91.2 billion, $69.1 billion and $51.7 billion in fiscal years 2022, 2021, and 2020, respectively. These amounts are primarily included in Server products and cloud services, Office products and cloud services, and LinkedIn in the table above.

Assets are not allocated to segments for internal reporting presentations. A portion of amortization and depreciation is included with various other costs in an overhead allocation to each segment. It is impracticable for us to separately identify the amount of amortization and depreciation by segment that is included in the measure of segment profit or loss.

Long-lived assets, excluding financial instruments and tax assets, classified by the location of the controlling statutory company and with countries over 10% of the total shown separately, were as follows:

(In millions)

June 30,	**2022**	**2021**	**2020**
United States	**$ 106,430**	$ 76,153	$ 60,789
Ireland	**15,505**	13,303	12,734
Other countries	**44,433**	38,858	29,770
Total	**$ 166,368**	$ 128,314	$ 103,293

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2022 and 2021, the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity, for each of the three years in the period ended June 30, 2022, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2022 and 2021, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2022, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of June 30, 2022, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated July 28, 2022, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current-period audit of the financial statements that were communicated or required to be communicated to the audit committee and that (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Revenue Recognition – Refer to Note 1 to the financial statements

Critical Audit Matter Description

The Company recognizes revenue upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. The Company offers customers the ability to acquire multiple licenses of software products and services, including cloud-based services, in its customer agreements through its volume licensing programs.

Significant judgment is exercised by the Company in determining revenue recognition for these customer agreements, and includes the following:

- Determination of whether products and services are considered distinct performance obligations that should be accounted for separately versus together, such as software licenses and related services that are sold with cloud-based services.
- The pattern of delivery (i.e., timing of when revenue is recognized) for each distinct performance obligation.
- Identification and treatment of contract terms that may impact the timing and amount of revenue recognized (e.g., variable consideration, optional purchases, and free services).
- Determination of stand-alone selling prices for each distinct performance obligation and for products and services that are not sold separately.

Given these factors and due to the volume of transactions, the related audit effort in evaluating management's judgments in determining revenue recognition for these customer agreements was extensive and required a high degree of auditor judgment.

How the Critical Audit Matter Was Addressed in the Audit

Our principal audit procedures related to the Company's revenue recognition for these customer agreements included the following:

- We tested the effectiveness of controls related to the identification of distinct performance obligations, the determination of the timing of revenue recognition, and the estimation of variable consideration.
- We evaluated management's significant accounting policies related to these customer agreements for reasonableness.
- We selected a sample of customer agreements and performed the following procedures:

- Obtained and read contract source documents for each selection, including master agreements, and other documents that were part of the agreement.
- Tested management's identification and treatment of contract terms.
- Assessed the terms in the customer agreement and evaluated the appropriateness of management's application of their accounting policies, along with their use of estimates, in the determination of revenue recognition conclusions.

- We evaluated the reasonableness of management's estimate of stand-alone selling prices for products and services that are not sold separately.
- We tested the mathematical accuracy of management's calculations of revenue and the associated timing of revenue recognized in the financial statements.

Income Taxes – Uncertain Tax Positions – Refer to Note 12 to the financial statements

Critical Audit Matter Description

The Company's long-term income taxes liability includes uncertain tax positions related to transfer pricing issues that remain unresolved with the Internal Revenue Service ("IRS"). The Company remains under IRS audit, or subject to IRS audit, for tax years subsequent to 2003. While the Company has settled a portion of the IRS audits, resolution of the remaining matters could have a material impact on the Company's financial statements.

Conclusions on recognizing and measuring uncertain tax positions involve significant estimates and management judgment and include complex considerations of the Internal Revenue Code, related regulations, tax case laws, and prior-year audit settlements. Given the complexity and the subjective nature of the transfer pricing issues that remain unresolved with the IRS, evaluating management's estimates relating to their determination of uncertain tax positions required extensive audit effort and a high degree of auditor judgment, including involvement of our tax specialists.

How the Critical Audit Matter Was Addressed in the Audit

Our principal audit procedures to evaluate management's estimates of uncertain tax positions related to unresolved transfer pricing issues included the following:

- We evaluated the appropriateness and consistency of management's methods and assumptions used in the identification, recognition, measurement, and disclosure of uncertain tax positions, which included testing the effectiveness of the related internal controls.
- We read and evaluated management's documentation, including relevant accounting policies and information obtained by management from outside tax specialists, that detailed the basis of the uncertain tax positions.
- We tested the reasonableness of management's judgments regarding the future resolution of the uncertain tax positions, including an evaluation of the technical merits of the uncertain tax positions.
- For those uncertain tax positions that had not been effectively settled, we evaluated whether management had appropriately considered new information that could significantly change the recognition, measurement or disclosure of the uncertain tax positions.
- We evaluated the reasonableness of management's estimates by considering how tax law, including statutes, regulations and case law, impacted management's judgments.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
July 28, 2022

We have served as the Company's auditor since 1983.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective.

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our consolidated financial statements; providing reasonable assurance that receipts and expenditures of company assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use, or disposition of company assets that could have a material effect on our consolidated financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our consolidated financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company’s internal control over financial reporting was effective as of June 30, 2022. There were no changes in our internal control over financial reporting during the quarter ended June 30, 2022 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Deloitte & Touche LLP has audited our internal control over financial reporting as of June 30, 2022; their report is included in Item 9A.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2022, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2022, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements as of and for the year ended June 30, 2022, of the Company and our report dated July 28, 2022, expressed an unqualified opinion on those financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
July 28, 2022

ITEM 9B. OTHER INFORMATION

Not applicable.

ITEM 9C. DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

A list of our executive officers and biographical information appears in Part I, Item 1 of this Form 10-K. Information about our directors may be found under the caption “Our Director Nominees” in our Proxy Statement for the Annual Meeting of Shareholders to be held December 13, 2022 (the “Proxy Statement”). Information about our Audit Committee may be found under the caption “Board Committees” in the Proxy Statement. That information is incorporated herein by reference.

We have adopted the Microsoft Finance Code of Professional Conduct (the “finance code of ethics”), a code of ethics that applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, and other finance organization employees. The finance code of ethics is publicly available on our website at https://aka.ms/FinanceCodeProfessionalConduct. If we make any substantive amendments to the finance code of ethics or grant any waiver, including any implicit waiver, from a provision of the code to our Chief Executive Officer, Chief Financial Officer, or Chief Accounting Officer, we will disclose the nature of the amendment or waiver on that website or in a report on Form 8-K.

ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions “Director Compensation,” “Named Executive Officer Compensation,” “Compensation Committee Report,” and, if required, “Compensation Committee Interlocks and Insider Participation,” is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information in the Proxy Statement set forth under the captions “Stock Ownership Information,” “Principal Shareholders” and “Equity Compensation Plan Information” is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information set forth in the Proxy Statement under the captions “Director Independence Guidelines” and “Certain Relationships and Related Transactions” is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information concerning fees and services provided by our principal accountant, Deloitte & Touche LLP (PCAOB ID No. 34), appears in the Proxy Statement under the headings “Fees Billed by Deloitte & Touche” and “Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditor” and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBIT AND FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements and Schedules

The financial statements are set forth under Part II, Item 8 of this Form 10-K, as indexed below. Financial statement schedules have been omitted since they either are not required, not applicable, or the information is otherwise included.

(b) Exhibit Listing

			Incorporated by Reference			
Exhibit Number	Exhibit Description	Filed Herewith	Form	Period Ending	Exhibit	Filing Date
3.1	Amended and Restated Articles of Incorporation of Microsoft Corporation		8-K		3.1	12/1/16
3.2	Bylaws of Microsoft Corporation		8-K		3.2	6/14/17
4.1	Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee ("Base Indenture")		S-3ASR		4.1	10/29/15
4.2	Form of First Supplemental Indenture for 2.95% Notes due 2014, 4.20% Notes due 2019, and 5.20% Notes due 2039, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Base Indenture		8-K		4.2	5/15/09
4.5	Form of Second Supplemental Indenture for 0.875% Notes due 2013, 1.625% Notes due 2015, 3.00% Notes due 2020, and 4.50% Notes due 2040, dated as of September 27, 2010, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	9/27/10

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.6	Third Supplemental Indenture for 2.500% Notes due 2016, 4.000% Notes due 2021, and 5.300% Notes due 2041, dated as of February 8, 2011, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	2/8/11
4.7	Fourth Supplemental Indenture for 0.875% Notes due 2017, 2.125% Notes due 2022, and 3.500% Notes due 2042, dated as of November 7, 2012, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	11/7/12
4.8	Fifth Supplemental Indenture for 2.625% Notes due 2033, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	5/1/13
4.9	Sixth Supplemental Indenture for 1.000% Notes due 2018, 2.375% Notes due 2023, and 3.750% Notes due 2043, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	5/1/13
4.10	Seventh Supplemental Indenture for 2.125% Notes due 2021 and 3.125% Notes due 2028, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New		8-K		4.1	12/6/13

York Mellon Trust Company, N.A.,
as Trustee

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.11	Eighth Supplemental Indenture for 1.625% Notes due 2018, 3.625% Notes due 2023, and 4.875% Notes due 2043, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	12/6/13
4.12	Ninth Supplemental Indenture for 1.850% Notes due 2020, 2.375% Notes due 2022, 2.700% Notes due 2025, 3.500% Notes due 2035, 3.750% Notes due 2045, and 4.000% Notes due 2055, dated as of February 12, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	2/12/15
4.13	Tenth Supplemental Indenture for 1.300% Notes due 2018, 2.000% Notes due 2020, 2.650% Notes due 2022, 3.125% Notes due 2025, 4.200% Notes due 2035, 4.450% Notes due 2045, and 4.750% Notes due 2055, dated as of November 3, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	11/3/15
4.14	Eleventh Supplemental Indenture for 1.100% Notes due 2019, 1.550% Notes due 2021, 2.000% Notes due 2023, 2.400% Notes due 2026, 3.450% Notes due 2036, 3.700% Notes due 2046, and 3.950% Notes due 2056, dated as of August 8, 2016, between Microsoft Corporation and U.S. Bank, National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	8/5/16

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.15	Twelfth Supplemental Indenture for 1.850% Notes due 2020, 2.400% Notes due 2022, 2.875% Notes due 2024, 3.300% Notes due 2027, 4.100% Notes due 2037, 4.250% Notes due 2047, and 4.500% Notes due 2057, dated as of February 6, 2017, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	2/3/17
4.16	Thirteenth Supplemental Indenture for 2.525% Notes due 2050 and 2.675% Notes due 2060, dated as of June 1, 2020, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	6/1/20
4.17	Fourteenth Supplemental Indenture for 2.921% Notes due 2052 and 3.041% Notes due 2062, dated as of March 17, 2021, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	3/17/21
4.18	Description of Securities		10-K	6/30/19	4.16	8/1/19
10.1*	Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.1	10/20/16
10.4*	Microsoft Corporation Employee Stock Purchase Plan		10-K	6/30/12	10.4	7/26/12
10.5*	Microsoft Corporation Deferred Compensation Plan		10-K	6/30/18	10.5	8/3/18
10.6*	Microsoft Corporation 2017 Stock Plan		DEF14A		Annex C	10/16/17

10.7*	Form of Stock Award Agreement Under the Microsoft Corporation 2017 Stock Plan	10-Q	3/31/2018	10.26	4/26/18
10.8*	Form of Performance Stock Award Agreement Under the Microsoft Corporation 2017 Stock Plan	10-Q	3/31/2018	10.27	4/26/18
10.9	Amended and Restated Officers' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee	10-Q	9/30/16	10.12	10/20/16

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
10.10	Assumption of Beneficiaries' Representative Obligations Under Amended and Restated Officers' Indemnification Trust Agreement		10-K	6/30/2020	10.25	7/30/2020
10.11	Form of Indemnification Agreement and Amended and Restated Directors' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		10-K	6/30/19	10.13	8/1/19
10.12	Assumption of Beneficiaries' Representative Obligations Under Amended and Restated Directors' Indemnification Trust Agreement		10-K	6/30/2020	10.26	7/30/2020
10.14*	Microsoft Corporation Deferred Compensation Plan for Non-Employee Directors		10-Q	12/31/17	10.14	1/31/18
10.15*	Microsoft Corporation Executive Incentive Plan		8-K		10.1	9/19/18
10.19*	Microsoft Corporation Executive Incentive Plan		10-Q	9/30/16	10.17	10/20/16
10.20*	Form of Executive Incentive Plan (Executive Officer SAs) Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.18	10/20/16
10.21*	Form of Executive Incentive Plan Performance Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.25	10/20/16
10.22*	Senior Executive Severance Benefit Plan		10-Q	9/30/16	10.22	10/20/16
10.23*	Offer Letter, dated February 3, 2014, between Microsoft Corporation and Satya Nadella		8-K		10.1	2/4/14
10.24*	Long-Term Performance Stock Award Agreement between Microsoft Corporation and Satya Nadella		10-Q	12/31/14	10.24	1/26/15
21	Subsidiaries of Registrant	X				
23.1	Consent of Independent Registered Public Accounting Firm	X				
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2		X				

	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
32.1**	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference			
			Form	Period Ending	Exhibit	Filing Date
32.2**	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
101.INS	Inline XBRL Instance Document—the instance document does not appear in the Interactive Data File as its XBRL tags are embedded within the Inline XBRL document	X				
101.SCH	Inline XBRL Taxonomy Extension Schema	X				
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase	X				
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase	X				
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase	X				
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase	X				
104	Cover page formatted as Inline XBRL and contained in Exhibit 101	X				

* *Indicates a management contract or compensatory plan or arrangement.*
** *Furnished, not filed.*

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned; thereunto duly authorized, in the City of Redmond, State of Washington, on July 28, 2022.

MICROSOFT CORPORATION

/s/ ALICE L. JOLLA

Alice L. Jolla
Corporate Vice President and Chief Accounting Officer (Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on July 28, 2022.

Signature	Title
/s/ SATYA NADELLA Satya Nadella	Chairman and Chief Executive Officer (Principal Executive Officer)
/s/ REID HOFFMAN Reid Hoffman	Director
/s/ HUGH F. JOHNSTON Hugh F. Johnston	Director
/s/ TERI L. LIST Teri L. List	Director
/s/ SANDRA E. PETERSON Sandra E. Peterson	Director
/s/ PENNY S. PRITZKER Penny S. Pritzker	Director
/s/ CARLOS A. RODRIGUEZ Carlos A. Rodriguez	Director
/s/ CHARLES W. SCHARF Charles W. Scharf	Director
/s/ JOHN W. STANTON John W. Stanton	Director
/s/ JOHN W. THOMPSON John W. Thompson	Lead Independent Director
/s/ EMMA N. WALMSLEY Emma N. Walmsley	Director
/s/ PADMASREE WARRIOR Padmasree Warrior	Director
/s/ AMY E. HOOD Amy E. Hood	Executive Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ ALICE L. JOLLA Alice L. Jolla	Corporate Vice President and Chief Accounting Officer (Principal Accounting Officer)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended June 30, 2021

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period From to

Commission File Number 001-37845

MICROSOFT CORPORATION

WASHINGTON	**91-1144442**
(STATE OF INCORPORATION)	**(I.R.S. ID)**

ONE MICROSOFT WAY, REDMOND, WASHINGTON 98052-6399

(425) 882-8080

www.microsoft.com/investor

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of exchange on which registered
Common stock, $0.00000625 par value per share	**MSFT**	**NASDAQ**
2.125% Notes due 2021	**MSFT**	**NASDAQ**
3.125% Notes due 2028	**MSFT**	**NASDAQ**
2.625% Notes due 2033	**MSFT**	**NASDAQ**

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☒	Accelerated Filer ☐
Non-accelerated Filer ☐	Smaller Reporting Company ☐
	Emerging Growth Company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management’s assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

As of December 31, 2020, the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant was $1.7 trillion based on the closing sale price as reported on the NASDAQ National Market System. As of July 26, 2021, there were 7,514,891,248 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on November 30, 2021 are incorporated by reference into Part III.

MICROSOFT CORPORATION
FORM 10-K
For the Fiscal Year Ended June 30, 2021
INDEX

Note About Forward-Looking Statements

This report includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including the following sections: "Business" (Part I, Item 1 of this Form 10-K), "Risk Factors" (Part I, Item 1A of this Form 10-K), and "Management's Discussion and Analysis of Financial Condition and Results of Operations" (Part II, Item 7 of this Form 10-K). These forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "future," "opportunity," "plan," "may," "should," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. We describe risks and uncertainties that could cause actual results and events to differ materially in "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Quantitative and Qualitative Disclosures about Market Risk" (Part II, Item 7A of this Form 10-K). Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date they are made. We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

PART I

ITEM 1. BUSINESS

GENERAL

Embracing Our Future

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity.

We bring technology and products together into experiences and solutions that unlock value for our customers. Our ecosystem of customers and partners has stepped up to help people and organizations in every country use technology to be resilient and transform during the most trying of circumstances. Amid rapid change we've witnessed technology empower telehealth, remote manufacturing, and new ways of working from home and serving customers. These capabilities have relied on the public cloud, which is built on the investments we have made over time.

We are living in the new era of the intelligent cloud and intelligent edge, which is being sharpened by rapid advances in distributed computing, ambient intelligence, and multidevice experiences. This means the places we go and the things we interact with will increasingly become digitized, creating new opportunities and new breakthroughs. In the next phase of innovation, computing is more powerful and ubiquitous from the cloud to the edge. Artificial intelligence ("AI") capabilities are rapidly advancing, fueled by data and knowledge of the world. Physical and virtual worlds are coming together with the Internet of Things ("IoT") and mixed reality to create richer experiences that understand the context surrounding people, the things they use, the places they go, and their activities and relationships. A person's experience with technology spans a multitude of devices and has become increasingly more natural and multi-sensory with voice, ink, and gaze interactions.

What We Offer

Founded in 1975, we develop and support software, services, devices, and solutions that deliver new value for customers and help people and businesses realize their full potential.

We offer an array of services, including cloud-based solutions that provide customers with software, services, platforms, and content, and we provide solution support and consulting services. We also deliver relevant online advertising to a global audience.

Our products include operating systems, cross-device productivity applications, server applications, business solution applications, desktop and server management tools, software development tools, and video games. We also design and sell devices, including PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

The Ambitions That Drive Us

To achieve our vision, our research and development efforts focus on three interconnected ambitions:

- Reinvent productivity and business processes.
- Build the intelligent cloud and intelligent edge platform.
- Create more personal computing.

Reinvent Productivity and Business Processes

At Microsoft, we're providing technology and resources to help our customers navigate a remote environment. We're seeing our family of products play key roles in the ways the world is continuing to work, learn, and connect.

Our growth depends on securely delivering continuous innovation and advancing our leading productivity and collaboration tools and services, including Office, Dynamics, and LinkedIn. Microsoft 365 brings together Office 365, Windows, and Enterprise Mobility + Security to help organizations empower their employees with AI-backed tools that unlock creativity, increase teamwork, and fuel innovation, all the while enabling compliance coverage and data protection. Microsoft Teams is enabling rapid digital transformation by giving people a single tool to chat, call, meet, and collaborate. Microsoft Viva is an employee experience platform that brings together communications, knowledge, learning, resources, and insights powered by Microsoft 365. Microsoft Relationship Sales solution brings together LinkedIn Sales Navigator and Dynamics to transform business to business sales through social selling. Dynamics 365 for Talent with LinkedIn Recruiter and Learning gives human resource professionals a complete solution to compete for talent. Microsoft Power Platform empowers employees to build custom applications, automate workflow, and analyze data no matter their technical expertise.

These scenarios represent a move to unlock creativity and discover new habits, while simplifying security and management. Organizations of all sizes have digitized business-critical functions, redefining what they can expect from their business applications. This creates an opportunity to reach new customers and increase usage and engagement with existing customers.

Build the Intelligent Cloud and Intelligent Edge Platform

In the new remote world, companies have accelerated their own digital transformation to empower their employees, optimize their operations, engage customers, and in some cases, change the very core of their products and services. Partnering with organizations on their digital transformation during this period is one of our largest opportunities and we are uniquely positioned to become the strategic digital transformation platform and partner of choice; their success is our success.

Our strategy requires continued investment in datacenters and other hybrid and edge infrastructure to support our services. Azure is a trusted cloud with comprehensive compliance coverage and AI-based security built in.

Our cloud business benefits from three economies of scale: datacenters that deploy computational resources at significantly lower cost per unit than smaller ones; datacenters that coordinate and aggregate diverse customer, geographic, and application demand patterns, improving the utilization of computing, storage, and network resources; and multi-tenancy locations that lower application maintenance labor costs.

The Microsoft Cloud is the most comprehensive and trusted cloud, providing the best integration across the technology stack while offering openness, improving time to value, reducing costs, and increasing agility. Being a global-scale cloud, Azure uniquely offers hybrid consistency, developer productivity, AI capabilities, and trusted security and compliance. We see more emerging use cases and needs for compute and security at the edge and are accelerating our innovation across the spectrum of intelligent edge devices, from IoT sensors to gateway devices and edge hardware to build, manage, and secure edge workloads. With Azure Stack, organizations can extend Azure into their own datacenters to create a consistent stack across the public cloud and the intelligent edge. Our hybrid infrastructure consistency spans security, compliance, identity, and management, helping to support the real-world needs and evolving regulatory requirements of commercial customers and enterprises. Azure Arc simplifies governance and management by delivering a consistent multi-cloud and on-premises management platform. Security, compliance, identity, and management underlie our entire tech stack. We offer integrated, end-to-end capabilities to protect people and organizations. In April 2021, we entered into a definitive agreement to acquire Nuance Communications, Inc., a cloud and AI software provider with healthcare and enterprise AI experience. The acquisition will build on our industry-specific cloud offerings.

We are accelerating our development of mixed reality solutions with new Azure services and devices. Microsoft Mesh enables presence and shared experiences from anywhere through mixed reality applications. The opportunity to merge the physical and digital worlds, when combined with the power of Azure cloud services, unlocks the potential for entirely new workloads and experiences which we believe will shape the next era of computing.

The ability to convert data into AI drives our competitive advantage. Azure SQL Database makes it possible for customers to take SQL Server from their on-premises datacenter to a fully managed instance in the cloud to utilize built-in AI. Azure Synapse Analytics, a limitless analytics service, brings together data integration, enterprise data warehousing, and big data analytics for immediate business intelligence and machine learning needs. We are accelerating adoption of AI innovations from research to products. Our innovation helps every developer be an AI developer, with approachable new tools from Azure Machine Learning Studio for creating simple machine learning models, to the powerful Azure Machine Learning Workbench for the most advanced AI modeling and data science. From GitHub to Visual Studio, we provide a developer tool chain for everyone, no matter the technical experience, across all platforms, whether Azure, Windows, or any other cloud or client platform.

Create More Personal Computing

We strive to make computing more personal by putting people at the core of the experience, enabling them to interact with technology in more intuitive, engaging, and dynamic ways. Microsoft 365 is empowering people and organizations to be productive and secure as they adapt to more fluid ways of working and learning. The PC has been mission-critical across work, school, and life to sustain productivity in a remote everything world.

Windows 10 serves the enterprise as the most secure and productive operating system. It empowers people with AI-first interfaces ranging from voice-activated commands through Cortana, inking, immersive 3D content storytelling, and mixed reality experiences. Our ambition for Windows 10 monetization opportunities includes gaming, services, subscriptions, and search advertising. In June 2021, Microsoft announced the next generation of Windows – Windows 11. Windows 11 builds on the strengths of productivity, versatility, and security on Windows 10 today and adds in new experiences that include powerful task switching tools like new snap layouts, snap groups, and desktops; new ways to stay connected through chat; the information you want at your fingertips; and more. Windows also plays a critical role in fueling our cloud business and Microsoft 365 strategy, and it powers the growing range of devices on the “intelligent edge.”

Microsoft Edge is our fast and secure browser that helps protect your data, with built-in shopping tools designed to save you time and money. Organizational tools such as Collections, Vertical Tabs, and Immersive Reader help you make the most of your time while browsing, streaming, searching, sharing, and more.

We are committed to designing and marketing first-party devices to help drive innovation, create new device categories, and stimulate demand in the Windows ecosystem. The Surface family includes Surface Book 3, Surface Laptop Go, Surface Go 2, Surface Pro 7, Surface Laptop 4, Surface Pro X, Surface Studio 2, and Surface Duo.

To expand usage and deepen engagement, we continue to invest in content, community, and cloud services as we pursue the expansive opportunity in the gaming industry. We have broadened our approach to how we think about gaming end-to-end, from the way games are created and distributed to how they are played, including cloud gaming so players can stream across PC, console, and mobile. We have a strong position with our large and growing highly engaged community of gamers, including the March 2021 acquisition of ZeniMax Media Inc., the parent company of Bethesda Softworks LLC, one of the largest, privately held game developers and publishers in the world. Xbox Game Pass is a community with access to a curated library of over 100 first- and third-party console and PC titles. Xbox Cloud Gaming is Microsoft’s game streaming technology that is complementary to our console hardware and gives fans the ultimate choice to play the games they want, with the people they want, on the devices they want.

Our Future Opportunity

In a time of great disruption and uncertainty, customers are looking to us to accelerate their own digital transformations as software and cloud computing play a huge role across every industry and around the world. We continue to develop complete, intelligent solutions for our customers that empower people to stay productive and collaborate, while safeguarding businesses and simplifying IT management. Our goal is to lead the industry in several distinct areas of technology over the long-term, which we expect will translate to sustained growth. We are investing significant resources in:

- Transforming the workplace to deliver new modern, modular business applications to improve how people communicate, collaborate, learn, work, play, and interact with one another.
- Building and running cloud-based services in ways that unleash new experiences and opportunities for businesses and individuals.
- Applying AI to drive insights and act on our customer's behalf by understanding and interpreting their needs using natural methods of communication.
- Using Windows to fuel our cloud business, grow our share of the PC market, and drive increased engagement with our services like Microsoft 365 Consumer, Teams, Edge, Bing, Xbox Game Pass, and more.
- Tackling security from all angles with our integrated, end-to-end solutions spanning security, compliance, identity, and management, across all clouds and platforms.
- Inventing new gaming experiences that bring people together around their shared love for games on any devices and pushing the boundaries of innovation with console and PC gaming by creating the next wave of entertainment.

Our future growth depends on our ability to transcend current product category definitions, business models, and sales motions. We have the opportunity to redefine what customers and partners can expect and are working to deliver new solutions that reflect the best of Microsoft.

COVID-19

In March 2020, the World Health Organization declared the outbreak of COVID-19 to be a pandemic. The COVID-19 pandemic continues to have widespread and unpredictable impacts on global society, economies, financial markets, and business practices, and continues to impact our business operations, including our employees, customers, partners, and communities. Refer to Management's Discussion and Analysis of Financial Condition and Results of Operations (Part II, Item 7 of this Form 10-K) for further discussion regarding the impact of COVID-19 on our fiscal year 2021 financial results. The extent to which the COVID-19 pandemic impacts our business going forward will depend on numerous evolving factors we cannot reliably predict. Refer to Risk Factors (Part I, Item 1A of this Form 10-K) for a discussion of these factors and other risks.

Corporate Social Responsibility

Commitment to Sustainability

We work to ensure that technology is inclusive, trusted, and increases sustainability. We are accelerating progress toward a more sustainable future by reducing our environmental footprint, advancing research, helping our customers build sustainable solutions, and advocating for policies that benefit the environment. In January 2020, we announced a bold commitment and detailed plan to be carbon negative by 2030, and to remove from the environment by 2050 all the carbon we have emitted since our founding in 1975. This included a commitment to invest $1 billion over four years in new technologies and innovative climate solutions. We built on this pledge by adding commitments to be water positive by 2030, zero waste by 2030, and to protect ecosystems by developing a Planetary Computer. We also help our suppliers and customers around the world use Microsoft technology to reduce their own carbon footprint.

In January 2021, we announced that in fiscal year 2020 we reduced Microsoft's carbon emissions by 586,683 metric tons. We purchased the removal of 1.3 million metric tons of carbon from 26 projects around the world. Furthermore, we shared a commitment to transparency by subjecting the data in our annual sustainability report to third-party review and to accountability by including progress on sustainability goals as a factor in determining executive pay.

The investments we make in sustainability carry through to our products, services, and devices. We design our devices, from Surface to Xbox, to minimize their impact on the environment. Our cloud and AI services and datacenters help businesses cut energy consumption, reduce physical footprints, and design sustainable products. We also pledged a $50 million investment in AI for Earth to accelerate innovation by putting AI in the hands of those working to directly address sustainability challenges. We are committed to playing our part to help accelerate the world's transition to a more economically and environmentally sustainable future for us all.

Addressing Racial Injustice and Inequity

Our future opportunity depends on reaching and empowering all communities, and we are committed to taking action to help address racial injustice and inequity. With significant input from employees and leaders who are members of the Black and African American community, our senior leadership team and board of directors announced in June 2020 that we had developed a set of actions to help improve the lived experience at Microsoft and drive change in the communities in which we live and work. These efforts include increasing our representation and strengthening our culture of inclusion by doubling the number of Black and African American people managers, senior individual contributors, and senior leaders in the United States by 2025; evolving our ecosystem with our supply chain, banking partners, and partner ecosystem; and strengthening our communities by using data, technology, and partnerships to help address racial injustice and inequities of the Black and African American communities in the U.S. and improve the safety and wellbeing of our employees and their communities.

Over the last year, we have collaborated with partners and worked within neighborhoods and communities to launch and scale a number of projects and programs including: expanding our existing justice reform work with a five-year, $50 million sustained effort, expanding access to affordable broadband and devices for Black and African American communities and key institutions that support them in major urban centers, expanding access to skills and education to support Black and African American students and adults to succeed in the digital economy, and increasing technology support for nonprofits that provide critical services to Black and African American communities.

We have more than doubled our percentage share of transaction volume with Black- and African American-owned financial institutions and increased our deposits with Black- and African American-owned minority depository institutions, enabling increased funds into local communities. Additionally, we have seen growth in our Black- and African American-owned supplier base and in Black- and African American-owned technology partners in the Microsoft Partner Network, and we launched the Black Channel Partner Alliance community to support partners onboarding to the Microsoft Cloud and to unlock partner benefits for co-selling with Microsoft.

We acknowledge we have more work ahead of us to address racial injustice and inequity, and are applying many of the programs above to help other underrepresented communities.

Investing in Digital Skills

With a continued focus on digital transformation, Microsoft is helping to ensure that no one is left behind, particularly as economies recover from the COVID-19 pandemic. We announced in June 2020 that we are expanding access to the digital skills that have become increasingly vital to many of the world's jobs, and especially to individuals hardest hit by recent job losses. Our skills initiative brings together learning resources, certification opportunities, and job-seeker tools from LinkedIn, GitHub, and Microsoft Learn, and is built on data insights drawn from LinkedIn's Economic Graph. We also invested $20 million in key non-profit partnerships through Microsoft Philanthropies to help people from underserved communities that are often excluded by the digital economy.

Over 42 million people across every continent have accessed free training through our skills initiative. The effort surpassed its initial goals and has been expanded with a new emphasis on connecting learners with jobs that help put their new training to use and connecting employers with skilled job seekers they might not find in traditional networks.

HUMAN CAPITAL RESOURCES

Overview

Microsoft aims to recruit, develop, and retain diverse, world-changing talent. To foster their and our success, we seek to create an environment where people can do their best work – a place where they can proudly be their authentic selves, guided by our values, and where they know their needs can be met. We strive to maximize the potential of our human capital resources by creating a respectful, rewarding, and inclusive work environment that enables our global employees to create products and services that further our mission to empower every person and every organization on the planet to achieve more.

As of June 30, 2021, we employed approximately 181,000 people on a full-time basis, 103,000 in the U.S. and 78,000 internationally. Of the total employed people, 67,000 were in operations, including manufacturing, distribution, product support, and consulting services; 60,000 were in product research and development; 40,000 were in sales and marketing; and 14,000 were in general and administration. Certain of our employees are subject to collective bargaining agreements.

Our Culture

Microsoft's culture is grounded in the growth mindset. This means everyone is on a continuous journey to learn and grow. We believe potential can be nurtured and is not pre-determined, and we should always be learning and curious - trying new things without fear of failure. We identified four attributes that allow growth mindset to flourish:

- Obsessing over what matters to our customers.
- Becoming more diverse and inclusive in everything we do.
- Operating as one company, One Microsoft, instead of multiple siloed businesses.
- Making a difference in the lives of each other, our customers, and the world around us.

Our employee listening systems enable us to gather feedback directly from our workforce to inform our programs and employee needs globally. 88% of employees globally participated in our fiscal year 2021 MS Poll engagement survey, which covers a variety of topics such as inclusion, pay and benefits, and learning and development. Throughout the fiscal year, we also collect nearly 75,000 Daily Pulse employee survey responses. During fiscal year 2021, our Daily Pulse surveys gave us invaluable insights into ways we could support employees through the COVID-19 pandemic and addressing racial injustice. In addition to poll and pulse surveys, we gain insights through onboarding and exit surveys, internal Yammer channels, employee Q&A sessions, and AskHR Service support.

Diversity and Inclusion

At Microsoft we have an inherently inclusive mission: to empower every person and every organization on the planet to achieve more. We think of diversity and inclusion as core to our business model, informing our actions to impact economies and people around the world. There are billions of people who want to achieve more, but have a different set of circumstances, abilities, and backgrounds that often limit access to opportunity and achievement. The better we represent that diversity inside Microsoft, the more effectively we can innovate for those we seek to empower.

We strive to include others by holding ourselves accountable for diversity, driving global systemic change in our workplace and workforce, and creating an inclusive work environment. Through this commitment we can allow everyone the chance to be their authentic selves and do their best work every day. We support multiple highly active Employee Resource Groups for women, families, racial and ethnic minorities, military, people with disabilities, or who identify as LGBTQI+, where employees can go for support, networking, and community-building. As described in our 2020 Proxy Statement, annual performance and compensation reviews of our senior leadership team include an evaluation of their contributions to employee culture and diversity. To ensure accountability over time, we publicly disclose our progress on a multitude of workforce metrics including:

- Detailed breakdowns of gender, racial, and ethnic minority representation in our employee population, with data by job types, levels, and segments of our business.
- Our EEO-1 report (equal employment opportunity).
- Disability representation.

Total Rewards

We develop dynamic, sustainable, and strategic programs with the goal of providing a highly differentiated portfolio to attract, reward, and retain top talent and enable our employees to do their best work. These programs reinforce our culture and values such as collaboration and growth mindset. Managers evaluate and recommend rewards based on, for example, how well we leverage the work of others and contribute to the success of our colleagues. We monitor pay equity and career progress across multiple dimensions.

As part of our effort to promote a One Microsoft and inclusive culture, we expanded stock eligibility to all Microsoft employees as part of our annual rewards process. This includes all non-exempt and exempt employees and equivalents across the globe including business support professionals and datacenter and retail employees.

Pay Equity

In our 2020 Diversity and Inclusion Report, we reported that all racial and ethnic minority employees in the U.S. combined earn $1.006 for every $1.000 earned by their white counterparts, that women in the U.S. earn $1.001 for every $1.000 earned by their counterparts in the U.S. who are men, and women in the U.S. plus our ten other largest employee geographies (Australia, Canada, China, France, Germany, India, Ireland, Israel, Japan, and United Kingdom) combined earn $1.000 for every $1.000 by men in these countries. Our intended result is a global performance and development approach that fosters our culture, and competitive compensation that ensures equitable pay by role while supporting pay for performance.

Wellness and Safety

Microsoft is committed to supporting our employees' well-being and safety while they are at work and in their personal lives.

We took a wide variety of measures to protect the health and well-being of our employees, suppliers, and customers during the COVID-19 pandemic. We made substantial modifications to employee travel policies and implemented office closures so non-essential employees could work remotely. We continued to pay hourly service providers such as cleaning and reception staff who may have otherwise been furloughed. We implemented a global Paid Pandemic School and Childcare Closure Leave to support working parents, added wellbeing days for those who needed to take time off for mental health and wellness, implemented on-demand COVID-19 testing and vaccinations on our Redmond, Washington campus, and extended full medical plan coverage for coronavirus testing, treatment, and telehealth services. We also expanded existing programs such as our Microsoft CARES Employee Assistance Program and family backup care.

In addition to the extraordinary steps and programs relating to COVID-19, our comprehensive benefits package includes many physical, emotional, and financial wellness programs including counseling through the Microsoft CARES Employee Assistance Program, flexible fitness benefits, savings and investment tools, adoption assistance, and back-up care for children and elders. Finally, our Occupational Health and Safety program helps ensure employees can stay safe while they are working.

Learning and Development

Our growth mindset culture begins with valuing learning over knowing – seeking out new ideas, driving innovation, embracing challenges, learning from failure, and improving over time. To support this culture, we offer a wide range of learning and development opportunities. We believe learning can be more than formal instruction, and our learning philosophy focuses on providing the right learning, at the right time, in the right way. Opportunities include:

- Personalized, integrated, and relevant views of all learning opportunities on our internal learning portal, our external learning portal MS Learn, and LinkedIn Learning that is available to all employees worldwide.
- In-the-classroom learning, learning "pods," our early-in-career Aspire program, and manager excellence communities.
- On-the-job "stretch" and advancement opportunities.
- Managers holding conversations about employees' career and development plans, coaching on career opportunities, and programs like mentoring and sponsorship.

- Customized manager learning to build people manager capabilities and similar learning solutions to build leadership skills for all employees including differentiated leadership development programs.

- New employee orientation covering a range of topics including company values, culture, and Standards of Business Conduct, as well as ongoing onboarding program.

Our employees embrace the growth mindset and take advantage of the formal learning opportunities as well as thousands of informal and on-the-job learning opportunities. In terms of formal on-line learning solutions, in fiscal year 2021 our employees completed over 5 million courses, averaging over 18 hours per employee. Given our focus on understanding core company beliefs and compliance topics, all employees complete required learning programs like Standards of Business Conduct, Privacy, Unconscious Bias, and preventing harassment courses. Our corporate learning portal has over 100,000 average monthly active users. All of our approximately 23,000 people managers must complete between 25-30 hours of required manager capability and excellence training and are assigned ongoing required training each year. In addition, all employees complete skills training based on the profession they are in each year.

New Ways of Working

The global pandemic has accelerated our capabilities and culture with respect to flexible work. Microsoft has introduced a Hybrid Workplace Flexibility Guide to better support managers and employees as they adapt to new ways of working that shift paradigms, embrace flexibility, promote inclusion, and drive innovation. Our ongoing survey data shows employees value the flexibility related to work location, work site, and work hours, and while many indicate they intend to return to a worksite once conditions permit, they also intend to adjust hours or spend some portions of workweeks working remotely. We are focused on building capabilities to support a variety of workstyles where individuals, teams, and our business can be successful.

OPERATING SEGMENTS

We operate our business and report our financial performance using three segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. Our segments provide management with a comprehensive financial view of our key businesses. The segments enable the alignment of strategies and objectives across the development, sales, marketing, and services organizations, and they provide a framework for timely and rational allocation of resources within businesses.

Additional information on our operating segments and geographic and product information is contained in Note 19 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Skype for Business.
- Office Consumer, including Microsoft 365 Consumer subscriptions and Office licensed on-premises, and Office Consumer Services, including Skype, Outlook.com, and OneDrive.
- LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, Sales Solutions, and Learning Solutions.
- Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications.

Office Commercial

Office Commercial is designed to increase personal, team, and organizational productivity through a range of products and services. Growth depends on our ability to reach new users in new markets such as frontline workers, small and medium businesses, and growth markets, as well as add value to our core product and service offerings to span productivity categories such as communication, collaboration, analytics, security, and compliance. Office Commercial revenue is mainly affected by a combination of continued installed base growth and average revenue per user expansion, as well as the continued shift from Office licensed on-premises to Office 365.

Office Consumer

Office Consumer is designed to increase personal productivity through a range of products and services. Growth depends on our ability to reach new users, add value to our core product set, and continue to expand our product and service offerings into new markets. Office Consumer revenue is mainly affected by the percentage of customers that buy Office with their new devices and the continued shift from Office licensed on-premises to Microsoft 365 Consumer subscriptions. Office Consumer Services revenue is mainly affected by the demand for communication and storage through Skype, Outlook.com, and OneDrive, which is largely driven by subscriptions, advertising, and the sale of minutes.

LinkedIn

LinkedIn connects the world’s professionals to make them more productive and successful and transforms the way companies hire, market, sell, and learn. Our vision is to create economic opportunity for every member of the global workforce through the ongoing development of the world’s first Economic Graph, a digital representation of the global economy. In addition to LinkedIn’s free services, LinkedIn offers monetized solutions: Talent Solutions, Marketing Solutions, Premium Subscriptions, Sales Solutions, and Learning Solutions. Talent Solutions provide insights for workforce planning and tools to hire, nurture, and develop talent. Marketing Solutions help companies reach, engage, and convert their audiences at scale. Premium Subscriptions enables professionals to manage their professional identity, grow their network, and connect with talent through additional services like premium search. Sales Solutions help companies strengthen customer relationships, empower teams with digital selling tools, and acquire new opportunities. Finally, Learning Solutions, including Glint, help businesses close critical skills gaps in times where companies are having to do more with existing talent. LinkedIn has over 750 million members and has offices around the globe. Growth will depend on our ability to increase the number of LinkedIn members and our ability to continue offering services that provide value for our members and increase their engagement. LinkedIn revenue is mainly affected by demand from enterprises and professional organizations for subscriptions to Talent Solutions, Learning Solutions, Sales Solutions, and Premium Subscriptions offerings, as well as member engagement and the quality of the sponsored content delivered to those members to drive Marketing Solutions.

Dynamics

Dynamics provides cloud-based and on-premises business solutions for financial management, enterprise resource planning (“ERP”), customer relationship management (“CRM”), supply chain management, and other application development platforms for small and medium businesses, large organizations, and divisions of global enterprises. Dynamics revenue is driven by the number of users licensed and applications consumed, expansion of average revenue per user, and the continued shift to Dynamics 365, a unified set of cloud-based intelligent business applications, including Power Apps and Power Automate.

Competition

Competitors to Office include software and global application vendors, such as Apple, Cisco Systems, Facebook, Google, IBM, Okta, Proofpoint, Slack, Symantec, Zoom, and numerous web-based and mobile application competitors as well as local application developers. Apple distributes versions of its pre-installed application software, such as email and calendar products, through its PCs, tablets, and phones. Cisco Systems is using its position in enterprise communications equipment to grow its unified communications business. Google provides a hosted messaging and productivity suite. Slack provides teamwork and collaboration software. Zoom offers videoconferencing and cloud phone solutions. Skype for Business and Skype also compete with a variety of instant messaging, voice, and video communication providers, ranging from start-ups to established enterprises. Okta, Proofpoint, and Symantec provide security solutions across email security, information protection, identity, and governance. Web-based offerings competing with individual applications have also positioned themselves as alternatives to our products and services. We compete by providing powerful, flexible, secure, integrated industry-specific, and easy-to-use productivity and collaboration tools and services that create comprehensive solutions and work well with technologies our customers already have both on-premises or in the cloud.

LinkedIn faces competition from online professional networks, recruiting companies, talent management companies, and larger companies that are focusing on talent management and human resource services; job boards; traditional recruiting firms; and companies that provide learning and development products and services. Marketing Solutions competes with online and offline outlets that generate revenue from advertisers and marketers, and Sales Solutions competes with online and offline outlets for companies with lead generation and customer intelligence and insights.

Dynamics competes with cloud-based and on-premises business solution providers such as Oracle, Salesforce.com, and SAP.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business and developers. This segment primarily comprises:

- Server products and cloud services, including Azure; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and GitHub.
- Enterprise Services, including Premier Support Services and Microsoft Consulting Services.

Server Products and Cloud Services

Azure is a comprehensive set of cloud services that offer developers, IT professionals, and enterprises freedom to build, deploy, and manage applications on any platform or device. Customers can use Azure through our global network of datacenters for computing, networking, storage, mobile and web application services, AI, IoT, cognitive services, and machine learning. Azure enables customers to devote more resources to development and use of applications that benefit their organizations, rather than managing on-premises hardware and software. Azure revenue is mainly affected by infrastructure-as-a-service and platform-as-a-service consumption-based services, and per user-based services such as Enterprise Mobility + Security.

Our server products are designed to make IT professionals, developers, and their systems more productive and efficient. Server software is integrated server infrastructure and middleware designed to support software applications built on the Windows Server operating system. This includes the server platform, database, business intelligence, storage, management and operations, virtualization, service-oriented architecture platform, security, and identity software. We also license standalone and software development lifecycle tools for software architects, developers, testers, and project managers. GitHub provides a collaboration platform and code hosting service for developers. Server products revenue is mainly affected by purchases through volume licensing programs, licenses sold to original equipment manufacturers (“OEM”), and retail packaged products. CALs provide access rights to certain server products, including SQL Server and Windows Server, and revenue is reported along with the associated server product.

Enterprise Services

Enterprise Services, including Premier Support Services and Microsoft Consulting Services, assist customers in developing, deploying, and managing Microsoft server and desktop solutions and provide training and certification to developers and IT professionals on various Microsoft products.

Competition

Azure faces diverse competition from companies such as Amazon, Google, IBM, Oracle, VMware, and open source offerings. Our Enterprise Mobility + Security offerings also compete with products from a range of competitors including identity vendors, security solution vendors, and numerous other security point solution vendors. Azure's competitive advantage includes enabling a hybrid cloud, allowing deployment of existing datacenters with our public cloud into a single, cohesive infrastructure, and the ability to run at a scale that meets the needs of businesses of all sizes and complexities. We believe our cloud's global scale, coupled with our broad portfolio of identity and security solutions, allows us to effectively solve complex cybersecurity challenges for our customers and differentiates us from the competition.

Our server products face competition from a wide variety of server operating systems and applications offered by companies with a range of market approaches. Vertically integrated computer manufacturers such as Hewlett-Packard, IBM, and Oracle offer their own versions of the Unix operating system preinstalled on server hardware. Nearly all computer manufacturers offer server hardware for the Linux operating system and many contribute to Linux operating system development. The competitive position of Linux has also benefited from the large number of compatible applications now produced by many commercial and non-commercial software developers. A number of companies, such as Red Hat, supply versions of Linux.

We compete to provide enterprise-wide computing solutions and point solutions with numerous commercial software vendors that offer solutions and middleware technology platforms, software applications for connectivity (both Internet and intranet), security, hosting, database, and e-business servers. IBM and Oracle lead a group of companies focused on the Java Platform Enterprise Edition that competes with our enterprise-wide computing solutions. Commercial competitors for our server applications for PC-based distributed client-server environments include CA Technologies, IBM, and Oracle. Our web application platform software competes with open source software such as Apache, Linux, MySQL, and PHP. In middleware, we compete against Java vendors.

Our database, business intelligence, and data warehousing solutions offerings compete with products from IBM, Oracle, SAP, and other companies. Our system management solutions compete with server management and server virtualization platform providers, such as BMC, CA Technologies, Hewlett-Packard, IBM, and VMware. Our products for software developers compete against offerings from Adobe, IBM, Oracle, and other companies, and also against open-source projects, including Eclipse (sponsored by CA Technologies, IBM, Oracle, and SAP), PHP, and Ruby on Rails.

We believe our server products provide customers with advantages in performance, total costs of ownership, and productivity by delivering superior applications, development tools, compatibility with a broad base of hardware and software applications, security, and manageability.

Our Enterprise Services business competes with a wide range of companies that provide strategy and business planning, application development, and infrastructure services, including multinational consulting firms and small niche businesses focused on specific technologies.

More Personal Computing

Our More Personal Computing segment consists of products and services that put customers at the center of the experience with our technology. This segment primarily comprises:

- Windows, including Windows OEM licensing ("Windows OEM") and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; Windows IoT; and MSN advertising.
- Devices, including Surface and PC accessories.
- Gaming, including Xbox hardware and Xbox content and services, comprising digital transactions, Xbox Game Pass and other subscriptions, video games, third-party video game royalties, cloud services, and advertising.
- Search advertising.

Windows

The Windows operating system is designed to deliver a more personal computing experience for users by enabling consistency of experience, applications, and information across their devices. Windows OEM revenue is impacted significantly by the number of Windows operating system licenses purchased by OEMs, which they pre-install on the devices they sell. In addition to computing device market volume, Windows OEM revenue is impacted by:

- The mix of computing devices based on form factor and screen size.
- Differences in device market demand between developed markets and growth markets.
- Attachment of Windows to devices shipped.
- Customer mix between consumer, small and medium businesses, and large enterprises.
- Changes in inventory levels in the OEM channel.
- Pricing changes and promotions, pricing variation that occurs when the mix of devices manufactured shifts from local and regional system builders to large multinational OEMs, and different pricing of Windows versions licensed.
- Constraints in the supply chain of device components.
- Piracy.

Windows Commercial revenue, which includes volume licensing of the Windows operating system and Windows cloud services such as Microsoft Defender Advanced Threat Protection, is affected mainly by the demand from commercial customers for volume licensing and Software Assurance (“SA”), as well as advanced security offerings. Windows Commercial revenue often reflects the number of information workers in a licensed enterprise and is relatively independent of the number of PCs sold in a given year.

Patent licensing includes our programs to license patents we own for use across a broad array of technology areas, including mobile devices and cloud offerings.

Windows IoT extends the power of Windows and the cloud to intelligent systems by delivering specialized operating systems, tools, and services for use in embedded devices.

MSN advertising includes both native and display ads.

Devices

We design and sell devices, including Surface and PC accessories. Our devices are designed to enable people and organizations to connect to the people and content that matter most using Windows and integrated Microsoft products and services. Surface is designed to help organizations, students, and consumers be more productive. Growth in Devices is dependent on total PC shipments, the ability to attract new customers, our product roadmap, and expanding into new categories.

Gaming

Our gaming platform is designed to provide a variety of entertainment through a unique combination of content, community, and cloud. Our exclusive game content is created through Xbox Game Studios, a collection of first-party studios creating iconic and differentiated gaming experiences. We continue to invest in new gaming studios and content to expand our IP roadmap and leverage new content creators. These unique gaming experiences are the cornerstone of Xbox Game Pass, a subscription service and gaming community with access to a curated library of over 100 first- and third-party console and PC titles.

The gamer remains at the heart of the Xbox ecosystem. We continue to open new opportunities for gamers to engage both on- and off-console with both the launch of Xbox Cloud Gaming, our game streaming service, and continued investment in gaming hardware. Xbox Cloud Gaming utilizes Microsoft’s Azure cloud technology to allow direct and on-demand streaming of games to PCs, consoles, and mobile devices, enabling gamers to take their favorites games with them and play on the device most convenient to them.

Xbox enables people to connect and share online gaming experiences that are accessible on Xbox consoles, Windows-enabled devices, and other devices. Xbox is designed to benefit users by providing access to a network of certified applications and services and to benefit our developer and partner ecosystems by providing access to a large customer base. Xbox revenue is mainly affected by subscriptions and sales of first- and third-party content, as well as advertising. Growth of our Gaming business is determined by the overall active user base through Xbox enabled content, availability of games, providing exclusive game content that gamers seek, the computational power and reliability of the devices used to access our content and services, and the ability to create new experiences through first-party content creators.

Search Advertising

Our Search business, including Bing and Microsoft Advertising, is designed to deliver relevant online advertising to a global audience. We have several partnerships with other companies, including Verizon Media Group, through which we provide and monetize search queries. Growth depends on our ability to attract new users, understand intent, and match intent with relevant content and advertiser offerings.

Competition

Windows faces competition from various software products and from alternative platforms and devices, mainly from Apple and Google. We believe Windows competes effectively by giving customers choice, value, flexibility, security, an easy-to-use interface, and compatibility with a broad range of hardware and software applications, including those that enable productivity.

Devices face competition from various computer, tablet, and hardware manufacturers who offer a unique combination of high-quality industrial design and innovative technologies across various price points. These manufacturers, many of which are also current or potential partners and customers, include Apple and our Windows OEMs.

Xbox and our cloud gaming services face competition from various online gaming ecosystems and game streaming services, including those operated by Amazon, Apple, Facebook, Google, and Tencent. We also compete with other providers of entertainment services such as video streaming platforms. Our gaming platform competes with console platforms from Nintendo and Sony, both of which have a large, established base of customers. We believe our gaming platform is effectively positioned against, and uniquely differentiated from, competitive products and services based on significant innovation in hardware architecture, user interface, developer tools, online gaming and entertainment services, and continued strong exclusive content from our own first-party game franchises as well as other digital content offerings.

Our search business competes with Google and a wide array of websites, social platforms like Facebook, and portals that provide content and online offerings to end users.

OPERATIONS

We have operations centers that support operations in their regions, including customer contract and order processing, credit and collections, information processing, and vendor management and logistics. The regional center in Ireland supports the European, Middle Eastern, and African region; the center in Singapore supports the Japan, India, Greater China, and Asia-Pacific region; and the centers in Fargo, North Dakota, Fort Lauderdale, Florida, Puerto Rico, Redmond, Washington, and Reno, Nevada support Latin America and North America. In addition to the operations centers, we also operate datacenters throughout the Americas, Europe, Australia, and Asia, as well as in the Middle East and Africa.

To serve the needs of customers around the world and to improve the quality and usability of products in international markets, we localize many of our products to reflect local languages and conventions. Localizing a product may require modifying the user interface, altering dialog boxes, and translating text.

Our devices are primarily manufactured by third-party contract manufacturers. For the majority of our products, we have the ability to use other manufacturers if a current vendor becomes unavailable or unable to meet our requirements. However, some of our products contain certain components for which there are very few qualified suppliers. For these components, we have limited near-term flexibility to use other manufacturers if a current vendor becomes unavailable or is unable to meet our requirements. Extended disruptions at these suppliers could lead to a similar disruption in our ability to manufacture devices on time to meet consumer demand.

RESEARCH AND DEVELOPMENT

Product and Service Development, and Intellectual Property

We develop most of our products and services internally through the following engineering groups.

- *Cloud and AI*, focuses on making IT professionals, developers, and their systems more productive and efficient through development of cloud infrastructure, server, database, CRM, ERP, management and development tools, AI cognitive services, and other business process applications and services for enterprises.
- *Experiences and Devices*, focuses on instilling a unifying product ethos across our end-user experiences and devices, including Office, Windows, Enterprise Mobility + Security, and Surface.
- *AI and Research*, focuses on our AI innovations and other forward-looking research and development efforts spanning infrastructure, services, applications, and search.
- *LinkedIn*, focuses on our services that transform the way customers hire, market, sell, and learn.
- *Gaming*, focuses on developing hardware, content, and services across a large range of platforms to help grow our user base through game experiences and social interaction.

Internal development allows us to maintain competitive advantages that come from product differentiation and closer technical control over our products and services. It also gives us the freedom to decide which modifications and enhancements are most important and when they should be implemented. We strive to obtain information as early as possible about changing usage patterns and hardware advances that may affect software and hardware design. Before releasing new software platforms, and as we make significant modifications to existing platforms, we provide application vendors with a range of resources and guidelines for development, training, and testing. Generally, we also create product documentation internally.

We protect our intellectual property investments in a variety of ways. We work actively in the U.S. and internationally to ensure the enforcement of copyright, trademark, trade secret, and other protections that apply to our software and hardware products, services, business plans, and branding. We are a leader among technology companies in pursuing patents and currently have a portfolio of over 65,000 U.S. and international patents issued and over 21,000 pending worldwide. While we employ much of our internally-developed intellectual property exclusively in our products and services, we also engage in outbound licensing of specific patented technologies that are incorporated into licensees' products. From time to time, we enter into broader cross-license agreements with other technology companies covering entire groups of patents. We may also purchase or license technology that we incorporate into our products and services. At times, we make select intellectual property broadly available at no or low cost to achieve a strategic objective, such as promoting industry standards, advancing interoperability, supporting societal and/or environmental efforts, or attracting and enabling our external development community. Our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations.

While it may be necessary in the future to seek or renew licenses relating to various aspects of our products, services, and business methods, we believe, based upon past experience and industry practice, such licenses generally can be obtained on commercially reasonable terms. We believe our continuing research and product development are not materially dependent on any single license or other agreement with a third party relating to the development of our products.

Investing in the Future

Our success is based on our ability to create new and compelling products, services, and experiences for our users, to initiate and embrace disruptive technology trends, to enter new geographic and product markets, and to drive broad adoption of our products and services. We invest in a range of emerging technology trends and breakthroughs that we believe offer significant opportunities to deliver value to our customers and growth for the Company. Based on our assessment of key technology trends, we maintain our long-term commitment to research and development across a wide spectrum of technologies, tools, and platforms spanning digital work and life experiences, cloud computing, AI, devices, and operating systems.

While our main product research and development facilities are located in Redmond, Washington, we also operate research and development facilities in other parts of the U.S. and around the world. This global approach helps us remain competitive in local markets and enables us to continue to attract top talent from across the world.

In addition to our main research and development operations, we also operate Microsoft Research. Microsoft Research is one of the world's largest corporate research organizations and works in close collaboration with top universities around the world to advance the state-of-the-art in computer science and a broad range of other disciplines, providing us a unique perspective on future trends and contributing to our innovation.

We generally fund research at the corporate level to ensure that we are looking beyond immediate product considerations to opportunities further in the future. We also fund research and development activities at the operating segment level. Much of our segment level research and development is coordinated with other segments and leveraged across the Company. We plan to continue to make significant investments in a broad range of research and development efforts.

DISTRIBUTION, SALES, AND MARKETING

We market and distribute our products and services through the following channels: OEMs, direct, and distributors and resellers. Our sales force performs a variety of functions, including working directly with commercial enterprises and public-sector organizations worldwide to identify and meet their technology and digital transformation requirements; managing OEM relationships; and supporting system integrators, independent software vendors, and other partners who engage directly with our customers to perform sales, consulting, and fulfillment functions for our products and services.

OEMs

We distribute our products and services through OEMs that pre-install our software on new devices and servers they sell. The largest component of the OEM business is the Windows operating system pre-installed on devices. OEMs also sell devices pre-installed with other Microsoft products and services, including applications such as Office and the capability to subscribe to Office 365.

There are two broad categories of OEMs. The largest category of OEMs are direct OEMs as our relationship with them is managed through a direct agreement between Microsoft and the OEM. We have distribution agreements covering one or more of our products with virtually all the multinational OEMs, including Dell, Hewlett-Packard, Lenovo, and with many regional and local OEMs. The second broad category of OEMs are system builders consisting of lower-volume PC manufacturers, which source Microsoft software for pre-installation and local redistribution primarily through the Microsoft distributor channel rather than through a direct agreement or relationship with Microsoft.

Direct

Many organizations that license our products and services transact directly with us through Enterprise Agreements and Enterprise Services contracts, with sales support from system integrators, independent software vendors, web agencies, and partners that advise organizations on licensing our products and services ("Enterprise Agreement Software Advisors" or "ESA"). Microsoft offers direct sales programs targeted to reach small, medium, and corporate customers, in addition to those offered through the reseller channel. A large network of partner advisors support many of these sales.

We also sell commercial and consumer products and services directly to customers, such as cloud services, search, and gaming, through our digital marketplaces and online stores. In fiscal year 2021, we closed our Microsoft Store physical locations and opened our Microsoft Experience Centers. Microsoft Experience Centers are designed to facilitate deeper engagement with our partners and customers across industries.

Distributors and Resellers

Organizations also license our products and services indirectly, primarily through licensing solution partners ("LSP"), distributors, value-added resellers ("VAR"), and retailers. Although each type of reselling partner may reach organizations of all sizes, LSPs are primarily engaged with large organizations, distributors resell primarily to VARs, and VARs typically reach small and medium organizations. ESAs are also typically authorized as LSPs and operate as resellers for our other volume licensing programs. Microsoft Cloud Solution Provider is our main partner program for reselling cloud services.

We distribute our retail packaged products primarily through independent non-exclusive distributors, authorized replicators, resellers, and retail outlets. Individual consumers obtain these products primarily through retail outlets. We distribute our devices through third-party retailers. We have a network of field sales representatives and field support personnel that solicit orders from distributors and resellers, and provide product training and sales support.

Our Dynamics business solutions are also licensed to enterprises through a global network of channel partners providing vertical solutions and specialized services.

LICENSING OPTIONS

We offer options for organizations that want to purchase our cloud services, on-premises software, and SA. We license software to organizations under volume licensing agreements to allow the customer to acquire multiple licenses of products and services instead of having to acquire separate licenses through retail channels. We use different programs designed to provide flexibility for organizations of various sizes. While these programs may differ in various parts of the world, generally they include those discussed below.

SA conveys rights to new software and upgrades for perpetual licenses released over the contract period. It also provides support, tools, training, and other licensing benefits to help customers deploy and use software efficiently. SA is included with certain volume licensing agreements and is an optional purchase with others.

Volume Licensing Programs

Enterprise Agreement

Enterprise Agreements offer large organizations a manageable volume licensing program that gives them the flexibility to buy cloud services and software licenses under one agreement. Enterprise Agreements are designed for medium or large organizations that want to license cloud services and on-premises software organization-wide over a three-year period. Organizations can elect to purchase perpetual licenses or subscribe to licenses. SA is included.

Microsoft Product and Services Agreement

Microsoft Product and Services Agreements are designed for medium and large organizations that want to license cloud services and on-premises software as needed, with no organization-wide commitment, under a single, non-expiring agreement. Organizations purchase perpetual licenses or subscribe to licenses. SA is optional for customers that purchase perpetual licenses.

Open

Open agreements are a simple, cost-effective way to acquire the latest Microsoft technology. Open agreements are designed for small and medium organizations that want to license cloud services and on-premises software over a one- to three-year period. Under the Open agreements, organizations purchase perpetual licenses and SA is optional. Under Open Value agreements, organizations can elect to purchase perpetual licenses or subscribe to licenses and SA is included.

Select Plus

Select Plus agreements are designed for government and academic organizations to acquire on-premises licenses at any affiliate or department level, while realizing advantages as one organization. Organizations purchase perpetual licenses and SA is optional.

Microsoft Online Subscription Agreement

Microsoft Online Subscription Agreements are designed for small and medium organizations that want to subscribe to, activate, provision, and maintain cloud services seamlessly and directly via the web. The agreement allows customers to acquire monthly or annual subscriptions for cloud-based services.

Partner Programs

The Microsoft Cloud Solution Provider program offers customers an easy way to license the cloud services they need in combination with the value-added services offered by their systems integrator, managed services provider, or cloud reseller partner. Partners in this program can easily package their own products and services to directly provision, manage, and support their customer subscriptions.

The Microsoft Services Provider License Agreement allows hosting service providers and independent software vendors who want to license eligible Microsoft software products to provide software services and hosted applications to their end customers. Partners license software over a three-year period and are billed monthly based on consumption.

The Independent Software Vendor Royalty program enables partners to integrate Microsoft products into other applications and then license the unified business solution to their end users.

CUSTOMERS

Our customers include individual consumers, small and medium organizations, large global enterprises, public-sector institutions, Internet service providers, application developers, and OEMs. Our practice is to ship our products promptly upon receipt of purchase orders from customers; consequently, backlog is not significant.

INFORMATION ABOUT OUR EXECUTIVE OFFICERS

Our executive officers as of July 29, 2021 were as follows:

Name	Age	Position with the Company
Satya Nadella	53	Chairman of the Board and Chief Executive Officer
Judson Althoff	48	Executive Vice President and Chief Commercial Officer
Christopher C. Capossela	51	Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer
Kathleen T. Hogan	55	Executive Vice President, Human Resources
Amy E. Hood	49	Executive Vice President, Chief Financial Officer
Bradford L. Smith	62	President and Chief Legal Officer
Christopher D. Young	49	Executive Vice President, Business Development, Strategy, and Ventures

Mr. Nadella was appointed Chairman of the Board in June 2021 and Chief Executive Officer in February 2014. He served as Executive Vice President, Cloud and Enterprise from July 2013 until that time. From 2011 to 2013, Mr. Nadella served as President, Server and Tools. From 2009 to 2011, he was Senior Vice President, Online Services Division. From 2008 to 2009, he was Senior Vice President, Search, Portal, and Advertising. Since joining Microsoft in 1992, Mr. Nadella's roles also included Vice President of the Business Division. Mr. Nadella also serves on the Board of Directors of Starbucks Corporation.

Mr. Althoff was appointed Executive Vice President and Chief Commercial Officer in July 2021. He served as Executive Vice President, Worldwide Commercial Business from July 2017 until that time. Prior to that, Mr. Althoff served as the President of Microsoft North America. Mr. Althoff joined Microsoft in March 2013 as President of Microsoft North America.

Mr. Capossela was appointed Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer in July 2016. He had served as Executive Vice President, Chief Marketing Officer since March 2014. Previously, he served as the worldwide leader of the Consumer Channels Group, responsible for sales and marketing activities with OEMs, operators, and retail partners. In his more than 28 years at Microsoft, Mr. Capossela has held a variety of marketing leadership roles in the Microsoft Office Division. He was responsible for marketing productivity solutions including Microsoft Office, Office 365, SharePoint, Exchange, Skype for Business, Project, and Visio.

Ms. Hogan was appointed Executive Vice President, Human Resources in November 2014. Prior to that Ms. Hogan was Corporate Vice President of Microsoft Services. She also served as Corporate Vice President of Customer Service and Support. Ms. Hogan joined Microsoft in 2003. Ms. Hogan also serves on the Board of Directors of Alaska Air Group, Inc.

Ms. Hood was appointed Executive Vice President and Chief Financial Officer in July 2013, subsequent to her appointment as Chief Financial Officer in May 2013. From 2010 to 2013, Ms. Hood was Chief Financial Officer of the Microsoft Business Division. From 2006 through 2009, Ms. Hood was General Manager, Microsoft Business Division Strategy. Since joining Microsoft in 2002, Ms. Hood has also held finance-related positions in the Server and Tools Business and the corporate finance organization. Ms. Hood also serves on the Board of Directors of 3M Corporation.

Mr. Smith was appointed President and Chief Legal Officer in September 2015. He served as Executive Vice President, General Counsel, and Secretary from 2011 to 2015, and served as Senior Vice President, General Counsel, and Secretary from 2001 to 2011. Mr. Smith was also named Chief Compliance Officer in 2002. Since joining Microsoft in 1993, he was Deputy General Counsel for Worldwide Sales and previously was responsible for managing the European Law and Corporate Affairs Group, based in Paris. Mr. Smith also serves on the Board of Directors of Netflix, Inc.

Mr. Young joined Microsoft in November 2020 as Executive Vice President, Business Development, Strategy, and Ventures. Prior to Microsoft, he served as the Chief Executive Officer of McAfee, LLC from 2017 to 2020, and served as a Senior Vice President and General Manager of Intel Security Group from 2014 until 2017, when he led the initiative to spin out McAfee into a standalone company. Mr. Young also serves on the Board of Directors of American Express Company.

AVAILABLE INFORMATION

Our Internet address is www.microsoft.com. At our Investor Relations website, www.microsoft.com/investor, we make available free of charge a variety of information for investors. Our goal is to maintain the Investor Relations website as a portal through which investors can easily find or navigate to pertinent information about us, including:

- Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file that material with or furnish it to the Securities and Exchange Commission ("SEC") at www.sec.gov.
- Information on our business strategies, financial results, and metrics for investors.
- Announcements of investor conferences, speeches, and events at which our executives talk about our product, service, and competitive strategies. Archives of these events are also available.
- Press releases on quarterly earnings, product and service announcements, legal developments, and international news.
- Corporate governance information including our articles of incorporation, bylaws, governance guidelines, committee charters, codes of conduct and ethics, global corporate social responsibility initiatives, and other governance-related policies.
- Other news and announcements that we may post from time to time that investors might find useful or interesting.
- Opportunities to sign up for email alerts to have information pushed in real time.

We publish a variety of reports and resources related to our Corporate Social Responsibility programs and progress on our Reports hub website, www.microsoft.com/corporate-responsibility/reports-hub, including reports on sustainability, responsible sourcing, accessibility, digital trust, and public policy engagement.

The information found on these websites is not part of, or incorporated by reference into, this or any other report we file with, or furnish to, the SEC. In addition to these channels, we use social media to communicate to the public. It is possible that the information we post on social media could be deemed to be material to investors. We encourage investors, the media, and others interested in Microsoft to review the information we post on the social media channels listed on our Investor Relations website.

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described below, that could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock.

STRATEGIC AND COMPETITIVE RISKS

We face intense competition across all markets for our products and services, which may lead to lower revenue or operating margins.

Competition in the technology sector

Our competitors range in size from diversified global companies with significant research and development resources to small, specialized firms whose narrower product lines may let them be more effective in deploying technical, marketing, and financial resources. Barriers to entry in many of our businesses are low and many of the areas in which we compete evolve rapidly with changing and disruptive technologies, shifting user needs, and frequent introductions of new products and services. Our ability to remain competitive depends on our success in making innovative products, devices, and services that appeal to businesses and consumers.

Competition among platform-based ecosystems

An important element of our business model has been to create platform-based ecosystems on which many participants can build diverse solutions. A well-established ecosystem creates beneficial network effects among users, application developers, and the platform provider that can accelerate growth. Establishing significant scale in the marketplace is necessary to achieve and maintain attractive margins. We face significant competition from firms that provide competing platforms.

- A competing vertically-integrated model, in which a single firm controls the software and hardware elements of a product and related services, has succeeded with some consumer products such as personal computers, tablets, phones, gaming consoles, wearables, and other endpoint devices. Competitors pursuing this model also earn revenue from services integrated with the hardware and software platform, including applications and content sold through their integrated marketplaces. They may also be able to claim security and performance benefits from their vertically integrated offer. We also offer some vertically-integrated hardware and software products and services. To the extent we shift a portion of our business to a vertically integrated model we increase our cost of revenue and reduce our operating margins.
- We derive substantial revenue from licenses of Windows operating systems on PCs. We face significant competition from competing platforms developed for new devices and form factors such as smartphones and tablet computers. These devices compete on multiple bases including price and the perceived utility of the device and its platform. Users are increasingly turning to these devices to perform functions that in the past were performed by personal computers. Even if many users view these devices as complementary to a personal computer, the prevalence of these devices may make it more difficult to attract application developers to our PC operating system platforms. Competing with operating systems licensed at low or no cost may decrease our PC operating system margins. Popular products or services offered on competing platforms could increase their competitive strength. In addition, some of our devices compete with products made by our original equipment manufacturer ("OEM") partners, which may affect their commitment to our platform.
- Competing platforms have content and application marketplaces with scale and significant installed bases. The variety and utility of content and applications available on a platform are important to device purchasing decisions. Users may incur costs to move data and buy new content and applications when switching platforms. To compete, we must successfully enlist developers to write applications for our platform and ensure that these applications have high quality, security, customer appeal, and value. Efforts to compete with competitors' content and application marketplaces may increase our cost of revenue and lower our operating margins. Competitors' rules governing their content and applications marketplaces may restrict our ability to distribute products and services through them in accordance with our technical and business model objectives.

Business model competition

Companies compete with us based on a growing variety of business models.

- Even as we transition more of our business to infrastructure-, platform-, and software-as-a-service business model, the license-based proprietary software model generates a substantial portion of our software revenue. We bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from licensing our products. Many of our competitors also develop and sell software to businesses and consumers under this model.
- Other competitors develop and offer free applications, online services and content, and make money by selling third-party advertising. Advertising revenue funds development of products and services these competitors provide to users at no or little cost, competing directly with our revenue-generating products.
- Some companies compete with us by modifying and then distributing open source software at little or no cost to end users, and earning revenue on advertising or integrated products and services. These firms do not bear the full costs of research and development for the open source software. Some open source software mimics the features and functionality of our products.

The competitive pressures described above may cause decreased sales volumes, price reductions, and/or increased operating costs, such as for research and development, marketing, and sales incentives. This may lead to lower revenue, gross margins, and operating income.

Our increasing focus on cloud-based services presents execution and competitive risks. A growing part of our business involves cloud-based services available across the spectrum of computing devices. Our strategic vision is to compete and grow by building best-in-class platforms and productivity services for an intelligent cloud and an intelligent edge infused with artificial intelligence (“AI”). At the same time, our competitors are rapidly developing and deploying cloud-based services for consumers and business customers. Pricing and delivery models are evolving. Devices and form factors influence how users access services in the cloud and sometimes the user’s choice of which cloud-based services to use. We are devoting significant resources to develop and deploy our cloud-based strategies. The Windows ecosystem must continue to evolve with this changing environment. We embrace cultural and organizational changes to drive accountability and eliminate obstacles to innovation. Our intelligent cloud and intelligent edge worldview is connected with the growth of the Internet of Things (“IoT”). Our success in the IoT will depend on the level of adoption of our offerings such as Azure, Azure Stack, Azure IoT Edge, and Azure Sphere. We may not establish market share sufficient to achieve scale necessary to achieve our business objectives.

Besides software development costs, we are incurring costs to build and maintain infrastructure to support cloud computing services. These costs will reduce the operating margins we have previously achieved. Whether we succeed in cloud-based services depends on our execution in several areas, including:

- Continuing to bring to market compelling cloud-based experiences that generate increasing traffic and market share.
- Maintaining the utility, compatibility, and performance of our cloud-based services on the growing array of computing devices, including PCs, smartphones, tablets, gaming consoles, and other devices, as well as sensors and other IoT endpoints.
- Continuing to enhance the attractiveness of our cloud platforms to third-party developers.
- Ensuring our cloud-based services meet the reliability expectations of our customers and maintain the security of their data as well as help them meet their own compliance needs.
- Making our suite of cloud-based services platform-agnostic, available on a wide range of devices and ecosystems, including those of our competitors.

It is uncertain whether our strategies will attract the users or generate the revenue required to succeed. If we are not effective in executing organizational and technical changes to increase efficiency and accelerate innovation, or if we fail to generate sufficient usage of our new products and services, we may not grow revenue in line with the infrastructure and development investments described above. This may negatively impact gross margins and operating income.

RISKS RELATING TO THE EVOLUTION OF OUR BUSINESS

We make significant investments in products and services that may not achieve expected returns. We will continue to make significant investments in research, development, and marketing for existing products, services, and technologies, including the Windows operating system, Microsoft 365, Office, Bing, SQL Server, Windows Server, Azure, Office 365, Xbox, LinkedIn, and other products and services. We also invest in the development and acquisition of a variety of hardware for productivity, communication, and entertainment including PCs, tablets, gaming devices, and HoloLens. Investments in new technology are speculative. Commercial success depends on many factors, including innovativeness, developer support, and effective distribution and marketing. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of new software and hardware products or upgrades, unfavorably affecting revenue. We may not achieve significant revenue from new product, service, and distribution channel investments for several years, if at all. New products and services may not be profitable, and even if they are profitable, operating margins for some new products and businesses will not be as high as the margins we have experienced historically. We may not get engagement in certain features, like Edge and Bing, that drive post-sale monetization opportunities. Our data handling practices across our products and services will continue to be under scrutiny and perceptions of mismanagement, driven by regulatory activity or negative public reaction to our practices or product experiences, which could negatively impact product and feature adoption, product design, and product quality.

Developing new technologies is complex. It can require long development and testing periods. Significant delays in new releases or significant problems in creating new products or services could adversely affect our revenue.

Acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business. We expect to continue making acquisitions and entering into joint ventures and strategic alliances as part of our long-term business strategy. For example, in October 2018 we completed our acquisition of GitHub, Inc. ("GitHub") for $7.5 billion, in March 2021 we completed our acquisition of ZeniMax Media Inc. for $8.1 billion, and in April 2021 we announced a definitive agreement to acquire Nuance Communications, Inc. for $19.7 billion. These acquisitions and other transactions and arrangements involve significant challenges and risks, including that they do not advance our business strategy, that we get an unsatisfactory return on our investment, that we have difficulty integrating and retaining new employees, business systems, and technology, that they distract management from our other businesses, or that announced transactions may not be completed. If an arrangement fails to adequately anticipate changing circumstances and interests of a party, it may result in early termination or renegotiation of the arrangement. The success of these transactions and arrangements will depend in part on our ability to leverage them to enhance our existing products and services or develop compelling new ones. It may take longer than expected to realize the full benefits from these transactions and arrangements such as increased revenue or enhanced efficiencies, or the benefits may ultimately be smaller than we expected. These events could adversely affect our consolidated financial statements.

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings. We acquire other companies and intangible assets and may not realize all the economic benefit from those acquisitions, which could cause an impairment of goodwill or intangibles. We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment at least annually. Factors that may be a change in circumstances, indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable, include a decline in our stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in industry segments in which we participate. We have in the past recorded, and may in the future be required to record, a significant charge in our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively affecting our results of operations.

CYBERSECURITY, DATA PRIVACY, AND PLATFORM ABUSE RISKS

Cyberattacks and security vulnerabilities could lead to reduced revenue, increased costs, liability claims, or harm to our reputation or competitive position.

Security of our information technology

Threats to IT security can take a variety of forms. Individual and groups of hackers and sophisticated organizations, including state-sponsored organizations or nation-states, continuously undertake attacks that pose threats to our customers and our IT. These actors may use a wide variety of methods, which may include developing and deploying malicious software or exploiting vulnerabilities in hardware, software, or other infrastructure in order to attack our products and services or gain access to our networks and datacenters, using social engineering techniques to induce our employees, users, partners, or customers to disclose passwords or other sensitive information or take other actions to gain access to our data or our users' or customers' data, or acting in a coordinated manner to launch distributed denial of service or other coordinated attacks. Nation state and state sponsored actors can deploy significant resources to plan and carry out exploits. Inadequate account security practices may also result in unauthorized access to confidential data. For example, system administrators may fail to timely remove employee account access when no longer appropriate. Employees or third parties may intentionally compromise our or our users' security or systems or reveal confidential information. Malicious actors may employ the IT supply chain to introduce malware through software updates or compromised supplier accounts or hardware.

Cyberthreats are constantly evolving and becoming increasingly sophisticated and complex, increasing the difficulty of detecting and successfully defending against them. We may have no current capability to detect certain vulnerabilities, which may allow them to persist in the environment over long periods of time. Cyberthreats can have cascading impacts that unfold with increasing speed across our internal networks and systems and those of our partners and customers. Breaches of our facilities, network, or data security could disrupt the security of our systems and business applications, impair our ability to provide services to our customers and protect the privacy of their data, result in product development delays, compromise confidential or technical business information harming our reputation or competitive position, result in theft or misuse of our intellectual property or other assets, require us to allocate more resources to improve technologies or remediate the impacts of attacks, or otherwise adversely affect our business.

The cyberattacks uncovered in late 2020 known as “Solorigate” or “Nobelium” are an example of a supply chain attack where malware was introduced to a software provider's customers, including us, through software updates. The attackers were later able to create false credentials that appeared legitimate to certain customers' systems. We may be targets of further attacks similar to Solorigate/Nobelium as both a supplier and consumer of IT.

In addition, our internal IT environment continues to evolve. Often, we are early adopters of new devices and technologies. We embrace new ways of sharing data and communicating internally and with partners and customers using methods such as social networking and other consumer-oriented technologies. Our business policies and internal security controls may not keep pace with these changes as new threats emerge.

Security of our products, services, devices, and customers' data

The security of our products and services is important in our customers' decisions to purchase or use our products or services across cloud and on-premises environments. Security threats are a significant challenge to companies like us whose business is providing technology products and services to others. Threats to our own IT infrastructure can also affect our customers. Customers using our cloud-based services rely on the security of our infrastructure, including hardware and other elements provided by third parties, to ensure the reliability of our services and the protection of their data. Adversaries tend to focus their efforts on the most popular operating systems, programs, and services, including many of ours, and we expect that to continue. In addition, adversaries can attack our customers' on-premises or cloud environments, sometimes exploiting previously unknown ("zero day") vulnerabilities, such as occurred in early calendar year 2021 with several of our Exchange Server on-premises products. Vulnerabilities in these or any product can persist even after we have issued security patches if customers have not installed the most recent updates, or if the attackers exploited the vulnerabilities before patching to install additional malware to further compromise customers' systems. Adversaries will continue to attack customers using our cloud services as customers embrace digital transformation. Adversaries that acquire user account information can use that information to compromise our users' accounts, including where accounts share the same attributes as passwords. Inadequate account security practices may also result in unauthorized access, and user activity may result in ransomware or other malicious software impacting a customer's use of our products or services. We are increasingly incorporating open source software into our products. There may be vulnerabilities in open source software that may make our products susceptible to cyberattacks.

Our customers operate complex IT systems with third-party hardware and software from multiple vendors that may include systems acquired over many years. They expect our products and services to support all these systems and products, including those that no longer incorporate the strongest current security advances or standards. As a result, we may not be able to discontinue support in our services for a product, service, standard, or feature solely because a more secure alternative is available. Failure to utilize the most current security advances and standards can increase our customers' vulnerability to attack. Further, customers of widely varied size and technical sophistication use our technology, and consequently may have limited capabilities and resources to help them adopt and implement state of the art cybersecurity practices and technologies. In addition, we must account for this wide variation of technical sophistication when defining default settings for our products and services, including security default settings, as these settings may limit or otherwise impact other aspects of IT operations and some customers may have limited capability to review and reset these defaults.

The Solorigate/Nobelium or similar cyberattacks may adversely impact our customers even if our production services are not directly compromised. We are committed to notifying our customers whose systems have been impacted as we become aware and have available information and actions for customers to help protect themselves. We are also committed to providing guidance and support on detection, tracking, and remediation. We may not be able to detect the existence or extent of these attacks for all of our customers or have information on how to detect or track an attack, especially where an attack involves on-premises software such as Exchange Server where we may have no or limited visibility into our customers' computing environments.

Development and deployment of defensive measures

To defend against security threats to our internal IT systems, our cloud-based services, and our customers' systems, we must continuously engineer more secure products and services, enhance security and reliability features, improve the deployment of software updates to address security vulnerabilities in our own products as well as those provided by others, develop mitigation technologies that help to secure customers from attacks even when software updates are not deployed, maintain the digital security infrastructure that protects the integrity of our network, products, and services, and provide security tools such as firewalls, anti-virus software, and advanced security and information about the need to deploy security measures and the impact of doing so. Customers in certain industries such as financial services, health care, and government may have enhanced or specialized requirements to which we must engineer our product and services.

The cost of measures to protect products and customer-facing services could reduce our operating margins. If we fail to do these things well, actual or perceived security vulnerabilities in our products and services, data corruption issues, or reduced performance could harm our reputation and lead customers to reduce or delay future purchases of products or subscriptions to services, or to use competing products or services. Customers may also spend more on protecting their existing computer systems from attack, which could delay adoption of additional products or services. Customers, and third parties granted access to their systems, may fail to update their systems, continue to run software or operating systems we no longer support, or may fail timely to install or enable security patches, or may otherwise fail to adopt adequate security practices. Any of these could adversely affect our reputation and revenue. Actual or perceived vulnerabilities may lead to claims against us. Our license agreements typically contain provisions that eliminate or limit our exposure to liability, but there is no assurance these provisions will withstand legal challenges. At times, to achieve commercial objectives, we may enter into agreements with larger liability exposure to customers.

Our products operate in conjunction with and are dependent on products and components across a broad ecosystem of third parties. If there is a security vulnerability in one of these components, and if there is a security exploit targeting it, we could face increased costs, liability claims, reduced revenue, or harm to our reputation or competitive position.

Disclosure and misuse of personal data could result in liability and harm our reputation. As we continue to grow the number and scale of our cloud-based offerings, we store and process increasingly large amounts of personally identifiable information of our customers and users. The continued occurrence of high-profile data breaches provides evidence of an external environment increasingly hostile to information security. Despite our efforts to improve the security controls across our business groups and geographies, it is possible our security controls over personal data, our training of employees and third parties on data security, and other practices we follow may not prevent the improper disclosure or misuse of customer or user data we or our vendors store and manage. In addition, third parties who have limited access to our customer or user data may use this data in unauthorized ways. Improper disclosure or misuse could harm our reputation, lead to legal exposure to customers or users, or subject us to liability under laws that protect personal data, resulting in increased costs or loss of revenue. Our software products and services also enable our customers and users to store and process personal data on-premises or, increasingly, in a cloud-based environment we host. Government authorities can sometimes require us to produce customer or user data in response to valid legal orders. In the U.S. and elsewhere, we advocate for transparency concerning these requests and appropriate limitations on government authority to compel disclosure. Despite our efforts to protect customer and user data, perceptions that the collection, use, and retention of personal information is not satisfactorily protected could inhibit sales of our products or services and could limit adoption of our cloud-based solutions by consumers, businesses, and government entities. Additional security measures we may take to address customer or user concerns, or constraints on our flexibility to determine where and how to operate datacenters in response to customer or user expectations or governmental rules or actions, may cause higher operating expenses or hinder growth of our products and services.

We may not be able to protect information in our products and services from use by others. LinkedIn and other Microsoft products and services contain valuable information and content protected by contractual restrictions or technical measures. In certain cases, we have made commitments to our members and users to limit access to or use of this information. Changes in the law or interpretations of the law may weaken our ability to prevent third parties from scraping or gathering information or content through use of bots or other measures and using it for their own benefit, thus diminishing the value of our products and services.

Abuse of our platforms may harm our reputation or user engagement.

Advertising, professional, and social platform abuses

For platform products and services that provide content or host ads that come from or can be influenced by third parties, including GitHub, LinkedIn, Microsoft Advertising, MSN, and Xbox, our reputation or user engagement may be negatively affected by activity that is hostile or inappropriate. This activity may come from users impersonating other people or organizations, use of our products or services to spread terrorist or violent extremist content or to disseminate information that may be viewed as misleading or intended to manipulate the opinions of our users, or the use of our products or services that violates our terms of service or otherwise for objectionable or illegal ends. Preventing or responding to these actions may require us to make substantial investments in people and technology and these investments may not be successful, adversely affecting our business and consolidated financial statements.

Digital safety and service misuse

Our hosted consumer services as well as our enterprise services may be used by third parties to disseminate harmful or illegal content in violation of our terms or applicable law. We may not proactively discover such content due to scale and the limitations of existing technologies, and when discovered by users, such content may negatively affect our reputation, our brands, and user engagement. Regulations and other initiatives to make platforms responsible for preventing or eliminating harmful content online are gaining momentum and we expect this to continue. We may be subject to enhanced regulatory oversight, civil or criminal liability, or reputational damage if we fail to comply with content moderation regulations, adversely affecting our business and consolidated financial statements.

The development of the IoT presents security, privacy, and execution risks. To support the growth of the intelligent cloud and the intelligent edge, we are developing products, services, and technologies to power the IoT, a network of distributed and interconnected devices employing sensors, data, and computing capabilities including AI. The IoT's great potential also carries substantial risks. IoT products and services may contain defects in design, manufacture, or operation that make them insecure or ineffective for their intended purposes. An IoT solution has multiple layers of hardware, sensors, processors, software, and firmware, several of which we may not develop or control. Each layer, including the weakest layer, can impact the security of the whole system. Many IoT devices have limited interfaces and ability to be updated or patched. IoT solutions may collect large amounts of data, and our handling of IoT data may not satisfy customers or regulatory requirements. IoT scenarios may increasingly affect personal health and safety. If IoT solutions that include our technologies do not work as intended, violate the law, or harm individuals or businesses, we may be subject to legal claims or enforcement actions. These risks, if realized, may increase our costs, damage our reputation or brands, or negatively impact our revenues or margins.

Issues in the use of AI in our offerings may result in reputational harm or liability. We are building AI into many of our offerings and we expect this element of our business to grow. We envision a future in which AI operating in our devices, applications, and the cloud helps our customers be more productive in their work and personal lives. As with many disruptive innovations, AI presents risks and challenges that could affect its adoption, and therefore our business. AI algorithms may be flawed. Datasets may be insufficient or contain biased information. Inappropriate or controversial data practices by Microsoft or others could impair the acceptance of AI solutions. These deficiencies could undermine the decisions, predictions, or analysis AI applications produce, subjecting us to competitive harm, legal liability, and brand or reputational harm. Some AI scenarios present ethical issues. If we enable or offer AI solutions that are controversial because of their impact on human rights, privacy, employment, or other social issues, we may experience brand or reputational harm.

OPERATIONAL RISKS

We may have excessive outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure. Our increasing user traffic, growth in services, and the complexity of our products and services demand more computing power. We spend substantial amounts to build, purchase, or lease datacenters and equipment and to upgrade our technology and network infrastructure to handle more traffic on our websites and in our datacenters. These demands continue to increase as we introduce new products and services and support the growth of existing services such as Bing, Azure, Microsoft Account services, Microsoft 365, Microsoft Teams, Dynamics 365, OneDrive, SharePoint Online, Skype, Xbox, and Outlook.com. We are rapidly growing our business of providing a platform and back-end hosting for services provided by third parties to their end users. Maintaining, securing, and expanding this infrastructure is expensive and complex, and requires development of principles for datacenter builds in geographies with higher safety risks. It requires that we maintain an Internet connectivity infrastructure and storage and compute capacity that is robust and reliable within competitive and regulatory constraints that continue to evolve. Inefficiencies or operational failures, including temporary or permanent loss of customer data, insufficient Internet connectivity, or inadequate storage and compute capacity, could diminish the quality of our products, services, and user experience resulting in contractual liability, claims by customers and other third parties, regulatory actions, damage to our reputation, and loss of current and potential users, subscribers, and advertisers, each of which may adversely impact our consolidated financial statements.

We may experience quality or supply problems. Our hardware products such as Xbox consoles, Surface devices, and other devices we design and market are highly complex and can have defects in design, manufacture, or associated software. We could incur significant expenses, lost revenue, and reputational harm as a result of recalls, safety alerts, or product liability claims if we fail to prevent, detect, or address such issues through design, testing, or warranty repairs.

Our software products and services also may experience quality or reliability problems. The highly sophisticated software we develop may contain bugs and other defects that interfere with their intended operation. Our customers increasingly rely on us for critical business functions and multiple workloads. Many of our products and services are interdependent with one another. Each of these circumstances potentially magnifies the impact of quality or reliability issues. Any defects we do not detect and fix in pre-release testing could cause reduced sales and revenue, damage to our reputation, repair or remediation costs, delays in the release of new products or versions, or legal liability. Although our license agreements typically contain provisions that eliminate or limit our exposure to liability, there is no assurance these provisions will withstand legal challenge.

We acquire some device and datacenter components from sole suppliers. Our competitors use some of the same suppliers and their demand for hardware components can affect the capacity available to us. If a component from a sole-source supplier is delayed or becomes unavailable, whether because of supplier capacity constraint, industry shortages, legal or regulatory changes that restrict supply sources, or other reasons, we may not obtain timely replacement supplies, resulting in reduced sales or inadequate datacenter capacity. Component shortages, excess or obsolete inventory, or price reductions resulting in inventory adjustments may increase our cost of revenue. Xbox consoles, Surface devices, datacenter servers, and other hardware are assembled in Asia and other geographies that may be subject to disruptions in the supply chain, resulting in shortages that would affect our revenue and operating margins. These same risks would apply to any other hardware and software products we may offer.

LEGAL, REGULATORY, AND LITIGATION RISKS

Government litigation and regulatory activity relating to competition rules may limit how we design and market our products. As a leading global software and device maker, government agencies closely scrutinize us under U.S. and foreign competition laws. Governments are actively enforcing competition laws and regulations, and this includes scrutiny in potentially large markets such as the European Union (“EU”), the U.S., and China. Some jurisdictions also allow competitors or consumers to assert claims of anti-competitive conduct. U.S. federal and state antitrust authorities have previously brought enforcement actions and continue to scrutinize our business.

The European Commission (“the Commission”) closely scrutinizes the design of high-volume Microsoft products and the terms on which we make certain technologies used in these products, such as file formats, programming interfaces, and protocols, available to other companies. Flagship product releases such as Windows can receive significant scrutiny under competition laws. For example, in 2004, the Commission ordered us to create new versions of our Windows operating system that do not include certain multimedia technologies and to provide our competitors with specifications for how to implement certain proprietary Windows communications protocols in their own products. In 2009, the Commission accepted a set of commitments we offered to address the Commission’s concerns relating to competition in web browsing software, including an undertaking to address Commission concerns relating to interoperability. The web browsing commitments expired in 2014. The remaining obligations may limit our ability to innovate in Windows or other products in the future, diminish the developer appeal of the Windows platform, and increase our product development costs. The availability of licenses related to protocols and file formats may enable competitors to develop software products that better mimic the functionality of our products, which could hamper sales of our products.

Our portfolio of first-party devices continues to grow; at the same time our OEM partners offer a large variety of devices for our platforms. As a result, increasingly we both cooperate and compete with our OEM partners, creating a risk that we fail to do so in compliance with competition rules. Regulatory scrutiny in this area may increase. Certain foreign governments, particularly in China and other countries in Asia, have advanced arguments under their competition laws that exert downward pressure on royalties for our intellectual property.

Government regulatory actions and court decisions such as these may result in fines or hinder our ability to provide the benefits of our software to consumers and businesses, reducing the attractiveness of our products and the revenue that come from them. New competition law actions could be initiated, potentially using previous actions as precedent. The outcome of such actions, or steps taken to avoid them, could adversely affect us in a variety of ways, including:

- We may have to choose between withdrawing products from certain geographies to avoid fines or designing and developing alternative versions of those products to comply with government rulings, which may entail a delay in a product release and removing functionality that customers want or on which developers rely.

- We may be required to make available licenses to our proprietary technologies on terms that do not reflect their fair market value or do not protect our associated intellectual property.
- We are subject to a variety of ongoing commitments because of court or administrative orders, consent decrees, or other voluntary actions we have taken. If we fail to comply with these commitments, we may incur litigation costs and be subject to substantial fines or other remedial actions.
- Our ability to realize anticipated Windows post-sale monetization opportunities may be limited.

Our global operations subject us to potential consequences under anti-corruption, trade, and other laws and regulations. The Foreign Corrupt Practices Act ("FCPA") and other anti-corruption laws and regulations ("Anti-Corruption Laws") prohibit corrupt payments by our employees, vendors, or agents, and the accounting provisions of the FCPA require us to maintain accurate books and records and adequate internal controls. From time to time, we receive inquiries from authorities in the U.S. and elsewhere which may be based on reports from employees and others about our business activities outside the U.S. and our compliance with Anti-Corruption Laws. Periodically, we receive such reports directly and investigate them. On July 22, 2019, our Hungarian subsidiary entered into a non-prosecution agreement ("NPA") with the U.S. Department of Justice ("DOJ") and we agreed to the terms of a cease and desist order with the Securities and Exchange Commission. These agreements required us to pay $25.3 million in monetary penalties, disgorgement, and interest pertaining to activities at Microsoft's subsidiary in Hungary. The NPA, which has a three-year term, also contains certain ongoing compliance requirements, including the obligations to disclose to the DOJ issues that may implicate the FCPA and to cooperate in any inquiries. Most countries in which we operate also have competition laws that prohibit competitors from colluding or otherwise attempting to reduce competition between themselves. While we devote substantial resources to our U.S. and international compliance programs and have implemented policies, training, and internal controls designed to reduce the risk of corrupt payments and collusive activity, our employees, vendors, or agents may violate our policies. Our failure to comply with Anti-Corruption Laws or competition laws could result in significant fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation.

Increasing trade laws, policies, sanctions, and other regulatory requirements also affect our operations in and outside the U.S. relating to trade and investment. Economic sanctions in the U.S., the EU, and other countries prohibit most business with restricted entities or countries such as Crimea, Cuba, Iran, North Korea, and Syria. U.S. export controls restrict Microsoft from offering many of its products and services to, or making investments in, certain entities in specified countries. U.S. import controls restrict us from integrating certain information and communication technologies into our supply chain and allow for government review of transactions involving information and communications technology from countries determined to be foreign adversaries. Non-compliance could result in reputational harm, operational delays, monetary fines, loss of export privileges, or criminal sanctions.

Other regulatory areas that may apply to our products and online services offerings include requirements related to user privacy, telecommunications, data storage and protection, advertising, and online content. For example, some regulators are taking the position that our offerings such as Microsoft Teams and Skype are covered by existing laws regulating telecommunications services, and some new laws, including EU Member State laws under the European Electronic Communications Code, are defining more of our services as regulated telecommunications services. This trend may continue and will result in these offerings being subjected to additional data protection, security, and law enforcement surveillance obligations. Regulators may assert that our collection, use, and management of customer and other data is inconsistent with their laws and regulations. Legislative or regulatory action relating to cybersecurity requirements may increase the costs to develop, implement, or secure our products and services. Legislative and regulatory action is emerging in the areas of AI and content moderation, which could increase costs or restrict opportunity. Applying these laws and regulations to our business is often unclear, subject to change over time, and sometimes may conflict from jurisdiction to jurisdiction. Additionally, these laws and governments' approach to their enforcement, and our products and services, are continuing to evolve. Compliance with these types of regulation may involve significant costs or require changes in products or business practices that result in reduced revenue. Noncompliance could result in the imposition of penalties or orders we stop the alleged noncompliant activity.

We strive to empower all people and organizations to achieve more, and accessibility of our products is an important aspect of this goal. There is increasing pressure from advocacy groups, regulators, competitors, customers, and other stakeholders to make technology more accessible. If our products do not meet customer expectations or global accessibility requirements, we could lose sales opportunities or face regulatory or legal actions.

Laws and regulations relating to the handling of personal data may impede the adoption of our services or result in increased costs, legal claims, fines against us, or reputational damage. The growth of our Internet- and cloud-based services internationally relies increasingly on the movement of data across national boundaries. Legal requirements relating to the collection, storage, handling, and transfer of personal data continue to evolve. For example, in July 2020 the Court of Justice of the EU invalidated a framework called Privacy Shield for companies to transfer data from EU member states to the United States. This ruling has led to uncertainty about the legal requirements for data transfers from the EU under other legal mechanisms. Potential new rules and restrictions on the flow of data across borders could increase the cost and complexity of delivering our products and services in some markets. In May 2018, the EU General Data Protection Regulation ("GDPR"), became effective. The law, which applies to all of our activities conducted from an establishment in the EU or related to products and services offered in the EU, imposes a range of compliance obligations regarding the handling of personal data. Engineering efforts to build and maintain capabilities to facilitate compliance with the law have entailed substantial expense and the diversion of engineering resources from other projects and may continue to do so. We might experience reduced demand for our offerings if we are unable to engineer products that meet our legal duties or help our customers meet their obligations under the GDPR or other data regulations, or if our implementation to comply with the GDPR makes our offerings less attractive. The GDPR imposes significant new obligations and compliance with these obligations depends in part on how particular regulators interpret and apply them. If we fail to comply with the GDPR, or if regulators assert we have failed to comply with the GDPR, it may lead to regulatory enforcement actions, which can result in monetary penalties of up to 4% of worldwide revenue, private lawsuits, reputational damage, and loss of customers. Countries around the world, and states in the U.S. such as California, Colorado, and Virginia, have adopted, or are considering adopting or expanding, laws and regulations imposing obligations regarding the handling of personal data.

The Company's investment in gaining insights from data is becoming central to the value of the services we deliver to customers, to our operational efficiency and key opportunities in monetization, customer perceptions of quality, and operational efficiency. Our ability to use data in this way may be constrained by regulatory developments that impede realizing the expected return from this investment. Ongoing legal analyses, reviews, and inquiries by regulators of Microsoft practices, or relevant practices of other organizations, may result in burdensome or inconsistent requirements, including data sovereignty and localization requirements, affecting the location, movement, collection, and use of our customer and internal employee data as well as the management of that data. Compliance with applicable laws and regulations regarding personal data may require changes in services, business practices, or internal systems that result in increased costs, lower revenue, reduced efficiency, or greater difficulty in competing with foreign-based firms. Compliance with data regulations might limit our ability to innovate or offer certain features and functionality in some jurisdictions where we operate. Failure to comply with existing or new rules may result in significant penalties or orders to stop the alleged noncompliant activity, as well as negative publicity and diversion of management time and effort.

We have claims and lawsuits against us that may result in adverse outcomes. We are subject to a variety of claims and lawsuits. These claims may arise from a wide variety of business practices and initiatives, including major new product releases such as Windows, significant business transactions, warranty or product claims, and employment practices. Adverse outcomes in some or all of these claims may result in significant monetary damages or injunctive relief that could adversely affect our ability to conduct our business. The litigation and other claims are subject to inherent uncertainties and management's view of these matters may change in the future. A material adverse impact in our consolidated financial statements could occur for the period in which the effect of an unfavorable outcome becomes probable and reasonably estimable.

Our business with government customers may present additional uncertainties. We derive substantial revenue from government contracts. Government contracts generally can present risks and challenges not present in private commercial agreements. For instance, we may be subject to government audits and investigations relating to these contracts, we could be suspended or debarred as a governmental contractor, we could incur civil and criminal fines and penalties, and under certain circumstances contracts may be rescinded. Some agreements may allow a government to terminate without cause and provide for higher liability limits for certain losses. Some contracts may be subject to periodic funding approval, reductions, or delays which could adversely impact public-sector demand for our products and services. These events could negatively impact our results of operations, financial condition, and reputation.

We may have additional tax liabilities. We are subject to income taxes in the U.S. and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. For example, compliance with the 2017 United States Tax Cuts and Jobs Act ("TCJA") and possible future legislative changes may require the collection of information not regularly produced within the Company, the use of estimates in our consolidated financial statements, and the exercise of significant judgment in accounting for its provisions. As regulations and guidance evolve with respect to the TCJA or possible future legislative changes, and as we gather more information and perform more analysis, our results may differ from previous estimates and may materially affect our consolidated financial statements.

We regularly are under audit by tax authorities in different jurisdictions. Although we believe that our provision for income taxes and our tax estimates are reasonable, tax authorities may disagree with certain positions we have taken. In addition, economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes favorably more difficult. We are currently under Internal Revenue Service audit for prior tax years, with the primary unresolved issues relating to transfer pricing. The final resolution of those audits, and other audits or litigation, may differ from the amounts recorded in our consolidated financial statements and may materially affect our consolidated financial statements in the period or periods in which that determination is made.

We earn a significant amount of our operating income outside the U.S. A change in the mix of earnings and losses in countries with differing statutory tax rates, changes in our business or structure, or the expiration of or disputes about certain tax agreements in a particular country may result in higher effective tax rates for the Company. In addition, changes in U.S. federal and state or international tax laws applicable to corporate multinationals, other fundamental law changes currently being considered by many countries, including in the U.S., and changes in taxing jurisdictions' administrative interpretations, decisions, policies, and positions may materially adversely impact our consolidated financial statements.

INTELLECTUAL PROPERTY RISKS

We may not be able to protect our source code from copying if there is an unauthorized disclosure. Source code, the detailed program commands for our operating systems and other software programs, is critical to our business. Although we license portions of our application and operating system source code to several licensees, we take significant measures to protect the secrecy of large portions of our source code. If our source code leaks, we might lose future trade secret protection for that code. It may then become easier for third parties to compete with our products by copying functionality, which could adversely affect our revenue and operating margins. Unauthorized disclosure of source code also could increase the security risks described elsewhere in these risk factors.

Legal changes, our evolving business model, piracy, and other factors may decrease the value of our intellectual property. Protecting our intellectual property rights and combating unlicensed copying and use of our software and other intellectual property on a global basis is difficult. While piracy adversely affects U.S. revenue, the impact on revenue from outside the U.S. is more significant, particularly countries in which the legal system provides less protection for intellectual property rights. Our revenue in these markets may grow more slowly than the underlying device market. Similarly, the absence of harmonized patent laws makes it more difficult to ensure consistent respect for patent rights. Throughout the world, we educate users about the benefits of licensing genuine products and obtaining indemnification benefits for intellectual property risks, and we educate lawmakers about the advantages of a business climate where intellectual property rights are protected. Reductions in the legal protection for software intellectual property rights could adversely affect revenue.

We expend significant resources to patent the intellectual property we create with the expectation that we will generate revenues by incorporating that intellectual property in our products or services or, in some instances, by licensing or cross-licensing our patents to others in return for a royalty and/or increased freedom to operate. Changes in the law may continue to weaken our ability to prevent the use of patented technology or collect revenue for licensing our patents. These include legislative changes and regulatory actions that make it more difficult to obtain injunctions, and the increasing use of legal process to challenge issued patents. Similarly, licensees of our patents may fail to satisfy their obligations to pay us royalties or may contest the scope and extent of their obligations. The royalties we can obtain to monetize our intellectual property may decline because of the evolution of technology, price changes in products using licensed patents, greater value from cross-licensing, or the difficulty of discovering infringements.

Finally, our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations and may negatively impact revenue.

Third parties may claim we infringe their intellectual property rights. From time to time, others claim we infringe their intellectual property rights. The number of these claims may grow because of constant technological change in the markets in which we compete, the extensive patent coverage of existing technologies, the rapid rate of issuance of new patents, and our offering of first-party devices, such as Surface. To resolve these claims, we may enter into royalty and licensing agreements on terms that are less favorable than currently available, stop selling or redesign affected products or services, or pay damages to satisfy indemnification commitments with our customers. These outcomes may cause operating margins to decline. Besides money damages, in some jurisdictions plaintiffs can seek injunctive relief that may limit or prevent importing, marketing, and selling our products or services that have infringing technologies. In some countries, such as Germany, an injunction can be issued before the parties have fully litigated the validity of the underlying patents. We have paid significant amounts to settle claims related to the use of technology and intellectual property rights and to procure intellectual property rights as part of our strategy to manage this risk, and may continue to do so.

GENERAL RISKS

If our reputation or our brands are damaged, our business and operating results may be harmed. Our reputation and brands are globally recognized and are important to our business. Our reputation and brands affect our ability to attract and retain consumer, business, and public-sector customers. There are numerous ways our reputation or brands could be damaged. These include product safety or quality issues, or our environmental impact and sustainability, supply chain practices, or human rights record. We may experience backlash from customers, government entities, advocacy groups, employees, and other stakeholders that disagree with our product offering decisions or public policy positions. Damage to our reputation or our brands may occur from, among other things:

- The introduction of new features, products, services, or terms of service that customers, users, or partners do not like.
- Public scrutiny of our decisions regarding user privacy, data practices, or content.
- Data security breaches, compliance failures, or actions of partners or individual employees.

The proliferation of social media may increase the likelihood, speed, and magnitude of negative brand events. If our brands or reputation are damaged, it could negatively impact our revenues or margins, or ability to attract the most highly qualified employees.

Adverse economic or market conditions may harm our business. Worsening economic conditions, including inflation, recession, pandemic, or other changes in economic conditions, may cause lower IT spending and adversely affect our revenue. If demand for PCs, servers, and other computing devices declines, or consumer or business spending for those products declines, our revenue will be adversely affected.

Our product distribution system relies on an extensive partner and retail network. OEMs building devices that run our software have also been a significant means of distribution. The impact of economic conditions on our partners, such as the bankruptcy of a major distributor, OEM, or retailer, could cause sales channel disruption.

Challenging economic conditions also may impair the ability of our customers to pay for products and services they have purchased. As a result, allowances for doubtful accounts and write-offs of accounts receivable may increase.

We maintain an investment portfolio of various holdings, types, and maturities. These investments are subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by market downturns or events that affect global financial markets. A significant part of our investment portfolio comprises U.S. government securities. If global financial markets decline for long periods, or if there is a downgrade of the U.S. government credit rating due to an actual or threatened default on government debt, our investment portfolio may be adversely affected and we could determine that more of our investments have experienced a decline in fair value, requiring impairment charges that could adversely affect our consolidated financial statements.

Catastrophic events or geopolitical conditions may disrupt our business. A disruption or failure of our systems or operations because of a major earthquake, weather event, cyberattack, terrorist attack, pandemic, or other catastrophic event could cause delays in completing sales, providing services, or performing other critical functions. Our corporate headquarters, a significant portion of our research and development activities, and certain other essential business operations are in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are seismically active regions. A catastrophic event that results in the destruction or disruption of any of our critical business or IT systems, or the infrastructure or systems they rely on, such as power grids, could harm our ability to conduct normal business operations. Providing our customers with more services and solutions in the cloud puts a premium on the resilience of our systems and strength of our business continuity management plans and magnifies the potential impact of prolonged service outages in our consolidated financial statements.

Abrupt political change, terrorist activity, and armed conflict pose a risk of general economic disruption in affected countries, which may increase our operating costs. These conditions also may add uncertainty to the timing and budget for technology investment decisions by our customers and may cause supply chain disruptions for hardware manufacturers. Geopolitical change may result in changing regulatory systems and requirements and market interventions that could impact our operating strategies, access to national, regional, and global markets, hiring, and profitability. Geopolitical instability may lead to sanctions and impact our ability to do business in some markets or with some public-sector customers. Any of these changes may negatively impact our revenues.

The occurrence of regional epidemics or a global pandemic may adversely affect our operations, financial condition, and results of operations. The COVID-19 pandemic continues to have widespread, rapidly evolving, and unpredictable impacts on global society, economies, financial markets, and business practices. Federal and state governments have implemented measures to contain the virus, including social distancing, travel restrictions, and vaccination programs. Even as efforts to contain the pandemic have made progress and some restrictions have relaxed, new variants of the virus are causing additional outbreaks. The COVID-19 pandemic has impacted and may continue to impact our business operations, including our employees, customers, partners, and communities, and there is substantial uncertainty in the nature and degree of its continued effects over time.

The extent to which the COVID-19 pandemic impacts our business going forward will depend on numerous evolving factors we cannot reliably predict, including the duration and scope of the pandemic; governmental, business, and individuals' actions in response to the pandemic; and the impact on economic activity including the possibility of recession or financial market instability. These factors may adversely impact consumer, business, and government spending on technology as well as customers' ability to pay for our products and services on an ongoing basis. This uncertainty also affects management's accounting estimates and assumptions, which could result in greater variability in a variety of areas that depend on these estimates and assumptions, including investments, receivables, and forward-looking guidance.

Measures to contain the virus that impact us, our partners, distributors, and suppliers may further intensify these impacts and other risks described in these Risk Factors. Any of these may adversely impact our ability to:

- Maintain our operations infrastructure, including the reliability and adequate capacity of cloud services.
- Satisfy our contractual and regulatory compliance obligations as we adapt to changing usage patterns, such as through datacenter load balancing.
- Ensure a high-quality and consistent supply chain and manufacturing operations for our hardware devices and datacenter operations.
- Effectively manage our international operations through changes in trade practices and policies.
- Hire and deploy people where we most need them.
- Sustain the effectiveness and productivity of our operations including our sales, marketing, engineering, and distribution functions.

We may incur increased costs to effectively manage these aspects of our business. If we are unsuccessful it may adversely impact our revenues, cash flows, market share growth, and reputation.

The long-term effects of climate change on the global economy and the IT industry in particular are unclear. Environmental regulations or changes in the supply, demand or available sources of energy or other resources may affect the availability or cost of goods and services, including natural resources, necessary to run our business. Changes in climate where we operate may increase the costs of powering and cooling computer hardware we use to develop software and provide cloud-based services.

Our global business exposes us to operational and economic risks. Our customers are located throughout the world and a significant part of our revenue comes from international sales. The global nature of our business creates operational, economic, and geopolitical risks. Our results of operations may be affected by global, regional, and local economic developments, monetary policy, inflation, and recession, as well as political and military disputes. In addition, our international growth strategy includes certain markets, the developing nature of which presents several risks, including deterioration of social, political, labor, or economic conditions in a country or region, and difficulties in staffing and managing foreign operations. Emerging nationalist and protectionist trends and concerns about human rights and political expression in specific countries may significantly alter the trade and commercial environments. Changes to trade policy or agreements as a result of populism, protectionism, or economic nationalism may result in higher tariffs, local sourcing initiatives, and non-local sourcing restrictions, export controls, investment restrictions, or other developments that make it more difficult to sell our products in foreign countries. Disruptions of these kinds in developed or emerging markets could negatively impact demand for our products and services or increase operating costs. Although we hedge a portion of our international currency exposure, significant fluctuations in foreign exchange rates between the U.S. dollar and foreign currencies may adversely affect our results of operations.

Our business depends on our ability to attract and retain talented employees. Our business is based on successfully attracting and retaining talented employees representing diverse backgrounds, experiences, and skill sets. The market for highly skilled workers and leaders in our industry is extremely competitive. Maintaining our brand and reputation, as well as a diverse and inclusive work environment that enables all our employees to thrive, are important to our ability to recruit and retain employees. We are also limited in our ability to recruit internationally by restrictive domestic immigration laws. Changes to U.S. immigration policies that restrain the flow of technical and professional talent may inhibit our ability to adequately staff our research and development efforts. If we are less successful in our recruiting efforts, or if we cannot retain highly skilled workers and key leaders, our ability to develop and deliver successful products and services may be adversely affected. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees could hinder our strategic planning and execution. How employment-related laws are interpreted and applied to our workforce practices may result in increased operating costs and less flexibility in how we meet our workforce needs.

ITEM 1B. UNRESOLVED STAFF COMMENTS

We have received no written comments regarding our periodic or current reports from the staff of the Securities and Exchange Commission that were issued 180 days or more preceding the end of our fiscal year 2021 that remain unresolved.

ITEM 2. PROPERTIES

Our corporate headquarters are located in Redmond, Washington. We have approximately 15 million square feet of space located in King County, Washington that is used for engineering, sales, marketing, and operations, among other general and administrative purposes. These facilities include approximately 10 million square feet of owned space situated on approximately 520 acres of land we own at our corporate headquarters, and approximately 5 million square feet of space we lease. In addition, we own and lease space domestically that includes office and datacenter space.

We also own and lease facilities internationally for datacenters, research and development, and other operations. The largest owned properties include space in the following locations: China, India, Ireland, the Netherlands, Singapore, and South Korea. The largest leased properties include space in the following locations: Australia, Canada, China, France, Germany, India, Israel, Japan, Netherlands, and the United Kingdom.

In addition to the above locations, we have various product development facilities, both domestically and internationally, as described under Research and Development (Part I, Item 1 of this Form 10-K).

The table below shows a summary of the square footage of our office, datacenter, and other facilities owned and leased domestically and internationally as of June 30, 2021:

(Square feet in millions)

Location	**Owned**	**Leased**	**Total**
U.S.	**22**	**17**	**39**
International	**9**	**19**	**28**
Total	**31**	**36**	**67**

ITEM 3. LEGAL PROCEEDINGS

While not material to the Company, the Company was required to make annual reports of the general activities of the Company's Antitrust Compliance Office as required by the Final Order and Judgment in *Barovic v. Ballmer et al,* United States District Court for the Western District of Washington ("Final Order"). For more information see http://aka.ms/MSLegalNotice2015. The Final Order expired in April of 2021. During fiscal year 2021, the Antitrust Compliance Office (a) monitored the Company's compliance with the European Commission Decision of March 24, 2004, ("2004 Decision") and with the Company's Public Undertaking to the European Commission dated December 16, 2009 ("2009 Undertaking"); (b) monitored, in the manner required by the Final Order, employee, customer, competitor, regulator, or other third-party complaints regarding compliance with the 2004 Decision, the 2009 Undertaking, or other EU or U.S. laws or regulations governing tying, bundling, and exclusive dealing contracts; and, (c) monitored, in the manner required by the Final Order, the training of the Company's employees regarding the Company's antitrust compliance polices. In addition, prior to expiration of the Final Order, the Antitrust Compliance Officer reported to the Regulatory and Public Policy Committee of the Board at each of its regularly scheduled meetings.

Refer to Note 15 – Contingencies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for information regarding legal proceedings in which we are involved.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

MARKET AND STOCKHOLDERS

Our common stock is traded on the NASDAQ Stock Market under the symbol MSFT. On July 26, 2021, there were 89,291 registered holders of record of our common stock.

SHARE REPURCHASES AND DIVIDENDS

Following are our monthly share repurchases for the fourth quarter of fiscal year 2021:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs
				(In millions)
April 1, 2021 – April 30, 2021	**7,493,732**	**$ 255.23**	**7,493,732**	**$ 13,030**
May 1, 2021 – May 31, 2021	**8,823,524**	**247.36**	**8,823,524**	**10,847**
June 1, 2021 – June 30, 2021	**8,155,857**	**258.07**	**8,155,857**	**8,742**
	24,473,113		**24,473,113**	

All share repurchases were made using cash resources. Our share repurchases may occur through open market purchases or pursuant to a Rule 10b5-1 trading plan. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards.

Our Board of Directors declared the following dividends during the fourth quarter of fiscal year 2021:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
June 16, 2021	**August 19, 2021**	**September 9, 2021**	**$ 0.56**	**$ 4,211**

We returned $10.4 billion to shareholders in the form of share repurchases and dividends in the fourth quarter of fiscal year 2021. Refer to Note 16 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion regarding share repurchases and dividends.

ITEM 6. [RESERVED]

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the results of operations and financial condition of Microsoft Corporation. MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying Notes to Financial Statements (Part II, Item 8 of this Form 10-K). This section generally discusses the results of our operations for the year ended June 30, 2021 compared to the year ended June 30, 2020. For a discussion of the year ended June 30, 2020 compared to the year ended June 30, 2019, please refer to Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended June 30, 2020.

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity.

We generate revenue by offering a wide range of cloud-based and other services to people and businesses; licensing and supporting an array of software products; designing, manufacturing, and selling devices; and delivering relevant online advertising to a global audience. Our most significant expenses are related to compensating employees; designing, manufacturing, marketing, and selling our products and services; datacenter costs in support of our cloud-based services; and income taxes.

As the world continues to respond to COVID-19, we are working to do our part by ensuring the safety of our employees, striving to protect the health and well-being of the communities in which we operate, and providing technology and resources to our customers to help them do their best work while remote.

Highlights from fiscal year 2021 compared with fiscal year 2020 included:

- Commercial cloud revenue increased 34% to $69.1 billion.
- Office Commercial products and cloud services revenue increased 13% driven by Office 365 Commercial growth of 22%.
- Office Consumer products and cloud services revenue increased 10% and Microsoft 365 Consumer subscribers increased to 51.9 million.
- LinkedIn revenue increased 27%.
- Dynamics products and cloud services revenue increased 25% driven by Dynamics 365 growth of 43%.
- Server products and cloud services revenue increased 27% driven by Azure growth of 50%.
- Windows original equipment manufacturer licensing ("Windows OEM") revenue increased slightly.
- Windows Commercial products and cloud services revenue increased 14%.
- Xbox content and services revenue increased 23%.
- Search advertising revenue, excluding traffic acquisition costs, increased 13%.
- Surface revenue increased 5%.

On March 9, 2021, we completed our acquisition of ZeniMax Media Inc. ("ZeniMax"), the parent company of Bethesda Softworks LLC, for a total purchase price of $8.1 billion, consisting primarily of cash. The purchase price included $768 million of cash and cash equivalents acquired. The financial results of ZeniMax have been included in our consolidated financial statements since the date of the acquisition. ZeniMax is reported as part of our More Personal Computing segment. Refer to Note 8 – Business Combinations of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Industry Trends

Our industry is dynamic and highly competitive, with frequent changes in both technologies and business models. Each industry shift is an opportunity to conceive new products, new technologies, or new ideas that can further transform the industry and our business. At Microsoft, we push the boundaries of what is possible through a broad range of research and development activities that seek to identify and address the changing demands of customers and users, industry trends, and competitive forces.

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, and influence how users access services in the cloud, and in some cases, the user’s choice of which suite of cloud-based services to use. We must continue to evolve and adapt over an extended time in pace with this changing environment. The investments we are making in infrastructure and devices will continue to increase our operating costs and may decrease our operating margins.

Our success is highly dependent on our ability to attract and retain qualified employees. We hire a mix of university and industry talent worldwide. We compete for talented individuals globally by offering an exceptional working environment, broad customer reach, scale in resources, the ability to grow one’s career across many different products and businesses, and competitive compensation and benefits. Aggregate demand for our software, services, and devices is correlated to global macroeconomic and geopolitical factors, which remain dynamic.

Our devices are primarily manufactured by third-party contract manufacturers, some of which contain certain components for which there are very few qualified suppliers. For these components, we have limited near-term flexibility to use other manufacturers if a current vendor becomes unavailable or is unable to meet our requirements. Extended disruptions at these suppliers could lead to a similar disruption in our ability to manufacture devices on time to meet consumer demand.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. Weakening of the U.S. dollar relative to certain foreign currencies increased reported revenue and did not have a material impact on reported expenses from our international operations in fiscal year 2021.

Refer to Risk Factors (Part I, Item 1A of this Form 10-K) for a discussion of these factors and other risks.

COVID-19

In fiscal year 2021, the COVID-19 pandemic continued to impact our business operations and financial results. Cloud usage and demand benefited as customers accelerate their digital transformation priorities. Our consumer businesses also benefited from the remote environment, with continued demand for PCs and productivity tools, as well as strong engagement across our Gaming platform. We saw improvement in customer advertising spend and savings in operating expenses related to COVID-19, but experienced weakness in transactional licensing. The COVID-19 pandemic may continue to impact our business operations and financial operating results, and there is uncertainty in the nature and degree of its continued effects over time. Refer to Risk Factors (Part I, Item 1A of this Form 10-K) for a discussion of these factors and other risks.

Seasonality

Our revenue fluctuates quarterly and is generally higher in the second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.

Change in Accounting Estimate

In July 2020, we completed an assessment of the useful lives of our server and network equipment and determined we should increase the estimated useful life of server equipment from three years to four years and increase the estimated useful life of network equipment from two years to four years. This change in accounting estimate was effective beginning fiscal year 2021. Based on the carrying amount of server and network equipment included in property and equipment, net as of June 30, 2020, the effect of this change in estimate for fiscal year 2021 was an increase in operating income of $2.7 billion and net income of $2.3 billion, or $0.30 per both basic and diluted share.

Reportable Segments

We report our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. The segment amounts included in MD&A are presented on a basis consistent with our internal management reporting. All differences between our internal management reporting basis and accounting principles generally accepted in the United States of America ("GAAP"), along with certain corporate-level and other activity, are included in Corporate and Other.

Additional information on our reportable segments is contained in Note 19 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

Metrics

We use metrics in assessing the performance of our business and to make informed decisions regarding the allocation of resources. We disclose metrics to enable investors to evaluate progress against our ambitions, provide transparency into performance trends, and reflect the continued evolution of our products and services. Our commercial and other business metrics are fundamentally connected based on how customers use our products and services. The metrics are disclosed in the MD&A or the Notes to Financial Statements (Part II, Item 8 of this Form 10-K). Financial metrics are calculated based on GAAP results and growth comparisons relate to the corresponding period of last fiscal year.

Commercial

Our commercial business primarily consists of Server products and cloud services, Office Commercial, Windows Commercial, the commercial portion of LinkedIn, Enterprise Services, and Dynamics. Our commercial metrics allow management and investors to assess the overall health of our commercial business and include leading indicators of future performance.

Commercial remaining performance obligation	Commercial portion of revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods
Commercial cloud revenue	Revenue from our commercial cloud business, which includes Azure, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties
Commercial cloud gross margin percentage	Gross margin percentage for our commercial cloud business

Productivity and Business Processes and Intelligent Cloud

Metrics related to our Productivity and Business Processes and Intelligent Cloud segments assess the health of our core businesses within these segments. The metrics reflect our cloud and on-premises product strategies and trends.

Office Commercial products and cloud services revenue growth	Revenue from Office Commercial products and cloud services (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Skype for Business
Office Consumer products and cloud services revenue growth	Revenue from Office Consumer products and cloud services, including Microsoft 365 Consumer subscriptions and Office licensed on-premises
Office 365 Commercial seat growth	The number of Office 365 Commercial seats at end of period where seats are paid users covered by an Office 365 Commercial subscription
Microsoft 365 Consumer subscribers	The number of Microsoft 365 Consumer (formerly Office 365 Consumer) subscribers at end of period
Dynamics products and cloud services revenue growth	Revenue from Dynamics products and cloud services, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications
LinkedIn revenue growth	Revenue from LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, Sales Solutions, and Learning Solutions
Server products and cloud services revenue growth	Revenue from Server products and cloud services, including Azure; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and GitHub

More Personal Computing

Metrics related to our More Personal Computing segment assess the performance of key lines of business within this segment. These metrics provide strategic product insights which allow us to assess the performance across our commercial and consumer businesses. As we have diversity of target audiences and sales motions within the Windows business, we monitor metrics that are reflective of those varying motions.

Windows OEM Pro revenue growth	Revenue from sales of Windows Pro licenses sold through the OEM channel, which primarily addresses demand in the commercial market
Windows OEM non-Pro revenue growth	Revenue from sales of Windows non-Pro licenses sold through the OEM channel, which primarily addresses demand in the consumer market

Windows Commercial products and cloud services revenue growth	Revenue from Windows Commercial products and cloud services, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings
Surface revenue	Revenue from Surface devices and accessories
Xbox content and services revenue growth	Revenue from Xbox content and services, comprising digital transactions, Xbox Game Pass and other subscriptions, video games, third-party video game royalties, cloud services, and advertising
Search advertising revenue, excluding TAC, growth	Revenue from search advertising excluding traffic acquisition costs ("TAC") paid to Bing Ads network publishers

SUMMARY RESULTS OF OPERATIONS

(In millions, except percentages and per share amounts)	2021	2020	Percentage Change
Revenue	**$ 168,088**	$ 143,015	18%
Gross margin	**115,856**	96,937	20%
Operating income	**69,916**	52,959	32%
Net income	**61,271**	44,281	38%
Diluted earnings per share	**8.05**	5.76	40%
Adjusted net income (non-GAAP)	**60,651**	44,281	37%
Adjusted diluted earnings per share (non-GAAP)	**7.97**	5.76	38%

Adjusted net income and adjusted diluted earnings per share ("EPS") are non-GAAP financial measures which exclude tax benefits related to an India Supreme Court decision on withholding taxes in fiscal year 2021. Refer to the Non-GAAP Financial Measures section below for a reconciliation of our financial results reported in accordance with GAAP to non-GAAP financial results. See Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Revenue increased $25.1 billion or 18% driven by growth across each of our segments. Intelligent Cloud revenue increased driven by Azure. Productivity and Business Processes revenue increased driven by Office 365 Commercial and LinkedIn. More Personal Computing revenue increased driven by Gaming.

Cost of revenue increased $6.2 billion or 13% driven by growth in commercial cloud and Gaming, offset in part by a reduction in depreciation expense due to the change in estimated useful lives of our server and network equipment.

Gross margin increased $18.9 billion or 20% driven by growth across each of our segments and the change in estimated useful lives of our server and network equipment. Gross margin percentage increased with the change in estimated useful lives of our server and network equipment. Excluding this impact, gross margin percentage decreased slightly driven by gross margin percentage reduction in More Personal Computing. Commercial cloud gross margin percentage increased 4 points to 71% driven by gross margin percentage improvement in Azure and the change in estimated useful lives of our server and network equipment, offset in part by sales mix shift to Azure.

Operating expenses increased $2.0 billion or 4% driven by investments in cloud engineering and commercial sales, offset in part by savings related to COVID-19 across each of our segments, prior year charges associated with the closing of our Microsoft Store physical locations, and a reduction in bad debt expense.

Key changes in operating expenses were:

- Research and development expenses increased $1.4 billion or 8% driven by investments in cloud engineering.
- Sales and marketing expenses increased $519 million or 3% driven by investments in commercial sales, offset in part by a reduction in bad debt expense. Sales and marketing included an unfavorable foreign currency impact of 2%.
- General and administrative expenses were relatively unchanged, driven by prior year charges associated with the closing of our Microsoft Store physical locations, offset in part by an increase in certain employee-related expenses and business taxes.

Operating income increased $17.0 billion or 32% driven by growth across each of our segments and the change in estimated useful lives of our server and network equipment.

Current year net income and diluted EPS were positively impacted by the tax benefit related to the India Supreme Court decision on withholding taxes, which resulted in an increase to net income and diluted EPS of $620 million and $0.08, respectively.

Revenue, gross margin, and operating income included a favorable foreign currency impact of 3%, 3%, and 4%, respectively.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	2021	2020	Percentage Change
Revenue			
Productivity and Business Processes	**$ 53,915**	$ 46,398	16%
Intelligent Cloud	**60,080**	48,366	24%
More Personal Computing	**54,093**	48,251	12%
Total	**$ 168,088**	$ 143,015	18%
Operating Income			
Productivity and Business Processes	**$ 24,351**	$ 18,724	30%
Intelligent Cloud	**26,126**	18,324	43%
More Personal Computing	**19,439**	15,911	22%
Total	**$ 69,916**	$ 52,959	32%

Reportable Segments

Productivity and Business Processes

Revenue increased $7.5 billion or 16%.

- Office Commercial products and cloud services revenue increased $4.0 billion or 13%. Office 365 Commercial revenue grew 22% driven by seat growth of 17% and higher revenue per user. Office Commercial products revenue declined 23% driven by continued customer shift to cloud offerings and transactional weakness.
- Office Consumer products and cloud services revenue increased $474 million or 10% driven by Microsoft 365 Consumer subscription revenue, on a strong prior year comparable that benefited from transactional strength in Japan. Microsoft 365 Consumer subscribers increased 22% to 51.9 million.
- LinkedIn revenue increased $2.2 billion or 27% driven by advertising demand in our Marketing Solutions business.
- Dynamics products and cloud services revenue increased 25% driven by Dynamics 365 growth of 43%.

Operating income increased $5.6 billion or 30%.

- Gross margin increased $6.5 billion or 18% driven by growth in Office 365 Commercial and LinkedIn, and the change in estimated useful lives of our server and network equipment. Gross margin percentage increased with the change in estimated useful lives of our server and network equipment. Excluding this impact, gross margin percentage decreased slightly driven by a sales mix shift to cloud offerings, on a low prior year comparable impacted by increased usage.
- Operating expenses increased $839 million or 5% driven by investments in commercial sales, cloud engineering, and LinkedIn.

Revenue, gross margin, and operating income included a favorable foreign currency impact of 2%, 3%, and 4%, respectively.

Intelligent Cloud

Revenue increased $11.7 billion or 24%.

- Server products and cloud services revenue increased $11.2 billion or 27% driven by Azure. Azure revenue grew 50% due to growth in our consumption-based services. Server products revenue increased 6% driven by hybrid and premium solutions, on a strong prior year comparable that benefited from demand related to SQL Server 2008 and Windows Server 2008 end of support.
- Enterprise Services revenue increased $534 million or 8% driven by growth in Premier Support Services.

Operating income increased $7.8 billion or 43%.

- Gross margin increased $9.7 billion or 29% driven by growth in Azure and the change in estimated useful lives of our server and network equipment. Gross margin percentage increased with the change in estimated useful lives of our server and network equipment. Excluding this impact, gross margin percentage was relatively unchanged driven by gross margin percentage improvement in Azure, offset in part by sales mix shift to Azure.
- Operating expenses increased $1.9 billion or 12% driven by investments in Azure.

Revenue, gross margin, and operating income included a favorable foreign currency impact of 2%, 3%, and 4%, respectively.

More Personal Computing

Revenue increased $5.8 billion or 12%.

- Windows revenue increased $933 million or 4% driven by growth in Windows Commercial. Windows Commercial products and cloud services revenue increased 14% driven by demand for Microsoft 365. Windows OEM revenue increased slightly driven by consumer PC demand, on a strong prior year OEM Pro comparable that benefited from Windows 7 end of support. Windows OEM Pro revenue decreased 9% and Windows OEM non-Pro revenue grew 21%.
- Gaming revenue increased $3.8 billion or 33% driven by growth in Xbox content and services and Xbox hardware. Xbox content and services revenue increased $2.3 billion or 23% driven by growth in third-party titles, Xbox Game Pass subscriptions, and first-party titles. Xbox hardware revenue increased 92% driven by higher price of consoles sold due to the Xbox Series X|S launches.
- Search advertising revenue increased $788 million or 10%. Search advertising revenue excluding traffic acquisition costs increased 13% driven by higher revenue per search and search volume.
- Surface revenue increased $302 million or 5%.

Operating income increased $3.5 billion or 22%.

- Gross margin increased $2.8 billion or 10% driven by growth in Windows, Gaming, and Search advertising. Gross margin percentage decreased driven by sales mix shift to Gaming hardware.
- Operating expenses decreased $752 million or 6% driven by prior year charges associated with the closing of our Microsoft Store physical locations and reductions in retail store expenses and marketing, offset in part by investments in Gaming.

Gross margin and operating income included a favorable foreign currency impact of 2% and 3%, respectively.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)		2021		2020	Percentage Change
Research and development	$	**20,716**	$	19,269	8%
As a percent of revenue		**12%**		13%	(1)ppt

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content.

Research and development expenses increased $1.4 billion or 8% driven by investments in cloud engineering.

Sales and Marketing

(In millions, except percentages)		2021		2020	Percentage Change
Sales and marketing	$	**20,117**	$	19,598	3%
As a percent of revenue		**12%**		14%	(2)ppt

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs.

Sales and marketing expenses increased $519 million or 3% driven by investments in commercial sales, offset in part by a reduction in bad debt expense. Sales and marketing included an unfavorable foreign currency impact of 2%.

General and Administrative

(In millions, except percentages)		2021		2020	Percentage Change
General and administrative	$	**5,107**	$	5,111	0%
As a percent of revenue		**3%**		4%	(1)ppt

General and administrative expenses include payroll, employee benefits, stock-based compensation expense, severance expense, and other headcount-related expenses associated with finance, legal, facilities, certain human resources and other administrative personnel, certain taxes, and legal and other administrative fees.

General and administrative expenses were relatively unchanged, driven by prior year charges associated with the closing of our Microsoft Store physical locations, offset in part by an increase in certain employee-related expenses and business taxes.

OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)

Year Ended June 30,		**2021**		**2020**
Interest and dividends income	**$**	**2,131**	$	2,680
Interest expense		**(2,346)**		(2,591)
Net recognized gains on investments		**1,232**		32
Net gains on derivatives		**17**		187
Net gains (losses) on foreign currency remeasurements		**54**		(191)
Other, net		**98**		(40)
Total	**$**	**1,186**	$	77

We use derivative instruments to manage risks related to foreign currencies, equity prices, interest rates, and credit; enhance investment returns; and facilitate portfolio diversification. Gains and losses from changes in fair values of derivatives that are not designated as hedging instruments are primarily recognized in other income (expense), net.

Interest and dividends income decreased due to lower yields on fixed-income securities. Interest expense decreased due to a decrease in outstanding long-term debt due to debt maturities. Net recognized gains on investments increased due to higher gains on equity securities. Net gains on derivatives decreased due to lower gains on foreign currency contracts.

INCOME TAXES

Effective Tax Rate

Our effective tax rate for fiscal years 2021 and 2020 was 14% and 17%, respectively. The decrease in our effective tax rate was primarily due to tax benefits from a decision by the India Supreme Court on withholding taxes in the case of Engineering Analysis Centre of Excellence Private Limited vs The Commissioner of Income Tax, an agreement between the U.S. and India tax authorities related to transfer pricing, final Tax Cuts and Jobs Act (“TCJA”) regulations, and an increase in tax benefits relating to stock-based compensation.

We have historically paid India withholding taxes on software sales through distributor withholding and tax audit assessments in India. In March 2021, the India Supreme Court ruled favorably for companies in 86 separate appeals, some dating back to 2012, holding that software sales are not subject to India withholding taxes. Although we were not a party to the appeals, our software sales in India were determined to be not subject to withholding taxes. Therefore, we recorded a net income tax benefit of $620 million in the third quarter of fiscal year 2021 to reflect the results of the India Supreme Court decision impacting fiscal year 1996 through fiscal year 2016.

Our effective tax rate was lower than the U.S. federal statutory rate, primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland and Puerto Rico, tax benefits relating to stock-based compensation, and tax benefits from the India Supreme Court decision on withholding taxes.

The mix of income before income taxes between the U.S. and foreign countries impacted our effective tax rate as a result of the geographic distribution of, and customer demand for, our products and services. In fiscal year 2021, our U.S. income before income taxes was $35.0 billion and our foreign income before income taxes was $36.1 billion. In fiscal year 2020, our U.S. income before income taxes was $24.1 billion and our foreign income before income taxes was $28.9 billion.

Uncertain Tax Positions

We settled a portion of the Internal Revenue Service (“IRS”) audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. In the second quarter of fiscal year 2021, we settled an additional portion of the IRS audits for tax years 2004 to 2013 and made a payment of $1.7 billion, including tax and interest. We remain under audit for tax years 2004 to 2017.

As of June 30, 2021, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved key transfer pricing issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2020, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NON-GAAP FINANCIAL MEASURES

Adjusted net income and adjusted diluted EPS are non-GAAP financial measures which exclude the tax benefits related to the India Supreme Court decision on withholding taxes in fiscal year 2021. We believe these non-GAAP measures aid investors by providing additional insight into our operational performance and help clarify trends affecting our business. For comparability of reporting, management considers non-GAAP measures in conjunction with GAAP financial results in evaluating business performance. These non-GAAP financial measures presented should not be considered a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP.

The following table reconciles our financial results reported in accordance with GAAP to non-GAAP financial results:

(In millions, except percentages and per share amounts)	**2021**	**2020**	**Percentage Change**
Net income	**$ 61,271**	$ 44,281	38%
Net income tax benefit related to India Supreme Court decision on withholding taxes	**(620)**	0	*
Adjusted net income (non-GAAP)	**$ 60,651**	$ 44,281	37%
Diluted earnings per share	**$ 8.05**	$ 5.76	40%
Net income tax benefit related to India Supreme Court decision on withholding taxes	**(0.08)**	0	*
Adjusted diluted earnings per share (non-GAAP)	**$ 7.97**	$ 5.76	38%

* *Not meaningful.*

FINANCIAL CONDITION

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $130.3 billion and $136.5 billion as of June 30, 2021 and 2020. Equity investments were $6.0 billion and $3.0 billion as of June 30, 2021 and 2020, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Valuation

In general, and where applicable, we use quoted prices in active markets for identical assets or liabilities to determine the fair value of our financial instruments. This pricing methodology applies to our Level 1 investments, such as U.S. government securities, common and preferred stock, and mutual funds. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then we use quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. This pricing methodology applies to our Level 2 investments, such as commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Level 3 investments are valued using internally-developed models with unobservable inputs. Assets and liabilities measured at fair value on a recurring basis using unobservable inputs are an immaterial portion of our portfolio.

A majority of our investments are priced by pricing vendors and are generally Level 1 or Level 2 investments as these vendors either provide a quoted market price in an active market or use observable inputs for their pricing without applying significant adjustments. Broker pricing is used mainly when a quoted price is not available, the investment is not priced by our pricing vendors, or when a broker price is more reflective of fair values in the market in which the investment trades. Our broker-priced investments are generally classified as Level 2 investments because the broker prices these investments based on similar assets without applying significant adjustments. In addition, all our broker-priced investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments. Our fair value processes include controls that are designed to ensure appropriate fair values are recorded. These controls include model validation, review of key model inputs, analysis of period-over-period fluctuations, and independent recalculation of prices where appropriate.

Cash Flows

Cash from operations increased $16.1 billion to $76.7 billion for fiscal year 2021, mainly due to an increase in cash received from customers, offset in part by an increase in cash paid to suppliers and employees. Cash used in financing increased $2.5 billion to $48.5 billion for fiscal year 2021, mainly due to a $4.4 billion increase in common stock repurchases and a $1.4 billion increase in dividends paid, offset in part by a $1.8 billion decrease in repayments of debt and a $1.7 billion decrease in cash premium paid on debt exchange. Cash used in investing increased $15.4 billion to $27.6 billion for fiscal year 2021, mainly due to a $6.4 billion increase in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets, a $5.2 billion increase in additions to property and equipment, and a $4.1 billion decrease in cash from net investment purchases, sales, and maturities.

Debt

We issue debt to take advantage of favorable pricing and liquidity in the debt markets, reflecting our credit rating and the low interest rate environment. The proceeds of these issuances were or will be used for general corporate purposes, which may include, among other things, funding for working capital, capital expenditures, repurchases of capital stock, acquisitions, and repayment of existing debt. In March 2021 and June 2020, we exchanged a portion of our existing debt at a premium for cash and new debt with longer maturities to take advantage of favorable financing rates in the debt markets, reflecting our credit rating and the low interest rate environment. Refer to Note 11 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Unearned Revenue

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include Software Assurance (“SA”) and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service. Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

The following table outlines the expected future recognition of unearned revenue as of June 30, 2021:

(In millions)

Three Months Ending		
September 30, 2021	$	**15,922**
December 31, 2021		**12,646**
March 31, 2022		**8,786**
June 30, 2022		**4,171**
Thereafter		**2,616**
Total	$	**44,141**

If our customers choose to license cloud-based versions of our products and services rather than licensing transaction-based products and services, the associated revenue will shift from being recognized at the time of the transaction to being recognized over the subscription period or upon consumption, as applicable.

Share Repurchases

During fiscal years 2021 and 2020, we repurchased 101 million shares and 126 million shares of our common stock for $23.0 billion and $19.7 billion, respectively, through our share repurchase programs. All repurchases were made using cash resources. Refer to Note 16 – Stockholders’ Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Dividends

Refer to Note 16 – Stockholders’ Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Off-Balance Sheet Arrangements

We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products and certain other matters. Additionally, we have agreed to cover damages resulting from breaches of certain security and privacy commitments in our cloud business. In evaluating estimated losses on these obligations, we consider factors such as the degree of probability of an unfavorable outcome and our ability to make a reasonable estimate of the amount of loss. These obligations did not have a material impact in our consolidated financial statements during the periods presented.

Contractual Obligations

The following table summarizes the payments due by fiscal year for our outstanding contractual obligations as of June 30, 2021:

(In millions)	2022	2023-2024	2025-2026	Thereafter	Total
Long-term debt: (a)					
Principal payments	$ 8,075	$ 8,000	$ 5,250	$ 42,585	$ 63,910
Interest payments	1,628	2,847	2,438	17,320	24,233
Construction commitments (b)	8,927	529	0	0	9,456
Operating leases, including imputed interest (c)	2,801	4,956	3,469	6,747	17,973
Finance leases, including imputed interest (c)	1,341	3,256	3,774	14,096	22,467
Transition tax (d)	1,427	4,105	8,030	0	13,562
Purchase commitments (e)	29,129	1,708	446	270	31,553
Other long-term liabilities (f)	0	365	68	263	696
Total	$ 53,328	$ 25,766	$ 23,475	$ 81,281	$ 183,850

(a) *Refer to Note 11 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(b) *Refer to Note 7 – Property and Equipment of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(c) *Refer to Note 14 – Leases of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(d) *Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(e) *Amounts represent purchase commitments, including open purchase orders and take-or-pay contracts that are not presented as construction commitments above.*

(f) *We have excluded long-term tax contingencies, other tax liabilities, and deferred income taxes of $14.6 billion from the amounts presented as the timing of these obligations is uncertain. We have also excluded unearned revenue and non-cash items.*

Other Planned Uses of Capital

On April 11, 2021, we entered into a definitive agreement to acquire Nuance Communications, Inc. (“Nuance”) for $56.00 per share in an all-cash transaction valued at $19.7 billion, inclusive of Nuance’s net debt. The acquisition has been approved by Nuance’s shareholders, and we expect it to close by the end of calendar year 2021, subject to the satisfaction of certain regulatory approvals and other customary closing conditions.

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as continue making acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings. We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. We have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of capital resources.

Liquidity

As a result of the TCJA, we are required to pay a one-time transition tax on deferred foreign income not previously subject to U.S. income tax. Under the TCJA, the transition tax is payable in interest-free installments over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. We have paid transition tax of $4.7 billion, which included $1.5 billion for fiscal year 2021. The remaining transition tax of $13.6 billion is payable over the next five years with a final payment in fiscal year 2026.

We expect existing cash, cash equivalents, short-term investments, cash flows from operations, and access to capital markets to continue to be sufficient to fund our operating activities and cash commitments for investing and financing activities, such as dividends, share repurchases, debt maturities, material capital expenditures, and the transition tax related to the TCJA, for at least the next 12 months and thereafter for the foreseeable future.

RECENT ACCOUNTING GUIDANCE

Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies, as well as uncertainty in the current economic environment due to COVID-19. Critical accounting policies for us include revenue recognition, impairment of investment securities, goodwill, research and development costs, contingencies, income taxes, and inventories.

Revenue Recognition

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the stand-alone selling price ("SSP") for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Impairment of Investment Securities

We review debt investments quarterly for credit losses and impairment. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the extent to which the fair value is less than cost. This determination requires significant judgment. In making this judgment, we employ a systematic methodology that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. In addition, we consider specific adverse conditions related to the financial health of, and business outlook for, the investee. If we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery, then a decline in fair value below cost is recorded as an impairment charge in other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Equity investments without readily determinable fair values are written down to fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than carrying value. We perform a qualitative assessment on a periodic basis. We are required to estimate the fair value of the investment to determine the amount of the impairment loss. Once an investment is determined to be impaired, an impairment charge is recorded in other income (expense), net.

Goodwill

We allocate goodwill to reporting units based on the reporting unit expected to benefit from the business combination. We evaluate our reporting units on an annual basis and, if necessary, reassign goodwill using a relative fair value allocation approach. Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated primarily through the use of a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur, and determination of our weighted average cost of capital.

The estimates used to calculate the fair value of a reporting unit change from year to year based on operating results, market conditions, and other factors. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit.

Research and Development Costs

Costs incurred internally in researching and developing a computer software product are charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, software costs are capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our software products is reached after all high-risk development issues have been resolved through coding and testing. Generally, this occurs shortly before the products are released to production. The amortization of these costs is included in cost of revenue over the estimated life of the products.

Legal and Other Contingencies

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our consolidated financial statements.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year, and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity’s financial statements or tax returns. We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting literature also provides guidance on derecognition of income tax assets and liabilities, classification of deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our consolidated financial statements.

The TCJA significantly changes existing U.S. tax law and includes numerous provisions that affect our business. Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

Management is responsible for the preparation of the consolidated financial statements and related information that are presented in this report. The consolidated financial statements, which include amounts based on management's estimates and judgments, have been prepared in conformity with accounting principles generally accepted in the United States of America.

The Company designs and maintains accounting and internal control systems to provide reasonable assurance at reasonable cost that assets are safeguarded against loss from unauthorized use or disposition, and that the financial records are reliable for preparing consolidated financial statements and maintaining accountability for assets. These systems are augmented by written policies, an organizational structure providing division of responsibilities, careful selection and training of qualified personnel, and a program of internal audits.

The Company engaged Deloitte & Touche LLP, an independent registered public accounting firm, to audit and render an opinion on the consolidated financial statements and internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Board of Directors, through its Audit Committee, consisting solely of independent directors of the Company, meets periodically with management, internal auditors, and our independent registered public accounting firm to ensure that each is meeting its responsibilities and to discuss matters concerning internal controls and financial reporting. Deloitte & Touche LLP and the internal auditors each have full and free access to the Audit Committee.

Satya Nadella
Chief Executive Officer

Amy E. Hood
Executive Vice President and Chief Financial Officer

Alice L. Jolla
Corporate Vice President and Chief Accounting Officer

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

RISKS

We are exposed to economic risk from foreign exchange rates, interest rates, credit risk, and equity prices. We use derivatives instruments to manage these risks, however, they may still impact our consolidated financial statements.

Foreign Currencies

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency positions, including hedges. Principal currency exposures include the Euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of the fixed-income portfolio to achieve economic returns that correlate to certain global fixed-income indices.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We manage credit exposures relative to broad-based indices and to facilitate portfolio diversification.

Equity

Securities held in our equity investments portfolio are subject to price risk.

SENSITIVITY ANALYSIS

The following table sets forth the potential loss in future earnings or fair values, including associated derivatives, resulting from hypothetical changes in relevant market rates or prices:

(In millions)

Risk Categories	Hypothetical Change		June 30, 2021	Impact
Foreign currency–Revenue	10% decrease in foreign exchange rates	$	**(6,756)**	Earnings
Foreign currency–Investments	10% decrease in foreign exchange rates		**(136)**	Fair Value
Interest rate	100 basis point increase in U.S. treasury interest rates		**(3,511)**	Fair Value
Credit	100 basis point increase in credit spreads		**(309)**	Fair Value
Equity	10% decrease in equity market prices		**(602)**	Earnings

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INCOME STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	2021	2020	2019
Revenue:			
Product	**$ 71,074**	$ 68,041	$ 66,069
Service and other	**97,014**	74,974	59,774
Total revenue	**168,088**	143,015	125,843
Cost of revenue:			
Product	**18,219**	16,017	16,273
Service and other	**34,013**	30,061	26,637
Total cost of revenue	**52,232**	46,078	42,910
Gross margin	**115,856**	96,937	82,933
Research and development	**20,716**	19,269	16,876
Sales and marketing	**20,117**	19,598	18,213
General and administrative	**5,107**	5,111	4,885
Operating income	**69,916**	52,959	42,959
Other income, net	**1,186**	77	729
Income before income taxes	**71,102**	53,036	43,688
Provision for income taxes	**9,831**	8,755	4,448
Net income	**$ 61,271**	$ 44,281	$ 39,240
Earnings per share:			
Basic	**$ 8.12**	$ 5.82	$ 5.11
Diluted	**$ 8.05**	$ 5.76	$ 5.06
Weighted average shares outstanding:			
Basic	**7,547**	7,610	7,673
Diluted	**7,608**	7,683	7,753

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions)

Year Ended June 30,	**2021**	**2020**	**2019**
Net income	**$ 61,271**	$ 44,281	$ 39,240
Other comprehensive income (loss), net of tax:			
Net change related to derivatives	**19**	(38)	(173)
Net change related to investments	**(2,266)**	3,990	2,405
Translation adjustments and other	**873**	(426)	(318)
Other comprehensive income (loss)	**(1,374)**	3,526	1,914
Comprehensive income	**$ 59,897**	$ 47,807	$ 41,154

Refer to accompanying notes.

BALANCE SHEETS

(In millions)

June 30,		**2021**		**2020**
Assets				
Current assets:				
Cash and cash equivalents	**$**	**14,224**	$	13,576
Short-term investments		**116,110**		122,951
Total cash, cash equivalents, and short-term investments		**130,334**		136,527
Accounts receivable, net of allowance for doubtful accounts of **$751** and $788		**38,043**		32,011
Inventories		**2,636**		1,895
Other current assets		**13,393**		11,482
Total current assets		**184,406**		181,915
Property and equipment, net of accumulated depreciation of **$51,351** and $43,197		**59,715**		44,151
Operating lease right-of-use assets		**11,088**		8,753
Equity investments		**5,984**		2,965
Goodwill		**49,711**		43,351
Intangible assets, net		**7,800**		7,038
Other long-term assets		**15,075**		13,138
Total assets	**$**	**333,779**	$	301,311
Liabilities and stockholders' equity				
Current liabilities:				
Accounts payable	**$**	**15,163**	$	12,530
Current portion of long-term debt		**8,072**		3,749
Accrued compensation		**10,057**		7,874
Short-term income taxes		**2,174**		2,130
Short-term unearned revenue		**41,525**		36,000
Other current liabilities		**11,666**		10,027
Total current liabilities		**88,657**		72,310
Long-term debt		**50,074**		59,578
Long-term income taxes		**27,190**		29,432
Long-term unearned revenue		**2,616**		3,180
Deferred income taxes		**198**		204
Operating lease liabilities		**9,629**		7,671
Other long-term liabilities		**13,427**		10,632
Total liabilities		**191,791**		183,007
Commitments and contingencies				
Stockholders' equity:				
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,519** and 7,571		**83,111**		80,552
Retained earnings		**57,055**		34,566
Accumulated other comprehensive income		**1,822**		3,186
Total stockholders' equity		**141,988**		118,304
Total liabilities and stockholders' equity	**$**	**333,779**	$	301,311

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions)

Year Ended June 30,	**2021**	**2020**	**2019**
Operations			
Net income	**$ 61,271**	$ 44,281	$ 39,240
Adjustments to reconcile net income to net cash from operations:			
Depreciation, amortization, and other	**11,686**	12,796	11,682
Stock-based compensation expense	**6,118**	5,289	4,652
Net recognized gains on investments and derivatives	**(1,249)**	(219)	(792)
Deferred income taxes	**(150)**	11	(6,463)
Changes in operating assets and liabilities:			
Accounts receivable	**(6,481)**	(2,577)	(2,812)
Inventories	**(737)**	168	597
Other current assets	**(932)**	(2,330)	(1,718)
Other long-term assets	**(3,459)**	(1,037)	(1,834)
Accounts payable	**2,798**	3,018	232
Unearned revenue	**4,633**	2,212	4,462
Income taxes	**(2,309)**	(3,631)	2,929
Other current liabilities	**4,149**	1,346	1,419
Other long-term liabilities	**1,402**	1,348	591
Net cash from operations	**76,740**	60,675	52,185
Financing			
Cash premium on debt exchange	**(1,754)**	(3,417)	0
Repayments of debt	**(3,750)**	(5,518)	(4,000)
Common stock issued	**1,693**	1,343	1,142
Common stock repurchased	**(27,385)**	(22,968)	(19,543)
Common stock cash dividends paid	**(16,521)**	(15,137)	(13,811)
Other, net	**(769)**	(334)	(675)
Net cash used in financing	**(48,486)**	(46,031)	(36,887)
Investing			
Additions to property and equipment	**(20,622)**	(15,441)	(13,925)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(8,909)**	(2,521)	(2,388)
Purchases of investments	**(62,924)**	(77,190)	(57,697)
Maturities of investments	**51,792**	66,449	20,043
Sales of investments	**14,008**	17,721	38,194
Other, net	**(922)**	(1,241)	0
Net cash used in investing	**(27,577)**	(12,223)	(15,773)
Effect of foreign exchange rates on cash and cash equivalents	**(29)**	(201)	(115)
Net change in cash and cash equivalents	**648**	2,220	(590)
Cash and cash equivalents, beginning of period	**13,576**	11,356	11,946
Cash and cash equivalents, end of period	**$ 14,224**	$ 13,576	$ 11,356

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	**2021**	**2020**	**2019**
Common stock and paid-in capital			
Balance, beginning of period	**$ 80,552**	$ 78,520	$ 71,223
Common stock issued	**1,963**	1,343	6,829
Common stock repurchased	**(5,539)**	(4,599)	(4,195)
Stock-based compensation expense	**6,118**	5,289	4,652
Other, net	**17**	(1)	11
Balance, end of period	**83,111**	80,552	78,520
Retained earnings			
Balance, beginning of period	**34,566**	24,150	13,682
Net income	**61,271**	44,281	39,240
Common stock cash dividends	**(16,871)**	(15,483)	(14,103)
Common stock repurchased	**(21,879)**	(18,382)	(15,346)
Cumulative effect of accounting changes	**(32)**	0	677
Balance, end of period	**57,055**	34,566	24,150
Accumulated other comprehensive income (loss)			
Balance, beginning of period	**3,186**	(340)	(2,187)
Other comprehensive income (loss)	**(1,374)**	3,526	1,914
Cumulative effect of accounting changes	**10**	0	(67)
Balance, end of period	**1,822**	3,186	(340)
Total stockholders' equity	**$ 141,988**	$ 118,304	$ 102,330
Cash dividends declared per common share	**$ 2.24**	$ 2.04	$ 1.84

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP").

We have recast certain prior period amounts to conform to the current period presentation. The recast of these prior period amounts had no impact on our consolidated balance sheets, consolidated income statements, or consolidated cash flows statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Microsoft Corporation and its subsidiaries. Intercompany transactions and balances have been eliminated.

Estimates and Assumptions

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates and assumptions include: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price ("SSP") of performance obligations, variable consideration, and other obligations such as product returns and refunds; loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized in our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management's estimates and assumptions due to risks and uncertainties, including uncertainty in the current economic environment due to COVID-19.

In July 2020, we completed an assessment of the useful lives of our server and network equipment and determined we should increase the estimated useful life of server equipment from three years to four years and increase the estimated useful life of network equipment from two years to four years. This change in accounting estimate was effective beginning fiscal year 2021. Based on the carrying amount of server and network equipment included in property and equipment, net as of June 30, 2020, the effect of this change in estimate for fiscal year 2021 was an increase in operating income of $2.7 billion and net income of $2.3 billion, or $0.30 per both basic and diluted share.

Foreign Currencies

Assets and liabilities recorded in foreign currencies are translated at the exchange rate on the balance sheet date. Revenue and expenses are translated at average rates of exchange prevailing during the year. Translation adjustments resulting from this process are recorded to other comprehensive income.

Revenue

Product Revenue and Service and Other Revenue

Product revenue includes sales from operating systems, cross-device productivity applications, server applications, business solution applications, desktop and server management tools, software development tools, video games, and hardware such as PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

Service and other revenue includes sales from cloud-based solutions that provide customers with software, services, platforms, and content such as Office 365, Azure, Dynamics 365, and Xbox; solution support; and consulting services. Service and other revenue also includes sales from online advertising and LinkedIn.

Revenue Recognition

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Nature of Products and Services

Licenses for on-premises software provide the customer with a right to use the software as it exists when made available to the customer. Customers may purchase perpetual licenses or subscribe to licenses, which provide customers with the same functionality and differ mainly in the duration over which the customer benefits from the software. Revenue from distinct on-premises licenses is recognized upfront at the point in time when the software is made available to the customer. In cases where we allocate revenue to software updates, primarily because the updates are provided at no additional charge, revenue is recognized as the updates are provided, which is generally ratably over the estimated life of the related device or license.

Certain volume licensing programs, including Enterprise Agreements, include on-premises licenses combined with Software Assurance (“SA”). SA conveys rights to new software and upgrades released over the contract period and provides support, tools, and training to help customers deploy and use products more efficiently. On-premises licenses are considered distinct performance obligations when sold with SA. Revenue allocated to SA is generally recognized ratably over the contract period as customers simultaneously consume and receive benefits, given that SA comprises distinct performance obligations that are satisfied over time.

Cloud services, which allow customers to use hosted software over the contract period without taking possession of the software, are provided on either a subscription or consumption basis. Revenue related to cloud services provided on a subscription basis is recognized ratably over the contract period. Revenue related to cloud services provided on a consumption basis, such as the amount of storage used in a period, is recognized based on the customer utilization of such resources. When cloud services require a significant level of integration and interdependency with software and the individual components are not considered distinct, all revenue is recognized over the period in which the cloud services are provided.

Revenue from search advertising is recognized when the advertisement appears in the search results or when the action necessary to earn the revenue has been completed. Revenue from consulting services is recognized as services are provided.

Our hardware is generally highly dependent on, and interrelated with, the underlying operating system and cannot function without the operating system. In these cases, the hardware and software license are accounted for as a single performance obligation and revenue is recognized at the point in time when ownership is transferred to resellers or directly to end customers through retail stores and online marketplaces.

Refer to Note 19 – Segment Information and Geographic Data for further information, including revenue by significant product and service offering.

Significant Judgments

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the SSP for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Contract Balances and Other Receivables

Timing of revenue recognition may differ from the timing of invoicing to customers. We record a receivable when revenue is recognized prior to invoicing, or unearned revenue when revenue is recognized subsequent to invoicing. For multi-year agreements, we generally invoice customers annually at the beginning of each annual coverage period. We record a receivable related to revenue recognized for multi-year on-premises licenses as we have an unconditional right to invoice and receive payment in the future related to those licenses.

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include SA and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for consulting services to be performed in the future, LinkedIn subscriptions, Office 365 subscriptions, Xbox subscriptions, Windows 10 post-delivery support, Dynamics business solutions, and other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service.

Refer to Note 13 – Unearned Revenue for further information, including unearned revenue by segment and changes in unearned revenue during the period.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers or to provide customers with financing. Examples include invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and multi-year on-premises licenses that are invoiced annually with revenue recognized upfront.

As of June 30, 2021 and 2020, other receivables due from suppliers were $965 million and $442 million, respectively, and are included in accounts receivable, net in our consolidated balance sheets.

As of June 30, 2021 and 2020, long-term accounts receivable, net of allowance for doubtful accounts, was $3.4 billion and $2.7 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

Activity in the allowance for doubtful accounts was as follows:

(In millions)

Year Ended June 30,		**2021**		**2020**		**2019**
Balance, beginning of period	**$**	**816**	$	434	$	397
Charged to costs and other		**234**		560		153
Write-offs		**(252)**		(178)		(116)
Balance, end of period	**$**	**798**	$	816	$	434

Allowance for doubtful accounts included in our consolidated balance sheets:

(In millions)

June 30,		**2021**		**2020**		**2019**
Accounts receivable, net of allowance for doubtful accounts	**$**	**751**	$	788	$	411
Other long-term assets		**47**		28		23
Total	**$**	**798**	$	816	$	434

We record financing receivables when we offer certain of our customers the option to acquire our software products and services offerings through a financing program in a limited number of countries. As of June 30, 2021 and 2020, our financing receivables, net were $4.4 billion and $5.2 billion, respectively, for short-term and long-term financing receivables, which are included in other current assets and other long-term assets in our consolidated balance sheets. We record an allowance to cover expected losses based on troubled accounts, historical experience, and other currently available evidence.

Assets Recognized from Costs to Obtain a Contract with a Customer

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We have determined that certain sales incentive programs meet the requirements to be capitalized. Total capitalized costs to obtain a contract were immaterial during the periods presented and are included in other current and long-term assets in our consolidated balance sheets.

We apply a practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less. These costs include our internal sales force compensation program and certain partner sales incentive programs as we have determined annual compensation is commensurate with annual sales activities.

Cost of Revenue

Cost of revenue includes: manufacturing and distribution costs for products sold and programs licensed; operating costs related to product support service centers and product distribution centers; costs incurred to include software on PCs sold by original equipment manufacturers (“OEM”), to drive traffic to our websites, and to acquire online advertising space; costs incurred to support and maintain online products and services, including datacenter costs and royalties; warranty costs; inventory valuation adjustments; costs associated with the delivery of consulting services; and the amortization of capitalized software development costs. Capitalized software development costs are amortized over the estimated lives of the products.

Product Warranty

We provide for the estimated costs of fulfilling our obligations under hardware and software warranties at the time the related revenue is recognized. For hardware warranties, we estimate the costs based on historical and projected product failure rates, historical and projected repair costs, and knowledge of specific product failures (if any). The specific hardware warranty terms and conditions vary depending upon the product sold and the country in which we do business, but generally include parts and labor over a period generally ranging from 90 days to three years. For software warranties, we estimate the costs to provide bug fixes, such as security patches, over the estimated life of the software. We regularly reevaluate our estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

Research and Development

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content. Such costs related to software development are included in research and development expense until the point that technological feasibility is reached, which for our software products, is generally shortly before the products are released to production. Once technological feasibility is reached, such costs are capitalized and amortized to cost of revenue over the estimated lives of the products.

Sales and Marketing

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs. Advertising costs are expensed as incurred. Advertising expense was $1.5 billion, $1.6 billion, and $1.6 billion in fiscal years 2021, 2020, and 2019, respectively.

Stock-Based Compensation

Compensation cost for stock awards, which include restricted stock units (“RSUs”) and performance stock units (“PSUs”), is measured at the fair value on the grant date and recognized as expense, net of estimated forfeitures, over the related service or performance period. The fair value of stock awards is based on the quoted price of our common stock on the grant date less the present value of expected dividends not received during the vesting period. We measure the fair value of PSUs using a Monte Carlo valuation model. Compensation cost for RSUs is recognized using the straight-line method and for PSUs is recognized using the accelerated method.

Compensation expense for the employee stock purchase plan (“ESPP”) is measured as the discount the employee is entitled to upon purchase and is recognized in the period of purchase.

Income Taxes

Income tax expense includes U.S. and international income taxes, and interest and penalties on uncertain tax positions. Certain income and expenses are not reported in tax returns and financial statements in the same year. The tax effect of such temporary differences is reported as deferred income taxes. Deferred tax assets are reported net of a valuation allowance when it is more likely than not that a tax benefit will not be realized. All deferred income taxes are classified as long-term in our consolidated balance sheets.

Financial Instruments

Investments

We consider all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. The fair values of these investments approximate their carrying values. In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations.

Debt investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in fair value, excluding credit losses and impairments, are recorded in other comprehensive income. Fair value is calculated based on publicly available market information or other estimates determined by management. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the extent to which the fair value is less than cost. To determine credit losses, we employ a systematic methodology that considers available quantitative and qualitative evidence. In addition, we consider specific adverse conditions related to the financial health of, and business outlook for, the investee. If we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery, then a decline in fair value below cost is recorded as an impairment charge in other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Equity investments with readily determinable fair values are measured at fair value. Equity investments without readily determinable fair values are measured using the equity method or measured at cost with adjustments for observable changes in price or impairments (referred to as the measurement alternative). We perform a qualitative assessment on a periodic basis and recognize an impairment if there are sufficient indicators that the fair value of the investment is less than carrying value. Changes in value are recorded in other income (expense), net.

Derivatives

Derivative instruments are recognized as either assets or liabilities and measured at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

For derivative instruments designated as fair value hedges, gains and losses are recognized in other income (expense), net with offsetting gains and losses on the hedged items. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in other income (expense), net.

For derivative instruments designated as cash flow hedges, gains and losses are initially reported as a component of other comprehensive income and subsequently recognized in earnings with the corresponding hedged item. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in earnings.

For derivative instruments that are not designated as hedges, gains and losses from changes in fair values are primarily recognized in other income (expense), net.

Fair Value Measurements

We account for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. We categorize each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 investments include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.
- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 investments include commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities,

corporate notes and bonds, and municipal securities. Our Level 2 derivative assets and liabilities primarily include certain over-the-counter option and swap contracts.

- *Level 3* – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 assets and liabilities include investments in corporate notes and bonds, municipal securities, and goodwill and intangible assets, when they are recorded at fair value due to an impairment charge. Unobservable inputs used in the models are significant to the fair values of the assets and liabilities.

We measure equity investments without readily determinable fair values on a nonrecurring basis. The fair values of these investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections.

Our other current financial assets and current financial liabilities have fair values that approximate their carrying values.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation, and depreciated using the straight-line method over the shorter of the estimated useful life of the asset or the lease term. The estimated useful lives of our property and equipment are generally as follows: computer software developed or acquired for internal use, three to seven years; computer equipment, two to four years; buildings and improvements, five to 15 years; leasehold improvements, three to 20 years; and furniture and equipment, one to 10 years. Land is not depreciated.

Leases

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities in our consolidated balance sheets. Finance leases are included in property and equipment, other current liabilities, and other long-term liabilities in our consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we generally use our incremental borrowing rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

We have lease agreements with lease and non-lease components, which are generally accounted for separately. For certain equipment leases, such as vehicles, we account for the lease and non-lease components as a single lease component. Additionally, for certain equipment leases, we apply a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Goodwill

Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value.

Intangible Assets

Our intangible assets are subject to amortization and are amortized using the straight-line method over their estimated period of benefit, ranging from one to 20 years. We evaluate the recoverability of intangible assets periodically by taking into account events or circumstances that may warrant revised estimates of useful lives or that indicate the asset may be impaired.

Recent Accounting Guidance

Recently Adopted Accounting Guidance

Financial Instruments – Credit Losses

In June 2016, the FASB issued a new standard to replace the incurred loss impairment methodology under current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. We adopted the standard effective July 1, 2020. We use a forward-looking expected credit loss model for accounts receivable, loans, and other financial instruments. Credit losses relating to available-for-sale debt securities are recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. We applied a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date to align our credit loss methodology with the new standard. The adoption of the standard did not have a material impact on our consolidated financial statements.

Recent Accounting Guidance Not Yet Adopted

Accounting for Income Taxes

In December 2019, the FASB issued a new standard to simplify the accounting for income taxes. The guidance eliminates certain exceptions related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period, and the recognition of deferred tax liabilities for outside basis differences related to changes in ownership of equity method investments and foreign subsidiaries. The guidance also simplifies aspects of accounting for franchise taxes and enacted changes in tax laws or rates, and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. The standard will be effective for us beginning July 1, 2021. We have completed our assessment and concluded that adoption of the new standard will not have a material impact on our consolidated financial statements.

NOTE 2 — EARNINGS PER SHARE

Basic earnings per share (“EPS”) is computed based on the weighted average number of shares of common stock outstanding during the period. Diluted EPS is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and stock awards.

The components of basic and diluted EPS were as follows:

(In millions, except earnings per share)

Year Ended June 30,	**2021**	**2020**	**2019**
Net income available for common shareholders (A)	**$ 61,271**	$ 44,281	$ 39,240
Weighted average outstanding shares of common stock (B)	**7,547**	7,610	7,673
Dilutive effect of stock-based awards	**61**	73	80
Common stock and common stock equivalents (C)	**7,608**	7,683	7,753

Earnings Per Share

Basic (A/B)	**$**	**8.12**	$	5.82	$	5.11
Diluted (A/C)	**$**	**8.05**	$	5.76	$	5.06

Anti-dilutive stock-based awards excluded from the calculations of diluted EPS were immaterial during the periods presented.

NOTE 3 — OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)

Year Ended June 30,	2021	2020	2019
Interest and dividends income	**$ 2,131**	$ 2,680	$ 2,762
Interest expense	**(2,346)**	(2,591)	(2,686)
Net recognized gains on investments	**1,232**	32	648
Net gains on derivatives	**17**	187	144
Net gains (losses) on foreign currency remeasurements	**54**	(191)	(82)
Other, net	**98**	(40)	(57)
Total	**$ 1,186**	$ 77	$ 729

Net Recognized Gains (Losses) on Investments

Net recognized gains (losses) on debt investments were as follows:

(In millions)

Year Ended June 30,	2021	2020	2019
Realized gains from sales of available-for-sale securities	**$ 105**	$ 50	$ 12
Realized losses from sales of available-for-sale securities	**(40)**	(37)	(93)
Impairments and allowance for credit losses	**(2)**	(17)	(16)
Total	**$ 63**	$ (4)	$ (97)

Net recognized gains (losses) on equity investments were as follows:

(In millions)

Year Ended June 30,	2021	2020	2019
Net realized gains on investments sold	**$ 123**	$ 83	$ 276
Net unrealized gains on investments still held	**1,057**	69	479
Impairments of investments	**(11)**	(116)	(10)
Total	**$ 1,169**	$ 36	$ 745

NOTE 4 — INVESTMENTS

Investment Components

The components of investments were as follows:

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-Investm
June 30, 2021							
Changes in Fair Value Recorded in Other Comprehensive Income							
Commercial paper	Level 2	**$ 4,316**	**$ 0**	**$ 0**	**$ 4,316**	**$ 1,331**	**$ 2,**
Certificates of deposit	Level 2	**3,615**	**0**	**0**	**3,615**	**2,920**	
U.S. government securities	Level 1	**90,664**	**3,832**	**(111)**	**94,385**	**1,500**	**92,**
U.S. agency securities	Level 2	**807**	**2**	**0**	**809**	**0**	
Foreign government bonds	Level 2	**6,213**	**9**	**(2)**	**6,220**	**225**	**5,**
Mortgage- and asset-backed securities	Level 2	**3,442**	**22**	**(6)**	**3,458**	**0**	**3,**
Corporate notes and bonds	Level 2	**8,443**	**249**	**(9)**	**8,683**	**0**	**8,**
Corporate notes and bonds	Level 3	**63**	**0**	**0**	**63**	**0**	
Municipal securities	Level 2	**308**	**63**	**0**	**371**	**0**	
Municipal securities	Level 3	**95**	**0**	**(7)**	**88**	**0**	
Total debt investments		**$ 117,966**	**$ 4,177**	**$ (135)**	**$ 122,008**	**$ 5,976**	**$ 116,**
Changes in Fair Value Recorded in Net Income							
Equity investments	Level 1				**$ 1,582**	**$ 976**	**$**
Equity investments	Other				**5,378**	**0**	
Total equity investments					**$ 6,960**	**$ 976**	**$**
Cash					**$ 7,272**	**$ 7,272**	**$**
Derivatives, net (a)					**78**	**0**	
Total					**$ 136,318**	**$ 14,224**	**$ 116**

(In millions)	Fair Value Level	Adjusted Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2020								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 4,687	$ 1	$ 0	$ 4,688	$ 1,618	$ 3,070	$ 0
Certificates of deposit	Level 2	2,898	0	0	2,898	1,646	1,252	0
U.S. government securities	Level 1	92,067	6,495	(1)	98,561	3,168	95,393	0
U.S. agency securities	Level 2	2,439	2	0	2,441	449	1,992	0
Foreign government bonds	Level 2	6,982	6	(3)	6,985	1	6,984	0
Mortgage- and asset-backed securities	Level 2	4,865	41	(6)	4,900	0	4,900	0
Corporate notes and bonds	Level 2	8,500	327	(17)	8,810	0	8,810	0
Corporate notes and bonds	Level 3	58	0	0	58	0	58	0
Municipal securities	Level 2	313	57	(4)	366	0	366	0
Municipal securities	Level 3	91	0	0	91	0	91	0
Total debt investments		$ 122,900	$ 6,929	$ (31)	$ 129,798	$ 6,882	$ 122,916	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 1,198	$ 784	$ 0	$ 414
Equity investments	Other				2,551	0	0	2,551
Total equity investments					$ 3,749	$ 784	$ 0	$ 2,965
Cash					$ 5,910	$ 5,910	$ 0	$ 0
Derivatives, net (a)					35	0	35	0
Total					$ 139,492	$ 13,576	$ 122,951	$ 2,965

(a) *Refer to Note 5 – Derivatives for further information on the fair value of our derivative instruments.*

Equity investments presented as “Other” in the tables above include investments without readily determinable fair values measured using the equity method or measured at cost with adjustments for observable changes in price or impairments, and investments measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of June 30, 2021 and 2020, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $3.3 billion and $1.4 billion, respectively.

Unrealized Losses on Debt Investments

Debt investments with continuous unrealized losses for less than 12 months and 12 months or greater and their related fair values were as follows:

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2021						
U.S. government and agency securities	$ 5,294	$ (111)	$ 0	$ 0	$ 5,294	$ (111)
Foreign government bonds	3,148	(1)	5	(1)	3,153	(2)
Mortgage- and asset-backed securities	1,211	(5)	87	(1)	1,298	(6)
Corporate notes and bonds	1,678	(8)	34	(1)	1,712	(9)
Municipal securities	58	(7)	1	0	59	(7)
Total	$ 11,389	$ (132)	$ 127	$ (3)	$ 11,516	$ (135)

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2020						
U.S. government and agency securities	$ 2,323	$ (1)	$ 0	$ 0	$ 2,323	$ (1)
Foreign government bonds	500	(3)	0	0	500	(3)
Mortgage- and asset-backed securities	1,014	(6)	0	0	1,014	(6)
Corporate notes and bonds	649	(17)	0	0	649	(17)
Municipal securities	66	(4)	0	0	66	(4)
Total	$ 4,552	$ (31)	$ 0	$ 0	$ 4,552	$ (31)

Unrealized losses from fixed-income securities are primarily attributable to changes in interest rates. Management does not believe any remaining unrealized losses represent impairments based on our evaluation of available evidence.

Debt Investment Maturities

(In millions)	Adjusted Cost Basis	Estimated Fair Value
June 30, 2021		
Due in one year or less	**$ 22,612**	**$ 22,676**
Due after one year through five years	**67,541**	**70,315**
Due after five years through 10 years	**25,212**	**26,327**
Due after 10 years	**2,601**	**2,690**
Total	**$ 117,966**	**$ 122,008**

NOTE 5 — DERIVATIVES

We use derivative instruments to manage risks related to foreign currencies, interest rates, equity prices, and credit; to enhance investment returns; and to facilitate portfolio diversification. Our objectives for holding derivatives include reducing, eliminating, and efficiently managing the economic impact of these exposures as effectively as possible. Our derivative programs include strategies that both qualify and do not qualify for hedge accounting treatment.

Foreign Currencies

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions.

Foreign currency risks related to certain non-U.S. dollar-denominated investments are hedged using foreign exchange forward contracts that are designated as fair value hedging instruments. Foreign currency risks related to certain Euro-denominated debt are hedged using foreign exchange forward contracts that are designated as cash flow hedging instruments.

In the past, option and forward contracts were used to hedge a portion of forecasted international revenue and were designated as cash flow hedging instruments. Principal currencies hedged included the Euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

Certain options and forwards not designated as hedging instruments are also used to manage the variability in foreign exchange rates on certain balance sheet amounts and to manage other foreign currency exposures.

Interest Rate

Interest rate risks related to certain fixed-rate debt are hedged using interest rate swaps that are designated as fair value hedging instruments to effectively convert the fixed interest rates to floating interest rates.

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using exchange-traded option and futures contracts and over-the-counter swap and option contracts. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Equity

Securities held in our equity investments portfolio are subject to market price risk. At times, we may hold options, futures, and swap contracts. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Credit-Risk-Related Contingent Features

Certain of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of June 30, 2021, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

The following table presents the notional amounts of our outstanding derivative instruments measured in U.S. dollar equivalents:

(In millions)	June 30, 2021	June 30, 2020
Designated as Hedging Instruments		
Foreign exchange contracts purchased	**$ 635**	$ 635
Foreign exchange contracts sold	**6,081**	6,754
Interest rate contracts purchased	**1,247**	1,295
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**14,223**	11,896
Foreign exchange contracts sold	**23,391**	15,595
Other contracts purchased	**2,456**	1,844
Other contracts sold	**763**	757

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		June 30, 2021		June 30, 2020
Designated as Hedging Instruments				
Foreign exchange contracts	**$ 76**	**$ (8)**	$ 44	$ (54)
Interest rate contracts	**40**	**0**	93	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**227**	**(291)**	245	(334)
Other contracts	**56**	**(36)**	18	(11)
Gross amounts of derivatives	**399**	**(335)**	400	(399)
Gross amounts of derivatives offset in the balance sheet	**(141)**	**142**	(154)	158
Cash collateral received	**0**	**(42)**	0	(154)
Net amounts of derivatives	**$ 258**	**$ (235)**	$ 246	$ (395)
Reported as				
Short-term investments	**$ 78**	**$ 0**	$ 35	$ 0
Other current assets	**137**	**0**	199	0
Other long-term assets	**43**	**0**	12	0
Other current liabilities	**0**	**(182)**	0	(334)
Other long-term liabilities	**0**	**(53)**	0	(61)
Total	**$ 258**	**$ (235)**	$ 246	$ (395)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $395 million and $335 million, respectively, as of June 30, 2021, and $399 million and $399 million, respectively, as of June 30, 2020.

The following table presents the fair value of our derivatives instruments on a gross basis:

(In millions)	Level 1	Level 2	Level 3	Total
June 30, 2021				
Derivative assets	**$ 0**	**$ 396**	**$ 3**	**$ 399**
Derivative liabilities	**0**	**(335)**	**0**	**(335)**
June 30, 2020				
Derivative assets	1	398	1	400
Derivative liabilities	0	(399)	0	(399)

Gains (losses) on derivative instruments recognized in our consolidated income statements were as follows:

(In millions)

Year Ended June 30,		**2021**		**2020**		**2019**
	Revenue	**Other Income (Expense), Net**	**Revenue**	**Other Income (Expense), Net**	**Revenue**	**Other Income (Expense), Net**
Designated as Fair Value Hedging Instruments						
Foreign exchange contracts						
Derivatives	**$ 0**	**$ 193**	$ 0	$ 1	$ 0	$ (130)
Hedged items	**0**	**(188)**	0	3	0	130
Excluded from effectiveness assessment	**0**	**30**	0	139	0	168
Interest rate contracts						
Derivatives	**0**	**(37)**	0	93	0	0
Hedged items	**0**	**53**	0	(93)	0	0
Designated as Cash Flow Hedging Instruments						
Foreign exchange contracts						
Amount reclassified from accumulated other comprehensive income	**0**	**17**	0	0	341	0
Excluded from effectiveness assessment	**0**	**0**	0	0	(64)	0
Not Designated as Hedging Instruments						
Foreign exchange contracts	**0**	**27**	0	(123)	0	(97)
Other contracts	**0**	**9**	0	50	0	38

Gains (losses), net of tax, on derivative instruments recognized in our consolidated comprehensive income statements were as follows:

(In millions)

Year Ended June 30,	**2021**	**2020**	**2019**
Designated as Cash Flow Hedging Instruments			
Foreign exchange contracts			
Included in effectiveness assessment	**$ 34**	$ (38)	$ 159

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)

June 30,	**2021**	**2020**
Raw materials	**$ 1,190**	$ 700
Work in process	**79**	83
Finished goods	**1,367**	1,112

Total	**$ 2,636**	$ 1,895

NOTE 7 — PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

(In millions)

June 30,	**2021**	**2020**
Land	**$ 3,660**	$ 1,823
Buildings and improvements	**43,928**	33,995
Leasehold improvements	**6,884**	5,487
Computer equipment and software	**51,250**	41,261
Furniture and equipment	**5,344**	4,782
Total, at cost	**111,066**	87,348
Accumulated depreciation	**(51,351)**	(43,197)
Total, net	**$ 59,715**	$ 44,151

During fiscal years 2021, 2020, and 2019, depreciation expense was $9.3 billion, $10.7 billion, and $9.7 billion, respectively. Depreciation expense declined in fiscal year 2021 due to the change in estimated useful lives of our server and network equipment. We have committed $9.5 billion for the construction of new buildings, building improvements, and leasehold improvements as of June 30, 2021.

During fiscal year 2020, we recorded an impairment charge of $186 million to Property and Equipment, primarily to leasehold improvements, due to the closing of our Microsoft Store physical locations.

NOTE 8 — BUSINESS COMBINATIONS

ZeniMax Media Inc.

On March 9, 2021, we completed our acquisition of ZeniMax Media Inc. (“ZeniMax”), the parent company of Bethesda Softworks LLC (“Bethesda”), for a total purchase price of $8.1 billion, consisting primarily of cash. The purchase price included $768 million of cash and cash equivalents acquired. Bethesda is one of the largest, privately held game developers and publishers in the world, and brings a broad portfolio of games, technology, and talent to Xbox. The financial results of ZeniMax have been included in our consolidated financial statements since the date of the acquisition. ZeniMax is reported as part of our More Personal Computing segment.

The purchase price allocation as of the date of acquisition was based on a preliminary valuation and is subject to revision as more detailed analyses are completed and additional information about the fair value of assets acquired and liabilities assumed becomes available.

The major classes of assets and liabilities to which we have preliminarily allocated the purchase price were as follows:

(In millions)

Cash and cash equivalents	$ 768
Goodwill	5,469
Intangible assets	1,968
Other assets	139
Other liabilities	(223)
Total	$ 8,121

Goodwill was assigned to our More Personal Computing segment. The goodwill was primarily attributed to increased synergies that are expected to be achieved from the integration of ZeniMax. None of the goodwill is expected to be deductible for income tax purposes.

Following are details of the purchase price allocated to the intangible assets acquired:

(In millions)	Amount	Weighted Average Life
Technology-based	$ 1,341	4 years
Marketing-related	627	11 years
Total	$ 1,968	6 years

GitHub, Inc.

On October 25, 2018, we acquired GitHub, Inc. (“GitHub”), a software development platform, in a $7.5 billion stock transaction (inclusive of total cash payments of $1.3 billion in respect of vested GitHub equity awards and an indemnity escrow). The acquisition is expected to empower developers to achieve more at every stage of the development lifecycle, accelerate enterprise use of GitHub, and bring Microsoft’s developer tools and services to new audiences. The financial results of GitHub have been included in our consolidated financial statements since the date of the acquisition. GitHub is reported as part of our Intelligent Cloud segment.

The allocation of the purchase price to goodwill was completed as of June 30, 2019. The major classes of assets and liabilities to which we allocated the purchase price were as follows:

(In millions)	
Cash, cash equivalents, and short-term investments	$ 234
Goodwill	5,497
Intangible assets	1,267
Other assets	143
Other liabilities	(217)
Total	$ 6,924

The goodwill recognized in connection with the acquisition is primarily attributable to anticipated synergies from future growth and is not expected to be deductible for tax purposes. We assigned the goodwill to our Intelligent Cloud segment.

Following are the details of the purchase price allocated to the intangible assets acquired:

(In millions)	Amount	Weighted Average Life
Customer-related	$ 648	8 years
Technology-based	447	5 years
Marketing-related	170	10 years
Contract-based	2	2 years
Total	$ 1,267	7 years

Transactions recognized separately from the purchase price allocation were approximately $600 million, primarily related to equity awards recognized as expense over the related service period.

Nuance Communications, Inc.

On April 11, 2021, we entered into a definitive agreement to acquire Nuance Communications, Inc. (“Nuance”) for $56.00 per share in an all-cash transaction valued at $19.7 billion, inclusive of Nuance’s net debt. Nuance is a cloud and artificial intelligence (“AI”) software provider with healthcare and enterprise AI experience, and the acquisition will build on our industry-specific cloud offerings. The acquisition has been approved by Nuance’s shareholders, and we expect it to close by the end of calendar year 2021, subject to the satisfaction of certain regulatory approvals and other customary closing conditions.

NOTE 9 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	June 30, 2019	Acquisitions	Other	June 30, 2020	Acquisitions	Other	June 30, 2021
Productivity and Business Processes	$ 24,277	$ 7	$ (94)	**$ 24,190**	**$ 0**	**$ 127**	**$ 24,317**
Intelligent Cloud	11,351	1,351	(5)	**12,697**	**505**	**54**	**13,256**
More Personal Computing	6,398	96	(30)	**6,464**	**5,556** (a)	**118** (a)	**12,138**
Total	$ 42,026	$ 1,454	$ (129)	**$ 43,351**	**$ 6,061**	**$ 299**	**$ 49,711**

(a) *Includes goodwill of $5.5 billion related to ZeniMax. See Note 8 – Business Combinations for further information*.

The measurement periods for the valuation of assets acquired and liabilities assumed end as soon as information on the facts and circumstances that existed as of the acquisition dates becomes available, but do not exceed 12 months. Adjustments in purchase price allocations may require a change in the amounts allocated to goodwill during the periods in which the adjustments are determined.

Any change in the goodwill amounts resulting from foreign currency translations and purchase accounting adjustments are presented as “Other” in the table above. Also included in “Other” are business dispositions and transfers between segments due to reorganizations, as applicable.

Goodwill Impairment

We test goodwill for impairment annually on May 1 at the reporting unit level, primarily using a discounted cash flow methodology with a peer-based, risk-adjusted weighted average cost of capital. We believe use of a discounted cash flow approach is the most reliable indicator of the fair values of the businesses.

No instances of impairment were identified in our May 1, 2021, May 1, 2020, or May 1, 2019 tests. As of June 30, 2021 and 2020, accumulated goodwill impairment was $11.3 billion.

NOTE 10 — INTANGIBLE ASSETS

The components of intangible assets, all of which are finite-lived, were as follows:

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
June 30,			**2021**			**2020**
Technology-based	**$ 9,779**	**$ (7,007)**	**$ 2,772**	$ 8,160	$ (6,381)	$ 1,779
Customer-related	**4,958**	**(2,859)**	**2,099**	4,967	(2,320)	2,647
Marketing-related	**4,792**	**(1,878)**	**2,914**	4,158	(1,588)	2,570
Contract-based	**446**	**(431)**	**15**	474	(432)	42
Total	**$ 19,975** (a)	**$ (12,175)**	**$ 7,800**	$ 17,759	$ (10,721)	$ 7,038

(a) *Includes intangible assets of $2.0 billion related to ZeniMax. See Note 8 – Business Combinations for further information*.

No material impairments of intangible assets were identified during fiscal years 2021, 2020, or 2019. We estimate that we have no significant residual value related to our intangible assets.

The components of intangible assets acquired during the periods presented were as follows:

(In millions)	Amount	Weighted Average Life	Amount	Weighted Average Life
Year Ended June 30,	**2021**		**2020**	
Technology-based	**$ 1,628**	**4 years**	$ 531	6 years
Customer-related	**96**	**4 years**	303	5 years
Marketing-related	**625**	**6 years**	2	2 years
Contract-based	**10**	**3 years**	0	0 years
Total	**$ 2,359**	**5 years**	$ 836	5 years

Intangible assets amortization expense was $1.6 billion, $1.6 billion, and $1.9 billion for fiscal years 2021, 2020, and 2019, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of June 30, 2021:

(In millions)	
Year Ending June 30,	
2022	**$ 1,683**
2023	**1,722**
2024	**1,415**
2025	**755**
2026	**498**
Thereafter	**1,727**
Total	**$ 7,800**

NOTE 11 — DEBT

The components of debt were as follows:

(In millions, issuance by calendar year)	Maturities (calendar year)	Stated Interest Rate	Effective Interest Rate	June 30, 2021	June 30, 2020
2009 issuance of $3.8 billion (a)	**2039**	**5.20%**	**5.24%**	**$ 520**	$ 559
2010 issuance of $4.8 billion (a)	**2040**	**4.50%**	**4.57%**	**486**	1,571
2011 issuance of $2.3 billion (a)	**2041**	**5.30%**	**5.36%**	**718**	1,270
2012 issuance of $2.3 billion (a)	**2022 – 2042**	**2.13% – 3.50%**	**2.24% – 3.57%**	**1,204**	1,650
2013 issuance of $5.2 billion (a)	**2023 – 2043**	**2.38% – 4.88%**	**2.47% – 4.92%**	**2,814**	2,919
2013 issuance of €4.1 billion	**2021 – 2033**	**2.13% – 3.13%**	**2.23% – 3.22%**	**4,803**	4,549
2015 issuance of $23.8 billion (a)	**2022 – 2055**	**2.38% – 4.75%**	**2.47% – 4.78%**	**12,305**	15,549
2016 issuance of $19.8 billion (a)	**2021 – 2056**	**1.55% – 3.95%**	**1.64% – 4.03%**	**12,180**	16,955
2017 issuance of $17.0 billion (a)	**2022 – 2057**	**2.40% – 4.50%**	**2.52% – 4.53%**	**10,695**	12,385
2020 issuance of $10.0 billion (a)	**2050 – 2060**	**2.53% – 2.68%**	**2.53% – 2.68%**	**10,000**	10,000
2021 issuance of $8.2 billion (a)	**2052 – 2062**	**2.92% – 3.04%**	**2.92% – 3.04%**	**8,185**	0
Total face value				**63,910**	67,407
Unamortized discount and issuance costs				**(511)**	(554)
Hedge fair value adjustments (b)				**40**	93
Premium on debt exchange (a)				**(5,293)**	(3,619)
Total debt				**58,146**	63,327
Current portion of long-term debt				**(8,072)**	(3,749)
Long-term debt				**$ 50,074**	$ 59,578

(a) *In March 2021 and June 2020, we exchanged a portion of our existing debt at a premium for cash and new debt with longer maturities. The premiums are amortized over the terms of the new debt.*

(b) *Refer to Note 5 – Derivatives for further information on the interest rate swaps related to fixed-rate debt.*

As of June 30, 2021 and 2020, the estimated fair value of long-term debt, including the current portion, was $70.0 billion and $77.1 billion, respectively. The estimated fair values are based on Level 2 inputs.

Debt in the table above is comprised of senior unsecured obligations and ranks equally with our other outstanding obligations. Interest is paid semi-annually, except for the Euro-denominated debt, which is paid annually. Cash paid for interest on our debt for fiscal years 2021, 2020, and 2019 was $2.0 billion, $2.4 billion, and $2.4 billion, respectively.

The following table outlines maturities of our long-term debt, including the current portion, as of June 30, 2021:

(In millions)

Year Ending June 30,		
2022	$	**8,075**
2023		**2,750**
2024		**5,250**
2025		**2,250**
2026		**3,000**
Thereafter		**42,585**
Total	$	**63,910**

NOTE 12 — INCOME TAXES

Tax Cuts and Jobs Act

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted into law, which significantly changed existing U.S. tax law and included numerous provisions that affect our business. We recorded a provisional net charge of $13.7 billion related to the enactment of the TCJA in fiscal year 2018 and adjusted the provisional net charge by recording additional tax expense of $157 million in fiscal year 2019 pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 118.

In fiscal year 2019, in response to the TCJA and recently issued regulations, we transferred certain intangible properties held by our foreign subsidiaries to the U.S. and Ireland. The transfers of intangible properties resulted in a $2.6 billion net income tax benefit recorded in the fourth quarter of fiscal year 2019, as the value of future tax deductions exceeded the current tax liability from foreign jurisdictions and U.S. global intangible low-taxed income ("GILTI") tax.

Provision for Income Taxes

The components of the provision for income taxes were as follows:

(In millions)

Year Ended June 30,	**2021**	**2020**	**2019**
Current Taxes			
U.S. federal	**$ 3,285**	$ 3,537	$ 4,718
U.S. state and local	**1,229**	763	662
Foreign	**5,467**	4,444	5,531
Current taxes	**$ 9,981**	$ 8,744	$ 10,911
Deferred Taxes			
U.S. federal	**$ 25**	$ 58	$ (5,647)
U.S. state and local	**(204)**	(6)	(1,010)
Foreign	**29**	(41)	194
Deferred taxes	**$ (150)**	$ 11	$ (6,463)
Provision for income taxes	**$ 9,831**	$ 8,755	$ 4,448

U.S. and foreign components of income before income taxes were as follows:

(In millions)

Year Ended June 30,	**2021**	**2020**	**2019**
U.S.	**$ 34,972**	$ 24,116	$ 15,799
Foreign	**36,130**	28,920	27,889
Income before income taxes	**$ 71,102**	$ 53,036	$ 43,688

Effective Tax Rate

The items accounting for the difference between income taxes computed at the U.S. federal statutory rate and our effective rate were as follows:

Year Ended June 30,	2021	2020	2019
Federal statutory rate	**21.0%**	21.0%	21.0%
Effect of:			
Foreign earnings taxed at lower rates	**(2.7)%**	(3.7)%	(4.1)%
Impact of the enactment of the TCJA	**0%**	0%	0.4%
Impact of intangible property transfers	**0%**	0%	(5.9)%
Foreign-derived intangible income deduction	**(1.3)%**	(1.1)%	(1.4)%
State income taxes, net of federal benefit	**1.4%**	1.3%	0.7%
Research and development credit	**(0.9)%**	(1.1)%	(1.1)%
Excess tax benefits relating to stock-based compensation	**(2.4)%**	(2.2)%	(2.2)%
Interest, net	**0.5%**	1.0%	1.0%
Other reconciling items, net	**(1.8)%**	1.3%	1.8%
Effective rate	**13.8%**	16.5%	10.2%

We have historically paid India withholding taxes on software sales through distributor withholding and tax audit assessments in India. In March 2021, the India Supreme Court ruled favorably in the case of Engineering Analysis Centre of Excellence Private Limited vs The Commissioner of Income Tax for companies in 86 separate appeals, some dating back to 2012, holding that software sales are not subject to India withholding taxes. Although we were not a party to the appeals, our software sales in India were determined to be not subject to withholding taxes. Therefore, we recorded a net income tax benefit of $620 million in the third quarter of fiscal year 2021 to reflect the results of the India Supreme Court decision impacting fiscal year 1996 through fiscal year 2016.

The decrease from the federal statutory rate in fiscal year 2021 is primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland and Puerto Rico, tax benefits relating to stock-based compensation, and tax benefits from the India Supreme Court decision on withholding taxes. The decrease from the federal statutory rate in fiscal year 2020 is primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland and Puerto Rico, and tax benefits relating to stock-based compensation. The decrease from the federal statutory rate in fiscal year 2019 is primarily due to a $2.6 billion net income tax benefit related to intangible property transfers, and earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland, Singapore, and Puerto Rico. In fiscal year 2021 and 2020, our foreign regional operating centers in Ireland and Puerto Rico, which are taxed at rates lower than the U.S. rate, generated 82% and 86% of our foreign income before tax. In fiscal years 2019, our foreign regional operating centers in Ireland, Singapore, and Puerto Rico, which are taxed at rates lower than the U.S. rate, generated 82% of our foreign income before tax, respectively. Other reconciling items, net consists primarily of tax credits and GILTI tax, and in fiscal year 2021, includes tax benefits from the India Supreme Court decision on withholding taxes. In fiscal years 2021, 2020, and 2019, there were no individually significant other reconciling items.

The decrease in our effective tax rate for fiscal year 2021 compared to fiscal year 2020 was primarily due to tax benefits from the India Supreme Court decision on withholding taxes, an agreement between the U.S. and India tax authorities related to transfer pricing, final TCJA regulations, and an increase in tax benefits relating to stock-based compensation. The increase in our effective tax rate for fiscal year 2020 compared to fiscal year 2019 was primarily due to a $2.6 billion net income tax benefit in the fourth quarter of fiscal year 2019 related to intangible property transfers.

The components of the deferred income tax assets and liabilities were as follows:

(In millions)

June 30,	**2021**	**2020**
Deferred Income Tax Assets		
Stock-based compensation expense	**$ 502**	$ 461
Accruals, reserves, and other expenses	**2,960**	2,721
Loss and credit carryforwards	**1,090**	865
Amortization	**6,346**	6,737
Leasing liabilities	**4,060**	3,025
Unearned revenue	**2,659**	1,553
Other	**543**	354
Deferred income tax assets	**18,160**	15,716
Less valuation allowance	**(769)**	(755)
Deferred income tax assets, net of valuation allowance	**$ 17,391**	$ 14,961
Deferred Income Tax Liabilities		
Book/tax basis differences in investments and debt	**$ (2,605)**	$ (2,642)
Leasing assets	**(3,834)**	(2,817)
Depreciation	**(1,010)**	(376)
Deferred GILTI tax liabilities	**(2,815)**	(2,581)
Other	**(144)**	(344)
Deferred income tax liabilities	**$ (10,408)**	$ (8,760)
Net deferred income tax assets	**$ 6,983**	$ 6,201
Reported As		
Other long-term assets	**$ 7,181**	$ 6,405
Long-term deferred income tax liabilities	**(198)**	(204)
Net deferred income tax assets	**$ 6,983**	$ 6,201

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when the taxes are paid or recovered.

As of June 30, 2021, we had federal, state, and foreign net operating loss carryforwards of $304 million, $1.3 billion, and $2.0 billion, respectively. The federal and state net operating loss carryforwards will expire in various years from fiscal 2022 through 2041, if not utilized. The majority of our foreign net operating loss carryforwards do not expire. Certain acquired net operating loss carryforwards are subject to an annual limitation but are expected to be realized with the exception of those which have a valuation allowance.

The valuation allowance disclosed in the table above relates to the foreign net operating loss carryforwards and other net deferred tax assets that may not be realized. In fiscal year 2020, we removed $2.0 billion of foreign net operating losses and corresponding valuation allowances as a result of the liquidation of a foreign subsidiary. There was no impact to our consolidated financial statements.

Income taxes paid, net of refunds, were $13.4 billion, $12.5 billion, and $8.4 billion in fiscal years 2021, 2020, and 2019, respectively.

Uncertain Tax Positions

Gross unrecognized tax benefits related to uncertain tax positions as of June 30, 2021, 2020, and 2019, were $14.6 billion, $13.8 billion, and $13.1 billion, respectively, which were primarily included in long-term income taxes in our consolidated balance sheets. If recognized, the resulting tax benefit would affect our effective tax rates for fiscal years 2021, 2020, and 2019 by $12.5 billion, $12.1 billion, and $12.0 billion, respectively.

As of June 30, 2021, 2020, and 2019, we had accrued interest expense related to uncertain tax positions of $4.3 billion, $4.0 billion, and $3.4 billion, respectively, net of income tax benefits. The provision for income taxes for fiscal years 2021, 2020, and 2019 included interest expense related to uncertain tax positions of $274 million, $579 million, and $515 million, respectively, net of income tax benefits.

The aggregate changes in the gross unrecognized tax benefits related to uncertain tax positions were as follows:

(In millions)

Year Ended June 30,	2021	2020	2019
Beginning unrecognized tax benefits	**$ 13,792**	$ 13,146	$ 11,961
Decreases related to settlements	**(195)**	(31)	(316)
Increases for tax positions related to the current year	**790**	647	2,106
Increases for tax positions related to prior years	**461**	366	508
Decreases for tax positions related to prior years	**(297)**	(331)	(1,113)
Decreases due to lapsed statutes of limitations	**(1)**	(5)	0
Ending unrecognized tax benefits	**$ 14,550**	$ 13,792	$ 13,146

We settled a portion of the Internal Revenue Service ("IRS") audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. In the second quarter of fiscal year 2021, we settled an additional portion of the IRS audits for tax years 2004 to 2013 and made a payment of $1.7 billion, including tax and interest. We remain under audit for tax years 2004 to 2017.

As of June 30, 2021, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved key transfer pricing issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2020, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 13 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

June 30,	2021	2020
Productivity and Business Processes	**$ 22,120**	$ 18,643
Intelligent Cloud	**17,710**	16,620
More Personal Computing	**4,311**	3,917

Total	**$ 44,141**	$ 39,180

Changes in unearned revenue were as follows:

(In millions)

Year Ended June 30, 2021	
Balance, beginning of period	**$ 39,180**
Deferral of revenue	**94,565**
Recognition of unearned revenue	**(89,604)**
Balance, end of period	**$ 44,141**

Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was $146 billion as of June 30, 2021, of which $141 billion is related to the commercial portion of revenue. We expect to recognize approximately 50% of this revenue over the next 12 months and the remainder thereafter.

NOTE 14 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. Our leases have remaining lease terms of 1 year to 15 years, some of which include options to extend the leases for up to 5 years, and some of which include options to terminate the leases within 1 year.

The components of lease expense were as follows:

(In millions)

Year Ended June 30,	2021	2020	2019
Operating lease cost	**$ 2,127**	$ 2,043	$ 1,707
Finance lease cost:			
Amortization of right-of-use assets	**$ 921**	$ 611	$ 370
Interest on lease liabilities	**386**	336	247
Total finance lease cost	**$ 1,307**	$ 947	$ 617

Supplemental cash flow information related to leases was as follows:

(In millions)

Year Ended June 30,	2021	2020	2019
Cash paid for amounts included in the measurement of lease liabilities:			
Operating cash flows from operating leases	**$ 2,052**	$ 1,829	$ 1,670
Operating cash flows from finance leases	**386**	336	247
Financing cash flows from finance leases	**648**	409	221
Right-of-use assets obtained in exchange for lease obligations:			
Operating leases	**4,380**	3,677	2,303
Finance leases	**3,290**	3,467	2,532

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

June 30,	**2021**	**2020**
Operating Leases		
Operating lease right-of-use assets	**$ 11,088**	$ 8,753
Other current liabilities	**$ 1,962**	$ 1,616
Operating lease liabilities	**9,629**	7,671
Total operating lease liabilities	**$ 11,591**	$ 9,287
Finance Leases		
Property and equipment, at cost	**$ 14,107**	$ 10,371
Accumulated depreciation	**(2,306)**	(1,385)
Property and equipment, net	**$ 11,801**	$ 8,986
Other current liabilities	**$ 791**	$ 540
Other long-term liabilities	**11,750**	8,956
Total finance lease liabilities	**$ 12,541**	$ 9,496
Weighted Average Remaining Lease Term		
Operating leases	**8 years**	8 years
Finance leases	**12 years**	13 years
Weighted Average Discount Rate		
Operating leases	**2.2%**	2.7%
Finance leases	**3.4%**	3.9%

The following table outlines maturities of our lease liabilities as of June 30, 2021:

(In millions)

Year Ending June 30,	**Operating Leases**	**Finance Leases**
2022	**$ 2,125**	**$ 1,179**
2023	**1,954**	**1,198**
2024	**1,751**	**1,211**
2025	**1,463**	**1,537**
2026	**1,133**	**1,220**
Thereafter	**4,111**	**8,856**
Total lease payments	**12,537**	**15,201**
Less imputed interest	**(946)**	**(2,660)**
Total	**$ 11,591**	**$ 12,541**

As of June 30, 2021, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $5.4 billion and $7.3 billion, respectively. These operating and finance leases will commence between fiscal year 2022 and fiscal year 2026 with lease terms of 1 year to 15 years.

During fiscal year 2020, we recorded an impairment charge of $161 million to operating lease right-of-use assets due to the closing of our Microsoft Store physical locations.

NOTE 15 — CONTINGENCIES

Patent and Intellectual Property Claims

There were 63 patent infringement cases pending against Microsoft as of June 30, 2021, none of which are material individually or in aggregate.

Antitrust, Unfair Competition, and Overcharge Class Actions

Antitrust and unfair competition class action lawsuits were filed against us in British Columbia, Ontario, and Quebec, Canada. All three have been certified on behalf of Canadian indirect purchasers who acquired licenses for Microsoft operating system software and/or productivity application software between 1998 and 2010.

The trial of the British Columbia action commenced in May 2016. Following a mediation, the parties agreed to a global settlement of all three Canadian actions and submitted the proposed settlement agreement to the courts in all three jurisdictions for approval. The final settlement and form of notice have been approved by the courts in British Columbia, Ontario, and Quebec. The ten-month claims period commenced on November 23, 2020 and will close on September 23, 2021.

Other Antitrust Litigation and Claims

***China State Administration for Market Regulation Investigatio*n**

In 2014, Microsoft was informed that China's State Agency for Market Regulation ("SAMR") (formerly State Administration for Industry and Commerce) had begun a formal investigation relating to China's Anti-Monopoly Law, and the SAMR conducted onsite inspections of Microsoft offices in Beijing, Shanghai, Guangzhou, and Chengdu. In 2019, the SAMR presented preliminary views as to certain possible violations of China's Anti-Monopoly Law.

Product-Related Litigation

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 46 lawsuits, including 45 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which the defendants have moved to strike. In August 2018, the trial court issued an order striking portions of the plaintiffs' expert reports. A hearing on general causation is scheduled for January and February of 2022.

Other Contingencies

We also are subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in aggregate, will not have a material adverse impact in our consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future.

As of June 30, 2021, we accrued aggregate legal liabilities of $339 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $500 million in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

NOTE 16 — STOCKHOLDERS' EQUITY

Shares Outstanding

Shares of common stock outstanding were as follows:

(In millions)

Year Ended June 30,	2021	2020	2019
Balance, beginning of year	**7,571**	7,643	7,677
Issued	**49**	54	116
Repurchased	**(101)**	(126)	(150)
Balance, end of year	**7,519**	7,571	7,643

Share Repurchases

On September 20, 2016, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program commenced in December 2016 and was completed in February 2020.

On September 18, 2019, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program commenced in February 2020, following completion of the program approved on September 20, 2016, has no expiration date, and may be terminated at any time. As of June 30, 2021, $8.7 billion remained of this $40.0 billion share repurchase program.

We repurchased the following shares of common stock under the share repurchase programs:

(In millions)	Shares	Amount	Shares	Amount	Shares	Amount
Year Ended June 30,		2021		2020		2019
First Quarter	**25**	**$ 5,270**	29	$ 4,000	24	$ 2,600
Second Quarter	**27**	**5,750**	32	4,600	57	6,100
Third Quarter	**25**	**5,750**	37	6,000	36	3,899
Fourth Quarter	**24**	**6,200**	28	5,088	33	4,200
Total	**101**	**$ 22,970**	126	$ 19,688	150	$ 16,799

Shares repurchased during fiscal year 2021 and the fourth quarter of fiscal year 2020 were under the share repurchase program approved on September 18, 2019. Shares repurchased during the third quarter of fiscal year 2020 were under the share repurchase programs approved on both September 20, 2016 and September 18, 2019. All other shares repurchased were under the share repurchase program approved on September 20, 2016. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $4.4 billion, $3.3 billion, and $2.7 billion for fiscal years 2021, 2020, and 2019, respectively. All share repurchases were made using cash resources.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2021				(In millions)
September 15, 2020	**November 19, 2020**	**December 10, 2020**	**$ 0.56**	**$ 4,230**
December 2, 2020	**February 18, 2021**	**March 11, 2021**	**0.56**	**4,221**
March 16, 2021	**May 20, 2021**	**June 10, 2021**	**0.56**	**4,214**
June 16, 2021	**August 19, 2021**	**September 9, 2021**	**0.56**	**4,211**
Total			**$ 2.24**	**$ 16,876**
Fiscal Year 2020				
September 18, 2019	November 21, 2019	December 12, 2019	$ 0.51	$ 3,886
December 4, 2019	February 20, 2020	March 12, 2020	0.51	3,876
March 9, 2020	May 21, 2020	June 11, 2020	0.51	3,865
June 17, 2020	August 20, 2020	September 10, 2020	0.51	3,856
Total			$ 2.04	$ 15,483

The dividend declared on June 16, 2021 was included in other current liabilities as of June 30, 2021.

NOTE 17 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes in accumulated other comprehensive income (loss) by component:

(In millions)

Year Ended June 30,	**2021**	**2020**	**2019**
Derivatives			
Balance, beginning of period	**$ (38)**	$ 0	$ 173
Unrealized gains (losses), net of tax of **$9**, $(10), and $2	**34**	(38)	160
Reclassification adjustments for gains included in earnings	**(17)**	0	(341)
Tax expense included in provision for income taxes	**2**	0	8
Amounts reclassified from accumulated other comprehensive income (loss)	**(15)**	0	(333)
Net change related to derivatives, net of tax of **$7**, $(10), and $(6)	**19**	(38)	(173)
Balance, end of period	**$ (19)**	$ (38)	$ 0
Investments			
Balance, beginning of period	**$ 5,478**	$ 1,488	$ (850)
Unrealized gains (losses), net of tax of **$(589)**, $1,057, and $616	**(2,216)**	3,987	2,331
Reclassification adjustments for (gains) losses included in other income (expense), net	**(63)**	4	93
Tax expense (benefit) included in provision for income taxes	**13**	(1)	(19)
Amounts reclassified from accumulated other comprehensive income (loss)	**(50)**	3	74
Net change related to investments, net of tax of **$(602)**, $1,058, and $635	**(2,266)**	3,990	2,405
Cumulative effect of accounting changes	**10**	0	(67)
Balance, end of period	**$ 3,222**	$ 5,478	$ 1,488
Translation Adjustments and Other			
Balance, beginning of period	**$ (2,254)**	$ (1,828)	$ (1,510)
Translation adjustments and other, net of tax effects of **$(9)**, $1, and $(1)	**873**	(426)	(318)
Balance, end of period	**$ (1,381)**	$ (2,254)	$ (1,828)
Accumulated other comprehensive income (loss), end of period	**$ 1,822**	$ 3,186	$ (340)

NOTE 18 — EMPLOYEE STOCK AND SAVINGS PLANS

We grant stock-based compensation to employees and directors. As of June 30, 2021, an aggregate of 251 million shares were authorized for future grant under our stock plans. Awards that expire or are canceled without delivery of shares generally become available for issuance under the plans. We issue new shares of Microsoft common stock to satisfy vesting of awards granted under our stock plans. We also have an ESPP for all eligible employees.

Stock-based compensation expense and related income tax benefits were as follows:

(In millions)			
Year Ended June 30,	**2021**	**2020**	**2019**
Stock-based compensation expense	**$ 6,118**	$ 5,289	$ 4,652
Income tax benefits related to stock-based compensation	**1,065**	938	816

Stock Plans

Stock awards entitle the holder to receive shares of Microsoft common stock as the award vests. Stock awards generally vest over a service period of four years or five years.

Executive Incentive Plan

Under the Executive Incentive Plan, the Compensation Committee approves stock awards to executive officers and certain senior executives. RSUs generally vest ratably over a service period of four years. PSUs generally vest over a performance period of three years. The number of shares the PSU holder receives is based on the extent to which the corresponding performance goals have been achieved.

Activity for All Stock Plans

The fair value of stock awards was estimated on the date of grant using the following assumptions:

Year ended June 30,	**2021**	**2020**	**2019**
Dividends per share (quarterly amounts)	**$ 0.51 – 0.56**	$ 0.46 – 0.51	$ 0.42 – 0.46
Interest rates	**0.01% – 1.5%**	0.1% – 2.2%	1.8% – 3.1%

During fiscal year 2021, the following activity occurred under our stock plans:

	Shares	**Weighted Average Grant-Date Fair Value**
	(In millions)	
Stock Awards		
Nonvested balance, beginning of year	**126**	**$ 105.23**
Granted (a)	**40**	**221.13**
Vested	**(58)**	**99.41**
Forfeited	**(8)**	**129.92**
Nonvested balance, end of year	**100**	**$ 152.51**

(a) *Includes 2 million of PSUs granted at target and performance adjustments above target levels for fiscal years 2021, 2020, and 2019.*

As of June 30, 2021, there was approximately $12.0 billion of total unrecognized compensation costs related to stock awards. These costs are expected to be recognized over a weighted average period of three years. The weighted average grant-date fair value of stock awards granted was $221.13, $140.49, and $107.02 for fiscal years 2021, 2020, and 2019, respectively. The fair value of stock awards vested was $13.4 billion, $10.1 billion, and $8.7 billion, for fiscal years 2021, 2020, and 2019, respectively.

Employee Stock Purchase Plan

We have an ESPP for all eligible employees. Shares of our common stock may be purchased by employees at three-month intervals at 90% of the fair market value on the last trading day of each three-month period. Employees may purchase shares having a value not exceeding 15% of their gross compensation during an offering period. Under the terms of the ESPP that were approved in 2012, the plan will terminate on December 31, 2022. We intend to request shareholder approval for a successor ESPP with a January 1, 2022 effective date and ten-year expiration of December 31, 2031 at our 2021 Annual Shareholders Meeting. No additional shares will be requested at this meeting. Employees purchased the following shares during the periods presented:

(Shares in millions)

Year Ended June 30,	**2021**	**2020**	**2019**

Shares purchased	**8**	9	11
Average price per share	**$ 207.88**	$ 142.22	$ 104.85

As of June 30, 2021, 88 million shares of our common stock were reserved for future issuance through the ESPP.

Savings Plan

We have savings plans in the U.S. that qualify under Section 401(k) of the Internal Revenue Code, and a number of savings plans in international locations. Eligible U.S. employees may contribute a portion of their salary into the savings plans, subject to certain limitations. We contribute fifty cents for each dollar a participant contributes into the plans, with a maximum employer contribution of 50% of the IRS contribution limit for the calendar year. Employer-funded retirement benefits for all plans were $1.2 billion, $1.0 billion, and $877 million in fiscal years 2021, 2020, and 2019, respectively, and were expensed as contributed.

NOTE 19 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

In its operation of the business, management, including our chief operating decision maker, who is also our Chief Executive Officer, reviews certain financial information, including segmented internal profit and loss statements prepared on a basis not consistent with GAAP. During the periods presented, we reported our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing.

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Skype for Business.
- Office Consumer, including Microsoft 365 Consumer subscriptions and Office licensed on-premises, and Office Consumer Services, including Skype, Outlook.com, and OneDrive.
- LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, Sales Solutions, and Learning Solutions.
- Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM, Customer Insights, Power Apps, and Power Automate; and on-premises ERP and CRM applications.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business and developers. This segment primarily comprises:

- Server products and cloud services, including Azure; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses (“CALs”); and GitHub.
- Enterprise Services, including Premier Support Services and Microsoft Consulting Services.

More Personal Computing

Our More Personal Computing segment consists of products and services that put customers at the center of the experience with our technology. This segment primarily comprises:

- Windows, including Windows OEM licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; Windows Internet of Things; and MSN advertising.
- Devices, including Surface and PC accessories.

- Gaming, including Xbox hardware and Xbox content and services, comprising digital transactions, Xbox Game Pass and other subscriptions, video games, third-party video game royalties, cloud services, and advertising.
- Search advertising.

Revenue and costs are generally directly attributed to our segments. However, due to the integrated structure of our business, certain revenue recognized and costs incurred by one segment may benefit other segments. Revenue from certain contracts is allocated among the segments based on the relative value of the underlying products and services, which can include allocation based on actual prices charged, prices when sold separately, or estimated costs plus a profit margin. Cost of revenue is allocated in certain cases based on a relative revenue methodology. Operating expenses that are allocated primarily include those relating to marketing of products and services from which multiple segments benefit and are generally allocated based on relative gross margin.

In addition, certain costs incurred at a corporate level that are identifiable and that benefit our segments are allocated to them. These allocated costs include legal, including settlements and fines, information technology, human resources, finance, excise taxes, field selling, shared facilities services, and customer service and support. Each allocation is measured differently based on the specific facts and circumstances of the costs being allocated. Certain corporate-level activity is not allocated to our segments.

Segment revenue and operating income were as follows during the periods presented:

(In millions)

Year Ended June 30,	**2021**	**2020**	**2019**
Revenue			
Productivity and Business Processes	**$ 53,915**	$ 46,398	$ 41,160
Intelligent Cloud	**60,080**	48,366	38,985
More Personal Computing	**54,093**	48,251	45,698
Total	**$ 168,088**	$ 143,015	$ 125,843
Operating Income			
Productivity and Business Processes	**$ 24,351**	$ 18,724	$ 16,219
Intelligent Cloud	**26,126**	18,324	13,920
More Personal Computing	**19,439**	15,911	12,820
Total	**$ 69,916**	$ 52,959	$ 42,959

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for fiscal years 2021, 2020, or 2019. Revenue, classified by the major geographic areas in which our customers were located, was as follows:

(In millions)

Year Ended June 30,	**2021**	**2020**	**2019**
United States (a)	**$ 83,953**	$ 73,160	$ 64,199
Other countries	**84,135**	69,855	61,644
Total	**$ 168,088**	$ 143,015	$ 125,843

(a) *Includes billings to OEMs and certain multinational organizations because of the nature of these businesses and the impracticability of determining the geographic source of the revenue.*

Revenue from external customers, classified by significant product and service offerings, was as follows:

(In millions)

Year Ended June 30,	**2021**	**2020**	**2019**
Server products and cloud services	**$ 52,589**	$ 41,379	$ 32,622
Office products and cloud services	**39,872**	35,316	31,769
Windows	**23,227**	22,294	20,395
Gaming	**15,370**	11,575	11,386
LinkedIn	**10,289**	8,077	6,754
Search advertising	**8,528**	7,740	7,628
Enterprise Services	**6,943**	6,409	6,124
Devices	**6,791**	6,457	6,095
Other	**4,479**	3,768	3,070
Total	**$ 168,088**	$ 143,015	$ 125,843

Our commercial cloud revenue, which includes Azure, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was $69.1 billion, $51.7 billion and $38.1 billion in fiscal years 2021, 2020, and 2019, respectively. These amounts are primarily included in Server products and cloud services, Office products and cloud services, and LinkedIn in the table above.

Assets are not allocated to segments for internal reporting presentations. A portion of amortization and depreciation is included with various other costs in an overhead allocation to each segment. It is impracticable for us to separately identify the amount of amortization and depreciation by segment that is included in the measure of segment profit or loss.

Long-lived assets, excluding financial instruments and tax assets, classified by the location of the controlling statutory company and with countries over 10% of the total shown separately, were as follows:

(In millions)

June 30,	**2021**	**2020**	**2019**
United States	**$ 76,153**	$ 60,789	$ 55,252
Ireland	**13,303**	12,734	12,958
Other countries	**38,858**	29,770	25,422
Total	**$ 128,314**	$ 103,293	$ 93,632

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2021 and 2020, the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity, for each of the three years in the period ended June 30, 2021, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2021 and 2020, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2021, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of June 30, 2021, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated July 29, 2021, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current-period audit of the financial statements that were communicated or required to be communicated to the audit committee and that (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Revenue Recognition – Refer to Note 1 to the financial statements

Critical Audit Matter Description

The Company recognizes revenue upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. The Company offers customers the ability to acquire multiple licenses of software products and services, including cloud-based services, in its customer agreements through its volume licensing programs.

Significant judgment is exercised by the Company in determining revenue recognition for these customer agreements, and includes the following:

- Determination of whether products and services are considered distinct performance obligations that should be accounted for separately versus together, such as software licenses and related services that are sold with cloud-based services.
- The pattern of delivery (i.e., timing of when revenue is recognized) for each distinct performance obligation.
- Identification and treatment of contract terms that may impact the timing and amount of revenue recognized (e.g., variable consideration, optional purchases, and free services).
- Determination of stand-alone selling prices for each distinct performance obligation and for products and services that are not sold separately.

Given these factors and due to the volume of transactions, the related audit effort in evaluating management's judgments in determining revenue recognition for these customer agreements was extensive and required a high degree of auditor judgment.

How the Critical Audit Matter Was Addressed in the Audit

Our principal audit procedures related to the Company's revenue recognition for these customer agreements included the following:

- We tested the effectiveness of controls related to the identification of distinct performance obligations, the determination of the timing of revenue recognition, and the estimation of variable consideration.
- We evaluated management's significant accounting policies related to these customer agreements for reasonableness.
- We selected a sample of customer agreements and performed the following procedures:

- Obtained and read contract source documents for each selection, including master agreements, and other documents that were part of the agreement.

- Tested management's identification and treatment of contract terms.

- Assessed the terms in the customer agreement and evaluated the appropriateness of management's application of their accounting policies, along with their use of estimates, in the determination of revenue recognition conclusions.

- We evaluated the reasonableness of management's estimate of stand-alone selling prices for products and services that are not sold separately.
- We tested the mathematical accuracy of management's calculations of revenue and the associated timing of revenue recognized in the financial statements.

Income Taxes – Uncertain Tax Positions – Refer to Note 12 to the financial statements

Critical Audit Matter Description

The Company's long-term income taxes liability includes uncertain tax positions related to transfer pricing issues that remain unresolved with the Internal Revenue Service ("IRS"). The Company remains under IRS audit, or subject to IRS audit, for tax years subsequent to 2003. While the Company has settled a portion of the IRS audits, resolution of the remaining matters could have a material impact on the Company's financial statements.

Conclusions on recognizing and measuring uncertain tax positions involve significant estimates and management judgment and include complex considerations of the Internal Revenue Code, related regulations, tax case laws, and prior-year audit settlements. Given the complexity and the subjective nature of the transfer pricing issues that remain unresolved with the IRS, evaluating management's estimates relating to their determination of uncertain tax positions required extensive audit effort and a high degree of auditor judgment, including involvement of our tax specialists.

How the Critical Audit Matter Was Addressed in the Audit

Our principal audit procedures to evaluate management's estimates of uncertain tax positions related to unresolved transfer pricing issues included the following:

- We evaluated the appropriateness and consistency of management's methods and assumptions used in the identification, recognition, measurement, and disclosure of uncertain tax positions, which included testing the effectiveness of the related internal controls.
- We read and evaluated management's documentation, including relevant accounting policies and information obtained by management from outside tax specialists, that detailed the basis of the uncertain tax positions.
- We tested the reasonableness of management's judgments regarding the future resolution of the uncertain tax positions, including an evaluation of the technical merits of the uncertain tax positions.
- For those uncertain tax positions that had not been effectively settled, we evaluated whether management had appropriately considered new information that could significantly change the recognition, measurement or disclosure of the uncertain tax positions.
- We evaluated the reasonableness of management's estimates by considering how tax law, including statutes, regulations and case law, impacted management's judgments.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
July 29, 2021

We have served as the Company's auditor since 1983.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective.

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our consolidated financial statements; providing reasonable assurance that receipts and expenditures of company assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use, or disposition of company assets that could have a material effect on our consolidated financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our consolidated financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company’s internal control over financial reporting was effective as of June 30, 2021. There were no changes in our internal control over financial reporting during the quarter ended June 30, 2021 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Deloitte & Touche LLP has audited our internal control over financial reporting as of June 30, 2021; their report is included in Item 9A.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2021, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2021, based on the criteria established in *Internal Control — Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements and the related notes (collectively referred to as the "financial statements") as of and for the year ended June 30, 2021, of the Company and our report dated July 29, 2021, expressed an unqualified opinion on those financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
July 29, 2021

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

A list of our executive officers and biographical information appears in Part I, Item 1 of this Form 10-K. Information about our directors may be found under the caption “Our director nominees” in our Proxy Statement for the Annual Meeting of Shareholders to be held November 30, 2021 (the “Proxy Statement”). Information about our Audit Committee may be found under the caption “Board committees” in the Proxy Statement. That information is incorporated herein by reference.

We have adopted the Microsoft Finance Code of Professional Conduct (the “finance code of ethics”), a code of ethics that applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, and other finance organization employees. The finance code of ethics is publicly available on our website at https://aka.ms/FinanceCodeProfessionalConduct. If we make any substantive amendments to the finance code of ethics or grant any waiver, including any implicit waiver, from a provision of the code to our Chief Executive Officer, Chief Financial Officer, or Chief Accounting Officer, we will disclose the nature of the amendment or waiver on that website or in a report on Form 8-K.

ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions “Director compensation,” “Named executive officer compensation,” “Compensation Committee report,” and, if required, “Compensation Committee interlocks and insider participation,” is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information in the Proxy Statement set forth under the captions “Stock ownership information,” “Principal shareholders” and “Equity compensation plan information” is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information set forth in the Proxy Statement under the captions “Director independence” and “Certain relationships and related transactions” is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information concerning principal accountant fees and services appears in the Proxy Statement under the headings “Fees billed by Deloitte & Touche” and “Policy on Audit Committee pre-approval of audit and permissible non-audit services of independent auditor” and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements and Schedules

The financial statements are set forth under Item 8 of this Form 10-K, as indexed below. Financial statement schedules have been omitted since they either are not required, not applicable, or the information is otherwise included.

(b) Exhibit Listing

			Incorporated by Reference			
Exhibit Number	Exhibit Description	Filed Herewith	Form	Period Ending	Exhibit	Filing Date
3.1	Amended and Restated Articles of Incorporation of Microsoft Corporation		8-K		3.1	12/1/16
3.2	Bylaws of Microsoft Corporation		8-K		3.2	6/14/17
4.1	Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee ("Base Indenture")		S-3ASR		4.1	10/29/15
4.2	Form of First Supplemental Indenture for 2.95% Notes due 2014, 4.20% Notes due 2019, and 5.20% Notes due 2039, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Base Indenture		8-K		4.2	5/15/09
4.5	Form of Second Supplemental Indenture for 0.875% Notes due 2013, 1.625% Notes due 2015, 3.00% Notes due 2020, and 4.50% Notes due 2040, dated as of September 27, 2010, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	9/27/10

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.6	Third Supplemental Indenture for 2.500% Notes due 2016, 4.000% Notes due 2021, and 5.300% Notes due 2041, dated as of February 8, 2011, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	2/8/11
4.7	Fourth Supplemental Indenture for 0.875% Notes due 2017, 2.125% Notes due 2022, and 3.500% Notes due 2042, dated as of November 7, 2012, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	11/7/12
4.8	Fifth Supplemental Indenture for 2.625% Notes due 2033, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	5/1/13
4.9	Sixth Supplemental Indenture for 1.000% Notes due 2018, 2.375% Notes due 2023, and 3.750% Notes due 2043, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	5/1/13
4.10	Seventh Supplemental Indenture for 2.125% Notes due 2021 and 3.125% Notes due 2028, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank		8-K		4.1	12/6/13

of New York Mellon Trust Company,
N.A., as Trustee

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference			
			Form	Period Ending	Exhibit	Filing Date
4.11	Eighth Supplemental Indenture for 1.625% Notes due 2018, 3.625% Notes due 2023, and 4.875% Notes due 2043, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	12/6/13
4.12	Ninth Supplemental Indenture for 1.850% Notes due 2020, 2.375% Notes due 2022, 2.700% Notes due 2025, 3.500% Notes due 2035, 3.750% Notes due 2045, and 4.000% Notes due 2055, dated as of February 12, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	2/12/15
4.13	Tenth Supplemental Indenture for 1.300% Notes due 2018, 2.000% Notes due 2020, 2.650% Notes due 2022, 3.125% Notes due 2025, 4.200% Notes due 2035, 4.450% Notes due 2045, and 4.750% Notes due 2055, dated as of November 3, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	11/3/15
4.14	Eleventh Supplemental Indenture for 1.100% Notes due 2019, 1.550% Notes due 2021, 2.000% Notes due 2023, 2.400% Notes due 2026, 3.450% Notes due 2036, 3.700% Notes due 2046, and 3.950% Notes due 2056, dated as of August 8, 2016, between Microsoft Corporation and U.S. Bank, National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	8/5/16

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference			
			Form	Period Ending	Exhibit	Filing Date
4.15	Twelfth Supplemental Indenture for 1.850% Notes due 2020, 2.400% Notes due 2022, 2.875% Notes due 2024, 3.300% Notes due 2027, 4.100% Notes due 2037, 4.250% Notes due 2047, and 4.500% Notes due 2057, dated as of February 6, 2017, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	2/3/17
4.16	Thirteenth Supplemental Indenture for 2.525% Notes due 2050 and 2.675% Notes due 2060, dated as of June 1, 2020, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	6/1/20
4.17	Fourteenth Supplemental Indenture for 2.921% Notes due 2052 and 3.041% Notes due 2062, dated as of March 17, 2021, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	3/17/21
4.18	Description of Securities		10-K	6/30/19	4.16	8/1/19
10.1*	Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.1	10/20/16
10.4*	Microsoft Corporation Employee Stock Purchase Plan		10-K	6/30/12	10.4	7/26/12
10.5*	Microsoft Corporation Deferred Compensation Plan		10-K	6/30/18	10.5	8/3/18
10.6*	Microsoft Corporation 2017 Stock Plan		DEF14A		Annex C	10/16/17

10.7*	Form of Stock Award Agreement Under the Microsoft Corporation 2017 Stock Plan	10-Q	3/31/2018	10.26	4/26/18
10.8*	Form of Performance Stock Award Agreement Under the Microsoft Corporation 2017 Stock Plan	10-Q	3/31/2018	10.27	4/26/18
10.12	Amended and Restated Officers' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee	10-Q	9/30/16	10.12	10/20/16

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
10.13	Form of Indemnification Agreement and Amended and Restated Directors' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		10-K	6/30/19	10.13	8/1/19
10.14*	Microsoft Corporation Deferred Compensation Plan for Non-Employee Directors		10-Q	12/31/17	10.14	1/31/18
10.15*	Microsoft Corporation Executive Incentive Plan		8-K		10.1	9/19/18
10.19*	Microsoft Corporation Executive Incentive Plan		10-Q	9/30/16	10.17	10/20/16
10.20*	Form of Executive Incentive Plan (Executive Officer SAs) Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.18	10/20/16
10.21*	Form of Executive Incentive Plan Performance Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.25	10/20/16
10.22*	Senior Executive Severance Benefit Plan		10-Q	9/30/16	10.22	10/20/16
10.23*	Offer Letter, dated February 3, 2014, between Microsoft Corporation and Satya Nadella		8-K		10.1	2/4/14
10.24*	Long-Term Performance Stock Award Agreement between Microsoft Corporation and Satya Nadella		10-Q	12/31/14	10.24	1/26/15
10.25	Assumption of Beneficiaries' Representative Obligations Under Amended and Restated Officers' Indemnification Trust Agreement		10-K	6/30/2020	10.25	7/30/2020
10.26	Assumption of Beneficiaries' Representative Obligations Under Amended and Restated Directors' Indemnification Trust Agreement		10-K	6/30/2020	10.26	7/30/2020
21	Subsidiaries of Registrant	X				
23.1	Consent of Independent Registered Public Accounting Firm	X				
31.1	Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2		X				

	Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
32.1**	Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference			
			Form	Period Ending	Exhibit	Filing Date
32.2**	Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
101.INS	Inline XBRL Instance Document—the instance document does not appear in the Interactive Data File as its XBRL tags are embedded within the Inline XBRL document	X				
101.SCH	Inline XBRL Taxonomy Extension Schema	X				
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase	X				
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase	X				
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase	X				
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase	X				
104	Cover page formatted as Inline XBRL and contained in Exhibit 101	X				

* *Indicates a management contract or compensatory plan or arrangement.*
** *Furnished, not filed.*

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned; thereunto duly authorized, in the City of Redmond, State of Washington, on July 29, 2021.

MICROSOFT CORPORATION

/s/ ALICE L. JOLLA

Alice L. Jolla
Corporate Vice President and Chief Accounting Officer
(Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on July 29, 2021.

Signature	Title
/s/ SATYA NADELLA Satya Nadella	Chairman and Chief Executive Officer (Principal Executive Officer)
/s/ REID HOFFMAN Reid Hoffman	Director
/s/ HUGH F. JOHNSTON Hugh F. Johnston	Director
/s/ TERI L. LIST Teri L. List	Director
/s/ SANDRA E. PETERSON Sandra E. Peterson	Director
/s/ PENNY S. PRITZKER Penny S. Pritzker	Director
/s/ CHARLES W. SCHARF Charles W. Scharf	Director
/s/ JOHN W. STANTON John W. Stanton	Director
/s/ JOHN W. THOMPSON John W. Thompson	Lead Independent Director
/s/ EMMA N. WALMSLEY Emma N. Walmsley	Director
/s/ PADMASREE WARRIOR Padmasree Warrior	Director
/s/ AMY E. HOOD Amy E. Hood	Executive Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ ALICE L. JOLLA Alice L. Jolla	Corporate Vice President and Chief Accounting Officer (Principal Accounting Officer)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended June 30, 2020

OR

☐

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From to

Commission File Number 001-37845

MICROSOFT CORPORATION

WASHINGTON	**91-1144442**
(STATE OF INCORPORATION)	**(I.R.S. ID)**

ONE MICROSOFT WAY, REDMOND, WASHINGTON 98052-6399

(425) 882-8080

www.microsoft.com/investor

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of exchange on which registered
Common stock, $0.00000625 par value per share	**MSFT**	**NASDAQ**
2.125% Notes due 2021	**MSFT**	**NASDAQ**
3.125% Notes due 2028	**MSFT**	**NASDAQ**
2.625% Notes due 2033	**MSFT**	**NASDAQ**

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☒	Accelerated Filer ☐
Non-accelerated Filer ☐	Smaller Reporting Company ☐
	Emerging Growth Company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management’s assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of December 31, 2019, the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant was $1.2 trillion based on the closing sale price as reported on the NASDAQ National Market System. As of July 27, 2020, there were 7,567,652,935 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on December 2, 2020 are incorporated by reference into Part III.

MICROSOFT CORPORATION

FORM 10-K

For the Fiscal Year Ended June 30, 2020

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Note About Forward-Looking Statements

This report includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including the following sections: “Business” (Part I, Item 1 of this Form 10-K), “Risk Factors” (Part I, Item 1A of this Form 10-K), and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” (Part II, Item 7 of this Form 10-K). These forward-looking statements generally are identified by the words “believe,” “project,” “expect,” “anticipate,” “estimate,” “intend,” “strategy,” “future,” “opportunity,” “plan,” “may,” “should,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. We describe risks and uncertainties that could cause actual results and events to differ materially in “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Quantitative and Qualitative Disclosures about Market Risk” (Part II, Item 7A of this Form 10-K). Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date they are made. We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

PART I

ITEM 1. BUSINESS

GENERAL

Embracing Our Future

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity. As the world responds to the outbreak of a novel strain of the coronavirus (“COVID-19”), we are working to do our part by ensuring the safety of our employees, striving to protect the health and well-being of the communities in which we operate, and providing technology and resources to our customers to help them do their best work while remote.

We continue to transform our business to lead in the new era of the intelligent cloud and intelligent edge. We bring technology and products together into experiences and solutions that unlock value for our customers. Our unique role as a platform and tools provider allows us to connect the dots, bring together an ecosystem of partners, and enable organizations of all sizes to build the digital capability required to address these challenges.

In this next phase of innovation, computing is more powerful and ubiquitous from the cloud to the edge. Artificial intelligence (“AI”) capabilities are rapidly advancing, fueled by data and knowledge of the world. Physical and virtual worlds are coming together with the Internet of Things (“IoT”) and mixed reality to create richer experiences that understand the context surrounding people, the things they use, the places they go, and their activities and relationships. A person’s experience with technology spans a multitude of devices and has become increasingly more natural and multi-sensory with voice, ink, and gaze interactions.

What We Offer

Founded in 1975, we develop and support software, services, devices, and solutions that deliver new value for customers and help people and businesses realize their full potential.

We offer an array of services, including cloud-based solutions that provide customers with software, services, platforms, and content, and we provide solution support and consulting services. We also deliver relevant online advertising to a global audience.

Our products include operating systems; cross-device productivity applications; server applications; business solution applications; desktop and server management tools; software development tools; and video games. We also design, manufacture, and sell devices, including PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

The Ambitions That Drive Us

To achieve our vision, our research and development efforts focus on three interconnected ambitions:

- Reinvent productivity and business processes.
- Build the intelligent cloud and intelligent edge platform.
- Create more personal computing.

Reinvent Productivity and Business Processes

At Microsoft, we're providing technology and resources to help our customers navigate a remote environment. We're seeing our family of products play key roles in the ways the world is continuing to work, learn, and connect.

Our growth depends on securely delivering continuous innovation and advancing our leading productivity and collaboration tools and services, including Office, Dynamics, and LinkedIn. Microsoft 365 brings together Office 365, Windows 10, and Enterprise Mobility + Security to help organizations empower their employees with AI-backed tools that unlock creativity, increase teamwork, and fuel innovation, all the while enabling compliance coverage and data protection. Microsoft Teams is enabling rapid digital transformation by giving people a single tool to chat, call, meet, and collaborate. Microsoft Relationship Sales solution brings together LinkedIn Sales Navigator and Dynamics to transform business to business sales through social selling. Dynamics 365 for Talent with LinkedIn Recruiter and Learning gives human resource professionals a complete solution to compete for talent. Microsoft Power Platform empowers employees to build custom applications, automate workflow, and analyze data no matter their technical expertise.

These scenarios represent a move to unlock creativity and discover new habits, while simplifying security and management. Organizations of all sizes have digitized business-critical functions, redefining what they can expect from their business applications. This creates an opportunity to reach new customers and increase usage and engagement with existing customers.

Build the Intelligent Cloud and Intelligent Edge Platform

In the new remote world, companies have accelerated their own digital transformation to empower their employees, optimize their operations, engage customers, and in some cases, change the very core of their products and services. Partnering with organizations on their digital transformation during this period is one of our largest opportunities and we are uniquely positioned to become the strategic digital transformation platform and partner of choice; their success is our success.

Our strategy requires continued investment in datacenters and other hybrid and edge infrastructure to support our services. Azure is a trusted cloud with comprehensive compliance coverage and AI-based security built in.

Our cloud business benefits from three economies of scale: datacenters that deploy computational resources at significantly lower cost per unit than smaller ones; datacenters that coordinate and aggregate diverse customer, geographic, and application demand patterns, improving the utilization of computing, storage, and network resources; and multi-tenancy locations that lower application maintenance labor costs.

As one of the two largest providers of cloud computing at scale, we believe we work from a position of strength. Being a global-scale cloud, Azure uniquely offers hybrid consistency, developer productivity, AI capabilities, and trusted security and compliance. We see more emerging use cases and needs for compute and security at the edge and are accelerating our innovation across the spectrum of intelligent edge devices, from IoT sensors to gateway devices and edge hardware to build, manage, and secure edge workloads. With Azure Stack, organizations can extend Azure into their own datacenters to create a consistent stack across the public cloud and the intelligent edge. Our hybrid infrastructure consistency spans identity, data, compute, management, and security, helping to support the real-world needs and evolving regulatory requirements of commercial customers and enterprises. We are accelerating our development of mixed reality solutions with new Azure services and devices. The opportunity to merge the physical and digital worlds, when combined with the power of Azure cloud services, unlocks the potential for entirely new workloads which we believe will shape the next era of computing.

The ability to convert data into AI drives our competitive advantage. Azure SQL Database makes it possible for customers to take SQL Server from their on-premises datacenter to a fully managed instance in the cloud to utilize built-in AI. We are accelerating adoption of AI innovations from research to products. Our innovation helps every developer be an AI developer, with approachable new tools from Azure Machine Learning Studio for creating simple machine learning models, to the powerful Azure Machine Learning Workbench for the most advanced AI modeling and data science.

Create More Personal Computing

We strive to make computing more personal by putting users at the core of the experience, enabling them to interact with technology in more intuitive, engaging, and dynamic ways. In support of this, we are bringing Office, Windows, and devices together for an enhanced and more cohesive customer experience.

Windows 10 serves the enterprise as the most secure and productive operating system. It empowers people with AI-first interfaces ranging from voice-activated commands through Cortana, inking, immersive 3D content storytelling, and mixed reality experiences. Our ambition for Windows 10 monetization opportunities includes gaming, services, subscriptions, and search advertising. Windows also plays a critical role in fueling our cloud business and Microsoft 365 strategy, and it powers the growing range of devices on the “intelligent edge.”

We are committed to designing and marketing first-party devices to help drive innovation, create new device categories, and stimulate demand in the Windows ecosystem. We recently added several new products and accessories into the Surface family, including Surface Book 3 and Surface Go 2. These new Surface products join Surface Pro 7, Surface Laptop 3, and Surface Pro X.

To expand usage and deepen engagement, we continue to invest in content, community, and cloud services as we pursue the expansive opportunity in the gaming industry. We are broadening our approach to how we think about gaming end-to-end, from the way games are created and distributed to how they are played and viewed across PC, console, and mobile. We have a strong position with our large and growing highly engaged community of gamers. Xbox Game Pass, with over 10 million members from 41 countries, is a community with access to a curated library of over 100 first- and third-party console and PC titles. Project xCloud is Microsoft’s game streaming technology that is complementary to our console hardware and will give fans the ultimate choice to play the games they want, with the people they want, on the devices they want.

Our Future Opportunity

In a time of great disruption and uncertainty, customers are looking to us to accelerate their own digital transformations as software and cloud computing play a huge role across every industry and around the world. We continue to develop complete, intelligent solutions for our customers that empower people to stay productive and collaborate, while safeguarding businesses and simplifying IT management. Our goal is to lead the industry in several distinct areas of technology over the long-term, which we expect will translate to sustained growth. We are investing significant resources in:

- Transforming the workplace to deliver new modern, modular business applications to improve how people communicate, collaborate, learn, work, play, and interact with one another.
- Building and running cloud-based services in ways that unleash new experiences and opportunities for businesses and individuals.
- Applying AI to drive insights and act on our customer’s behalf by understanding and interpreting their needs using natural methods of communication.
- Using Windows to fuel our cloud business and Microsoft 365 strategy, and to develop new categories of devices – both our own and third-party – on the intelligent edge.
- Inventing new gaming experiences that bring people together around their shared love for games on any devices and pushing the boundaries of innovation with console and PC gaming by creating the next wave of entertainment.

Our future growth depends on our ability to transcend current product category definitions, business models, and sales motions. We have the opportunity to redefine what customers and partners can expect and are working to deliver new solutions that reflect the best of Microsoft.

COVID-19

In March 2020, the World Health Organization declared the outbreak of COVID-19 to be a pandemic. The COVID-19 pandemic is having widespread, rapidly evolving, and unpredictable impacts on global society, economies, financial markets, and business practices. Federal and state governments have implemented measures in an effort to contain the virus, including social distancing, travel restrictions, border closures, limitations on public gatherings, work from home, supply chain logistical changes, and closure of non-essential businesses. To protect the health and well-being of our employees, suppliers, and customers, we have made substantial modifications to employee travel policies, implemented office closures as employees are advised to work from home, and cancelled or shifted our conferences and other marketing events to virtual-only through fiscal year 2021. The COVID-19 pandemic has impacted and may continue to impact our business operations, including our employees, customers, partners, and communities, and there is substantial uncertainty in the nature and degree of its continued effects over time. Refer to Management’s Discussion and Analysis of Financial Condition and Results of Operations (Part II, Item 7 of this Form 10-K) for further discussion regarding the impact of COVID-19 on our fiscal year 2020 financial results.

The extent to which the COVID-19 pandemic impacts our business going forward will depend on numerous evolving factors we cannot reliably predict, including the duration and scope of the pandemic; governmental, business, and individuals' actions in response to the pandemic; and the impact on economic activity including the possibility of recession or financial market instability. These factors may adversely impact consumer, business, and government spending on technology as well as customers' ability to pay for our products and services on an ongoing basis. This uncertainty also affects management’s accounting estimates and assumptions, which could result in greater variability in a variety of areas that depend on these estimates and assumptions, including investments, receivables, and forward-looking guidance. Refer to Risk Factors (Part I, Item 1A of this Form 10-K) for a discussion of these factors and other risks.

Commitment to Sustainability

We work to ensure that technology is inclusive, trusted, and increases sustainability. We’re empowering our customers and partners with new technology to help them drive efficiencies, transform their businesses, and create their own solutions for sustainability. In January 2020, we announced a bold new environmental sustainability strategy focused on carbon, water, waste, and ecosystems. As part of our commitment, we are investing $1 billion over the next four years in new technologies and innovative climate solutions. We set an ambitious goal to reduce and ultimately remove Microsoft’s carbon footprint. By 2030 Microsoft will be carbon negative, and by 2050 Microsoft will remove from the environment all the carbon the company has emitted directly or by electrical consumption since it was founded in 1975. We also launched a new initiative to use Microsoft technology to help our suppliers and customers around the world reduce their own carbon footprint.

The investments we make in sustainability carry through to our products, services, and devices. We design our devices, from Surface to Xbox, to minimize their impact on the environment. Our cloud and AI services help businesses cut energy consumption, reduce physical footprints, and design sustainable products. We also pledged a $50 million investment in AI for Earth to accelerate innovation by putting AI in the hands of those working to directly address sustainability challenges. Lastly, this work is supported by using our voice to support policies we think can advance sustainability efforts.

Addressing Racial Injustice

Our future opportunity depends on reaching and empowering all communities, and we are committed to taking action to help address racial injustice and inequity. With significant input from employees and leaders who are members of the Black and African American community, our senior leadership team and board of directors has developed a set of actions to help improve the lived experience at Microsoft and drive change in the communities in which we live and work. These efforts include increasing our representation and culture of inclusion by doubling the number of Black and African American people managers, senior individual contributors, and senior leaders in the United States by 2025; engaging our ecosystem by using our balance sheet and engagement with suppliers and partners to extend the vision for societal change; and strengthening our communities by using the power of data, technology, and partnership to help improve the lives of Black and African American citizens across the United States.

Investing in Digital Skills

With a continued focus on digital transformation, Microsoft is making efforts to help ensure that no one is left behind, particularly as economies start to recover from the COVID-19 pandemic. We are expanding access to the digital skills that have become increasingly vital to many of the world's jobs, and especially to individuals hardest hit by recent job losses, including those with lower incomes, women, and underrepresented minorities. Our skills initiative brings together learning resources, certification opportunities, and job-seeker tools from LinkedIn, GitHub, and Microsoft Learn, and is built on data insights drawn from LinkedIn's Economic Graph. This is combined with $20 million we are investing in key non-profit partnerships through Microsoft Philanthropies.

OPERATING SEGMENTS

We operate our business and report our financial performance using three segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. Our segments provide management with a comprehensive financial view of our key businesses. The segments enable the alignment of strategies and objectives across the development, sales, marketing, and services organizations, and they provide a framework for timely and rational allocation of resources within businesses.

Additional information on our operating segments and geographic and product information is contained in Note 19 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial, including Office 365 subscriptions, the Office portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises, comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Skype for Business, and related Client Access Licenses ("CALs").
- Office Consumer, including Microsoft 365 Consumer (formerly Office 365 Consumer) subscriptions and Office licensed on-premises, and Office Consumer Services, including Skype, Outlook.com, and OneDrive.
- LinkedIn, including Talent Solutions, Learning Solutions, Marketing Solutions, Sales Solutions, and Premium Subscriptions.
- Dynamics business solutions, including Dynamics 365, a set of cloud-based applications across ERP and CRM, Dynamics ERP on-premises, and Dynamics CRM on-premises.

Office Commercial

Office Commercial is designed to increase personal, team, and organizational productivity through a range of products and services. Growth depends on our ability to reach new users in new markets such as first-line workers, small and medium businesses, and growth markets, as well as add value to our core product and service offerings to span productivity categories such as communication, collaboration, analytics, security, and compliance. Office Commercial revenue is mainly affected by a combination of continued installed base growth and average revenue per user expansion, as well as the continued shift from Office licensed on-premises to Office 365. CALs provide certain Office Commercial products and services with access rights to our server products and CAL revenue is reported with the associated Office products and services.

Office Consumer

Office Consumer is designed to increase personal productivity through a range of products and services. Growth depends on our ability to reach new users, add value to our core product set, and continue to expand our product and service offerings into new markets. Office Consumer revenue is mainly affected by the percentage of customers that buy Office with their new devices and the continued shift from Office licensed on-premises to Microsoft 365 Consumer subscriptions. Office Consumer Services revenue is mainly affected by the demand for communication and storage through Skype, Outlook.com, and OneDrive, which is largely driven by subscriptions, advertising, and the sale of minutes.

LinkedIn

LinkedIn connects the world's professionals to make them more productive and successful and transforms the way companies hire, market, sell, and learn. Our vision is to create economic opportunity for every member of the global workforce through the ongoing development of the world's first Economic Graph, a digital representation of the global economy. In addition to LinkedIn's free services, LinkedIn offers monetized solutions: Talent Solutions, Learning Solutions, Marketing Solutions, Sales Solutions, and Premium Subscriptions. Talent Solutions provide insights for workforce planning and tools to hire, nurture, and develop talent. Learning Solutions, including Glint, help businesses close critical skills gaps in times where companies are having to do more with existing talent. Marketing Solutions help companies grow relationships between businesses. Sales Solutions help companies strengthen customer relationships, empower teams with digital selling tools, and acquire new opportunities. Finally, Premium Subscriptions enables professionals to manage their professional identity, grow their network, and connect with talent through additional services like premium search. LinkedIn has over 700 million members and has offices around the globe. Growth will depend on our ability to increase the number of LinkedIn members and our ability to continue offering services that provide value for our members and increase their engagement. LinkedIn revenue is mainly affected by demand from enterprises and professional organizations for subscriptions to Talent Solutions, Learning Solutions, Sales Solutions, and Premium Subscriptions offerings, as well as member engagement and the quality of the sponsored content delivered to those members to drive Marketing Solutions.

Dynamics

Dynamics provides cloud-based and on-premises business solutions for financial management, enterprise resource planning ("ERP"), customer relationship management ("CRM"), supply chain management, and other application development platforms for small and medium businesses, large organizations, and divisions of global enterprises. Dynamics revenue is driven by the number of users licensed, expansion of average revenue per user, and the continued shift to Dynamics 365, a unified set of cloud-based intelligent business applications.

Competition

Competitors to Office include software and global application vendors, such as Apple, Cisco Systems, Facebook, Google, IBM, Okta, Proofpoint, Slack, Symantec, Zoom, and numerous web-based and mobile application competitors as well as local application developers. Apple distributes versions of its pre-installed application software, such as email and calendar products, through its PCs, tablets, and phones. Cisco Systems is using its position in enterprise communications equipment to grow its unified communications business. Google provides a hosted messaging and productivity suite. Slack provides teamwork and collaboration software. Zoom offers videoconferencing and cloud phone solutions. Skype for Business and Skype also compete with a variety of instant messaging, voice, and video communication providers, ranging from start-ups to established enterprises. Okta, Proofpoint, and Symantec provide security solutions across email security, information protection, identity, and governance. Web-based offerings competing with individual applications have also positioned themselves as alternatives to our products and services. We compete by providing powerful, flexible, secure, integrated industry-specific, and easy-to-use productivity and collaboration tools and services that create comprehensive solutions and work well with technologies our customers already have both on-premises or in the cloud.

LinkedIn faces competition from online professional networks, recruiting companies, talent management companies, and larger companies that are focusing on talent management and human resource services; job boards; traditional recruiting firms; and companies that provide learning and development products and services. Marketing Solutions competes with online and offline outlets that generate revenue from advertisers and marketers, and Sales Solutions competes with online and offline outlets for companies with lead generation and customer intelligence and insights.

Dynamics competes with vendors such as Oracle, Salesforce.com, and SAP to provide cloud-based and on-premises business solutions for small, medium, and large organizations.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business and developers. This segment primarily comprises:

- Server products and cloud services, including Azure; SQL Server, Windows Server, Visual Studio, System Center, and related CALs; and GitHub.
- Enterprise Services, including Premier Support Services and Microsoft Consulting Services.

Server Products and Cloud Services

Azure is a comprehensive set of cloud services that offer developers, IT professionals, and enterprises freedom to build, deploy, and manage applications on any platform or device. Customers can use Azure through our global network of datacenters for computing, networking, storage, mobile and web application services, AI, IoT, cognitive services, and machine learning. Azure enables customers to devote more resources to development and use of applications that benefit their organizations, rather than managing on-premises hardware and software. Azure revenue is mainly affected by infrastructure-as-a-service and platform-as-a-service consumption-based services, and per user-based services such as Enterprise Mobility + Security.

Our server products are designed to make IT professionals, developers, and their systems more productive and efficient. Server software is integrated server infrastructure and middleware designed to support software applications built on the Windows Server operating system. This includes the server platform, database, business intelligence, storage, management and operations, virtualization, service-oriented architecture platform, security, and identity software. We also license standalone and software development lifecycle tools for software architects, developers, testers, and project managers. GitHub provides a collaboration platform and code hosting service for developers. Server products revenue is mainly affected by purchases through volume licensing programs, licenses sold to original equipment manufacturers (“OEM”), and retail packaged products. CALs provide access rights to certain server products, including SQL Server and Windows Server, and revenue is reported along with the associated server product.

Enterprise Services

Enterprise Services, including Premier Support Services and Microsoft Consulting Services, assist customers in developing, deploying, and managing Microsoft server and desktop solutions and provide training and certification to developers and IT professionals on various Microsoft products.

Competition

Azure faces diverse competition from companies such as Amazon, Google, IBM, Oracle, VMware, and open source offerings. Our Enterprise Mobility + Security offerings also compete with products from a range of competitors including identity vendors, security solution vendors, and numerous other security point solution vendors. Azure’s competitive advantage includes enabling a hybrid cloud, allowing deployment of existing datacenters with our public cloud into a single, cohesive infrastructure, and the ability to run at a scale that meets the needs of businesses of all sizes and complexities. We believe our cloud’s global scale, coupled with our broad portfolio of identity and security solutions, allows us to effectively solve complex cybersecurity challenges for our customers and differentiates us from the competition.

Our server products face competition from a wide variety of server operating systems and applications offered by companies with a range of market approaches. Vertically integrated computer manufacturers such as Hewlett-Packard, IBM, and Oracle offer their own versions of the Unix operating system preinstalled on server hardware. Nearly all computer manufacturers offer server hardware for the Linux operating system and many contribute to Linux operating system development. The competitive position of Linux has also benefited from the large number of compatible applications now produced by many commercial and non-commercial software developers. A number of companies, such as Red Hat, supply versions of Linux.

We compete to provide enterprise-wide computing solutions and point solutions with numerous commercial software vendors that offer solutions and middleware technology platforms, software applications for connectivity (both Internet and intranet), security, hosting, database, and e-business servers. IBM and Oracle lead a group of companies focused on the Java Platform Enterprise Edition that competes with our enterprise-wide computing solutions. Commercial competitors for our server applications for PC-based distributed client-server environments include CA Technologies, IBM, and Oracle. Our web application platform software competes with open source software such as Apache, Linux, MySQL, and PHP. In middleware, we compete against Java vendors.

Our database, business intelligence, and data warehousing solutions offerings compete with products from IBM, Oracle, SAP, and other companies. Our system management solutions compete with server management and server virtualization platform providers, such as BMC, CA Technologies, Hewlett-Packard, IBM, and VMware. Our products for software developers compete against offerings from Adobe, IBM, Oracle, and other companies, and also against open-source projects, including Eclipse (sponsored by CA Technologies, IBM, Oracle, and SAP), PHP, and Ruby on Rails.

We believe our server products provide customers with advantages in performance, total costs of ownership, and productivity by delivering superior applications, development tools, compatibility with a broad base of hardware and software applications, security, and manageability.

Our Enterprise Services business competes with a wide range of companies that provide strategy and business planning, application development, and infrastructure services, including multinational consulting firms and small niche businesses focused on specific technologies.

More Personal Computing

Our More Personal Computing segment consists of products and services that put customers at the center of the experience with our technology. This segment primarily comprises:

- Windows, including Windows OEM licensing (“Windows OEM”) and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; Windows IoT; and MSN advertising.
- Devices, including Surface and PC accessories.
- Gaming, including Xbox hardware and Xbox content and services, comprising Xbox Live (transactions, subscriptions, cloud services, and advertising), video games, and third-party video game royalties.
- Search.

Windows

The Windows operating system is designed to deliver a more personal computing experience for users by enabling consistency of experience, applications, and information across their devices. Windows OEM revenue is impacted significantly by the number of Windows operating system licenses purchased by OEMs, which they pre-install on the devices they sell. In addition to computing device market volume, Windows OEM revenue is impacted by:

- The mix of computing devices based on form factor and screen size.
- Differences in device market demand between developed markets and growth markets.
- Attachment of Windows to devices shipped.
- Customer mix between consumer, small and medium businesses, and large enterprises.
- Changes in inventory levels in the OEM channel.
- Pricing changes and promotions, pricing variation that occurs when the mix of devices manufactured shifts from local and regional system builders to large multinational OEMs, and different pricing of Windows versions licensed.
- Constraints in the supply chain of device components.
- Piracy.

Windows Commercial revenue, which includes volume licensing of the Windows operating system and Windows cloud services such as Microsoft Defender Advanced Threat Protection, is affected mainly by the demand from commercial customers for volume licensing and Software Assurance ("SA"), as well as advanced security offerings. Windows Commercial revenue often reflects the number of information workers in a licensed enterprise and is relatively independent of the number of PCs sold in a given year.

Patent licensing includes our programs to license patents we own for use across a broad array of technology areas, including mobile devices and cloud offerings.

Windows IoT extends the power of Windows and the cloud to intelligent systems by delivering specialized operating systems, tools, and services for use in embedded devices.

MSN advertising includes both native and display ads.

Devices

We design, manufacture, and sell devices, including Surface and PC accessories. Our devices are designed to enable people and organizations to connect to the people and content that matter most using Windows and integrated Microsoft products and services. Surface is designed to help organizations, students, and consumers be more productive. Growth in Devices is dependent on total PC shipments, the ability to attract new customers, our product roadmap, and expanding into new categories.

Gaming

Our gaming platform is designed to provide a variety of entertainment through a unique combination of content, community, and cloud. Our exclusive game content is created through Xbox Game Studios, a collection of first-party studios creating iconic and differentiated gaming experiences. We continue to invest in new gaming studios and content to expand our IP roadmap and leverage new content creators. These unique gaming experiences are the cornerstone of Xbox Game Pass, a subscription service and gaming community with access to a curated library of over 100 first- and third-party console and PC titles.

The gamer remains at the heart of the Xbox ecosystem. We continue to open new opportunities for gamers to engage both on- and off-console with both the launch of Project xCloud, our game streaming service, and continued investment in gaming hardware. Project xCloud utilizes Microsoft's Azure cloud technology to allow direct and on-demand streaming of games to PCs, consoles, and mobile devices, enabling gamers to take their favorites games with them and play on the device most convenient to them. Project xCloud will provide players with more choice over how and where they play.

Xbox Live enables people to connect and share online gaming experiences and is accessible on Xbox consoles, Windows-enabled devices, and other devices. Xbox Live is designed to benefit users by providing access to a network of certified applications and services and to benefit our developer and partner ecosystems by providing access to a large customer base. Xbox revenue is mainly affected by subscriptions and sales of first- and third-party content, as well as advertising. Growth of our Gaming business is determined by the overall active user base through Xbox enabled content, availability of games, providing exclusive game content that gamers seek, the computational power and reliability of the devices used to access our content and services, and the ability to create new experiences through first-party content creators.

Search

Our Search business, including Bing and Microsoft Advertising, is designed to deliver relevant online advertising to a global audience. We have several partnerships with other companies, including Verizon Media Group, through which we provide and monetize search queries. Growth depends on our ability to attract new users, understand intent, and match intent with relevant content and advertiser offerings.

Competition

Windows faces competition from various software products and from alternative platforms and devices, mainly from Apple and Google. We believe Windows competes effectively by giving customers choice, value, flexibility, security, an easy-to-use interface, and compatibility with a broad range of hardware and software applications, including those that enable productivity.

Devices face competition from various computer, tablet, and hardware manufacturers who offer a unique combination of high-quality industrial design and innovative technologies across various price points. These manufacturers, many of which are also current or potential partners and customers, include Apple and our Windows OEMs.

Xbox Live and our cloud gaming services face competition from various online gaming ecosystems and game streaming services, including those operated by Amazon, Apple, Facebook, Google, and Tencent. We also compete with other providers of entertainment services such as Netflix and Hulu. Our gaming platform competes with console platforms from Nintendo and Sony, both of which have a large, established base of customers. We believe our gaming platform is effectively positioned against, and uniquely differentiated from, competitive products and services based on significant innovation in hardware architecture, user interface, developer tools, online gaming and entertainment services, and continued strong exclusive content from our own first-party game franchises as well as other digital content offerings.

Our search business competes with Google and a wide array of websites, social platforms like Facebook, and portals that provide content and online offerings to end users.

OPERATIONS

We have operations centers that support operations in their regions, including customer contract and order processing, credit and collections, information processing, and vendor management and logistics. The regional center in Ireland supports the European, Middle Eastern, and African region; the center in Singapore supports the Japan, India, Greater China, and Asia-Pacific region; and the centers in Fargo, North Dakota, Fort Lauderdale, Florida, Puerto Rico, Redmond, Washington, and Reno, Nevada support Latin America and North America. In addition to the operations centers, we also operate datacenters throughout the Americas, Europe, Australia, and Asia, as well as in the Middle East and Africa.

To serve the needs of customers around the world and to improve the quality and usability of products in international markets, we localize many of our products to reflect local languages and conventions. Localizing a product may require modifying the user interface, altering dialog boxes, and translating text.

Our devices are primarily manufactured by third-party contract manufacturers. We generally have the ability to use other manufacturers if a current vendor becomes unavailable or unable to meet our requirements. The majority of our hardware products contain components for which there is only one qualified supplier. Extended disruptions at these suppliers could lead to a similar disruption in our ability to manufacture devices.

RESEARCH AND DEVELOPMENT

Product and Service Development, and Intellectual Property

We develop most of our products and services internally through the following engineering groups.

- *Cloud and AI*, focuses on making IT professionals, developers, and their systems more productive and efficient through development of cloud infrastructure, server, database, CRM, ERP, management and development tools, AI cognitive services, and other business process applications and services for enterprises.
- *Experiences and Devices*, focuses on instilling a unifying product ethos across our end-user experiences and devices, including Office, Windows, Enterprise Mobility + Security, and Surface.
- *AI and Research*, focuses on our AI innovations and other forward-looking research and development efforts spanning infrastructure, services, applications, and search.
- *LinkedIn*, focuses on our services that transform the way customers hire, market, sell, and learn.
- *Gaming*, focuses on developing hardware, content, and services across a large range of platforms to help grow our user base through game experiences and social interaction.

Internal development allows us to maintain competitive advantages that come from product differentiation and closer technical control over our products and services. It also gives us the freedom to decide which modifications and enhancements are most important and when they should be implemented. We strive to obtain information as early as possible about changing usage patterns and hardware advances that may affect software and hardware design. Before releasing new software platforms, and as we make significant modifications to existing platforms, we provide application vendors with a range of resources and guidelines for development, training, and testing. Generally, we also create product documentation internally.

We protect our intellectual property investments in a variety of ways. We work actively in the U.S. and internationally to ensure the enforcement of copyright, trademark, trade secret, and other protections that apply to our software and hardware products, services, business plans, and branding. We are a leader among technology companies in pursuing patents and currently have a portfolio of over 63,000 U.S. and international patents issued and over 24,500 pending worldwide. While we employ much of our internally-developed intellectual property exclusively in our products and services, we also engage in outbound licensing of specific patented technologies that are incorporated into licensees' products. From time to time, we enter into broader cross-license agreements with other technology companies covering entire groups of patents. We also purchase or license technology that we incorporate into our products and services. At times, we make select intellectual property broadly available at no or low cost to achieve a strategic objective, such as promoting industry standards, advancing interoperability, or attracting and enabling our external development community. Our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations.

While it may be necessary in the future to seek or renew licenses relating to various aspects of our products, services, and business methods, we believe, based upon past experience and industry practice, such licenses generally can be obtained on commercially reasonable terms. We believe our continuing research and product development are not materially dependent on any single license or other agreement with a third party relating to the development of our products.

Investing in the Future

Our success is based on our ability to create new and compelling products, services, and experiences for our users, to initiate and embrace disruptive technology trends, to enter new geographic and product markets, and to drive broad adoption of our products and services. We invest in a range of emerging technology trends and breakthroughs that we believe offer significant opportunities to deliver value to our customers and growth for the Company. Based on our assessment of key technology trends, we maintain our long-term commitment to research and development across a wide spectrum of technologies, tools, and platforms spanning digital work and life experiences, cloud computing, AI, devices, and operating systems.

While our main product research and development facilities are located in Redmond, Washington, we also operate research and development facilities in other parts of the U.S. and around the world, including Canada, China, Czech Republic, India, Ireland, Israel, and the United Kingdom. This global approach helps us remain competitive in local markets and enables us to continue to attract top talent from across the world.

In addition to our main research and development operations, we also operate Microsoft Research. Microsoft Research is one of the world's largest corporate research organizations and works in close collaboration with top universities around the world to advance the state-of-the-art in computer science and a broad range of other disciplines, providing us a unique perspective on future trends and contributing to our innovation.

We generally fund research at the corporate level to ensure that we are looking beyond immediate product considerations to opportunities further in the future. We also fund research and development activities at the operating segment level. Much of our segment level research and development is coordinated with other segments and leveraged across the Company. We plan to continue to make significant investments in a broad range of research and development efforts.

DISTRIBUTION, SALES, AND MARKETING

We market and distribute our products and services through the following channels: OEMs, direct, and distributors and resellers. Our sales force performs a variety of functions, including working directly with commercial enterprises and public-sector organizations worldwide to identify and meet their technology and digital transformation requirements; managing OEM relationships; and supporting system integrators, independent software vendors, and other partners who engage directly with our customers to perform sales, consulting, and fulfillment functions for our products and services.

OEMs

We distribute our products and services through OEMs that pre-install our software on new devices and servers they sell. The largest component of the OEM business is the Windows operating system pre-installed on devices. OEMs also sell devices pre-installed with other Microsoft products and services, including applications such as Office and the capability to subscribe to Office 365.

There are two broad categories of OEMs. The largest category of OEMs are direct OEMs as our relationship with them is managed through a direct agreement between Microsoft and the OEM. We have distribution agreements covering one or more of our products with virtually all the multinational OEMs, including Acer, ASUS, Dell, Fujitsu, Hewlett-Packard, Lenovo, Samsung, Sharp, Toshiba, and with many regional and local OEMs. The second broad category of OEMs are system builders consisting of lower-volume PC manufacturers, which source Microsoft software for pre-installation and local redistribution primarily through the Microsoft distributor channel rather than through a direct agreement or relationship with Microsoft.

Direct

Many organizations that license our products and services transact directly with us through Enterprise Agreements and Enterprise Services contracts, with sales support from system integrators, independent software vendors, web agencies, and partners that advise organizations on licensing our products and services ("Enterprise Agreement Software Advisors" or "ESA"). Microsoft offers direct sales programs targeted to reach small, medium, and corporate customers, in addition to those offered through the reseller channel. A large network of partner advisors support many of these sales.

We also sell commercial and consumer products and services directly to customers, such as cloud services, search, and gaming, through our digital marketplaces and online stores. In June 2020, we announced a strategic change in our retail operations, including closing our Microsoft Store physical locations.

Distributors and Resellers

Organizations also license our products and services indirectly, primarily through licensing solution partners ("LSP"), distributors, value-added resellers ("VAR"), and retailers. Although each type of reselling partner may reach organizations of all sizes, LSPs are primarily engaged with large organizations, distributors resell primarily to VARs, and VARs typically reach small and medium organizations. ESAs are also typically authorized as LSPs and operate as resellers for our other volume licensing programs. Microsoft Cloud Solution Provider is our main partner program for reselling cloud services.

We distribute our retail packaged products primarily through independent non-exclusive distributors, authorized replicators, resellers, and retail outlets. Individual consumers obtain these products primarily through retail outlets. We distribute our devices through third-party retailers. We have a network of field sales representatives and field support personnel that solicit orders from distributors and resellers, and provide product training and sales support.

Our Dynamics business solutions are also licensed to enterprises through a global network of channel partners providing vertical solutions and specialized services.

LICENSING OPTIONS

We offer options for organizations that want to purchase our cloud services, on-premises software, and Software Assurance. We license software to organizations under volume licensing agreements to allow the customer to acquire multiple licenses of products and services instead of having to acquire separate licenses through retail channels. We use different programs designed to provide flexibility for organizations of various sizes. While these programs may differ in various parts of the world, generally they include those discussed below.

SA conveys rights to new software and upgrades for perpetual licenses released over the contract period. It also provides support, tools, training, and other licensing benefits to help customers deploy and use software efficiently. SA is included with certain volume licensing agreements and is an optional purchase with others.

Volume Licensing Programs

Enterprise Agreement

Enterprise Agreements offer large organizations a manageable volume licensing program that gives them the flexibility to buy cloud services and software licenses under one agreement. Enterprise Agreements are designed for medium or large organizations that want to license cloud services and on-premises software organization-wide over a three-year period. Organizations can elect to purchase perpetual licenses or subscribe to licenses. SA is included.

Microsoft Product and Services Agreement

Microsoft Product and Services Agreements are designed for medium and large organizations that want to license cloud services and on-premises software as needed, with no organization-wide commitment, under a single, non-expiring agreement. Organizations purchase perpetual licenses or subscribe to licenses. SA is optional for customers that purchase perpetual licenses.

Open

Open agreements are a simple, cost-effective way to acquire the latest Microsoft technology. Open agreements are designed for small and medium organizations that want to license cloud services and on-premises software over a one- to three-year period. Under the Open agreements, organizations purchase perpetual licenses and SA is optional. Under Open Value agreements, organizations can elect to purchase perpetual licenses or subscribe to licenses and SA is included.

Select Plus

Select Plus agreements are designed for government and academic organizations to acquire on-premises licenses at any affiliate or department level, while realizing advantages as one organization. Organizations purchase perpetual licenses and SA is optional.

Microsoft Online Subscription Agreement

Microsoft Online Subscription Agreements are designed for small and medium organizations that want to subscribe to, activate, provision, and maintain cloud services seamlessly and directly via the web. The agreement allows customers to acquire monthly or annual subscriptions for cloud-based services.

Partner Programs

The Microsoft Cloud Solution Provider program offers customers an easy way to license the cloud services they need in combination with the value-added services offered by their systems integrator, managed services provider, or cloud reseller partner. Partners in this program can easily package their own products and services to directly provision, manage, and support their customer subscriptions.

The Microsoft Services Provider License Agreement allows hosting service providers and independent software vendors who want to license eligible Microsoft software products to provide software services and hosted applications to their end customers. Partners license software over a three-year period and are billed monthly based on consumption.

The Independent Software Vendor Royalty program enables partners to integrate Microsoft products into other applications and then license the unified business solution to their end users.

CUSTOMERS

Our customers include individual consumers, small and medium organizations, large global enterprises, public-sector institutions, Internet service providers, application developers, and OEMs. Our practice is to ship our products promptly upon receipt of purchase orders from customers; consequently, backlog is not significant.

EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers as of July 30, 2020 were as follows:

Name	Age	Position with the Company
Satya Nadella	52	Chief Executive Officer
Christopher C. Capossela	50	Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer
Jean-Philippe Courtois	59	Executive Vice President and President, Microsoft Global Sales, Marketing and Operations
Kathleen T. Hogan	54	Executive Vice President, Human Resources
Amy E. Hood	48	Executive Vice President, Chief Financial Officer
Bradford L. Smith	61	President and Chief Legal Officer

Mr. Nadella was appointed Chief Executive Officer in February 2014. He served as Executive Vice President, Cloud and Enterprise from July 2013 until that time. From 2011 to 2013, Mr. Nadella served as President, Server and Tools. From 2009 to 2011, he was Senior Vice President, Online Services Division. From 2008 to 2009, he was Senior Vice President, Search, Portal, and Advertising. Since joining Microsoft in 1992, Mr. Nadella's roles also included Vice President of the Business Division. Mr. Nadella also serves on the Board of Directors of Starbucks Corporation.

Mr. Capossela was appointed Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer in July 2016. He had served as Executive Vice President, Chief Marketing Officer since March 2014. Previously, he served as the worldwide leader of the Consumer Channels Group, responsible for sales and marketing activities with OEMs, operators, and retail partners. In his more than 26 years at Microsoft, Mr. Capossela has held a variety of marketing leadership roles in the Microsoft Office Division. He was responsible for marketing productivity solutions including Microsoft Office, Office 365, SharePoint, Exchange, Skype for Business, Project, and Visio.

Mr. Courtois was appointed Executive Vice President and President, Microsoft Global Sales, Marketing and Operations in July 2016. Before that he was President of Microsoft International since 2005. He was Chief Executive Officer, Microsoft Europe, Middle East, and Africa from 2003 to 2005. He was Senior Vice President and President, Microsoft Europe, Middle East, and Africa from 2000 to 2003. He was Corporate Vice President, Worldwide Customer Marketing from 1998 to 2000. Mr. Courtois joined Microsoft in 1984.

Ms. Hogan was appointed Executive Vice President, Human Resources in November 2014. Prior to that Ms. Hogan was Corporate Vice President of Microsoft Services. She also served as Corporate Vice President of Customer Service and Support. Ms. Hogan joined Microsoft in 2003. Ms. Hogan also serves on the Board of Directors of Alaska Air Group, Inc.

Ms. Hood was appointed Executive Vice President and Chief Financial Officer in July 2013, subsequent to her appointment as Chief Financial Officer in May 2013. From 2010 to 2013, Ms. Hood was Chief Financial Officer of the Microsoft Business Division. From 2006 through 2009, Ms. Hood was General Manager, Microsoft Business Division Strategy. Since joining Microsoft in 2002, Ms. Hood has also held finance-related positions in the Server and Tools Business and the corporate finance organization. Ms. Hood also serves on the Board of Directors of 3M Corporation.

Mr. Smith was appointed President and Chief Legal Officer in September 2015. He served as Executive Vice President, General Counsel, and Secretary from 2011 to 2015, and served as Senior Vice President, General Counsel, and Secretary from 2001 to 2011. Mr. Smith was also named Chief Compliance Officer in 2002. Since joining Microsoft in 1993, he was Deputy General Counsel for Worldwide Sales and previously was responsible for managing the European Law and Corporate Affairs Group, based in Paris. Mr. Smith also serves on the Board of Directors of Netflix, Inc.

EMPLOYEES

As of June 30, 2020, we employed approximately 163,000 people on a full-time basis, 96,000 in the U.S. and 67,000 internationally. Of the total employed people, 56,000 were in operations, including manufacturing, distribution, product support, and consulting services; 55,000 were in product research and development; 40,000 were in sales and marketing; and 12,000 were in general and administration. Certain of our employees are subject to collective bargaining agreements.

AVAILABLE INFORMATION

Our Internet address is www.microsoft.com. At our Investor Relations website, www.microsoft.com/investor, we make available free of charge a variety of information for investors. Our goal is to maintain the Investor Relations website as a portal through which investors can easily find or navigate to pertinent information about us, including:

- Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file that material with or furnish it to the Securities and Exchange Commission ("SEC") at www.sec.gov.
- Information on our business strategies, financial results, and metrics for investors.
- Announcements of investor conferences, speeches, and events at which our executives talk about our product, service, and competitive strategies. Archives of these events are also available.
- Press releases on quarterly earnings, product and service announcements, legal developments, and international news.
- Corporate governance information including our articles of incorporation, bylaws, governance guidelines, committee charters, codes of conduct and ethics, global corporate social responsibility initiatives, and other governance-related policies.
- Other news and announcements that we may post from time to time that investors might find useful or interesting.
- Opportunities to sign up for email alerts to have information pushed in real time.

The information found on our website is not part of this or any other report we file with, or furnish to, the SEC. In addition to these channels, we use social media to communicate to the public. It is possible that the information we post on social media could be deemed to be material to investors. We encourage investors, the media, and others interested in Microsoft to review the information we post on the social media channels listed on our Investor Relations website.

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described below, that could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock.

We face intense competition across all markets for our products and services, which may lead to lower revenue or operating margins.

Competition in the technology sector

Our competitors range in size from diversified global companies with significant research and development resources to small, specialized firms whose narrower product lines may let them be more effective in deploying technical, marketing, and financial resources. Barriers to entry in many of our businesses are low and many of the areas in which we compete evolve rapidly with changing and disruptive technologies, shifting user needs, and frequent introductions of new products and services. Our ability to remain competitive depends on our success in making innovative products, devices, and services that appeal to businesses and consumers.

Competition among platform-based ecosystems

An important element of our business model has been to create platform-based ecosystems on which many participants can build diverse solutions. A well-established ecosystem creates beneficial network effects among users, application developers, and the platform provider that can accelerate growth. Establishing significant scale in the marketplace is necessary to achieve and maintain attractive margins. We face significant competition from firms that provide competing platforms.

- A competing vertically-integrated model, in which a single firm controls the software and hardware elements of a product and related services, has succeeded with some consumer products such as personal computers, tablets, phones, gaming consoles, wearables, and other endpoint devices. Competitors pursuing this model also earn revenue from services integrated with the hardware and software platform, including applications and content sold through their integrated marketplaces. They may also be able to claim security and performance benefits from their vertically integrated offer. We also offer some vertically-integrated hardware and software products and services. To the extent we shift a portion of our business to a vertically integrated model we increase our cost of revenue and reduce our operating margins.
- We derive substantial revenue from licenses of Windows operating systems on PCs. We face significant competition from competing platforms developed for new devices and form factors such as smartphones and tablet computers. These devices compete on multiple bases including price and the perceived utility of the device and its platform. Users are increasingly turning to these devices to perform functions that in the past were performed by personal computers. Even if many users view these devices as complementary to a personal computer, the prevalence of these devices may make it more difficult to attract application developers to our PC operating system platforms. Competing with operating systems licensed at low or no cost may decrease our PC operating system margins. Popular products or services offered on competing platforms could increase their competitive strength. In addition, some of our devices compete with products made by our original equipment manufacturer ("OEM") partners, which may affect their commitment to our platform.
- Competing platforms have content and application marketplaces with scale and significant installed bases. The variety and utility of content and applications available on a platform are important to device purchasing decisions. Users may incur costs to move data and buy new content and applications when switching platforms. To compete, we must successfully enlist developers to write applications for our platform and ensure that these applications have high quality, security, customer appeal, and value. Efforts to compete with competitors' content and application marketplaces may increase our cost of revenue and lower our operating margins. Competitors' rules governing their content and applications marketplaces may restrict our ability to distribute products and services through them in accordance with our technical and business model objectives.

Business model competition

Companies compete with us based on a growing variety of business models.

- Even as we transition more of our business to infrastructure-, platform-, and software-as-a-service business model, the license-based proprietary software model generates a substantial portion of our software revenue. We bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from licensing our products. Many of our competitors also develop and sell software to businesses and consumers under this model.
- Other competitors develop and offer free applications, online services and content, and make money by selling third-party advertising. Advertising revenue funds development of products and services these competitors provide to users at no or little cost, competing directly with our revenue-generating products.
- Some companies compete with us by modifying and then distributing open source software at little or no cost to end users, and earning revenue on advertising or integrated products and services. These firms do not bear the full costs of research and development for the open source software. Some open source software mimics the features and functionality of our products.

The competitive pressures described above may cause decreased sales volumes, price reductions, and/or increased operating costs, such as for research and development, marketing, and sales incentives. This may lead to lower revenue, gross margins, and operating income.

Our increasing focus on cloud-based services presents execution and competitive risks. A growing part of our business involves cloud-based services available across the spectrum of computing devices. Our strategic vision is to compete and grow by building best-in-class platforms and productivity services for an intelligent cloud and an intelligent edge infused with artificial intelligence (“AI”). At the same time, our competitors are rapidly developing and deploying cloud-based services for consumers and business customers. Pricing and delivery models are evolving. Devices and form factors influence how users access services in the cloud and sometimes the user’s choice of which cloud-based services to use. We are devoting significant resources to develop and deploy our cloud-based strategies. The Windows ecosystem must continue to evolve with this changing environment. We are undertaking cultural and organizational changes to drive accountability and eliminate obstacles to innovation. Our intelligent cloud and intelligent edge worldview is connected with the growth of the Internet of Things (“IoT”). Our success in the IoT will depend on the level of adoption of our offerings such as Azure, Azure Stack, Azure IoT Edge, and Azure Sphere. We may not establish market share sufficient to achieve scale necessary to achieve our business objectives.

Besides software development costs, we are incurring costs to build and maintain infrastructure to support cloud computing services. These costs will reduce the operating margins we have previously achieved. Whether we succeed in cloud-based services depends on our execution in several areas, including:

- Continuing to bring to market compelling cloud-based experiences that generate increasing traffic and market share.
- Maintaining the utility, compatibility, and performance of our cloud-based services on the growing array of computing devices, including PCs, smartphones, tablets, gaming consoles, and other devices, as well as sensors and other endpoints.
- Continuing to enhance the attractiveness of our cloud platforms to third-party developers.
- Ensuring our cloud-based services meet the reliability expectations of our customers and maintain the security of their data as well as help them meet their own compliance needs.
- Making our suite of cloud-based services platform-agnostic, available on a wide range of devices and ecosystems, including those of our competitors.

It is uncertain whether our strategies will attract the users or generate the revenue required to succeed. If we are not effective in executing organizational and technical changes to increase efficiency and accelerate innovation, or if we fail to generate sufficient usage of our new products and services, we may not grow revenue in line with the infrastructure and development investments described above. This may negatively impact gross margins and operating income.

We make significant investments in products and services that may not achieve expected returns. We will continue to make significant investments in research, development, and marketing for existing products, services, and technologies, including the Windows operating system, Microsoft 365, Office, Bing, SQL Server, Windows Server, Azure, Office 365, Xbox Live, LinkedIn, and other products and services. We also invest in the development and acquisition of a variety of hardware for productivity, communication, and entertainment including PCs, tablets, gaming devices, and HoloLens. Investments in new technology are speculative. Commercial success depends on many factors, including innovativeness, developer support, and effective distribution and marketing. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of new software and hardware products or upgrades, unfavorably affecting revenue. We may not achieve significant revenue from new product, service, and distribution channel investments for several years, if at all. New products and services may not be profitable, and even if they are profitable, operating margins for some new products and businesses will not be as high as the margins we have experienced historically. We may not get engagement in certain features, like Edge and Bing, that drive post-sale monetization opportunities. Our data handling practices across our products and services will continue to be under scrutiny and perceptions of mismanagement, driven by regulatory activity or negative public reaction to our practices or product experiences, which could negatively impact product and feature adoption, product design, and product quality.

Developing new technologies is complex. It can require long development and testing periods. Significant delays in new releases or significant problems in creating new products or services could adversely affect our revenue.

Acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business. We expect to continue making acquisitions and entering into joint ventures and strategic alliances as part of our long-term business strategy. For example, in October 2018, we completed our acquisition of GitHub, Inc. ("GitHub") for $7.5 billion. These acquisitions and other transactions and arrangements involve significant challenges and risks, including that they do not advance our business strategy, that we get an unsatisfactory return on our investment, that we have difficulty integrating and retaining new employees, business systems, and technology, or that they distract management from our other businesses. If an arrangement fails to adequately anticipate changing circumstances and interests of a party, it may result in early termination or renegotiation of the arrangement. The success of these transactions and arrangements will depend in part on our ability to leverage them to enhance our existing products and services or develop compelling new ones. It may take longer than expected to realize the full benefits from these transactions and arrangements such as increased revenue or enhanced efficiencies, or the benefits may ultimately be smaller than we expected. These events could adversely affect our consolidated financial statements.

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings. We acquire other companies and intangible assets and may not realize all the economic benefit from those acquisitions, which could cause an impairment of goodwill or intangibles. We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment at least annually. Factors that may be a change in circumstances, indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable, include a decline in our stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in industry segments in which we participate. We have in the past recorded, and may in the future be required to record a significant charge in our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively affecting our results of operations.

Cyberattacks and security vulnerabilities could lead to reduced revenue, increased costs, liability claims, or harm to our reputation or competitive position.

Security of our information technology

Threats to IT security can take a variety of forms. Individual and groups of hackers and sophisticated organizations, including state-sponsored organizations or nation-states, continuously undertake attacks that pose threats to our customers and our IT. These actors may use a wide variety of methods, which may include developing and deploying malicious software or exploiting vulnerabilities in hardware, software, or other infrastructure in order to attack our products and services or gain access to our networks and datacenters, using social engineering techniques to induce our employees, users, partners, or customers to disclose passwords or other sensitive information or take other actions to gain access to our data or our users' or customers' data, or acting in a coordinated manner to launch distributed denial of service or other coordinated attacks. Inadequate account security practices may also result in unauthorized access to confidential data. For example, system administrators may fail to timely remove employee account access when no longer appropriate. Employees or third parties may intentionally compromise our or our users' security or systems, or reveal confidential information.

Cyberthreats are constantly evolving, increasing the difficulty of detecting and successfully defending against them. We may have no current capability to detect certain vulnerabilities, which may allow them to persist in the environment over long periods of time. Cyberthreats can have cascading impacts that unfold with increasing speed across our internal networks and systems and those of our partners and customers. Breaches of our facilities, network, or data security could disrupt the security of our systems and business applications, impair our ability to provide services to our customers and protect the privacy of their data, result in product development delays, compromise confidential or technical business information harming our reputation or competitive position, result in theft or misuse of our intellectual property or other assets, require us to allocate more resources to improve technologies, or otherwise adversely affect our business.

In addition, our internal IT environment continues to evolve. Often, we are early adopters of new devices and technologies. We embrace new ways of sharing data and communicating internally and with partners and customers using methods such as social networking and other consumer-oriented technologies. Our business policies and internal security controls may not keep pace with these changes as new threats emerge.

Security of our products, services, devices, and customers' data

The security of our products and services is important in our customers' decisions to purchase or use our products or services. Security threats are a significant challenge to companies like us whose business is providing technology products and services to others. Threats to our own IT infrastructure can also affect our customers. Customers using our cloud-based services rely on the security of our infrastructure, including hardware and other elements provided by third parties, to ensure the reliability of our services and the protection of their data. Adversaries tend to focus their efforts on the most popular operating systems, programs, and services, including many of ours, and we expect that to continue. Adversaries that acquire user account information at other companies can use that information to compromise our users' accounts where accounts share the same attributes as passwords. Inadequate account security practices may also result in unauthorized access. User activity may also result in ransomware or other malicious software impacting a customer's use of our products or services. We are also increasingly incorporating open source software into our products. There may be vulnerabilities in open source software that may make our products susceptible to cyberattacks.

To defend against security threats to our internal IT systems, our cloud-based services, and our customers' systems, we must continuously engineer more secure products and services, enhance security and reliability features, improve the deployment of software updates to address security vulnerabilities in our own products as well as those provided by others, develop mitigation technologies that help to secure customers from attacks even when software updates are not deployed, maintain the digital security infrastructure that protects the integrity of our network, products, and services, and provide security tools such as firewalls and anti-virus software and information about the need to deploy security measures and the impact of doing so. Customers in certain industries such as financial services, health care, and government may have enhanced or specialized requirements to which we must engineer our product and services.

The cost of these steps could reduce our operating margins. If we fail to do these things well, actual or perceived security vulnerabilities in our products and services, data corruption issues, or reduced performance could harm our reputation and lead customers to reduce or delay future purchases of products or subscriptions to services, or to use competing products or services. Customers may also spend more on protecting their existing computer systems from attack, which could delay adoption of additional products or services. Customers, and third parties granted access to their systems, may fail to update their systems, continue to run software or operating systems we no longer support, or may fail timely to install or enable security patches, or may otherwise fail to adopt adequate security practices. Any of these could adversely affect our reputation and revenue. Actual or perceived vulnerabilities may lead to claims against us. Our license agreements typically contain provisions that eliminate or limit our exposure to liability, but there is no assurance these provisions will withstand legal challenges. At times, to achieve commercial objectives, we may enter into agreements with larger liability exposure to customers.

Our products operate in conjunction with and are dependent on products and components across a broad ecosystem of third parties. If there is a security vulnerability in one of these components, and if there is a security exploit targeting it, we could face increased costs, liability claims, reduced revenue, or harm to our reputation or competitive position.

Disclosure and misuse of personal data could result in liability and harm our reputation. As we continue to grow the number and scale of our cloud-based offerings, we store and process increasingly large amounts of personally identifiable information of our customers and users. The continued occurrence of high-profile data breaches provides evidence of an external environment increasingly hostile to information security. Despite our efforts to improve the security controls across our business groups and geographies, it is possible our security controls over personal data, our training of employees and third parties on data security, and other practices we follow may not prevent the improper disclosure or misuse of customer or user data we or our vendors store and manage. In addition, third parties who have limited access to our customer or user data may use this data in unauthorized ways. Improper disclosure or misuse could harm our reputation, lead to legal exposure to customers or users, or subject us to liability under laws that protect personal data, resulting in increased costs or loss of revenue. Our software products and services also enable our customers and users to store and process personal data on-premises or, increasingly, in a cloud-based environment we host. Government authorities can sometimes require us to produce customer or user data in response to valid legal orders. In the U.S. and elsewhere, we advocate for transparency concerning these requests and appropriate limitations on government authority to compel disclosure. Despite our efforts to protect customer and user data, perceptions that the collection, use, and retention of personal information is not satisfactorily protected could inhibit sales of our products or services, and could limit adoption of our cloud-based solutions by consumers, businesses, and government entities. Additional security measures we may take to address customer or user concerns, or constraints on our flexibility to determine where and how to operate datacenters in response to customer or user expectations or governmental rules or actions, may cause higher operating expenses or hinder growth of our products and services.

We may not be able to protect information in our products and services from use by others. LinkedIn and other Microsoft products and services contain valuable information and content protected by contractual restrictions or technical measures. In certain cases, we have made commitments to our members and users to limit access to or use of this information. Changes in the law or interpretations of the law may weaken our ability to prevent third parties from scraping or gathering information or content through use of bots or other measures and using it for their own benefit, thus diminishing the value of our products and services.

Abuse of our platforms may harm our reputation or user engagement.

Advertising, professional, and social platform abuses

For platform products and services that provide content or host ads that come from or can be influenced by third parties, including GitHub, LinkedIn, Microsoft Advertising, MSN, and Xbox Live, our reputation or user engagement may be negatively affected by activity that is hostile or inappropriate. This activity may come from users impersonating other people or organizations, use of our products or services to spread terrorist or violent extremist content or to disseminate information that may be viewed as misleading or intended to manipulate the opinions of our users, or the use of our products or services that violates our terms of service or otherwise for objectionable or illegal ends. Preventing or responding to these actions may require us to make substantial investments in people and technology and these investments may not be successful, adversely affecting our business and consolidated financial statements.

Digital safety and service misuse

Our hosted consumer services as well as our enterprise services may be used by third parties to disseminate harmful or illegal content in violation of our terms or applicable law. We may not proactively discover such content due to scale and the limitations of existing technologies, and when discovered by users, such content may negatively affect our reputation, our brands, and user engagement. Regulations and other initiatives to make platforms responsible for preventing or eliminating harmful content online are gaining momentum and we expect this to continue. We may be subject to enhanced regulatory oversight, civil or criminal liability, or reputational damage if we fail to comply with content moderation regulations, adversely affecting our business and consolidated financial statements.

The development of the IoT presents security, privacy, and execution risks. To support the growth of the intelligent cloud and the intelligent edge, we are developing products, services, and technologies to power the IoT, a network of distributed and interconnected devices employing sensors, data, and computing capabilities including AI. The IoT's great potential also carries substantial risks. IoT products and services may contain defects in design, manufacture, or operation, that make them insecure or ineffective for their intended purposes. An IoT solution has multiple layers of hardware, sensors, processors, software, and firmware, several of which we may not develop or control. Each layer, including the weakest layer, can impact the security of the whole system. Many IoT devices have limited interfaces and ability to be updated or patched. IoT solutions may collect large amounts of data, and our handling of IoT data may not satisfy customers or regulatory requirements. IoT scenarios may increasingly affect personal health and safety. If IoT solutions that include our technologies do not work as intended, violate the law, or harm individuals or businesses, we may be subject to legal claims or enforcement actions. These risks, if realized, may increase our costs, damage our reputation or brands, or negatively impact our revenues or margins.

Issues in the use of AI in our offerings may result in reputational harm or liability. We are building AI into many of our offerings and we expect this element of our business to grow. We envision a future in which AI operating in our devices, applications, and the cloud helps our customers be more productive in their work and personal lives. As with many disruptive innovations, AI presents risks and challenges that could affect its adoption, and therefore our business. AI algorithms may be flawed. Datasets may be insufficient or contain biased information. Inappropriate or controversial data practices by Microsoft or others could impair the acceptance of AI solutions. These deficiencies could undermine the decisions, predictions, or analysis AI applications produce, subjecting us to competitive harm, legal liability, and brand or reputational harm. Some AI scenarios present ethical issues. If we enable or offer AI solutions that are controversial because of their impact on human rights, privacy, employment, or other social issues, we may experience brand or reputational harm.

We may have excessive outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure. Our increasing user traffic, growth in services, and the complexity of our products and services demand more computing power. We spend substantial amounts to build, purchase, or lease datacenters and equipment and to upgrade our technology and network infrastructure to handle more traffic on our websites and in our datacenters. These demands continue to increase as we introduce new products and services and support the growth of existing services such as Bing, Azure, Microsoft Account services, Office 365, Microsoft Teams, Dynamics 365, OneDrive, SharePoint Online, Skype, Xbox Live, and Outlook.com. We are rapidly growing our business of providing a platform and back-end hosting for services provided by third parties to their end users. Maintaining, securing, and expanding this infrastructure is expensive and complex, and requires development of principles for datacenter builds in geographies with higher safety risks. It requires that we maintain an Internet connectivity infrastructure and storage and compute capacity that is robust and reliable within competitive and regulatory constraints that continue to evolve. Inefficiencies or operational failures, including temporary or permanent loss of customer data, insufficient Internet connectivity, or inadequate storage and compute capacity, could diminish the quality of our products, services, and user experience resulting in contractual liability, claims by customers and other third parties, regulatory actions, damage to our reputation, and loss of current and potential users, subscribers, and advertisers, each of which may adversely impact our consolidated financial statements.

We may experience quality or supply problems. Our hardware products such as Xbox consoles, Surface devices, and other devices we design, manufacture, and market are highly complex and can have defects in design, manufacture, or associated software. We could incur significant expenses, lost revenue, and reputational harm as a result of recalls, safety alerts, or product liability claims if we fail to prevent, detect, or address such issues through design, testing, or warranty repairs.

Our software products and services also may experience quality or reliability problems. The highly sophisticated software we develop may contain bugs and other defects that interfere with their intended operation. Our customers increasingly rely on us for critical functions, potentially magnifying the impact of quality or reliability issues. Any defects we do not detect and fix in pre-release testing could cause reduced sales and revenue, damage to our reputation, repair or remediation costs, delays in the release of new products or versions, or legal liability. Although our license agreements typically contain provisions that eliminate or limit our exposure to liability, there is no assurance these provisions will withstand legal challenge.

We acquire some device and datacenter components from sole suppliers. Our competitors use some of the same suppliers and their demand for hardware components can affect the capacity available to us. If a component from a sole-source supplier is delayed or becomes unavailable, whether because of supplier capacity constraint, industry shortages, legal or regulatory changes, or other reasons, we may not obtain timely replacement supplies, resulting in reduced sales or inadequate datacenter capacity. Component shortages, excess or obsolete inventory, or price reductions resulting in inventory adjustments may increase our cost of revenue. Xbox consoles, Surface devices, datacenter servers, and other hardware are assembled in Asia and other geographies that may be subject to disruptions in the supply chain, resulting in shortages that would affect our revenue and operating margins. These same risks would apply to any other hardware and software products we may offer.

We may not be able to protect our source code from copying if there is an unauthorized disclosure. Source code, the detailed program commands for our operating systems and other software programs, is critical to our business. Although we license portions of our application and operating system source code to several licensees, we take significant measures to protect the secrecy of large portions of our source code. If our source code leaks, we might lose future trade secret protection for that code. It may then become easier for third parties to compete with our products by copying functionality, which could adversely affect our revenue and operating margins. Unauthorized disclosure of source code also could increase the security risks described elsewhere in these risk factors.

Legal changes, our evolving business model, piracy, and other factors may decrease the value of our intellectual property. Protecting our intellectual property rights and combating unlicensed copying and use of our software and other intellectual property on a global basis is difficult. While piracy adversely affects U.S. revenue, the impact on revenue from outside the U.S. is more significant, particularly countries in which the legal system provides less protection for intellectual property rights. Our revenue in these markets may grow more slowly than the underlying device market. Similarly, the absence of harmonized patent laws makes it more difficult to ensure consistent respect for patent rights. Throughout the world, we educate users about the benefits of licensing genuine products and obtaining indemnification benefits for intellectual property risks, and we educate lawmakers about the advantages of a business climate where intellectual property rights are protected. Reductions in the legal protection for software intellectual property rights could adversely affect revenue.

We expend significant resources to patent the intellectual property we create with the expectation that we will generate revenues by incorporating that intellectual property in our products or services or, in some instances, by licensing our patents to others in return for a royalty. Changes in the law may continue to weaken our ability to prevent the use of patented technology or collect revenue for licensing our patents. These include legislative changes and regulatory actions that make it more difficult to obtain injunctions, and the increasing use of legal process to challenge issued patents. Similarly, licensees of our patents may fail to satisfy their obligations to pay us royalties, or may contest the scope and extent of their obligations. The royalties we can obtain to monetize our intellectual property may decline because of the evolution of technology, selling price changes in products using licensed patents, or the difficulty of discovering infringements. Finally, our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations and may negatively impact revenue.

Third parties may claim we infringe their intellectual property rights. From time to time, others claim we infringe their intellectual property rights. The number of these claims may grow because of constant technological change in the markets in which we compete, the extensive patent coverage of existing technologies, the rapid rate of issuance of new patents, and our offering of first-party devices, such as Surface. To resolve these claims, we may enter into royalty and licensing agreements on terms that are less favorable than currently available, stop selling or redesign affected products or services, or pay damages to satisfy indemnification commitments with our customers. These outcomes may cause operating margins to decline. Besides money damages, in some jurisdictions plaintiffs can seek injunctive relief that may limit or prevent importing, marketing, and selling our products or services that have infringing technologies. In some countries, such as Germany, an injunction can be issued before the parties have fully litigated the validity of the underlying patents. We have paid significant amounts to settle claims related to the use of technology and intellectual property rights and to procure intellectual property rights as part of our strategy to manage this risk, and may continue to do so.

We have claims and lawsuits against us that may result in adverse outcomes. We are subject to a variety of claims and lawsuits. These claims may arise from a wide variety of business practices and initiatives, including major new product releases such as Windows 10, significant business transactions, warranty or product claims, and employment practices. Adverse outcomes in some or all of these claims may result in significant monetary damages or injunctive relief that could adversely affect our ability to conduct our business. The litigation and other claims are subject to inherent uncertainties and management's view of these matters may change in the future. A material adverse impact in our consolidated financial statements could occur for the period in which the effect of an unfavorable outcome becomes probable and reasonably estimable.

Government litigation and regulatory activity relating to competition rules may limit how we design and market our products. As a leading global software and device maker, government agencies closely scrutinize us under U.S. and foreign competition laws. Governments are actively enforcing competition laws and regulations, and this includes scrutiny in potentially large markets such as the European Union ("EU"), the U.S., and China. Some jurisdictions also allow competitors or consumers to assert claims of anti-competitive conduct. U.S. federal and state antitrust authorities have previously brought enforcement actions and continue to scrutinize our business.

The European Commission ("the Commission") closely scrutinizes the design of high-volume Microsoft products and the terms on which we make certain technologies used in these products, such as file formats, programming interfaces, and protocols, available to other companies. Flagship product releases such as Windows 10 can receive significant scrutiny under competition laws. For example, in 2004, the Commission ordered us to create new versions of our Windows operating system that do not include certain multimedia technologies and to provide our competitors with specifications for how to implement certain proprietary Windows communications protocols in their own products. In 2009, the Commission accepted a set of commitments we offered to address the Commission's concerns relating to competition in web browsing software, including an undertaking to address Commission concerns relating to interoperability. The web browsing commitments expired in 2014. The remaining obligations may limit our ability to innovate in Windows or other products in the future, diminish the developer appeal of the Windows platform, and increase our product development costs. The availability of licenses related to protocols and file formats may enable competitors to develop software products that better mimic the functionality of our products, which could hamper sales of our products.

Our portfolio of first-party devices continues to grow; at the same time our OEM partners offer a large variety of devices for our platforms. As a result, increasingly we both cooperate and compete with our OEM partners, creating a risk that we fail to do so in compliance with competition rules. Regulatory scrutiny in this area may increase. Certain foreign governments, particularly in China and other countries in Asia, have advanced arguments under their competition laws that exert downward pressure on royalties for our intellectual property.

Government regulatory actions and court decisions such as these may result in fines, or hinder our ability to provide the benefits of our software to consumers and businesses, reducing the attractiveness of our products and the revenue that come from them. New competition law actions could be initiated, potentially using previous actions as precedent. The outcome of such actions, or steps taken to avoid them, could adversely affect us in a variety of ways, including:

- We may have to choose between withdrawing products from certain geographies to avoid fines or designing and developing alternative versions of those products to comply with government rulings, which may entail a delay in a product release and removing functionality that customers want or on which developers rely.

- We may be required to make available licenses to our proprietary technologies on terms that do not reflect their fair market value or do not protect our associated intellectual property.
- We are subject to a variety of ongoing commitments because of court or administrative orders, consent decrees, or other voluntary actions we have taken. If we fail to comply with these commitments, we may incur litigation costs and be subject to substantial fines or other remedial actions.
- Our ability to realize anticipated Windows 10 post-sale monetization opportunities may be limited.

Our global operations subject us to potential liability under anti-corruption, trade protection, and other laws and regulations. The Foreign Corrupt Practices Act ("FCPA") and other anti-corruption laws and regulations ("Anti-Corruption Laws") prohibit corrupt payments by our employees, vendors, or agents, and the accounting provisions of the FCPA require us to maintain accurate books and records and adequate internal controls. From time to time, we receive inquiries from authorities in the U.S. and elsewhere which may be based on reports from employees and others about our business activities outside the U.S. and our compliance with Anti-Corruption Laws. Periodically, we receive such reports directly and investigate them. On July 22, 2019, our Hungarian subsidiary entered into a non-prosecution agreement ("NPA") with the U.S. Department of Justice ("DOJ") and we agreed to the terms of a cease and desist order with the Securities and Exchange Commission. These agreements required us to pay $25.3 million in monetary penalties, disgorgement, and interest pertaining to activities at Microsoft's subsidiary in Hungary. The NPA, which has a three-year term, also contains certain ongoing compliance requirements, including the obligations to disclose to the DOJ issues that may implicate the FCPA and to cooperate in any inquiries. Most countries in which we operate also have competition laws that prohibit competitors from colluding or otherwise attempting to reduce competition between themselves. While we devote substantial resources to our U.S. and international compliance programs and have implemented policies, training, and internal controls designed to reduce the risk of corrupt payments and collusive activity, our employees, vendors, or agents may violate our policies. Our failure to comply with Anti-Corruption Laws or competition laws could result in significant fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation. Operations outside the U.S. may be affected by changes in trade protection laws, policies, sanctions, and other regulatory requirements affecting trade and investment. We may be subject to legal liability and reputational damage if we sell goods or services in violation of U.S. trade sanctions on restricted entities or countries such as Crimea, Cuba, Iran, North Korea, Sudan, and Syria.

Other regulatory areas that may apply to our products and online services offerings include user privacy, telecommunications, data storage and protection, and online content. For example, some regulators are taking the position that our offerings such as Microsoft Teams and Skype are covered by existing laws regulating telecommunications services, and some new laws, including EU Member State laws under the European Electronic Communications Code, are defining more of our services as regulated telecommunications services. This trend may continue and will result in these offerings being subjected to additional data protection, security, and law enforcement surveillance obligations. Data protection authorities may assert that our collection, use, and management of customer data is inconsistent with their laws and regulations. Legislative or regulatory action relating to cybersecurity requirements may increase the costs to develop, implement, or secure our products and services. Legislative or regulatory action could also emerge in the area of AI and content moderation, increasing costs or restricting opportunity. Applying these laws and regulations to our business is often unclear, subject to change over time, and sometimes may conflict from jurisdiction to jurisdiction. Additionally, these laws and governments' approach to their enforcement, and our products and services, are continuing to evolve. Compliance with these types of regulation may involve significant costs or require changes in products or business practices that result in reduced revenue. Noncompliance could result in the imposition of penalties or orders we stop the alleged noncompliant activity.

We strive to empower all people and organizations to achieve more, and accessibility of our products is an important aspect of this goal. There is increasing pressure from advocacy groups, regulators, competitors, customers, and other stakeholders to make technology more accessible. If our products do not meet customer expectations or emerging global accessibility requirements, we could lose sales opportunities or face regulatory actions

Laws and regulations relating to the handling of personal data may impede the adoption of our services or result in increased costs, legal claims, fines against us, or reputational damage. The growth of our Internet- and cloud-based services internationally relies increasingly on the movement of data across national boundaries. Legal requirements relating to the collection, storage, handling, and transfer of personal data continue to evolve. For example, in July 2020 the Court of Justice of the EU invalidated a framework called Privacy Shield for companies to transfer data from EU member states to the United States. This ruling has led to uncertainty about the legal requirements for data transfers from the EU under other legal mechanisms. Potential new rules and restrictions on the flow of data across borders could increase the cost and complexity of delivering our products and services in some markets. In May 2018, the EU General Data Protection Regulation ("GDPR"), became effective. The law, which applies to all of our activities conducted from an establishment in the EU or related to products and services offered in the EU, imposes a range of compliance obligations regarding the handling of personal data. Engineering efforts to build and maintain capabilities to facilitate compliance with the law have entailed substantial expense and the diversion of engineering resources from other projects and may continue to do so. We might experience reduced demand for our offerings if we are unable to engineer products that meet our legal duties or help our customers meet their obligations under the GDPR or other data regulations, or if our implementation to comply with the GDPR makes our offerings less attractive. The GDPR imposes significant new obligations and compliance with these obligations depends in part on how particular regulators interpret and apply them. If we fail to comply with the GDPR, or if regulators assert we have failed to comply with the GDPR, it may lead to regulatory enforcement actions, which can result in monetary penalties of up to 4% of worldwide revenue, private lawsuits, reputational damage, and loss of customers. Countries around the world, and states in the U.S. such as California, have adopted, or are considering adopting or expanding, laws and regulations imposing obligations regarding the handling of personal data.

The Company's investment in gaining insights from data is becoming central to the value of the services we deliver to customers, to our operational efficiency and key opportunities in monetization, customer perceptions of quality, and operational efficiency. Our ability to use data in this way may be constrained by regulatory developments that impede realizing the expected return from this investment. Ongoing legal analyses, reviews, and inquiries by regulators of Microsoft practices, or relevant practices of other organizations, may result in burdensome or inconsistent requirements, including data sovereignty and localization requirements, affecting the location, movement, collection, and use of our customer and internal employee data as well as the management of that data. Compliance with applicable laws and regulations regarding personal data may require changes in services, business practices, or internal systems that result in increased costs, lower revenue, reduced efficiency, or greater difficulty in competing with foreign-based firms. Compliance with data regulations might limit our ability to innovate or offer certain features and functionality in some jurisdictions where we operate. Failure to comply with existing or new rules may result in significant penalties or orders to stop the alleged noncompliant activity, as well as negative publicity and diversion of management time and effort.

We may have additional tax liabilities. We are subject to income taxes in the U.S. and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. For example, compliance with the 2017 United States Tax Cuts and Jobs Act ("TCJA") may require the collection of information not regularly produced within the Company, the use of estimates in our consolidated financial statements, and the exercise of significant judgment in accounting for its provisions. As regulations and guidance evolve with respect to the TCJA, and as we gather more information and perform more analysis, our results may differ from previous estimates and may materially affect our consolidated financial statements.

We regularly are under audit by tax authorities in different jurisdictions. Although we believe that our provision for income taxes and our tax estimates are reasonable, tax authorities may disagree with certain positions we have taken. In addition, economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes favorably more difficult. We are currently under Internal Revenue Service audit for prior tax years, with the primary unresolved issues relating to transfer pricing. The final resolution of those audits, and other audits or litigation, may differ from the amounts recorded in our consolidated financial statements and may materially affect our consolidated financial statements in the period or periods in which that determination is made.

We earn a significant amount of our operating income outside the U.S. A change in the mix of earnings and losses in countries with differing statutory tax rates, changes in our business or structure, or the expiration of or disputes about certain tax agreements in a particular country may result in higher effective tax rates for the Company. In addition, changes in U.S. federal and state or international tax laws applicable to corporate multinationals, other fundamental law changes currently being considered by many countries, including in the U.S., and changes in taxing jurisdictions' administrative interpretations, decisions, policies, and positions may materially adversely impact our consolidated financial statements.

If our reputation or our brands are damaged, our business and operating results may be harmed. Our reputation and brands are globally recognized and are important to our business. Our reputation and brands affect our ability to attract and retain consumer, business, and public-sector customers. There are numerous ways our reputation or brands could be damaged. These include product safety or quality issues, or our environmental impact and sustainability, supply chain practices, or human rights record. We may experience backlash from customers, government entities, advocacy groups, employees, and other stakeholders that disagree with our product offering decisions or public policy positions. Damage to our reputation or our brands may occur from, among other things:

- The introduction of new features, products, services, or terms of service that customers, users, or partners do not like.
- Public scrutiny of our decisions regarding user privacy, data practices, or content.
- Data security breaches, compliance failures, or actions of partners or individual employees.

The proliferation of social media may increase the likelihood, speed, and magnitude of negative brand events. If our brands or reputation are damaged, it could negatively impact our revenues or margins, or ability to attract the most highly qualified employees.

Our global business exposes us to operational and economic risks. Our customers are located throughout the world and a significant part of our revenue comes from international sales. The global nature of our business creates operational and economic risks. Our results of operations may be affected by global, regional, and local economic developments, monetary policy, inflation, and recession, as well as political and military disputes. In addition, our international growth strategy includes certain markets, the developing nature of which presents several risks, including deterioration of social, political, labor, or economic conditions in a country or region, and difficulties in staffing and managing foreign operations. Emerging nationalist trends in specific countries may significantly alter the trade environment. Changes to trade policy or agreements as a result of populism, protectionism, or economic nationalism may result in higher tariffs, local sourcing initiatives, or other developments that make it more difficult to sell our products in foreign countries. Disruptions of these kinds in developed or emerging markets could negatively impact demand for our products and services or increase operating costs. Although we hedge a portion of our international currency exposure, significant fluctuations in foreign exchange rates between the U.S. dollar and foreign currencies may adversely affect our results of operations.

Our business with government customers may present additional uncertainties. We derive substantial revenue from government contracts. Government contracts generally can present risks and challenges not present in private commercial agreements. For instance, we may be subject to government audits and investigations relating to these contracts, we could be suspended or debarred as a governmental contractor, we could incur civil and criminal fines and penalties, and under certain circumstances contracts may be rescinded. Some agreements may allow a government to terminate without cause and provide for higher liability limits for certain losses. Some contracts may be subject to periodic funding approval, reductions, or delays which could adversely impact public-sector demand for our products and services. These events could negatively impact our results of operations, financial condition, and reputation**.**

Adverse economic or market conditions may harm our business. Worsening economic conditions, including inflation, recession, pandemic, or other changes in economic conditions, may cause lower IT spending and adversely affect our revenue. If demand for PCs, servers, and other computing devices declines, or consumer or business spending for those products declines, our revenue will be adversely affected.

Our product distribution system relies on an extensive partner and retail network. OEMs building devices that run our software have also been a significant means of distribution. The impact of economic conditions on our partners, such as the bankruptcy of a major distributor, OEM, or retailer, could cause sales channel disruption.

Challenging economic conditions also may impair the ability of our customers to pay for products and services they have purchased. As a result, allowances for doubtful accounts and write-offs of accounts receivable may increase.

We maintain an investment portfolio of various holdings, types, and maturities. These investments are subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by market downturns or events that affect global financial markets. A significant part of our investment portfolio comprises U.S. government securities. If global financial markets decline for long periods, or if there is a downgrade of the U.S. government credit rating due to an actual or threatened default on government debt, our investment portfolio may be adversely affected and we could determine that more of our investments have experienced an other-than-temporary decline in fair value, requiring impairment charges that could adversely affect our consolidated financial statements.

Catastrophic events or geopolitical conditions may disrupt our business. A disruption or failure of our systems or operations because of a major earthquake, weather event, cyberattack, terrorist attack, pandemic, or other catastrophic event could cause delays in completing sales, providing services, or performing other critical functions. Our corporate headquarters, a significant portion of our research and development activities, and certain other essential business operations are in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are seismically active regions. A catastrophic event that results in the destruction or disruption of any of our critical business or IT systems, or the infrastructure or systems they rely on, such as power grids, could harm our ability to conduct normal business operations. Providing our customers with more services and solutions in the cloud puts a premium on the resilience of our systems and strength of our business continuity management plans, and magnifies the potential impact of prolonged service outages in our consolidated financial statements.

Abrupt political change, terrorist activity, and armed conflict pose a risk of general economic disruption in affected countries, which may increase our operating costs. These conditions also may add uncertainty to the timing and budget for technology investment decisions by our customers, and may cause supply chain disruptions for hardware manufacturers. Geopolitical change may result in changing regulatory requirements that could impact our operating strategies, access to global markets, hiring, and profitability. Geopolitical instability may lead to sanctions and impact our ability to do business in some markets or with some public-sector customers. Any of these changes may negatively impact our revenues.

The occurrence of regional epidemics or a global pandemic may adversely affect our operations, financial condition, and results of operations. The COVID-19 pandemic is having widespread, rapidly evolving, and unpredictable impacts on global society, economies, financial markets, and business practices. Federal and state governments have implemented measures in an effort to contain the virus, including social distancing, travel restrictions, border closures, limitations on public gatherings, work from home, supply chain logistical changes, and closure of non-essential businesses. To protect the health and well-being of our employees, suppliers, and customers, we have made substantial modifications to employee travel policies, implemented office closures as employees are advised to work from home, and cancelled or shifted our conferences and other marketing events to virtual-only through fiscal year 2021. The COVID-19 pandemic has impacted and may continue to impact our business operations, including our employees, customers, partners, and communities, and there is substantial uncertainty in the nature and degree of its continued effects over time.

In the third and fourth quarters of fiscal year 2020, we have experienced adverse impacts to our supply chain, a slowdown in transactional licensing, and lower demand for our advertising services. The extent to which the COVID-19 pandemic impacts our business going forward will depend on numerous evolving factors we cannot reliably predict, including the duration and scope of the pandemic; governmental, business, and individuals' actions in response to the pandemic; and the impact on economic activity including the possibility of recession or financial market instability. These factors may adversely impact consumer, business, and government spending on technology as well as customers' ability to pay for our products and services on an ongoing basis. This uncertainty also affects management’s accounting estimates and assumptions, which could result in greater variability in a variety of areas that depend on these estimates and assumptions, including investments, receivables, and forward-looking guidance.

Measures to contain the virus that impact us, our partners, distributors, and suppliers may further intensify these impacts and other risks described in these Risk Factors. Any of these may adversely impact our ability to:

- Maintain our operations infrastructure, including the reliability and adequate capacity of cloud services.
- Satisfy our contractual and regulatory compliance obligations as we adapt to changing usage patterns, such as through datacenter load balancing.
- Ensure a high-quality and consistent supply chain and manufacturing operations for our hardware devices and datacenter operations.
- Effectively manage our international operations through changes in trade practices and policies.
- Hire and deploy people where we most need them.
- Sustain the effectiveness and productivity of our operations including our sales, marketing, engineering, and distribution functions.

We may incur increased costs to effectively manage these aspects of our business. If we are unsuccessful it may adversely impact our revenues, cash flows, market share growth, and reputation.

The long-term effects of climate change on the global economy and the IT industry in particular are unclear. Environmental regulations or changes in the supply, demand or available sources of energy or other resources may affect the availability or cost of goods and services, including natural resources, necessary to run our business. Changes in climate where we operate may increase the costs of powering and cooling computer hardware we use to develop software and provide cloud-based services.

Our business depends on our ability to attract and retain talented employees. Our business is based on successfully attracting and retaining talented employees representing diverse backgrounds, experiences, and skill sets. The market for highly skilled workers and leaders in our industry is extremely competitive. Maintaining our brand and reputation, as well as a diverse and inclusive work environment that enables all our employees to thrive, are important to our ability to recruit and retain employees. We are also limited in our ability to recruit internationally by restrictive domestic immigration laws. Changes to U.S. immigration policies that restrain the flow of technical and professional talent may inhibit our ability to adequately staff our research and development efforts. If we are less successful in our recruiting efforts, or if we cannot retain highly skilled workers and key leaders, our ability to develop and deliver successful products and services may be adversely affected. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees could hinder our strategic planning and execution. How employment-related laws are interpreted and applied to our workforce practices may result in increased operating costs and less flexibility in how we meet our workforce needs.

ITEM 1B. UNRESOLVED STAFF COMMENTS

We have received no written comments regarding our periodic or current reports from the staff of the Securities and Exchange Commission that were issued 180 days or more preceding the end of our fiscal year 2020 that remain unresolved.

ITEM 2. PROPERTIES

Our corporate headquarters are located in Redmond, Washington. We have approximately 15 million square feet of space located in King County, Washington that is used for engineering, sales, marketing, and operations, among other general and administrative purposes. These facilities include approximately 10 million square feet of owned space situated on approximately 520 acres of land we own at our corporate headquarters, and approximately five million square feet of space we lease. In addition, we own and lease space domestically that includes office, datacenter, and retail space.

We also own and lease facilities internationally. The largest owned properties include: our research and development centers in China and India; our datacenters in Ireland, the Netherlands, and Singapore; and our operations and facilities in Ireland and the United Kingdom. The largest leased properties include space in the following locations: Australia, Canada, China, France, Germany, India, Israel, Japan, Netherlands, and the United Kingdom.

In addition to the above locations, we have various product development facilities, both domestically and internationally, as described under Research and Development (Part I, Item 1 of this Form 10-K).

The table below shows a summary of the square footage of our office, datacenter, retail, and other facilities owned and leased domestically and internationally as of June 30, 2020:

(Square feet in millions)

Location	Owned	Leased	Total
U.S.	**20**	**14**	**34**
International	**7**	**16**	**23**
Total	**27**	**30**	**57**

ITEM 3. LEGAL PROCEEDINGS

While not material to the Company, the Company makes the following annual report of the general activities of the Company’s Antitrust Compliance Office as required by the Final Order and Judgment in *Barovic v. Ballmer et al,* United States District Court for the Western District of Washington (“Final Order”). For more information see http://aka.ms/MSLegalNotice2015. This will be the last annual report under the Final Order. During fiscal year 2020, the Antitrust Compliance Office (a) monitored the Company’s compliance with the European Commission Decision of March 24, 2004, (“2004 Decision”) and with the Company’s Public Undertaking to the European Commission dated December 16, 2009 (“2009 Undertaking”); (b) monitored, in the manner required by the Final Order, employee, customer, competitor, regulator, or other third-party complaints regarding compliance with the 2004 Decision, the 2009 Undertaking, or other EU or U.S. laws or regulations governing tying, bundling, and exclusive dealing contracts; and, (c) monitored, in the manner required by the Final Order, the training of the Company’s employees regarding the Company’s antitrust compliance polices. In addition, the Antitrust Compliance Officer reports to the Regulatory and Public Policy Committee of the Board at each of its regularly scheduled meetings and to the full Board annually.

Refer to Note 15 – Contingencies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for information regarding legal proceedings in which we are involved.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

MARKET AND STOCKHOLDERS

Our common stock is traded on the NASDAQ Stock Market under the symbol MSFT. On July 27, 2020, there were 91,674 registered holders of record of our common stock.

SHARE REPURCHASES AND DIVIDENDS

Following are our monthly share repurchases for the fourth quarter of fiscal year 2020:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs
				(In millions)
April 1, 2020 – April 30, 2020	**8,906,563**	**$ 165.90**	**8,906,563**	**$ 35,323**
May 1, 2020 – May 31, 2020	**9,655,700**	**182.31**	**9,655,700**	**33,563**
June 1, 2020 – June 30, 2020	**9,648,400**	**191.80**	**9,648,400**	**31,712**
	28,210,663		**28,210,663**	

All share repurchases were made using cash resources. Our share repurchases may occur through open market purchases or pursuant to a Rule 10b5-1 trading plan. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards.

Our Board of Directors declared the following dividends during the fourth quarter of fiscal year 2020:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
June 17, 2020	**August 20, 2020**	**September 10, 2020**	**$ 0.51**	**$ 3,861**

We returned $8.9 billion to shareholders in the form of share repurchases and dividends in the fourth quarter of fiscal year 2020. Refer to Note 16 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion regarding share repurchases and dividends.

ITEM 6. SELECTED FINANCIAL DATA

FINANCIAL HIGHLIGHTS

(In millions, except per share amounts)

Year Ended June 30,	**2020**	**2019**(a)	**2018**	**2017**(d)(e)	**2016**(d)
Revenue	**$ 143,015**	$ 125,843	$ 110,360	$ 96,571	$ 91,154
Gross margin	**96,937**	82,933	72,007	62,310	58,374
Operating income	**52,959**	42,959	35,058	29,025(f)	26,078(g)
Net income	**44,281**	39,240(b)	16,571(c)	25,489(f)	20,539(g)
Diluted earnings per share	**5.76**	5.06(b)	2.13(c)	3.25(f)	2.56(g)
Cash dividends declared per common share	**2.04**	1.84	1.68	1.56	1.44
Cash, cash equivalents, and short-term investments	**136,527**	133,819	133,768	132,981	113,240
Total assets	**301,311**	286,556	258,848	250,312	202,897
Long-term obligations	**110,697**	114,806	117,642	106,856	66,705
Stockholders' equity	**118,304**	102,330	82,718	87,711	83,090

(a) *GitHub has been included in our consolidated results of operations starting on the October 25, 2018 acquisition date*.

(b) *Includes a $2.6 billion net income tax benefit related to intangible property transfers and a $157 million net charge related to the enactment of the Tax Cuts and Jobs Act ("TCJA"), which together increased net income and diluted earnings per share ("EPS") by $2.4 billion and $0.31, respectively. Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.*

(c) *Includes a $13.7 billion net charge related to the enactment of the TCJA, which decreased net income and diluted EPS by $13.7 billion and $1.75, respectively. Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.*

(d) *Reflects the impact of the adoption of new accounting standards in fiscal year 2018 related to revenue recognition and leases.*

(e) *LinkedIn has been included in our consolidated results of operations starting on the December 8, 2016 acquisition date.*

(f) *Includes $306 million of employee severance expenses primarily related to our sales and marketing restructuring plan, which decreased operating income, net income, and diluted EPS by $306 million, $243 million, and $0.04, respectively.*

(g) *Includes $630 million of asset impairment charges related to our Phone business and $480 million of restructuring charges associated with our Phone business restructuring plans, which together decreased operating income, net income, and diluted EPS by $1.1 billion, $895 million, and $0.11, respectively.*

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the results of operations and financial condition of Microsoft Corporation. MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity.

We generate revenue by offering a wide range of cloud-based and other services to people and businesses; licensing and supporting an array of software products; designing, manufacturing, and selling devices; and delivering relevant online advertising to a global audience. Our most significant expenses are related to compensating employees; designing, manufacturing, marketing, and selling our products and services; datacenter costs in support of our cloud-based services; and income taxes.

As the world responds to the outbreak of a novel strain of the coronavirus ("COVID-19"), we are working to do our part by ensuring the safety of our employees, striving to protect the health and well-being of the communities in which we operate, and providing technology and resources to our customers to help them do their best work while remote.

Highlights from fiscal year 2020 compared with fiscal year 2019 included:

- Commercial cloud revenue increased 36% to $51.7 billion.
- Office Commercial products and cloud services revenue increased 12%, driven by Office 365 Commercial growth of 24%.
- Office Consumer products and cloud services revenue increased 11%, with continued growth in Office 365 Consumer subscribers to 42.7 million.
- LinkedIn revenue increased 20%.
- Dynamics products and cloud services revenue increased 14%, driven by Dynamics 365 growth of 42%.
- Server products and cloud services revenue increased 27%, driven by Azure growth of 56%.
- Enterprise Services revenue increased 5%.
- Windows Commercial products and cloud services revenue increased 18%.
- Windows original equipment manufacturer licensing ("Windows OEM") revenue increased 9%.
- Surface revenue increased 8%.
- Xbox content and services revenue increased 11%.
- Search advertising revenue, excluding traffic acquisition costs, was relatively unchanged.

Industry Trends

Our industry is dynamic and highly competitive, with frequent changes in both technologies and business models. Each industry shift is an opportunity to conceive new products, new technologies, or new ideas that can further transform the industry and our business. At Microsoft, we push the boundaries of what is possible through a broad range of research and development activities that seek to identify and address the changing demands of customers and users, industry trends, and competitive forces.

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, and influence how users access services in the cloud, and in some cases, the user's choice of which suite of cloud-based services to use. We must continue to evolve and adapt over an extended time in pace with this changing environment. The investments we are making in infrastructure and devices will continue to increase our operating costs and may decrease our operating margins.

Our success is highly dependent on our ability to attract and retain qualified employees. We hire a mix of university and industry talent worldwide. We compete for talented individuals globally by offering an exceptional working environment, broad customer reach, scale in resources, the ability to grow one's career across many different products and businesses, and competitive compensation and benefits. Aggregate demand for our software, services, and devices is correlated to global macroeconomic and geopolitical factors, which remain dynamic.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. Strengthening of the U.S. dollar relative to certain foreign currencies did not significantly impact reported revenue or expenses from our international operations in the first and second quarters of fiscal year 2019, and reduced reported revenue and expenses from our international operations in the third and fourth quarters of fiscal year 2019. Strengthening of the U.S. dollar relative to certain foreign currencies reduced reported revenue and expenses from our international operations in fiscal year 2020.

Refer to Risk Factors (Part I, Item 1A of this Form 10-K) for a discussion of these factors and other risks.

COVID-19

In fiscal year 2020, the COVID-19 pandemic impacted our business operations, including our employees, customers, partners, and communities, and we saw the following trends in our financial operating results. In the Productivity and Business Processes and Intelligent Cloud segments, cloud usage and demand increased as customers shifted to work and learn from home. We also experienced a slowdown in transactional licensing, particularly in small and medium businesses, and LinkedIn was negatively impacted by the weak job market and reductions in advertising spend. In the More Personal Computing segment, Windows OEM, Surface, and Gaming benefited from increased demand to support remote work-, play-, and learn-from-home scenarios, while Search was negatively impacted by reductions in advertising spend. The COVID-19 pandemic may continue to impact our business operations and financial operating results, and there is substantial uncertainty in the nature and degree of its continued effects over time.

The extent to which the COVID-19 pandemic impacts our business going forward will depend on numerous evolving factors we cannot reliably predict, including the duration and scope of the pandemic; governmental, business, and individuals' actions in response to the pandemic; and the impact on economic activity including the possibility of recession or financial market instability. These factors may adversely impact consumer, business, and government spending on technology as well as customers' ability to pay for our products and services on an ongoing basis. This uncertainty also affects management's accounting estimates and assumptions, which could result in greater variability in a variety of areas that depend on these estimates and assumptions, including investments, receivables, and forward-looking guidance. Refer to Risk Factors (Part I, Item 1A of this Form 10-K) for a discussion of these factors and other risks.

Seasonality

Our revenue fluctuates quarterly and is generally higher in the second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.

Reportable Segments

We report our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. The segment amounts included in MD&A are presented on a basis consistent with our internal management reporting. All differences between our internal management reporting basis and accounting principles generally accepted in the United States of America ("GAAP"), along with certain corporate-level and other activity, are included in Corporate and Other.

Additional information on our reportable segments is contained in Note 19 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

Metrics

We use metrics in assessing the performance of our business and to make informed decisions regarding the allocation of resources. We disclose metrics to enable investors to evaluate progress against our ambitions, provide transparency into performance trends, and reflect the continued evolution of our products and services. Our commercial and other business metrics are fundamentally connected based on how customers use our products and services. The metrics are disclosed in the MD&A or the Notes to Financial Statements (Part II, Item 8 of this Form 10-K). Financial metrics are calculated based on GAAP results and growth comparisons relate to the corresponding period of last fiscal year.

Commercial

Our commercial business primarily consists of Server products and cloud services, Office Commercial, Windows Commercial, the commercial portion of LinkedIn, Enterprise Services, and Dynamics. Our commercial metrics allow management and investors to assess the overall health of our commercial business and include leading indicators of future performance.

Commercial remaining performance obligation	Commercial portion of revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods
Commercial cloud revenue	Revenue from our commercial cloud business, which includes Office 365 Commercial, Azure, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties
Commercial cloud gross margin percentage	Gross margin percentage for our commercial cloud business

Productivity and Business Processes and Intelligent Cloud

Metrics related to our Productivity and Business Processes and Intelligent Cloud segments assess the health of our core businesses within these segments. The metrics reflect our cloud and on-premises product strategies and trends.

Office Commercial products and cloud services revenue growth	Revenue from Office Commercial products and cloud services, including Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises, comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Skype for Business, and related Client Access Licenses (“CALs”)
Office Consumer products and cloud services revenue growth	Revenue from Office Consumer products and cloud services, including Microsoft 365 Consumer (formerly Office 365 Consumer) subscriptions and Office licensed on-premises
Office 365 Commercial seat growth	The number of Office 365 Commercial seats at end of period where seats are paid users covered by an Office 365 Commercial subscription
Office 365 Consumer subscribers	The number of Office 365 Consumer subscribers at end of period
Dynamics products and cloud services revenue growth	Revenue from Dynamics products and cloud services, including Dynamics 365, a set of cloud-based applications across ERP and CRM, Dynamics ERP on-premises, and Dynamics CRM on-premises
LinkedIn revenue growth	Revenue from LinkedIn, including Talent Solutions, Learning Solutions, Marketing Solutions, Sales Solutions, and Premium Subscriptions
Server products and cloud services revenue growth	Revenue from Server products and cloud services, including Azure; SQL Server, Windows Server, Visual Studio, System Center, and related CALs; and GitHub
Enterprise Services revenue growth	Revenue from Enterprise Services, including Premier Support Services and Microsoft Consulting Services

More Personal Computing

Metrics related to our More Personal Computing segment assess the performance of key lines of business within this segment. These metrics provide strategic product insights which allow us to assess the performance across our commercial and consumer businesses. As we have diversity of target audiences and sales motions within the Windows business, we monitor metrics that are reflective of those varying motions.

Windows OEM Pro revenue growth	Revenue from sales of Windows Pro licenses sold through the OEM channel, which primarily addresses demand in the commercial market
Windows OEM non-Pro revenue growth	

	Revenue from sales of Windows non-Pro licenses sold through the OEM channel, which primarily addresses demand in the consumer market
Windows Commercial products and cloud services revenue growth	Revenue from Windows Commercial products and cloud services, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings
Surface revenue	Revenue from Surface devices and accessories
Xbox content and services revenue growth	Revenue from Xbox content and services, comprising Xbox Live (transactions, subscriptions, cloud services, and advertising), video games, and third-party video game royalties
Search advertising revenue, excluding TAC, growth	Revenue from search advertising excluding traffic acquisition costs ("TAC") paid to Bing Ads network publishers

SUMMARY RESULTS OF OPERATIONS

(In millions, except percentages and per share amounts)	2020	2019	2018	Percentage Change 2020 Versus 2019	Percentage Change 2019 Versus 2018
Revenue	**$ 143,015**	$ 125,843	$ 110,360	14%	14%
Gross margin	**96,937**	82,933	72,007	17%	15%
Operating income	**52,959**	42,959	35,058	23%	23%
Net income	**44,281**	39,240	16,571	13%	137%
Diluted earnings per share	**5.76**	5.06	2.13	14%	138%
Non-GAAP net income	**44,281**	36,830	30,267	20%	22%
Non-GAAP diluted earnings per share	**5.76**	4.75	3.88	21%	22%

Non-GAAP net income and diluted earnings per share (“EPS”) exclude the net tax impact of transfer of intangible properties in fiscal year 2019 and the net tax impact of the Tax Cuts and Jobs Act (“TCJA”) in fiscal years 2019 and 2018. Refer to the Non-GAAP Financial Measures section below for a reconciliation of our financial results reported in accordance with GAAP to non-GAAP financial results.

Fiscal Year 2020 Compared with Fiscal Year 2019

Revenue increased $17.2 billion or 14%, driven by growth across each of our segments. Intelligent Cloud revenue increased, driven by server products and cloud services. Productivity and Business Processes revenue increased, driven by Office Commercial and LinkedIn. More Personal Computing revenue increased, driven by Windows and Surface.

Gross margin increased $14.0 billion or 17%, driven by growth across each of our segments. Gross margin percentage increased, driven by sales mix shift to higher margin businesses. Commercial cloud gross margin percentage increased 4 points to 67%, primarily driven by improvement in Azure.

Operating income increased $10.0 billion or 23%, driven by growth across each of our segments.

Key changes in expenses were:

- Cost of revenue increased $3.2 billion or 7%, driven by growth in commercial cloud.
- Research and development expenses increased $2.4 billion or 14%, driven by investments in cloud engineering, LinkedIn, Devices, and Gaming.
- Sales and marketing expenses increased $1.4 billion or 8%, driven by investments in LinkedIn and commercial sales, and an increase in bad debt expense.
- General and administrative expenses increased $226 million or 5%, driven by charges associated with the closing of our Microsoft Store physical locations, offset in part by a reduction in business taxes and legal expenses.

Gross margin and operating income included an unfavorable foreign currency impact of 2% and 4%, respectively.

Prior year net income included a $2.6 billion net income tax benefit related to intangible property transfers and a $157 million net charge related to the enactment of the TCJA, which together resulted in an increase to net income and diluted EPS of $2.4 billion and $0.31, respectively.

Fiscal Year 2019 Compared with Fiscal Year 2018

Revenue increased $15.5 billion or 14%, driven by growth across each of our segments. Intelligent Cloud revenue increased, driven by server products and cloud services. Productivity and Business Processes revenue increased, driven by Office and LinkedIn. More Personal Computing revenue increased, driven by Surface, Gaming, and Windows.

Gross margin increased $10.9 billion or 15%, driven by growth across each of our segments. Gross margin percentage increased slightly, due to gross margin percentage improvement across each of our segments and favorable segment sales mix. Gross margin included a 5 percentage point improvement in commercial cloud, primarily from Azure.

Operating income increased $7.9 billion or 23%, driven by growth across each of our segments.

Key changes in expenses were:

- Cost of revenue increased $4.6 billion or 12%, driven by growth in commercial cloud, Surface, and Gaming.
- Research and development expenses increased $2.2 billion or 15%, driven by investments in cloud and artificial intelligence ("AI") engineering, Gaming, LinkedIn, and GitHub.
- Sales and marketing expenses increased $744 million or 4%, driven by investments in commercial sales capacity, LinkedIn, and GitHub, offset in part by a decrease in marketing. Sales and marketing expenses included a favorable foreign currency impact of 2%.

Fiscal year 2019 net income included a $2.6 billion net income tax benefit related to intangible property transfers and a $157 million net charge related to the enactment of the TCJA, which together resulted in an increase to net income and diluted EPS of $2.4 billion and $0.31, respectively. Fiscal year 2018 net income and diluted EPS were negatively impacted by the net charge related to the enactment of the TCJA, which resulted in a decrease to net income and diluted EPS of $13.7 billion and $1.75, respectively.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	2020	2019	2018	Percentage Change 2020 Versus 2019	Percentage Change 2019 Versus 2018
Revenue					
Productivity and Business Processes	**$ 46,398**	$ 41,160	$ 35,865	13%	15%
Intelligent Cloud	**48,366**	38,985	32,219	24%	21%
More Personal Computing	**48,251**	45,698	42,276	6%	8%
Total	**$ 143,015**	$ 125,843	$ 110,360	14%	14%
Operating Income					
Productivity and Business Processes	**$ 18,724**	$ 16,219	$ 12,924	15%	25%
Intelligent Cloud	**18,324**	13,920	11,524	32%	21%
More Personal Computing	**15,911**	12,820	10,610	24%	21%
Total	**$ 52,959**	$ 42,959	$ 35,058	23%	23%

Reportable Segments

Fiscal Year 2020 Compared with Fiscal Year 2019

Productivity and Business Processes

Revenue increased $5.2 billion or 13%.

- Office Commercial products and cloud services revenue increased $3.1 billion or 12%, driven by Office 365 Commercial, offset in part by lower revenue from products licensed on-premises, reflecting a continued shift to cloud offerings. Office 365 Commercial revenue grew 24%, due to seat growth and higher revenue per user.
- Office Consumer products and cloud services revenue increased $458 million or 11%, driven by Microsoft 365 Consumer subscription revenue and transactional strength in Japan. Office 365 Consumer subscribers increased 23% to 42.7 million with increased demand from remote work and learn scenarios.
- LinkedIn revenue increased $1.3 billion or 20%, driven by growth across all businesses.
- Dynamics products and cloud services revenue increased 14%, driven by Dynamics 365 growth of 42%.

Operating income increased $2.5 billion or 15%.

- Gross margin increased $4.1 billion or 13%, driven by growth in Office Commercial and LinkedIn. Gross margin percentage was relatively unchanged, due to gross margin percentage improvement in LinkedIn, offset in part by an increased mix of cloud offerings.
- Operating expenses increased $1.6 billion or 11%, driven by investments in LinkedIn and cloud engineering.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 2%, 2%, and 4%, respectively.

Intelligent Cloud

Revenue increased $9.4 billion or 24%.

- Server products and cloud services revenue increased $8.8 billion or 27%, driven by Azure. Azure revenue grew 56%, due to growth in our consumption-based services. Server products revenue increased 8%, due to hybrid and premium solutions, as well as demand related to SQL Server 2008 and Windows Server 2008 end of support.
- Enterprise Services revenue increased $285 million or 5%, driven by growth in Premier Support Services.

Operating income increased $4.4 billion or 32%.

- Gross margin increased $6.9 billion or 26%, driven by growth in server products and cloud services revenue and cloud services scale and efficiencies. Gross margin percentage increased slightly, due to gross margin percentage improvement in Azure, offset in part by an increased mix of cloud offerings.
- Operating expenses increased $2.5 billion or 19%, driven by investments in Azure.

Revenue, gross margin, and operating income included an unfavorable foreign currency impact of 2%, 2%, and 4%, respectively.

More Personal Computing

Revenue increased $2.6 billion or 6%.

- Windows revenue increased $1.9 billion or 9%, driven by growth in Windows Commercial and Windows OEM. Windows Commercial products and cloud services revenue increased 18%, driven by increased demand for Microsoft 365. Windows OEM revenue increased 9%, ahead of PC market growth. Windows OEM Pro revenue grew 11%, driven by Windows 7 end of support and healthy Windows 10 demand, offset in part by weakness in small and medium businesses. Windows OEM non-Pro revenue grew 5%, driven by consumer demand from remote work and learn scenarios.
- Surface revenue increased $457 million or 8%, driven by increased demand from remote work and learn scenarios.
- Gaming revenue increased $189 million or 2%, driven by an increase in Xbox content and services, offset in part by a decrease in Xbox hardware. Xbox content and services revenue increased $943 million or 11% on a strong prior year comparable, driven by growth in Minecraft, third-party titles, and subscriptions, accelerated by higher engagement during stay-at-home guidelines. Xbox hardware revenue declined 31%, primarily due to a decrease in volume and price of consoles sold.
- Search advertising revenue increased $112 million or 1%. Search advertising revenue, excluding traffic acquisition costs, was relatively unchanged.

Operating income increased $3.1 billion or 24%.

- Gross margin increased $3.0 billion or 12%, driven by growth in Windows, Gaming, and Surface. Gross margin percentage increased, due to sales mix shift to higher margin businesses and gross margin percentage improvement in Gaming.
-

Operating expenses decreased $119 million or 1%, driven by the redeployment of engineering resources, offset in part by charges associated with the closing of our Microsoft Store physical locations and investments in Gaming.

Gross margin and operating income included an unfavorable foreign currency impact of 2% and 3%, respectively.

Fiscal Year 2019 Compared with Fiscal Year 2018

Productivity and Business Processes

Revenue increased $5.3 billion or 15%.

- Office Commercial products and cloud services revenue increased $3.2 billion or 13%, driven by Office 365 Commercial, offset in part by lower revenue from products licensed on-premises, reflecting a continued shift to cloud offerings. Office 365 Commercial grew 33%, due to growth in seats and higher average revenue per user.
- Office Consumer products and cloud services revenue increased $286 million or 7%, driven by Microsoft 365 Consumer, due to recurring subscription revenue and transactional strength in Japan.
- LinkedIn revenue increased $1.5 billion or 28%, driven by growth across each line of business.
- Dynamics products and cloud services revenue increased 15%, driven by Dynamics 365 growth.

Operating income increased $3.3 billion or 25%, including an unfavorable foreign currency impact of 2%.

- Gross margin increased $4.1 billion or 15%, driven by growth in Office Commercial and LinkedIn. Gross margin percentage increased slightly, due to gross margin percentage improvement in LinkedIn and Office 365 Commercial, offset in part by an increased mix of cloud offerings.
- Operating expenses increased $806 million or 6%, driven by investments in LinkedIn and cloud engineering, offset in part by a decrease in marketing.

Intelligent Cloud

Revenue increased $6.8 billion or 21%.

- Server products and cloud services revenue, including GitHub, increased $6.5 billion or 25%, driven by Azure. Azure revenue growth was 72%, due to higher infrastructure-as-a-service and platform-as-a-service consumption-based and per user-based services. Server products revenue increased 6%, due to continued demand for premium versions and hybrid solutions, GitHub, and demand ahead of end-of-support for SQL Server 2008 and Windows Server 2008.
- Enterprise Services revenue increased $278 million or 5%, driven by growth in Premier Support Services and Microsoft Consulting Services.

Operating income increased $2.4 billion or 21%.

- Gross margin increased $4.8 billion or 22%, driven by growth in server products and cloud services revenue and cloud services scale and efficiencies. Gross margin percentage increased slightly, due to gross margin percentage improvement in Azure, offset in part by an increased mix of cloud offerings.
- Operating expenses increased $2.4 billion or 22%, driven by investments in cloud and AI engineering, GitHub, and commercial sales capacity.

More Personal Computing

Revenue increased $3.4 billion or 8%.

- Windows revenue increased $877 million or 4%, driven by growth in Windows Commercial and Windows OEM, offset in part by a decline in patent licensing. Windows Commercial products and cloud services revenue increased 14%, driven by an increased mix of multi-year agreements that carry higher in-quarter revenue recognition. Windows OEM revenue increased 4%. Windows OEM Pro revenue grew 10%, ahead of the commercial PC market, driven by healthy Windows 10 demand. Windows OEM non-Pro revenue declined 7%, below the consumer PC market, driven by continued pressure in the entry level category.

- Surface revenue increased $1.1 billion or 23%, with strong growth across commercial and consumer.

- Gaming revenue increased $1.0 billion or 10%, driven by Xbox software and services growth of 19%, primarily due to third-party title strength and subscriptions growth, offset in part by a decline in Xbox hardware of 13% primarily due to a decrease in volume of consoles sold.
- Search advertising revenue increased $616 million or 9%. Search advertising revenue, excluding traffic acquisition costs, increased 13%, driven by higher revenue per search.

Operating income increased $2.2 billion or 21%, including an unfavorable foreign currency impact of 2%.

- Gross margin increased $2.0 billion or 9%, driven by growth in Windows, Gaming, and Search. Gross margin percentage increased slightly, due to sales mix shift to higher gross margin businesses in Windows and Gaming.
- Operating expenses decreased $172 million or 1%.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)	2020	2019	2018	Percentage Change 2020 Versus 2019	Percentage Change 2019 Versus 2018
Research and development	**$ 19,269**	$ 16,876	$ 14,726	14%	15%
As a percent of revenue	**13%**	13%	13%	0ppt	0ppt

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content.

Fiscal Year 2020 Compared with Fiscal Year 2019

Research and development expenses increased $2.4 billion or 14%, driven by investments in cloud engineering, LinkedIn, Devices, and Gaming.

Fiscal Year 2019 Compared with Fiscal Year 2018

Research and development expenses increased $2.2 billion or 15%, driven by investments in cloud and AI engineering, Gaming, LinkedIn, and GitHub.

Sales and Marketing

(In millions, except percentages)	2020	2019	2018	Percentage Change 2020 Versus 2019	Percentage Change 2019 Versus 2018
Sales and marketing	**$ 19,598**	$ 18,213	$ 17,469	8%	4%
As a percent of revenue	**14%**	14%	16%	0ppt	(2)ppt

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs.

Fiscal Year 2020 Compared with Fiscal Year 2019

Sales and marketing expenses increased $1.4 billion or 8%, driven by investments in LinkedIn and commercial sales, and an increase in bad debt expense.

Fiscal Year 2019 Compared with Fiscal Year 2018

Sales and marketing expenses increased $744 million or 4%, driven by investments in commercial sales capacity, LinkedIn, and GitHub, offset in part by a decrease in marketing. Expenses included a favorable foreign currency impact of 2%.

General and Administrative

(In millions, except percentages)	2020	2019	2018	Percentage Change 2020 Versus 2019	Percentage Change 2019 Versus 2018
General and administrative	**$ 5,111**	$ 4,885	$ 4,754	5%	3%
As a percent of revenue	**4%**	4%	4%	0ppt	0ppt

General and administrative expenses include payroll, employee benefits, stock-based compensation expense, severance expense, and other headcount-related expenses associated with finance, legal, facilities, certain human resources and other administrative personnel, certain taxes, and legal and other administrative fees.

Fiscal Year 2020 Compared with Fiscal Year 2019

General and administrative expenses increased $226 million or 5%, driven by charges associated with the closing of our Microsoft Store physical locations, offset in part by a reduction in business taxes and legal expenses.

Fiscal Year 2019 Compared with Fiscal Year 2018

General and administrative expenses increased $131 million or 3%.

OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)

Year Ended June 30,	2020	2019	2018
Interest and dividends income	**$ 2,680**	$ 2,762	$ 2,214
Interest expense	**(2,591)**	(2,686)	(2,733)
Net recognized gains on investments	**32**	648	2,399
Net gains (losses) on derivatives	**187**	144	(187)
Net losses on foreign currency remeasurements	**(191)**	(82)	(218)
Other, net	**(40)**	(57)	(59)
Total	**$ 77**	$ 729	$ 1,416

We use derivative instruments to: manage risks related to foreign currencies, equity prices, interest rates, and credit; enhance investment returns; and facilitate portfolio diversification. Gains and losses from changes in fair values of derivatives that are not designated as hedging instruments are primarily recognized in other income (expense), net.

Fiscal Year 2020 Compared with Fiscal Year 2019

Interest and dividends income decreased due to lower yields, offset in part by higher average portfolio balances on fixed-income securities. Interest expense decreased due to capitalization of interest expense and a decrease in outstanding long-term debt due to debt maturities, offset in part by debt exchange transaction fees and higher finance lease expense. Net recognized gains on investments decreased due to lower gains and higher other-than-temporary impairments on equity investments, offset in part by gains on fixed income securities in the current period compared to losses in the prior period. Net gains on derivatives increased due to higher gains on foreign exchange and equity derivatives.

Fiscal Year 2019 Compared with Fiscal Year 2018

Interest and dividends income increased primarily due to higher yields on fixed-income securities. Interest expense decreased primarily driven by a decrease in outstanding long-term debt due to debt maturities, offset in part by higher finance lease expense. Net recognized gains on investments decreased primarily due to lower gains on sales of equity investments. Net gains on derivatives includes gains on foreign exchange and interest rate derivatives in the current period as compared to losses in the prior period.

INCOME TAXES

Effective Tax Rate

Fiscal Year 2020 Compared with Fiscal Year 2019

Our effective tax rate for fiscal years 2020 and 2019 was 17% and 10%, respectively. The increase in our effective tax rate for fiscal year 2020 compared to fiscal year 2019 was primarily due to a $2.6 billion net income tax benefit in the fourth quarter of fiscal year 2019 related to intangible property transfers. Our effective tax rate was lower than the U.S. federal statutory rate, primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland and Puerto Rico, and tax benefits relating to stock-based compensation.

The mix of income before income taxes between the U.S. and foreign countries impacted our effective tax rate as a result of the geographic distribution of, and customer demand for, our products and services. In fiscal year 2020, our U.S. income before income taxes was $24.1 billion and our foreign income before income taxes was $28.9 billion. In fiscal year 2019, our U.S. income before income taxes was $15.8 billion and our foreign income before income taxes was $27.9 billion.

Fiscal Year 2019 Compared with Fiscal Year 2018

Our effective tax rate for fiscal years 2019 and 2018 was 10% and 55%, respectively. The decrease in our effective tax rate for fiscal year 2019 compared to fiscal year 2018 was primarily due to the net charge related to the enactment of the TCJA in the second quarter of fiscal year 2018 and a $2.6 billion net income tax benefit in the fourth quarter of fiscal year 2019 related to intangible property transfers. Our effective tax rate was lower than the U.S. federal statutory rate, primarily due to the tax benefit related to intangible property transfers, and earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland, Singapore, and Puerto Rico.

The mix of income before income taxes between the U.S. and foreign countries impacted our effective tax rate as a result of the geographic distribution of, and customer demand for, our products and services. In fiscal year 2019, our U.S. income before income taxes was $15.8 billion and our foreign income before income taxes was $27.9 billion. In fiscal year 2018, our U.S. income before income taxes was $11.5 billion and our foreign income before income taxes was $24.9 billion.

Tax Cuts and Jobs Act

On December 22, 2017, the TCJA was enacted into law, which significantly changed existing U.S. tax law and included numerous provisions that affect our business. We recorded a provisional net charge of $13.7 billion related to the enactment of the TCJA in fiscal year 2018, and adjusted the provisional net charge by recording additional tax expense of $157 million in fiscal year 2019 pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 118.

In fiscal year 2019, in response to the TCJA and recently issued regulations, we transferred certain intangible properties held by our foreign subsidiaries to the U.S. and Ireland. The transfers of intangible properties resulted in a $2.6 billion net income tax benefit recorded in the fourth quarter of fiscal year 2019, as the value of future tax deductions exceeded the current tax liability from foreign jurisdictions and U.S. global intangible low-taxed income tax.

Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Uncertain Tax Positions

We settled a portion of the Internal Revenue Service (“IRS”) audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. We remain under audit for tax years 2004 to 2013. In April 2020, the IRS commenced the audit for tax years 2014 to 2017.

As of June 30, 2020, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2019, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NON-GAAP FINANCIAL MEASURES

Non-GAAP net income and diluted EPS are non-GAAP financial measures which exclude the net tax impact of transfer of intangible properties in fiscal year 2019 and the net tax impact of the TCJA in fiscal years 2019 and 2018. We believe these non-GAAP measures aid investors by providing additional insight into our operational performance and help clarify trends affecting our business. For comparability of reporting, management considers non-GAAP measures in conjunction with GAAP financial results in evaluating business performance. These non-GAAP financial measures presented should not be considered a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP.

The following table reconciles our financial results reported in accordance with GAAP to non-GAAP financial results:

(In millions, except percentages and per share amounts)	2020	2019	2018	Percentage Change 2020 Versus 2019	Percentage Change 2019 Versus 2018
Net income	**$ 44,281**	$ 39,240	$ 16,571	13%	137%
Net tax impact of transfer of intangible properties	**0**	(2,567)	0	*	*
Net tax impact of the TCJA	**0**	157	13,696	*	*
Non-GAAP net income	**$ 44,281**	$ 36,830	$ 30,267	20%	22%
Diluted earnings per share	**$ 5.76**	$ 5.06	$ 2.13	14%	138%
Net tax impact of transfer of intangible properties	**0**	(0.33)	0	*	*
Net tax impact of the TCJA	**0**	0.02	1.75	*	*
Non-GAAP diluted earnings per share	**$ 5.76**	$ 4.75	$ 3.88	21%	22%

* *Not meaningful.*

FINANCIAL CONDITION

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $136.5 billion and $133.8 billion as of June 30, 2020 and 2019. Equity investments were $3.0 billion and $2.6 billion as of June 30, 2020 and 2019, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Valuation

In general, and where applicable, we use quoted prices in active markets for identical assets or liabilities to determine the fair value of our financial instruments. This pricing methodology applies to our Level 1 investments, such as U.S. government securities, common and preferred stock, and mutual funds. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then we use quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. This pricing methodology applies to our Level 2 investments, such as commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Level 3 investments are valued using internally-developed models with unobservable inputs. Assets and liabilities measured at fair value on a recurring basis using unobservable inputs are an immaterial portion of our portfolio.

A majority of our investments are priced by pricing vendors and are generally Level 1 or Level 2 investments as these vendors either provide a quoted market price in an active market or use observable inputs for their pricing without applying significant adjustments. Broker pricing is used mainly when a quoted price is not available, the investment is not priced by our pricing vendors, or when a broker price is more reflective of fair values in the market in which the investment trades. Our broker-priced investments are generally classified as Level 2 investments because the broker prices these investments based on similar assets without applying significant adjustments. In addition, all our broker-priced investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments. Our fair value processes include controls that are designed to ensure appropriate fair values are recorded. These controls include model validation, review of key model inputs, analysis of period-over-period fluctuations, and independent recalculation of prices where appropriate.

Cash Flows

Fiscal Year 2020 Compared with Fiscal Year 2019

Cash from operations increased $8.5 billion to $60.7 billion for fiscal year 2020, mainly due to an increase in cash from customers, offset in part by an increase in cash used to pay income taxes, suppliers, and employees. Cash used in financing increased $9.1 billion to $46.0 billion for fiscal year 2020, mainly due to a $3.4 billion cash premium on our debt exchange, a $3.4 billion increase in common stock repurchases, a $1.5 billion increase in repayments of debt, and a $1.3 billion increase in dividends paid. Cash used in investing decreased $3.6 billion to $12.2 billion for fiscal year 2020, mainly due to a $6.4 billion increase in cash from net investment purchases, sales, and maturities, offset in part by a $1.5 billion increase in additions to property and equipment and $1.2 billion in other investing to facilitate the purchase of components.

Fiscal Year 2019 Compared with Fiscal Year 2018

Cash from operations increased $8.3 billion to $52.2 billion for fiscal year 2019, mainly due to an increase in cash received from customers, offset in part by an increase in cash paid to suppliers and employees and an increase in cash paid for income taxes. Cash used in financing increased $3.3 billion to $36.9 billion for fiscal year 2019, mainly due to an $8.8 billion increase in common stock repurchases and a $1.1 billion increase in dividends paid, offset in part by a $6.2 billion decrease in repayments of debt, net of proceeds from issuance of debt. Cash used in investing increased $9.7 billion to $15.8 billion for fiscal year 2019, mainly due to a $6.0 billion decrease in cash from net investment purchases, sales, and maturities, a $2.3 billion increase in additions to property and equipment, and a $1.5 billion increase in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets.

Debt

We issue debt to take advantage of favorable pricing and liquidity in the debt markets, reflecting our credit rating and the low interest rate environment. The proceeds of these issuances were or will be used for general corporate purposes, which may include, among other things, funding for working capital, capital expenditures, repurchases of capital stock, acquisitions, and repayment of existing debt. In June 2020, we exchanged a portion of our existing debt at premium for cash and new debt with longer maturities to take advantage of favorable financing rates in the debt markets, reflecting our credit rating and the low interest rate environment. Refer to Note 11 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Unearned Revenue

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include Software Assurance (“SA”) and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service. Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

The following table outlines the expected future recognition of unearned revenue as of June 30, 2020:

(In millions)

Three Months Ending	
September 30, 2020	**$13,884**
December 31, 2020	**10,950**
March 31, 2021	**7,476**
June 30, 2021	**3,690**
Thereafter	**3,180**
Total	**$39,180**

If our customers choose to license cloud-based versions of our products and services rather than licensing transaction-based products and services, the associated revenue will shift from being recognized at the time of the transaction to being recognized over the subscription period or upon consumption, as applicable.

Share Repurchases

For fiscal years 2020, 2019, and 2018, we repurchased 126 million shares, 150 million shares, and 99 million shares of our common stock for $19.7 billion, $16.8 billion, and $8.6 billion, respectively, through our share repurchase programs. All repurchases were made using cash resources. Refer to Note 16 – Stockholders’ Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Dividends

Refer to Note 16 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Off-Balance Sheet Arrangements

We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products and certain other matters. Additionally, we have agreed to cover damages resulting from breaches of certain security and privacy commitments in our cloud business. In evaluating estimated losses on these obligations, we consider factors such as the degree of probability of an unfavorable outcome and our ability to make a reasonable estimate of the amount of loss. These obligations did not have a material impact in our consolidated financial statements during the periods presented.

Contractual Obligations

The following table summarizes the payments due by fiscal year for our outstanding contractual obligations as of June 30, 2020:

(In millions)	2021	2022-2023	2024-2025	Thereafter	Total
Long-term debt: (a)					
Principal payments	$ 3,750	$ 10,716	$ 7,500	$ 45,441	$ 67,407
Interest payments	2,028	3,736	3,293	25,265	34,322
Construction commitments (b)	4,761	280	0	0	5,041
Operating leases, including imputed interest (c)	2,420	3,986	2,929	4,409	13,744
Finance leases, including imputed interest (c)	992	2,243	2,676	9,611	15,522
Transition tax (d)	1,450	2,899	6,343	4,531	15,223
Purchase commitments (e)	25,059	1,324	369	272	27,024
Other long-term liabilities (f)	0	294	32	356	682
Total	$ 40,460	$ 25,478	$ 23,142	$ 89,885	$ 178,965

(a) *Refer to Note 11 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(b) *Refer to Note 7 – Property and Equipment of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(c) *Refer to Note 14 – Leases of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(d) *Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(e) *Amounts represent purchase commitments, including open purchase orders and take-or-pay contracts that are not presented as construction commitments above.*

(f) *We have excluded long-term tax contingencies, other tax liabilities, and deferred income taxes of $15.2 billion from the amounts presented as the timing of these obligations is uncertain. We have also excluded unearned revenue and non-cash items.*

Other Planned Uses of Capital

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as continue making acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings. We have operating and finance leases for datacenters, corporate offices, research and development facilities, retail stores, and certain equipment. We have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of capital resources.

Liquidity

As a result of the TCJA, we are required to pay a one-time transition tax on deferred foreign income not previously subject to U.S. income tax. Under the TCJA, the transition tax is payable in interest-free installments over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. We have paid transition tax of $3.2 billion, which included $1.2 billion for fiscal year 2020. The remaining transition tax of $15.2 billion is payable over the next six years with a final payment in fiscal year 2026. During fiscal year 2020, we also paid $3.7 billion related to the transfer of intangible properties that occurred in the fourth quarter of fiscal year 2019.

We expect existing cash, cash equivalents, short-term investments, cash flows from operations, and access to capital markets to continue to be sufficient to fund our operating activities and cash commitments for investing and financing activities, such as dividends, share repurchases, debt maturities, material capital expenditures, and the transition tax related to the TCJA, for at least the next 12 months and thereafter for the foreseeable future.

RECENT ACCOUNTING GUIDANCE

Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies, as well as uncertainty in the current economic environment due to the recent outbreak of COVID-19. Critical accounting policies for us include revenue recognition, impairment of investment securities, goodwill, research and development costs, contingencies, income taxes, and inventories.

Revenue Recognition

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the stand-alone selling price ("SSP") for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Impairment of Investment Securities

We review debt investments quarterly for indicators of other-than-temporary impairment. This determination requires significant judgment. In making this judgment, we employ a systematic methodology quarterly that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the duration and extent to which the fair value is less than cost. We also evaluate whether we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery. In addition, we consider specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Equity investments without readily determinable fair values are written down to fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than carrying value. We perform a qualitative assessment on a quarterly basis. We are required to estimate the fair value of the investment to determine the amount of the impairment loss. Once an investment is determined to be impaired, an impairment charge is recorded in other income (expense), net.

Goodwill

We allocate goodwill to reporting units based on the reporting unit expected to benefit from the business combination. We evaluate our reporting units on an annual basis and, if necessary, reassign goodwill using a relative fair value allocation approach. Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated primarily through the use of a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur, and determination of our weighted average cost of capital.

The estimates used to calculate the fair value of a reporting unit change from year to year based on operating results, market conditions, and other factors. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit.

Research and Development Costs

Costs incurred internally in researching and developing a computer software product are charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, software costs are capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our software products is reached after all high-risk development issues have been resolved through coding and testing. Generally, this occurs shortly before the products are released to production. The amortization of these costs is included in cost of revenue over the estimated life of the products.

Legal and Other Contingencies

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our consolidated financial statements.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year, and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting literature also provides guidance on derecognition of income tax assets and liabilities, classification of deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our consolidated financial statements.

The TCJA significantly changes existing U.S. tax law and includes numerous provisions that affect our business. Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

CHANGE IN ACCOUNTING ESTIMATE

In July 2020, we completed an assessment of the useful lives of our server and network equipment and determined we should increase the estimated useful life of server equipment from three years to four years and increase the estimated useful life of network equipment from two years to four years. This change in accounting estimate will be effective beginning fiscal year 2021. Based on the carrying amount of server and network equipment included in "Property and equipment, net" as of June 30, 2020, it is estimated this change will increase our fiscal year 2021 operating income by $2.7 billion.

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

Management is responsible for the preparation of the consolidated financial statements and related information that are presented in this report. The consolidated financial statements, which include amounts based on management's estimates and judgments, have been prepared in conformity with accounting principles generally accepted in the United States of America.

The Company designs and maintains accounting and internal control systems to provide reasonable assurance at reasonable cost that assets are safeguarded against loss from unauthorized use or disposition, and that the financial records are reliable for preparing consolidated financial statements and maintaining accountability for assets. These systems are augmented by written policies, an organizational structure providing division of responsibilities, careful selection and training of qualified personnel, and a program of internal audits.

The Company engaged Deloitte & Touche LLP, an independent registered public accounting firm, to audit and render an opinion on the consolidated financial statements and internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Board of Directors, through its Audit Committee, consisting solely of independent directors of the Company, meets periodically with management, internal auditors, and our independent registered public accounting firm to ensure that each is meeting its responsibilities and to discuss matters concerning internal controls and financial reporting. Deloitte & Touche LLP and the internal auditors each have full and free access to the Audit Committee.

Satya Nadella
Chief Executive Officer

Amy E. Hood
Executive Vice President and Chief Financial Officer

Frank H. Brod
Corporate Vice President, Finance and Administration;
Chief Accounting Officer

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

RISKS

We are exposed to economic risk from foreign exchange rates, interest rates, credit risk, and equity prices. We use derivatives instruments to manage these risks, however, they may still impact our consolidated financial statements.

Foreign Currencies

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency positions, including hedges. Principal currency exposures include the Euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of the fixed-income portfolio to achieve economic returns that correlate to certain global fixed-income indices.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We manage credit exposures relative to broad-based indices and to facilitate portfolio diversification.

Equity

Securities held in our equity investments portfolio are subject to price risk.

SENSITIVITY ANALYSIS

The following table sets forth the potential loss in future earnings or fair values, including associated derivatives, resulting from hypothetical changes in relevant market rates or prices:

(In millions)

Risk Categories	**Hypothetical Change**		**June 30, 2020**	**Impact**
Foreign currency–Revenue	10% decrease in foreign exchange rates	**$**	**(4,142)**	Earnings
Foreign currency–Investments	10% decrease in foreign exchange rates		**(119)**	Fair Value
Interest rate	100 basis point increase in U.S. treasury interest rates		**(3,951)**	Fair Value
Credit	100 basis point increase in credit spreads		**(301)**	Fair Value
Equity	10% decrease in equity market prices		**(239)**	Earnings

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INCOME STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	2020	2019	2018
Revenue:			
Product	**$ 68,041**	$ 66,069	$ 64,497
Service and other	**74,974**	59,774	45,863
Total revenue	**143,015**	125,843	110,360
Cost of revenue:			
Product	**16,017**	16,273	15,420
Service and other	**30,061**	26,637	22,933
Total cost of revenue	**46,078**	42,910	38,353
Gross margin	**96,937**	82,933	72,007
Research and development	**19,269**	16,876	14,726
Sales and marketing	**19,598**	18,213	17,469
General and administrative	**5,111**	4,885	4,754
Operating income	**52,959**	42,959	35,058
Other income, net	**77**	729	1,416
Income before income taxes	**53,036**	43,688	36,474
Provision for income taxes	**8,755**	4,448	19,903
Net income	**$ 44,281**	$ 39,240	$ 16,571
Earnings per share:			
Basic	**$ 5.82**	$ 5.11	$ 2.15
Diluted	**$ 5.76**	$ 5.06	$ 2.13
Weighted average shares outstanding:			
Basic	**7,610**	7,673	7,700
Diluted	**7,683**	7,753	7,794

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Net income	**$ 44,281**	$ 39,240	$ 16,571
Other comprehensive income (loss), net of tax:			
Net change related to derivatives	**(38)**	(173)	39
Net change related to investments	**3,990**	2,405	(2,717)
Translation adjustments and other	**(426)**	(318)	(178)
Other comprehensive income (loss)	**3,526**	1,914	(2,856)
Comprehensive income	**$ 47,807**	$ 41,154	$ 13,715

Refer to accompanying notes.

BALANCE SHEETS

(In millions)

June 30,	**2020**	**2019**
Assets		
Current assets:		
Cash and cash equivalents	**$ 13,576**	$ 11,356
Short-term investments	**122,951**	122,463
Total cash, cash equivalents, and short-term investments	**136,527**	133,819
Accounts receivable, net of allowance for doubtful accounts of **$788** and $411	**32,011**	29,524
Inventories	**1,895**	2,063
Other current assets	**11,482**	10,146
Total current assets	**181,915**	175,552
Property and equipment, net of accumulated depreciation of **$43,197** and $35,330	**44,151**	36,477
Operating lease right-of-use assets	**8,753**	7,379
Equity investments	**2,965**	2,649
Goodwill	**43,351**	42,026
Intangible assets, net	**7,038**	7,750
Other long-term assets	**13,138**	14,723
Total assets	**$ 301,311**	$ 286,556
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**$ 12,530**	$ 9,382
Current portion of long-term debt	**3,749**	5,516
Accrued compensation	**7,874**	6,830
Short-term income taxes	**2,130**	5,665
Short-term unearned revenue	**36,000**	32,676
Other current liabilities	**10,027**	9,351
Total current liabilities	**72,310**	69,420
Long-term debt	**59,578**	66,662
Long-term income taxes	**29,432**	29,612
Long-term unearned revenue	**3,180**	4,530
Deferred income taxes	**204**	233
Operating lease liabilities	**7,671**	6,188
Other long-term liabilities	**10,632**	7,581
Total liabilities	**183,007**	184,226
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,571** and 7,643	**80,552**	78,520
Retained earnings	**34,566**	24,150
Accumulated other comprehensive income (loss)	**3,186**	(340)
Total stockholders' equity	**118,304**	102,330
Total liabilities and stockholders' equity	**$ 301,311**	$ 286,556

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Operations			
Net income	**$ 44,281**	$ 39,240	$ 16,571
Adjustments to reconcile net income to net cash from operations:			
Depreciation, amortization, and other	**12,796**	11,682	10,261
Stock-based compensation expense	**5,289**	4,652	3,940
Net recognized gains on investments and derivatives	**(219)**	(792)	(2,212)
Deferred income taxes	**11**	(6,463)	(5,143)
Changes in operating assets and liabilities:			
Accounts receivable	**(2,577)**	(2,812)	(3,862)
Inventories	**168**	597	(465)
Other current assets	**(2,330)**	(1,718)	(952)
Other long-term assets	**(1,037)**	(1,834)	(285)
Accounts payable	**3,018**	232	1,148
Unearned revenue	**2,212**	4,462	5,922
Income taxes	**(3,631)**	2,929	18,183
Other current liabilities	**1,346**	1,419	798
Other long-term liabilities	**1,348**	591	(20)
Net cash from operations	**60,675**	52,185	43,884
Financing			
Repayments of short-term debt, maturities of 90 days or less, net	**0**	0	(7,324)
Proceeds from issuance of debt	**0**	0	7,183
Cash premium on debt exchange	**(3,417)**	0	0
Repayments of debt	**(5,518)**	(4,000)	(10,060)
Common stock issued	**1,343**	1,142	1,002
Common stock repurchased	**(22,968)**	(19,543)	(10,721)
Common stock cash dividends paid	**(15,137)**	(13,811)	(12,699)
Other, net	**(334)**	(675)	(971)
Net cash used in financing	**(46,031)**	(36,887)	(33,590)
Investing			
Additions to property and equipment	**(15,441)**	(13,925)	(11,632)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(2,521)**	(2,388)	(888)
Purchases of investments	**(77,190)**	(57,697)	(137,380)
Maturities of investments	**66,449**	20,043	26,360
Sales of investments	**17,721**	38,194	117,577
Other, net	**(1,241)**	0	(98)
Net cash used in investing	**(12,223)**	(15,773)	(6,061)
Effect of foreign exchange rates on cash and cash equivalents	**(201)**	(115)	50
Net change in cash and cash equivalents	**2,220**	(590)	4,283
Cash and cash equivalents, beginning of period	**11,356**	11,946	7,663
Cash and cash equivalents, end of period	**$ 13,576**	$ 11,356	$ 11,946

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Common stock and paid-in capital			
Balance, beginning of period	**$ 78,520**	$ 71,223	$ 69,315
Common stock issued	**1,343**	6,829	1,002
Common stock repurchased	**(4,599)**	(4,195)	(3,033)
Stock-based compensation expense	**5,289**	4,652	3,940
Other, net	**(1)**	11	(1)
Balance, end of period	**80,552**	78,520	71,223
Retained earnings			
Balance, beginning of period	**24,150**	13,682	17,769
Net income	**44,281**	39,240	16,571
Common stock cash dividends	**(15,483)**	(14,103)	(12,917)
Common stock repurchased	**(18,382)**	(15,346)	(7,699)
Cumulative effect of accounting changes	**0**	677	(42)
Balance, end of period	**34,566**	24,150	13,682
Accumulated other comprehensive income (loss)			
Balance, beginning of period	**(340)**	(2,187)	627
Other comprehensive income (loss)	**3,526**	1,914	(2,856)
Cumulative effect of accounting changes	**0**	(67)	42
Balance, end of period	**3,186**	(340)	(2,187)
Total stockholders' equity	**$ 118,304**	$ 102,330	$ 82,718
Cash dividends declared per common share	**$ 2.04**	$ 1.84	$ 1.68

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP").

We have recast certain prior period amounts to conform to the current period presentation. The recast of these prior period amounts had no impact on our consolidated balance sheets, consolidated income statements, or net cash from or used in operating, financing, or investing on our consolidated cash flows statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Microsoft Corporation and its subsidiaries. Intercompany transactions and balances have been eliminated.

Estimates and Assumptions

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates and assumptions include: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price ("SSP") of performance obligations, variable consideration, and other obligations such as product returns and refunds; loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized in our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management's estimates and assumptions due to risks and uncertainties, including uncertainty in the current economic environment due to the recent outbreak of a novel strain of the coronavirus ("COVID-19").

In July 2020, we completed an assessment of the useful lives of our server and network equipment and determined we should increase the estimated useful life of server equipment from three years to four years and increase the estimated useful life of network equipment from two years to four years. This change in accounting estimate will be effective beginning fiscal year 2021.

Foreign Currencies

Assets and liabilities recorded in foreign currencies are translated at the exchange rate on the balance sheet date. Revenue and expenses are translated at average rates of exchange prevailing during the year. Translation adjustments resulting from this process are recorded to other comprehensive income.

Revenue

Product Revenue and Service and Other Revenue

Product revenue includes sales from operating systems; cross-device productivity applications; server applications; business solution applications; desktop and server management tools; software development tools; video games; and hardware such as PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

Service and other revenue includes sales from cloud-based solutions that provide customers with software, services, platforms, and content such as Office 365, Azure, Dynamics 365, and Xbox Live; solution support; and consulting services. Service and other revenue also includes sales from online advertising and LinkedIn.

Revenue Recognition

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Nature of Products and Services

Licenses for on-premises software provide the customer with a right to use the software as it exists when made available to the customer. Customers may purchase perpetual licenses or subscribe to licenses, which provide customers with the same functionality and differ mainly in the duration over which the customer benefits from the software. Revenue from distinct on-premises licenses is recognized upfront at the point in time when the software is made available to the customer. In cases where we allocate revenue to software updates, primarily because the updates are provided at no additional charge, revenue is recognized as the updates are provided, which is generally ratably over the estimated life of the related device or license.

Certain volume licensing programs, including Enterprise Agreements, include on-premises licenses combined with Software Assurance (“SA”). SA conveys rights to new software and upgrades released over the contract period and provides support, tools, and training to help customers deploy and use products more efficiently. On-premises licenses are considered distinct performance obligations when sold with SA. Revenue allocated to SA is generally recognized ratably over the contract period as customers simultaneously consume and receive benefits, given that SA comprises distinct performance obligations that are satisfied over time.

Cloud services, which allow customers to use hosted software over the contract period without taking possession of the software, are provided on either a subscription or consumption basis. Revenue related to cloud services provided on a subscription basis is recognized ratably over the contract period. Revenue related to cloud services provided on a consumption basis, such as the amount of storage used in a period, is recognized based on the customer utilization of such resources. When cloud services require a significant level of integration and interdependency with software and the individual components are not considered distinct, all revenue is recognized over the period in which the cloud services are provided.

Revenue from search advertising is recognized when the advertisement appears in the search results or when the action necessary to earn the revenue has been completed. Revenue from consulting services is recognized as services are provided.

Our hardware is generally highly dependent on, and interrelated with, the underlying operating system and cannot function without the operating system. In these cases, the hardware and software license are accounted for as a single performance obligation and revenue is recognized at the point in time when ownership is transferred to resellers or directly to end customers through retail stores and online marketplaces.

Refer to Note 19 – Segment Information and Geographic Data for further information, including revenue by significant product and service offering.

Significant Judgments

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the SSP for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Contract Balances

Timing of revenue recognition may differ from the timing of invoicing to customers. We record a receivable when revenue is recognized prior to invoicing, or unearned revenue when revenue is recognized subsequent to invoicing. For multi-year agreements, we generally invoice customers annually at the beginning of each annual coverage period. We record a receivable related to revenue recognized for multi-year on-premises licenses as we have an unconditional right to invoice and receive payment in the future related to those licenses.

As of June 30, 2020 and 2019, long-term accounts receivable, net of allowance for doubtful accounts, was $2.7 billion and $2.2 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

Activity in the allowance for doubtful accounts was as follows:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Balance, beginning of period	**$ 434**	$ 397	$ 361
Charged to costs and other	**560**	153	134
Write-offs	**(178)**	(116)	(98)
Balance, end of period	**$ 816**	$ 434	$ 397

Allowance for doubtful accounts included in our consolidated balance sheets:

(In millions)

June 30,	**2020**	**2019**	**2018**
Accounts receivable, net of allowance for doubtful accounts	**$ 788**	$ 411	$ 377
Other long-term assets	**28**	23	20
Total	**$ 816**	$ 434	$ 397

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include SA and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for consulting services to be performed in the future; LinkedIn subscriptions; Office 365 subscriptions; Xbox Live subscriptions; Windows 10 post-delivery support; Dynamics business solutions; Skype prepaid credits and subscriptions; and other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service.

Refer to Note 13 – Unearned Revenue for further information, including unearned revenue by segment and changes in unearned revenue during the period.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers or to provide customers with financing. Examples include invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and multi-year on-premises licenses that are invoiced annually with revenue recognized upfront.

We record financing receivables when we offer certain of our customers the option to acquire our software products and services offerings through a financing program in a limited number of countries. As of June 30, 2020 and 2019, our financing receivables, net were $5.2 billion and $4.3 billion, respectively, for short-term and long-term financing receivables, which are included in other current assets and other long-term assets in our consolidated balance sheets. We record an allowance to cover expected losses based on troubled accounts, historical experience, and other currently available evidence.

Assets Recognized from Costs to Obtain a Contract with a Customer

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We have determined that certain sales incentive programs meet the requirements to be capitalized. Total capitalized costs to obtain a contract were immaterial during the periods presented and are included in other current and long-term assets in our consolidated balance sheets.

We apply a practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less. These costs include our internal sales force compensation program and certain partner sales incentive programs as we have determined annual compensation is commensurate with annual sales activities.

Cost of Revenue

Cost of revenue includes: manufacturing and distribution costs for products sold and programs licensed; operating costs related to product support service centers and product distribution centers; costs incurred to include software on PCs sold by original equipment manufacturers ("OEM"), to drive traffic to our websites, and to acquire online advertising space; costs incurred to support and maintain online products and services, including datacenter costs and royalties; warranty costs; inventory valuation adjustments; costs associated with the delivery of consulting services; and the amortization of capitalized software development costs. Capitalized software development costs are amortized over the estimated lives of the products.

Product Warranty

We provide for the estimated costs of fulfilling our obligations under hardware and software warranties at the time the related revenue is recognized. For hardware warranties, we estimate the costs based on historical and projected product failure rates, historical and projected repair costs, and knowledge of specific product failures (if any). The specific hardware warranty terms and conditions vary depending upon the product sold and the country in which we do business, but generally include parts and labor over a period generally ranging from 90 days to three years. For software warranties, we estimate the costs to provide bug fixes, such as security patches, over the estimated life of the software. We regularly reevaluate our estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

Research and Development

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content. Such costs related to software development are included in research and development expense until the point that technological feasibility is reached, which for our software products, is generally shortly before the products are released to production. Once technological feasibility is reached, such costs are capitalized and amortized to cost of revenue over the estimated lives of the products.

Sales and Marketing

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs. Advertising costs are expensed as incurred. Advertising expense was $1.6 billion in fiscal years 2020, 2019, and 2018.

Stock-Based Compensation

Compensation cost for stock awards, which include restricted stock units ("RSUs") and performance stock units ("PSUs"), is measured at the fair value on the grant date and recognized as expense, net of estimated forfeitures, over the related service or performance period. The fair value of stock awards is based on the quoted price of our common stock on the grant date less the present value of expected dividends not received during the vesting period. We measure the fair value of PSUs using a Monte Carlo valuation model. Compensation cost for RSUs is recognized using the straight-line method and for PSUs is recognized using the accelerated method.

Compensation expense for the employee stock purchase plan ("ESPP") is measured as the discount the employee is entitled to upon purchase and is recognized in the period of purchase.

Income Taxes

Income tax expense includes U.S. and international income taxes, and interest and penalties on uncertain tax positions. Certain income and expenses are not reported in tax returns and financial statements in the same year. The tax effect of such temporary differences is reported as deferred income taxes. Deferred tax assets are reported net of a valuation allowance when it is more likely than not that a tax benefit will not be realized. All deferred income taxes are classified as long-term in our consolidated balance sheets.

Financial Instruments

Investments

We consider all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. The fair values of these investments approximate their carrying values. In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations.

Debt investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in fair value, excluding other-than-temporary impairments, are recorded in other comprehensive income. Debt investments are impaired when a decline in fair value is judged to be other-than-temporary. Fair value is calculated based on publicly available market information or other estimates determined by management. We employ a systematic methodology on a quarterly basis that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the duration and extent to which the fair value is less than cost. We also evaluate whether we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery. In addition, we consider specific adverse conditions related to the financial health of, and business outlook, for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in other income (expense), net and a new cost basis in the investment is established.

Equity investments with readily determinable fair values are measured at fair value. Equity investments without readily determinable fair values are measured using the equity method or measured at cost with adjustments for observable changes in price or impairments (referred to as the measurement alternative). We perform a qualitative assessment on a quarterly basis and recognize an impairment if there are sufficient indicators that the fair value of the investment is less than carrying value. Changes in value are recorded in other income (expense), net.

Derivatives

Derivative instruments are recognized as either assets or liabilities and measured at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

For derivative instruments designated as fair value hedges, gains and losses are recognized in other income (expense), net with offsetting gains and losses on the hedged items. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in other income (expense), net.

For derivative instruments designated as cash flow hedges, gains and losses are initially reported as a component of other comprehensive income and subsequently recognized in earnings with the corresponding hedged item. Gains and losses representing hedge components excluded from the assessment of effectiveness are recognized in earnings.

For derivative instruments that are not designated as hedges, gains and losses from changes in fair values are primarily recognized in other income (expense), net.

Fair Value Measurements

We account for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. We categorize each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 investments include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.
- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 investments include commercial paper, certificates of deposit,

U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Our Level 2 derivative assets and liabilities primarily include certain over-the-counter option and swap contracts.

- *Level 3* – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 assets and liabilities include investments in corporate notes and bonds, municipal securities, and goodwill and intangible assets, when they are recorded at fair value due to an impairment charge. Unobservable inputs used in the models are significant to the fair values of the assets and liabilities.

We measure equity investments without readily determinable fair values on a nonrecurring basis. The fair values of these investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections.

Our other current financial assets and current financial liabilities have fair values that approximate their carrying values.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation, and depreciated using the straight-line method over the shorter of the estimated useful life of the asset or the lease term. The estimated useful lives of our property and equipment are generally as follows: computer software developed or acquired for internal use, three to seven years; computer equipment, two to three years; buildings and improvements, five to 15 years; leasehold improvements, three to 20 years; and furniture and equipment, one to 10 years. Land is not depreciated.

Leases

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities in our consolidated balance sheets. Finance leases are included in property and equipment, other current liabilities, and other long-term liabilities in our consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we generally use our incremental borrowing rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

We have lease agreements with lease and non-lease components, which are generally accounted for separately. For certain equipment leases, such as vehicles, we account for the lease and non-lease components as a single lease component. Additionally, for certain equipment leases, we apply a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Goodwill

Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value.

Intangible Assets

Our intangible assets are subject to amortization and are amortized using the straight-line method over their estimated period of benefit, ranging from one to 20 years. We evaluate the recoverability of intangible assets periodically by taking into account events or circumstances that may warrant revised estimates of useful lives or that indicate the asset may be impaired.

Recent Accounting Guidance

Recently Adopted Accounting Guidance

Financial Instruments – Targeted Improvements to Accounting for Hedging Activities

In August 2017, the Financial Accounting Standards Board ("FASB") issued new guidance related to accounting for hedging activities. This guidance expands strategies that qualify for hedge accounting, changes how many hedging relationships are presented in the financial statements, and simplifies the application of hedge accounting in certain situations. We adopted the standard effective July 1, 2019. As we did not hold derivative instruments requiring an adjustment upon adoption, there was no impact in our consolidated financial statements. Adoption of the standard enhanced the presentation of the effects of our hedging instruments and the hedged items in our consolidated financial statements to increase the understandability of the results of our hedging strategies.

Recent Accounting Guidance Not Yet Adopted

Financial Instruments – Credit Losses

In June 2016, the FASB issued a new standard to replace the incurred loss impairment methodology under current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. We will be required to use a forward-looking expected credit loss model for accounts receivable, loans, and other financial instruments. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The standard will be adopted upon the effective date for us beginning July 1, 2020. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date to align our credit loss methodology with the new standard. We have evaluated the impact of this standard in our consolidated financial statements, including accounting policies, processes, and systems. We continue to monitor economic implications of the COVID-19 pandemic. Based on current market conditions, adoption of the standard will not have a material impact on our consolidated financial statements.

Accounting for Income Taxes

In December 2019, the FASB issued a new standard to simplify the accounting for income taxes. The guidance eliminates certain exceptions related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period, and the recognition of deferred tax liabilities for outside basis differences related to changes in ownership of equity method investments and foreign subsidiaries. The guidance also simplifies aspects of accounting for franchise taxes and enacted changes in tax laws or rates, and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. The standard will be effective for us beginning July 1, 2021, with early adoption permitted. We are currently evaluating the impact of this standard in our consolidated financial statements, including accounting policies, processes, and systems.

NOTE 2 — EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed based on the weighted average number of shares of common stock outstanding during the period. Diluted EPS is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and stock awards.

The components of basic and diluted EPS were as follows:

(In millions, except earnings per share)

Year Ended June 30,	2020	2019	2018
Net income available for common shareholders (A)	**$ 44,281**	$ 39,240	$ 16,571
Weighted average outstanding shares of common stock (B)	**7,610**	7,673	7,700
Dilutive effect of stock-based awards	**73**	80	94
Common stock and common stock equivalents (C)	**7,683**	7,753	7,794
Earnings Per Share			
Basic (A/B)	**$ 5.82**	$ 5.11	$ 2.15
Diluted (A/C)	**$ 5.76**	$ 5.06	$ 2.13

Anti-dilutive stock-based awards excluded from the calculations of diluted EPS were immaterial during the periods presented.

NOTE 3 — OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)

Year Ended June 30,	2020	2019	2018
Interest and dividends income	**$ 2,680**	$ 2,762	$ 2,214
Interest expense	**(2,591)**	(2,686)	(2,733)
Net recognized gains on investments	**32**	648	2,399
Net gains (losses) on derivatives	**187**	144	(187)
Net losses on foreign currency remeasurements	**(191)**	(82)	(218)
Other, net	**(40)**	(57)	(59)
Total	**$ 77**	$ 729	$ 1,416

Net Recognized Gains (Losses) on Investments

Net recognized gains (losses) on debt investments were as follows:

(In millions)

Year Ended June 30,	2020	2019	2018
Realized gains from sales of available-for-sale securities	**$ 50**	$ 12	$ 27
Realized losses from sales of available-for-sale securities	**(37)**	(93)	(987)
Other-than-temporary impairments of investments	**(17)**	(16)	(6)
Total	**$ (4)**	$ (97)	$ (966)

Net recognized gains (losses) on equity investments were as follows:

(In millions)

Year Ended June 30,	2020	2019	2018

Net realized gains on investments sold	**$ 83**	$ 276	$ 3,406
Net unrealized gains on investments still held	**69**	479	0
Impairments of investments	**(116)**	(10)	(41)
Total	**$ 36**	$ 745	$ 3,365

NOTE 4 — INVESTMENTS

Investment Components

The components of investments were as follows:

(In millions)	Fair Value Level	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2020								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 4,687	$ 1	$ 0	$ 4,688	$ 1,618	$ 3,070	$ 0
Certificates of deposit	Level 2	2,898	0	0	2,898	1,646	1,252	0
U.S. government securities	Level 1	92,067	6,495	(1)	98,561	3,168	95,393	0
U.S. agency securities	Level 2	2,439	2	0	2,441	449	1,992	0
Foreign government bonds	Level 2	6,982	6	(3)	6,985	1	6,984	0
Mortgage- and asset-backed securities	Level 2	4,865	41	(6)	4,900	0	4,900	0
Corporate notes and bonds	Level 2	8,500	327	(17)	8,810	0	8,810	0
Corporate notes and bonds	Level 3	58	0	0	58	0	58	0
Municipal securities	Level 2	313	57	(4)	366	0	366	0
Municipal securities	Level 3	91	0	0	91	0	91	0
Total debt investments		$ 122,900	$ 6,929	$ (31)	$ 129,798	$ 6,882	$ 122,916	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 1,198	$ 784	$ 0	$ 414
Equity investments	Other				2,551	0	0	2,551
Total equity investments					$ 3,749	$ 784	$ 0	$ 2,965
Cash					$ 5,910	$ 5,910	$ 0	$ 0
Derivatives, net (a)					35	0	35	0
Total					$ 139,492	$ 13,576	$ 122,951	$ 2,965

(In millions)	Fair Value Level	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2019								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 2,211	$ 0	$ 0	$ 2,211	$ 1,773	$ 438	$ 0
Certificates of deposit	Level 2	2,018	0	0	2,018	1,430	588	0
U.S. government securities	Level 1	104,925	1,854	(104)	106,675	769	105,906	0
U.S. agency securities	Level 2	988	0	0	988	698	290	0
Foreign government bonds	Level 2	6,350	4	(8)	6,346	2,506	3,840	0
Mortgage- and asset-backed securities	Level 2	3,554	10	(3)	3,561	0	3,561	0
Corporate notes and bonds	Level 2	7,437	111	(7)	7,541	0	7,541	0
Corporate notes and bonds	Level 3	15	0	0	15	0	15	0
Municipal securities	Level 2	242	48	0	290	0	290	0
Municipal securities	Level 3	7	0	0	7	0	7	0
Total debt investments		$ 127,747	$ 2,027	$ (122)	$ 129,652	$ 7,176	$ 122,476	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 973	$ 409	$ 0	$ 564
Equity investments	Other				2,085	0	0	2,085
Total equity investments					$ 3,058	$ 409	$ 0	$ 2,649
Cash					$ 3,771	$ 3,771	$ 0	$ 0
Derivatives, net (a)					(13)	0	(13)	0
Total					$ 136,468	$ 11,356	$ 122,463	$ 2,649

(a) *Refer to Note 5 – Derivatives for further information on the fair value of our derivative instruments.*

Equity investments presented as “Other” in the tables above include investments without readily determinable fair values measured using the equity method or measured at cost with adjustments for observable changes in price or impairments, and investments measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of June 30, 2020 and

2019, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $1.4 billion and $1.2 billion, respectively.

Unrealized Losses on Debt Investments

Debt investments with continuous unrealized losses for less than 12 months and 12 months or greater and their related fair values were as follows:

	Less than 12 Months		12 Months or Greater			
(In millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2020						
U.S. government and agency securities	$ 2,323	$ (1)	$ 0	$ 0	$ 2,323	$ (1)
Foreign government bonds	500	(3)	0	0	500	(3)
Mortgage- and asset-backed securities	1,014	(6)	0	0	1,014	(6)
Corporate notes and bonds	649	(17)	0	0	649	(17)
Municipal securities	66	(4)	0	0	66	(4)
Total	$ 4,552	$ (31)	$ 0	$ 0	$ 4,552	$ (31)

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2019						
U.S. government and agency securities	$ 1,491	$ (1)	$ 39,158	$ (103)	$ 40,649	$ (104)
Foreign government bonds	25	0	77	(8)	102	(8)
Mortgage- and asset-backed securities	664	(1)	378	(2)	1,042	(3)
Corporate notes and bonds	498	(3)	376	(4)	874	(7)
Total	$ 2,678	$ (5)	$ 39,989	$ (117)	$ 42,667	$ (122)

Unrealized losses from fixed-income securities are primarily attributable to changes in interest rates. Management does not believe any remaining unrealized losses represent other-than-temporary impairments based on our evaluation of available evidence.

Debt Investment Maturities

(In millions)	Cost Basis	Estimated Fair Value
June 30, 2020		
Due in one year or less	**$ 36,169**	**$ 36,276**
Due after one year through five years	**51,465**	**54,700**
Due after five years through 10 years	**32,299**	**35,674**
Due after 10 years	**2,967**	**3,148**
Total	**$ 122,900**	**$ 129,798**

NOTE 5 — DERIVATIVES

We use derivative instruments to manage risks related to foreign currencies, interest rates, equity prices, and credit; to enhance investment returns; and to facilitate portfolio diversification. Our objectives for holding derivatives include reducing, eliminating, and efficiently managing the economic impact of these exposures as effectively as possible. Our derivative programs include strategies that both qualify and do not qualify for hedge accounting treatment.

Foreign Currencies

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions.

Foreign currency risks related to certain non-U.S. dollar-denominated investments are hedged using foreign exchange forward contracts that are designated as fair value hedging instruments. Foreign currency risks related to certain Euro-denominated debt are hedged using foreign exchange forward contracts that are designated as cash flow hedging instruments.

In the past, option and forward contracts were used to hedge a portion of forecasted international revenue and were designated as cash flow hedging instruments. Principal currencies hedged included the Euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

Certain options and forwards not designated as hedging instruments are also used to manage the variability in foreign exchange rates on certain balance sheet amounts and to manage other foreign currency exposures.

Interest Rate

Interest rate risks related to certain fixed-rate debt are hedged using interest rate swaps that are designated as fair value hedging instruments to effectively convert the fixed interest rates to floating interest rates.

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using exchange-traded option and futures contracts and over-the-counter swap and option contracts. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Equity

Securities held in our equity investments portfolio are subject to market price risk. At times, we may hold options, futures, and swap contracts. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. These contracts are not designated as hedging instruments and are included in “Other contracts” in the tables below.

Credit-Risk-Related Contingent Features

Certain of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of June 30, 2020, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

The following table presents the notional amounts of our outstanding derivative instruments measured in U.S. dollar equivalents:

(In millions)	**June 30, 2020**	**June 30, 2019**
Designated as Hedging Instruments		
Foreign exchange contracts purchased	**$ 635**	$ 0
Foreign exchange contracts sold	**6,754**	6,034
Interest rate contracts purchased	**1,295**	0
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**11,896**	14,889
Foreign exchange contracts sold	**15,595**	15,614
Other contracts purchased	**1,844**	2,007
Other contracts sold	**757**	456

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		June 30, 2020		June 30, 2019
Designated as Hedging Instruments				
Foreign exchange contracts	**$ 44**	**$ (54)**	$ 0	$ (93)
Interest rate contracts	**93**	**0**	0	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**245**	**(334)**	204	(172)
Other contracts	**18**	**(11)**	46	(7)
Gross amounts of derivatives	**400**	**(399)**	250	(272)
Gross amounts of derivatives offset in the balance sheet	**(154)**	**158**	(113)	114
Cash collateral received	**0**	**(154)**	0	(78)
Net amounts of derivatives	**$ 246**	**$ (395)**	$ 137	$ (236)
Reported as				
Short-term investments	**$ 35**	**$ 0**	$ (13)	$ 0
Other current assets	**199**	**0**	146	0
Other long-term assets	**12**	**0**	4	0
Other current liabilities	**0**	**(334)**	0	(221)
Other long-term liabilities	**0**	**(61)**	0	(15)
Total	**$ 246**	**$ (395)**	$ 137	$ (236)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $399 million and $399 million, respectively, as of June 30, 2020, and $247 million and $272 million, respectively, as of June 30, 2019.

The following table presents the fair value of our derivatives instruments on a gross basis:

(In millions)	Level 1	Level 2	Level 3	Total
June 30, 2020				
Derivative assets	**$ 1**	**$ 398**	**$ 1**	**$ 400**
Derivative liabilities	**0**	**(399)**	**0**	**(399)**
June 30, 2019				
Derivative assets	0	247	3	250
Derivative liabilities	0	(272)	0	(272)

Gains (losses) on derivative instruments recognized in our consolidated income statements were as follows:

(In millions)

Year Ended June 30,	2020		2019		2018	
	Revenue	Other Income (Expense), Net	Revenue	Other Income (Expense), Net	Revenue	Other Income (Expense), Net
Designated as Fair Value Hedging Instruments						
Foreign exchange contracts						
Derivatives	**$ 0**	**$ 1**	$ 0	$ (130)	$ 0	$ (78)
Hedged items	**0**	**3**	0	130	0	78
Excluded from effectiveness assessment	**0**	**139**	0	168	0	103
Interest rate contracts						
Derivatives	**0**	**93**	0	0	0	0
Hedged items	**0**	**(93)**	0	0	0	0
Equity contracts						
Derivatives	**0**	**0**	0	0	0	(324)
Hedged items	**0**	**0**	0	0	0	324
Excluded from effectiveness assessment	**0**	**0**	0	0	0	80
Designated as Cash Flow Hedging Instruments						
Foreign exchange contracts						
Amount reclassified from accumulated other comprehensive income	**0**	**0**	341	0	185	0
Excluded from effectiveness assessment	**0**	**0**	(64)	0	(255)	0
Not Designated as Hedging Instruments						
Foreign exchange contracts	**0**	**(123)**	0	(97)	0	(33)
Other contracts	**0**	**50**	0	38	0	(104)

Gains (losses), net of tax, on derivative instruments recognized in our consolidated comprehensive income statements were as follows:

(In millions)

Year Ended June 30,	2020	2019	2018
Designated as Cash Flow Hedging Instruments			
Foreign exchange contracts			
Included in effectiveness assessment	**$ (38)**	$ 159	$ 219

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)

June 30,		2020		2019
Raw materials	**$**	**700**	$	399
Work in process		**83**		53
Finished goods		**1,112**		1,611
Total	**$**	**1,895**	$	2,063

NOTE 7 — PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

(In millions)

June 30,	2020	2019
Land	**$ 1,823**	$ 1,540
Buildings and improvements	**33,995**	26,288
Leasehold improvements	**5,487**	5,316
Computer equipment and software	**41,261**	33,823
Furniture and equipment	**4,782**	4,840
Total, at cost	**87,348**	71,807
Accumulated depreciation	**(43,197)**	(35,330)
Total, net	**$ 44,151**	$ 36,477

During fiscal years 2020, 2019, and 2018, depreciation expense was $10.7 billion, $9.7 billion, and $7.7 billion, respectively. We have committed $5.0 billion for the construction of new buildings, building improvements, and leasehold improvements as of June 30, 2020.

During fiscal year 2020, we recorded an impairment charge of $186 million to Property and Equipment, primarily to leasehold improvements, due to the closing of our Microsoft Store physical locations.

NOTE 8 — BUSINESS COMBINATIONS

GitHub, Inc.

On October 25, 2018, we acquired GitHub, Inc. (“GitHub”), a software development platform, in a $7.5 billion stock transaction (inclusive of total cash payments of $1.3 billion in respect of vested GitHub equity awards and an indemnity escrow). The acquisition is expected to empower developers to achieve more at every stage of the development lifecycle, accelerate enterprise use of GitHub, and bring Microsoft’s developer tools and services to new audiences. The financial results of GitHub have been included in our consolidated financial statements since the date of the acquisition. GitHub is reported as part of our Intelligent Cloud segment.

The allocation of the purchase price to goodwill was completed as of June 30, 2019. The major classes of assets and liabilities to which we allocated the purchase price were as follows:

(In millions)

Cash, cash equivalents, and short-term investments	$ 234
Goodwill	5,497
Intangible assets	1,267
Other assets	143
Other liabilities	(217)
Total	$ 6,924

The goodwill recognized in connection with the acquisition is primarily attributable to anticipated synergies from future growth and is not expected to be deductible for tax purposes. We assigned the goodwill to our Intelligent Cloud segment.

Following are the details of the purchase price allocated to the intangible assets acquired:

(In millions)		Amount	Weighted Average Life
Customer-related	$	648	8 years
Technology-based		447	5 years
Marketing-related		170	10 years
Contract-based		2	2 years
Total	$	1,267	7 years

Transactions recognized separately from the purchase price allocation were approximately $600 million, primarily related to equity awards recognized as expense over the related service period.

Other

During fiscal year 2020, we completed 15 acquisitions for $2.4 billion, substantially all of which were paid in cash. These entities have been included in our consolidated results of operations since their respective acquisition dates. The effects of these business combinations, individually and in aggregate, were not material to our consolidated results of operations.

NOTE 9 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	June 30, 2018	Acquisitions	Other	June 30, 2019	Acquisitions	Other	June 30, 2020
Productivity and Business Processes	$ 23,823	$ 514	$ (60)	**$ 24,277**	**$ 7**	**$ (94)**	**$ 24,190**
Intelligent Cloud	5,703	5,605 (a)	43 (a)	**11,351**	**1,351**	**(5)**	**12,697**
More Personal Computing	6,157	289	(48)	**6,398**	**96**	**(30)**	**6,464**
Total	$ 35,683	$ 6,408	$ (65)	**$ 42,026**	**$ 1,454**	**$ (129)**	**$ 43,351**

(a) *Includes goodwill of $5.5 billion related to GitHub. See Note 8 – Business Combinations for further information.*

The measurement periods for the valuation of assets acquired and liabilities assumed end as soon as information on the facts and circumstances that existed as of the acquisition dates becomes available, but do not exceed 12 months. Adjustments in purchase price allocations may require a change in the amounts allocated to goodwill during the periods in which the adjustments are determined.

Any change in the goodwill amounts resulting from foreign currency translations and purchase accounting adjustments are presented as “Other” in the table above. Also included in “Other” are business dispositions and transfers between segments due to reorganizations, as applicable.

Goodwill Impairment

We test goodwill for impairment annually on May 1 at the reporting unit level, primarily using a discounted cash flow methodology with a peer-based, risk-adjusted weighted average cost of capital. We believe use of a discounted cash flow approach is the most reliable indicator of the fair values of the businesses.

No instances of impairment were identified in our May 1, 2020, May 1, 2019, or May 1, 2018 tests. As of June 30, 2020 and 2019, accumulated goodwill impairment was $11.3 billion.

NOTE 10 — INTANGIBLE ASSETS

The components of intangible assets, all of which are finite-lived, were as follows:

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
June 30,			**2020**			**2019**
Technology-based	**$ 8,160**	**$ (6,381)**	**$ 1,779**	$ 7,691	$ (5,771)	$ 1,920
Customer-related	**4,967**	**(2,320)**	**2,647**	4,709	(1,785)	2,924
Marketing-related	**4,158**	**(1,588)**	**2,570**	4,165	(1,327)	2,838
Contract-based	**474**	**(432)**	**42**	574	(506)	68
Total	**$ 17,759**	**$ (10,721)**	**$ 7,038**	$ 17,139 (a)	$ (9,389)	$ 7,750

(a) *Includes intangible assets of $1.3 billion related to GitHub. See Note 8 – Business Combinations for further information.*

No material impairments of intangible assets were identified during fiscal years 2020, 2019, or 2018. We estimate that we have no significant residual value related to our intangible assets.

The components of intangible assets acquired during the periods presented were as follows:

(In millions)	Amount	Weighted Average Life	Amount	Weighted Average Life
Year Ended June 30,	**2020**		**2019**	
Technology-based	**$ 531**	**6 years**	$ 814	5 years
Customer-related	**303**	**5 years**	710	8 years
Marketing-related	**2**	**2 years**	177	10 years
Contract-based	**0**	**0 years**	7	3 years
Total	**$ 836**	**5 years**	$ 1,708	7 years

Intangible assets amortization expense was $1.6 billion, $1.9 billion, and $2.2 billion for fiscal years 2020, 2019, and 2018, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of June 30, 2020:

(In millions)	
Year Ending June 30,	
2021	**$ 1,483**
2022	**1,399**
2023	**1,219**
2024	**851**
2025	**447**
Thereafter	**1,639**
Total	**$ 7,038**

NOTE 11 — DEBT

The components of debt were as follows:

(In millions, issuance by calendar year)	Maturities (calendar year)	Stated Interest Rate	Effective Interest Rate	June 30, 2020	June 30, 2019
2009 issuance of $3.8 billion (a)	**2039**	**5.20%**	**5.24%**	**$ 559**	$ 750
2010 issuance of $4.8 billion (a)	**2020 – 2040**	**3.00% – 4.50%**	**3.14% – 4.57%**	**1,571**	2,000
2011 issuance of $2.3 billion (a)	**2021 – 2041**	**4.00% – 5.30%**	**4.08% – 5.36%**	**1,270**	1,500
2012 issuance of $2.3 billion	**2022 – 2042**	**2.13% – 3.50%**	**2.24% – 3.57%**	**1,650**	1,650
2013 issuance of $5.2 billion (a)	**2023 – 2043**	**2.38% – 4.88%**	**2.47% – 4.92%**	**2,919**	3,500
2013 issuance of €4.1 billion	**2021 – 2033**	**2.13% – 3.13%**	**2.23% – 3.22%**	**4,549**	4,613
2014 issuance				**0**	18
2015 issuance of $23.8 billion (a)	**2020 – 2055**	**2.00% – 4.75%**	**2.09% – 4.78%**	**15,549**	22,000
2016 issuance of $19.8 billion (a)	**2021 – 2056**	**1.55% – 3.95%**	**1.64% – 4.03%**	**16,955**	19,750
2017 issuance of $17.0 billion (a)	**2022 – 2057**	**2.40% – 4.50%**	**2.52% – 4.53%**	**12,385**	17,000
2020 issuance of $10.0 billion (a)	**2050 – 2060**	**2.53% – 2.68%**	**2.53% – 2.68%**	**10,000**	0
Total face value				**67,407**	72,781
Unamortized discount and issuance costs				**(554)**	(603)
Hedge fair value adjustments (b)				**93**	0
Premium on debt exchange (a)				**(3,619)**	0
Total debt				**63,327**	72,178
Current portion of long-term debt				**(3,749)**	(5,516)
Long-term debt				**$ 59,578**	$ 66,662

(a) *In June 2020, we exchanged a portion of our existing debt at premium for cash and new debt with longer maturities. The premium will be amortized over the term of the new debt.*

(b) *Refer to Note 5 – Derivatives for further information on the interest rate swaps related to fixed-rate debt.*

As of June 30, 2020 and 2019, the estimated fair value of long-term debt, including the current portion, was $77.1 billion and $78.9 billion, respectively. The estimated fair values are based on Level 2 inputs.

Debt in the table above is comprised of senior unsecured obligations and ranks equally with our other outstanding obligations. Interest is paid semi-annually, except for the Euro-denominated debt, which is paid annually.

The following table outlines maturities of our long-term debt, including the current portion, as of June 30, 2020:

(In millions)

Year Ending June 30,

2021	$	3,750
2022		7,966
2023		2,750
2024		5,250
2025		2,250
Thereafter		45,441
Total	$	67,407

NOTE 12 — INCOME TAXES

Tax Cuts and Jobs Act

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted into law, which significantly changed existing U.S. tax law and included numerous provisions that affect our business. We recorded a provisional net charge of $13.7 billion related to the enactment of the TCJA in fiscal year 2018, and adjusted the provisional net charge by recording additional tax expense of $157 million in fiscal year 2019 pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 118.

In fiscal year 2019, in response to the TCJA and recently issued regulations, we transferred certain intangible properties held by our foreign subsidiaries to the U.S. and Ireland. The transfers of intangible properties resulted in a $2.6 billion net income tax benefit recorded in the fourth quarter of fiscal year 2019, as the value of future tax deductions exceeded the current tax liability from foreign jurisdictions and U.S. global intangible low-taxed income ("GILTI") tax.

Provision for Income Taxes

The components of the provision for income taxes were as follows:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Current Taxes			
U.S. federal	**$ 3,537**	$ 4,718	$ 19,764
U.S. state and local	**763**	662	934
Foreign	**4,444**	5,531	4,348
Current taxes	**$ 8,744**	$ 10,911	$ 25,046
Deferred Taxes			
U.S. federal	**$ 58**	$ (5,647)	$ (4,292)
U.S. state and local	**(6)**	(1,010)	(458)
Foreign	**(41)**	194	(393)
Deferred taxes	**$ 11**	$ (6,463)	$ (5,143)
Provision for income taxes	**$ 8,755**	$ 4,448	$ 19,903

U.S. and foreign components of income before income taxes were as follows:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
U.S.	**$ 24,116**	$ 15,799	$ 11,527
Foreign	**28,920**	27,889	24,947
Income before income taxes	**$ 53,036**	$ 43,688	$ 36,474

Effective Tax Rate

The items accounting for the difference between income taxes computed at the U.S. federal statutory rate and our effective rate were as follows:

Year Ended June 30,	2020	2019	2018
Federal statutory rate	**21.0%**	21.0%	28.1%
Effect of:			
Foreign earnings taxed at lower rates	**(3.7)%**	(4.1)%	(7.8)%
Impact of the enactment of the TCJA	**0%**	0.4%	37.7%
Impact of intangible property transfers	**0%**	(5.9)%	0%
Foreign-derived intangible income deduction	**(1.1)%**	(1.4)%	0%
State income taxes, net of federal benefit	**1.3%**	0.7%	1.3%
Research and development credit	**(1.1)%**	(1.1)%	(1.3)%
Excess tax benefits relating to stock-based compensation	**(2.2)%**	(2.2)%	(2.5)%
Interest, net	**1.0%**	1.0%	1.2%
Other reconciling items, net	**1.3%**	1.8%	(2.1)%
Effective rate	**16.5%**	10.2%	54.6%

The decrease from the federal statutory rate in fiscal year 2020 is primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland and Puerto Rico, and tax benefits relating to stock-based compensation. The decrease from the federal statutory rate in fiscal year 2019 is primarily due to a $2.6 billion net income tax benefit related to intangible property transfers, and earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland, Singapore, and Puerto Rico. The increase from the federal statutory rate in fiscal year 2018 is primarily due to the net charge related to the enactment of the TCJA in the second quarter of fiscal year 2018, offset in part by earnings taxed at lower rates in foreign jurisdictions. In fiscal year 2020, our foreign regional operating centers in Ireland and Puerto Rico, which are taxed at rates lower than the U.S. rate, generated 86% of our foreign income before tax. In fiscal years 2019 and 2018, our foreign regional operating centers in Ireland, Singapore, and Puerto Rico, which are taxed at rates lower than the U.S. rate, generated 82% and 87% of our foreign income before tax, respectively. Other reconciling items, net consists primarily of tax credits and GILTI tax. In fiscal years 2020, 2019, and 2018, there were no individually significant other reconciling items.

The increase in our effective tax rate for fiscal year 2020 compared to fiscal year 2019 was primarily due to a $2.6 billion net income tax benefit in the fourth quarter of fiscal year 2019 related to intangible property transfers. The decrease in our effective tax rate for fiscal year 2019 compared to fiscal year 2018 was primarily due to the net charge related to the enactment of the TCJA in the second quarter of fiscal year 2018, and a $2.6 billion net income tax benefit in the fourth quarter of fiscal year 2019 related to intangible property transfers.

The components of the deferred income tax assets and liabilities were as follows:

(In millions)

June 30,	2020	2019
Deferred Income Tax Assets		
Stock-based compensation expense	**$ 461**	$ 406
Accruals, reserves, and other expenses	**2,721**	2,287
Loss and credit carryforwards	**865**	3,518
Depreciation and amortization	**6,361**	7,046
Leasing liabilities	**3,025**	1,594
Unearned revenue	**1,553**	475
Other	**354**	367
Deferred income tax assets	**15,340**	15,693
Less valuation allowance	**(755)**	(3,214)
Deferred income tax assets, net of valuation allowance	**$ 14,585**	$ 12,479
Deferred Income Tax Liabilities		
Book/tax basis differences in investments and debt	**$ (2,642)**	$ (738)
Unearned revenue	**0**	(30)
Leasing assets	**(2,817)**	(1,510)
Deferred GILTI tax liabilities	**(2,581)**	(2,607)
Other	**(344)**	(291)
Deferred income tax liabilities	**$ (8,384)**	$ (5,176)
Net deferred income tax assets	**$ 6,201**	$ 7,303
Reported As		
Other long-term assets	**$ 6,405**	$ 7,536
Long-term deferred income tax liabilities	**(204)**	(233)
Net deferred income tax assets	**$ 6,201**	$ 7,303

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when the taxes are paid or recovered.

As of June 30, 2020, we had federal, state, and foreign net operating loss carryforwards of $547 million, $975 million, and $2.0 billion, respectively. The federal and state net operating loss carryforwards will expire in various years from fiscal 2021 through 2040, if not utilized. The majority of our foreign net operating loss carryforwards do not expire. Certain acquired net operating loss carryforwards are subject to an annual limitation, but are expected to be realized with the exception of those which have a valuation allowance.

The valuation allowance disclosed in the table above relates to the foreign net operating loss carryforwards and other net deferred tax assets that may not be realized. In fiscal year 2020, we removed $2.0 billion of foreign net operating losses and corresponding valuation allowances as a result of the liquidation of a foreign subsidiary. There was no impact to our consolidated financial statements.

Income taxes paid, net of refunds, were $12.5 billion, $8.4 billion, and $5.5 billion in fiscal years 2020, 2019, and 2018, respectively.

Uncertain Tax Positions

Gross unrecognized tax benefits related to uncertain tax positions as of June 30, 2020, 2019, and 2018, were $13.8 billion, $13.1 billion, and $12.0 billion, respectively, which were primarily included in long-term income taxes in our consolidated balance sheets. If recognized, the resulting tax benefit would affect our effective tax rates for fiscal years 2020, 2019, and 2018 by $12.1 billion, $12.0 billion, and $11.3 billion, respectively.

As of June 30, 2020, 2019, and 2018, we had accrued interest expense related to uncertain tax positions of $4.0 billion, $3.4 billion, and $3.0 billion, respectively, net of income tax benefits. The provision for income taxes for fiscal years 2020, 2019, and 2018 included interest expense related to uncertain tax positions of $579 million, $515 million, and $688 million, respectively, net of income tax benefits.

The aggregate changes in the gross unrecognized tax benefits related to uncertain tax positions were as follows:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Beginning unrecognized tax benefits	**$ 13,146**	$ 11,961	$ 11,737
Decreases related to settlements	**(31)**	(316)	(193)
Increases for tax positions related to the current year	**647**	2,106	1,445
Increases for tax positions related to prior years	**366**	508	151
Decreases for tax positions related to prior years	**(331)**	(1,113)	(1,176)
Decreases due to lapsed statutes of limitations	**(5)**	0	(3)
Ending unrecognized tax benefits	**$ 13,792**	$ 13,146	$ 11,961

We settled a portion of the Internal Revenue Service ("IRS") audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. We remain under audit for tax years 2004 to 2013. In April 2020, the IRS commenced the audit for tax years 2014 to 2017.

As of June 30, 2020, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact in our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2019, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 13 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

June 30,	**2020**	**2019**
Productivity and Business Processes	**$ 18,643**	$ 16,831
Intelligent Cloud	**16,620**	16,988
More Personal Computing	**3,917**	3,387
Total	**$ 39,180**	$ 37,206

Changes in unearned revenue were as follows:

(In millions)

Year Ended June 30, 2020

Balance, beginning of period	**$ 37,206**
Deferral of revenue	**78,922**
Recognition of unearned revenue	**(76,948)**
Balance, end of period	**$ 39,180**

Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was $111 billion as of June 30, 2020, of which $107 billion is related to the commercial portion of revenue. We expect to recognize approximately 50% of this revenue over the next 12 months and the remainder thereafter.

NOTE 14 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, retail stores, and certain equipment. Our leases have remaining lease terms of 1 year to 20 years, some of which include options to extend the leases for up to 5 years, and some of which include options to terminate the leases within 1 year.

The components of lease expense were as follows:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Operating lease cost	**$ 2,043**	$ 1,707	$ 1,585
Finance lease cost:			
Amortization of right-of-use assets	**$ 611**	$ 370	$ 243
Interest on lease liabilities	**336**	247	175
Total finance lease cost	**$ 947**	$ 617	$ 418

Supplemental cash flow information related to leases was as follows:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Cash paid for amounts included in the measurement of lease liabilities:			
Operating cash flows from operating leases	**$ 1,829**	$ 1,670	$ 1,522
Operating cash flows from finance leases	**336**	247	175
Financing cash flows from finance leases	**409**	221	144
Right-of-use assets obtained in exchange for lease obligations:			
Operating leases	**3,677**	2,303	1,571
Finance leases	**3,467**	2,532	1,933

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

June 30,	2020	2019
Operating Leases		
Operating lease right-of-use assets	**$ 8,753**	$ 7,379
Other current liabilities	**$ 1,616**	$ 1,515
Operating lease liabilities	**7,671**	6,188
Total operating lease liabilities	**$ 9,287**	$ 7,703
Finance Leases		
Property and equipment, at cost	**$ 10,371**	$ 7,041
Accumulated depreciation	**(1,385)**	(774)
Property and equipment, net	**$ 8,986**	$ 6,267
Other current liabilities	**$ 540**	$ 317
Other long-term liabilities	**8,956**	6,257
Total finance lease liabilities	**$ 9,496**	$ 6,574
Weighted Average Remaining Lease Term		
Operating leases	**8 years**	7 years
Finance leases	**13 years**	13 years
Weighted Average Discount Rate		
Operating leases	**2.7%**	3.0%
Finance leases	**3.9%**	4.6%

Maturities of lease liabilities were as follows:

(In millions)

Year Ending June 30,	Operating Leases	Finance Leases
2021	**$ 1,807**	**$ 880**
2022	**1,652**	**894**
2023	**1,474**	**903**
2024	**1,262**	**916**
2025	**1,000**	**1,236**
Thereafter	**3,122**	**7,194**
Total lease payments	**10,317**	**12,023**
Less imputed interest	**(1,030)**	**(2,527)**
Total	**$ 9,287**	**$ 9,496**

As of June 30, 2020, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $3.4 billion and $3.5 billion, respectively. These operating and finance leases will commence between fiscal year 2021 and fiscal year 2023 with lease terms of 1 year to 16 years.

During fiscal year 2020, we recorded an impairment charge of $161 million to operating lease right-of-use assets due to the closing of our Microsoft Store physical locations.

NOTE 15 — CONTINGENCIES

Patent and Intellectual Property Claims

There were 64 patent infringement cases pending against Microsoft as of June 30, 2020, none of which are material individually or in aggregate.

Antitrust, Unfair Competition, and Overcharge Class Actions

Antitrust and unfair competition class action lawsuits were filed against us in British Columbia, Ontario, and Quebec, Canada. All three have been certified on behalf of Canadian indirect purchasers who acquired licenses for Microsoft operating system software and/or productivity application software between 1998 and 2010.

The trial of the British Columbia action commenced in May 2016. Following a mediation, the parties agreed to a global settlement of all three Canadian actions, and submitted the proposed settlement agreement to the courts in all three jurisdictions for approval. The final settlement has been approved by the courts in British Columbia, Ontario, and Quebec, and the claims administration process will commence once each court approves the form of notice to the class.

Other Antitrust Litigation and Claims

China State Administration for Industry and Commerce Investigation

In 2014, Microsoft was informed that China's State Agency for Market Regulation ("SAMR") (formerly State Administration for Industry and Commerce) had begun a formal investigation relating to China's Anti-Monopoly Law, and the SAMR conducted onsite inspections of Microsoft offices in Beijing, Shanghai, Guangzhou, and Chengdu. The SAMR has presented its preliminary views as to certain possible violations of China's Anti-Monopoly Law, and discussions are expected to continue.

Product-Related Litigation

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 40 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which the defendants have moved to strike. In August 2018, the trial court issued an order striking portions of the plaintiffs' expert reports. A hearing is expected to occur in the second quarter of fiscal year 2021.

Other Contingencies

We also are subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in aggregate, will not have a material adverse impact in our consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future.

As of June 30, 2020, we accrued aggregate legal liabilities of $306 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $500 million in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

NOTE 16 — STOCKHOLDERS' EQUITY

Shares Outstanding

Shares of common stock outstanding were as follows:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Balance, beginning of year	**7,643**	7,677	7,708
Issued	**54**	116	68
Repurchased	**(126)**	(150)	(99)
Balance, end of year	**7,571**	7,643	7,677

Share Repurchases

On September 20, 2016, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program commenced in December 2016 and was completed in February 2020.

On September 18, 2019, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program commenced in February 2020, following completion of the program approved on September 20, 2016, has no expiration date, and may be terminated at any time. As of June 30, 2020, $31.7 billion remained of this $40.0 billion share repurchase program.

We repurchased the following shares of common stock under the share repurchase programs:

(In millions)	Shares	Amount	Shares	Amount	Shares	Amount
Year Ended June 30,		2020		2019		2018
First Quarter	**29**	**$ 4,000**	24	$ 2,600	22	$ 1,600
Second Quarter	**32**	**4,600**	57	6,100	22	1,800
Third Quarter	**37**	**6,000**	36	3,899	34	3,100
Fourth Quarter	**28**	**5,088**	33	4,200	21	2,100
Total	**126**	**$ 19,688**	150	$ 16,799	99	$ 8,600

Shares repurchased during the fourth quarter of fiscal year 2020 were under the share repurchase program approved on September 18, 2019. Shares repurchased during the third quarter of fiscal year 2020 were under the share repurchase programs approved on both September 20, 2016 and September 18, 2019. All other shares repurchased were under the share repurchase program approved on September 20, 2016. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $3.3 billion, $2.7 billion, and $2.1 billion for fiscal years 2020, 2019, and 2018, respectively. All share repurchases were made using cash resources.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2020				(In millions)
September 18, 2019	**November 21, 2019**	**December 12, 2019**	**$ 0.51**	**$ 3,886**
December 4, 2019	**February 20, 2020**	**March 12, 2020**	**0.51**	**3,876**
March 9, 2020	**May 21, 2020**	**June 11, 2020**	**0.51**	**3,865**
June 17, 2020	**August 20, 2020**	**September 10, 2020**	**0.51**	**3,861**
Total			**$ 2.04**	**$ 15,488**
Fiscal Year 2019				
September 18, 2018	November 15, 2018	December 13, 2018	$ 0.46	$ 3,544
November 28, 2018	February 21, 2019	March 14, 2019	0.46	3,526
March 11, 2019	May 16, 2019	June 13, 2019	0.46	3,521
June 12, 2019	August 15, 2019	September 12, 2019	0.46	3,510
Total			$ 1.84	$ 14,101

The dividend declared on June 17, 2020 was included in other current liabilities as of June 30, 2020.

NOTE 17 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes in accumulated other comprehensive income (loss) by component:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Derivatives			
Balance, beginning of period	**$ 0**	$ 173	$ 134
Unrealized gains (losses), net of tax of **$(10)**, $2, and $11	**(38)**	160	218
Reclassification adjustments for gains included in revenue	**0**	(341)	(185)
Tax expense included in provision for income taxes	**0**	8	6
Amounts reclassified from accumulated other comprehensive income (loss)	**0**	(333)	(179)
Net change related to derivatives, net of tax of **$(10)**, $(6), and $5	**(38)**	(173)	39
Balance, end of period	**$ (38)**	$ 0	$ 173
Investments			
Balance, beginning of period	**$ 1,488**	$ (850)	$ 1,825
Unrealized gains (losses), net of tax of **$1,057**, $616, and $(427)	**3,987**	2,331	(1,146)
Reclassification adjustments for (gains) losses included in other income (expense), net	**4**	93	(2,309)
Tax expense (benefit) included in provision for income taxes	**(1)**	(19)	738
Amounts reclassified from accumulated other comprehensive income (loss)	**3**	74	(1,571)
Net change related to investments, net of tax of **$1,058**, $635, and $(1,165)	**3,990**	2,405	(2,717)
Cumulative effect of accounting changes	**0**	(67)	42
Balance, end of period	**$ 5,478**	$ 1,488	$ (850)
Translation Adjustments and Other			
Balance, beginning of period	**$ (1,828)**	$ (1,510)	$ (1,332)
Translation adjustments and other, net of tax effects of **$1**, $(1), and $0	**(426)**	(318)	(178)
Balance, end of period	**$ (2,254)**	$ (1,828)	$ (1,510)
Accumulated other comprehensive income (loss), end of period	**$ 3,186**	$ (340)	$ (2,187)

NOTE 18 — EMPLOYEE STOCK AND SAVINGS PLANS

We grant stock-based compensation to employees and directors. As of June 30, 2020, an aggregate of 283 million shares were authorized for future grant under our stock plans. Awards that expire or are canceled without delivery of shares generally become available for issuance under the plans. We issue new shares of Microsoft common stock to satisfy vesting of awards granted under our stock plans. We also have an ESPP for all eligible employees.

Stock-based compensation expense and related income tax benefits were as follows:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Stock-based compensation expense	**$ 5,289**	$ 4,652	$ 3,940
Income tax benefits related to stock-based compensation	**938**	816	823

Stock Plans

Stock awards entitle the holder to receive shares of Microsoft common stock as the award vests. Stock awards generally vest over a service period of four years or five years.

Executive Incentive Plan

Under the Executive Incentive Plan, the Compensation Committee approves stock awards to executive officers and certain senior executives. RSUs generally vest ratably over a service period of four years. PSUs generally vest over a performance period of three years. The number of shares the PSU holder receives is based on the extent to which the corresponding performance goals have been achieved.

Activity for All Stock Plans

The fair value of stock awards was estimated on the date of grant using the following assumptions:

Year ended June 30,	2020	2019	2018
Dividends per share (quarterly amounts)	**$ 0.46 – 0.51**	$ 0.42 – 0.46	$ 0.39 – 0.42
Interest rates	**0.1% – 2.2%**	1.8% – 3.1%	1.7% – 2.9%

During fiscal year 2020, the following activity occurred under our stock plans:

	Shares	Weighted Average Grant-Date Fair Value
	(In millions)	
Stock Awards		
Nonvested balance, beginning of year	**147**	**$ 78.49**
Granted (a)	**53**	**140.49**
Vested	**(65)**	**75.35**
Forfeited	**(9)**	**90.30**
Nonvested balance, end of year	**126**	**$ 105.23**

(a) *Includes 2 million, 2 million, and 3 million of PSUs granted at target and performance adjustments above target levels for fiscal years 2020, 2019, and 2018, respectively.*

As of June 30, 2020, there was approximately $10.2 billion of total unrecognized compensation costs related to stock awards. These costs are expected to be recognized over a weighted average period of three years. The weighted average grant-date fair value of stock awards granted was $140.49, $107.02, and $75.88 for fiscal years 2020, 2019, and 2018, respectively. The fair value of stock awards vested was $10.1 billion, $8.7 billion, and $6.6 billion, for fiscal years 2020, 2019, and 2018, respectively.

Employee Stock Purchase Plan

We have an ESPP for all eligible employees. Shares of our common stock may be purchased by employees at three-month intervals at 90% of the fair market value on the last trading day of each three-month period. Employees may purchase shares having a value not exceeding 15% of their gross compensation during an offering period. Employees purchased the following shares during the periods presented:

(Shares in millions)

Year Ended June 30,	2020	2019	2018
Shares purchased	**9**	11	13
Average price per share	**$ 142.22**	$ 104.85	$ 76.40

As of June 30, 2020, 96 million shares of our common stock were reserved for future issuance through the ESPP.

Savings Plan

We have savings plans in the U.S. that qualify under Section 401(k) of the Internal Revenue Code, and a number of savings plans in international locations. Eligible U.S. employees may contribute a portion of their salary into the savings plans, subject to certain limitations. We contribute fifty cents for each dollar a participant contributes into the plans, with a maximum employer contribution of 50% of the IRS contribution limit for the calendar year. Employer-funded retirement benefits for all plans were $1.0 billion, $877 million, and $807 million in fiscal years 2020, 2019, and 2018, respectively, and were expensed as contributed.

NOTE 19 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

In its operation of the business, management, including our chief operating decision maker, who is also our Chief Executive Officer, reviews certain financial information, including segmented internal profit and loss statements prepared on a basis not consistent with GAAP. During the periods presented, we reported our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing.

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial, including Office 365 subscriptions, the Office portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises, comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Skype for Business, and related Client Access Licenses (“CALs”).
- Office Consumer, including Microsoft 365 Consumer (formerly Office 365 Consumer) subscriptions and Office licensed on-premises, and Office Consumer Services, including Skype, Outlook.com, and OneDrive.
- LinkedIn, including Talent Solutions, Learning Solutions, Marketing Solutions, Sales Solutions, and Premium Subscriptions.
- Dynamics business solutions, including Dynamics 365, a set of cloud-based applications across ERP and CRM, Dynamics ERP on-premises, and Dynamics CRM on-premises.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business and developers. This segment primarily comprises:

- Server products and cloud services, including Azure; SQL Server, Windows Server, Visual Studio, System Center, and related CALs; and GitHub.
- Enterprise Services, including Premier Support Services and Microsoft Consulting Services.

More Personal Computing

Our More Personal Computing segment consists of products and services that put customers at the center of the experience with our technology. This segment primarily comprises:

- Windows, including Windows OEM licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; Windows Internet of Things; and MSN advertising.
- Devices, including Surface and PC accessories.

- Gaming, including Xbox hardware and Xbox content and services, comprising Xbox Live (transactions, subscriptions, cloud services, and advertising), video games, and third-party video game royalties.
- Search.

Revenue and costs are generally directly attributed to our segments. However, due to the integrated structure of our business, certain revenue recognized and costs incurred by one segment may benefit other segments. Revenue from certain contracts is allocated among the segments based on the relative value of the underlying products and services, which can include allocation based on actual prices charged, prices when sold separately, or estimated costs plus a profit margin. Cost of revenue is allocated in certain cases based on a relative revenue methodology. Operating expenses that are allocated primarily include those relating to marketing of products and services from which multiple segments benefit and are generally allocated based on relative gross margin.

In addition, certain costs incurred at a corporate level that are identifiable and that benefit our segments are allocated to them. These allocated costs include costs of: legal, including settlements and fines; information technology; human resources; finance; excise taxes; field selling; shared facilities services; and customer service and support. Each allocation is measured differently based on the specific facts and circumstances of the costs being allocated. Certain corporate-level activity is not allocated to our segments.

Segment revenue and operating income were as follows during the periods presented:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Revenue			
Productivity and Business Processes	**$ 46,398**	$ 41,160	$ 35,865
Intelligent Cloud	**48,366**	38,985	32,219
More Personal Computing	**48,251**	45,698	42,276
Total	**$ 143,015**	$ 125,843	$ 110,360
Operating Income			
Productivity and Business Processes	**$ 18,724**	$ 16,219	$ 12,924
Intelligent Cloud	**18,324**	13,920	11,524
More Personal Computing	**15,911**	12,820	10,610
Total	**$ 52,959**	$ 42,959	$ 35,058

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for fiscal years 2020, 2019, or 2018. Revenue, classified by the major geographic areas in which our customers were located, was as follows:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
United States (a)	**$ 73,160**	$ 64,199	$ 55,926
Other countries	**69,855**	61,644	54,434
Total	**$ 143,015**	$ 125,843	$ 110,360

(a) *Includes billings to OEMs and certain multinational organizations because of the nature of these businesses and the impracticability of determining the geographic source of the revenue.*

Revenue from external customers, classified by significant product and service offerings, was as follows:

(In millions)

Year Ended June 30,	**2020**	**2019**	**2018**
Server products and cloud services	**$ 41,379**	$ 32,622	$ 26,129
Office products and cloud services	**35,316**	31,769	28,316
Windows	**22,294**	20,395	19,518
Gaming	**11,575**	11,386	10,353
LinkedIn	**8,077**	6,754	5,259
Search advertising	**7,740**	7,628	7,012
Devices	**6,457**	6,095	5,134
Enterprise Services	**6,409**	6,124	5,846
Other	**3,768**	3,070	2,793
Total	**$ 143,015**	$ 125,843	$ 110,360

Our commercial cloud revenue, which includes Office 365 Commercial, Azure, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was $51.7 billion, $38.1 billion and $26.6 billion in fiscal years 2020, 2019, and 2018, respectively. These amounts are primarily included in Office products and cloud services, Server products and cloud services, and LinkedIn in the table above.

Assets are not allocated to segments for internal reporting presentations. A portion of amortization and depreciation is included with various other costs in an overhead allocation to each segment. It is impracticable for us to separately identify the amount of amortization and depreciation by segment that is included in the measure of segment profit or loss.

Long-lived assets, excluding financial instruments and tax assets, classified by the location of the controlling statutory company and with countries over 10% of the total shown separately, were as follows:

(In millions)

June 30,	**2020**	**2019**	**2018**
United States	**$ 60,789**	$ 55,252	$ 44,501
Ireland	**12,734**	12,958	12,843
Other countries	**29,770**	25,422	22,538
Total	**$ 103,293**	$ 93,632	$ 79,882

NOTE 20 — QUARTERLY INFORMATION (UNAUDITED)

(In millions, except per share amounts)

Quarter Ended	September 30	December 31	March 31	June 30	Total
Fiscal Year 2020					
Revenue	**$ 33,055**	**$ 36,906**	**$ 35,021**	**$ 38,033**	**$ 143,015**
Gross margin	**22,649**	**24,548**	**24,046**	**25,694**	**96,937**
Operating income	**12,686**	**13,891**	**12,975**	**13,407**	**52,959**
Net income	**10,678**	**11,649**	**10,752**	**11,202**	**44,281**
Basic earnings per share	**1.40**	**1.53**	**1.41**	**1.48**	**5.82**
Diluted earnings per share	**1.38**	**1.51**	**1.40**	**1.46**	**5.76**
Fiscal Year 2019					
Revenue	29,084	32,471	30,571	33,717	125,843
Gross margin	19,179	20,048	20,401	23,305	82,933
Operating income	9,955	10,258	10,341	12,405	42,959
Net income (a)	8,824	8,420	8,809	13,187	39,240
Basic earnings per share	1.15	1.09	1.15	1.72	5.11
Diluted earnings per share (b)	1.14	1.08	1.14	1.71	5.06

(a) *Reflects the $157 million net charge related to the enactment of the TCJA for the second quarter and the $2.6 billion net income tax benefit related to the intangible property transfers for the fourth quarter, which together increased net income by $2.4 billion for fiscal year 2019. See Note 12 – Income Taxes for further information.*

(b) *Reflects the net charge related to the enactment of the TCJA and the net income tax benefit related to the intangible property transfers, which decreased (increased) diluted EPS $0.02 for the second quarter, $(0.34) for the fourth quarter, and $(0.31) for fiscal year 2019.*

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2020 and 2019, the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity, for each of the three years in the period ended June 30, 2020, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2020 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2020, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of June 30, 2020, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated July 30, 2020, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current-period audit of the financial statements that were communicated or required to be communicated to the audit committee and that (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Revenue Recognition – Refer to Note 1 to the financial statements

Critical Audit Matter Description

The Company recognizes revenue upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. The Company offers customers the ability to acquire multiple licenses of software products and services, including cloud-based services, in its customer agreements through its volume licensing programs.

Significant judgment is exercised by the Company in determining revenue recognition for these customer agreements, and includes the following:

- Determination of whether products and services are considered distinct performance obligations that should be accounted for separately versus together, such as software licenses and related services that are sold with cloud-based services.
- The pattern of delivery (i.e., timing of when revenue is recognized) for each distinct performance obligation.
- Identification and treatment of contract terms that may impact the timing and amount of revenue recognized (e.g., variable consideration, optional purchases, and free services).
- Determination of stand-alone selling prices for each distinct performance obligation and for products and services that are not sold separately.

Given these factors and due to the volume of transactions, the related audit effort in evaluating management's judgments in determining revenue recognition for these customer agreements was extensive and required a high degree of auditor judgment.

How the Critical Audit Matter Was Addressed in the Audit

Our principal audit procedures related to the Company's revenue recognition for these customer agreements included the following:

- We tested the effectiveness of controls related to the identification of distinct performance obligations, the determination of the timing of revenue recognition, and the estimation of variable consideration.
- We evaluated management's significant accounting policies related to these customer agreements for reasonableness.
- We selected a sample of customer agreements and performed the following procedures:

– Obtained and read contract source documents for each selection, including master agreements, and other documents that were part of the agreement.

– Tested management's identification and treatment of contract terms.

– Assessed the terms in the customer agreement and evaluated the appropriateness of management's application of their accounting policies, along with their use of estimates, in the determination of revenue recognition conclusions.

- We evaluated the reasonableness of management's estimate of stand-alone selling prices for products and services that are not sold separately.

- We tested the mathematical accuracy of management's calculations of revenue and the associated timing of revenue recognized in the financial statements.

Income Taxes – Uncertain Tax Positions – Refer to Note 12 to the financial statements

Critical Audit Matter Description

The Company's long-term income taxes liability includes uncertain tax positions related to transfer pricing issues that remain unresolved with the Internal Revenue Service ("IRS"). The Company remains under IRS audit, or subject to IRS audit, for tax years subsequent to 2003. While the Company has settled a portion of the IRS audits, resolution of the remaining matters could have a material impact on the Company's financial statements.

Conclusions on recognizing and measuring uncertain tax positions involve significant estimates and management judgment and include complex considerations of the Internal Revenue Code, related regulations, tax case laws, and prior-year audit settlements. Given the complexity and the subjective nature of the transfer pricing issues that remain unresolved with the IRS, evaluating management's estimates relating to their determination of uncertain tax positions required extensive audit effort and a high degree of auditor judgment, including involvement of our tax specialists.

How the Critical Audit Matter Was Addressed in the Audit

Our principal audit procedures to evaluate management's estimates of uncertain tax positions related to unresolved transfer pricing issues included the following:

- We evaluated the appropriateness and consistency of management's methods and assumptions used in the identification, recognition, measurement, and disclosure of uncertain tax positions, which included testing the effectiveness of the related internal controls.

- We read and evaluated management's documentation, including relevant accounting policies and information obtained by management from outside tax specialists, that detailed the basis of the uncertain tax positions.

- We tested the reasonableness of management's judgments regarding the future resolution of the uncertain tax positions, including an evaluation of the technical merits of the uncertain tax positions.

- For those uncertain tax positions that had not been effectively settled, we evaluated whether management had appropriately considered new information that could significantly change the recognition, measurement or disclosure of the uncertain tax positions.

- We evaluated the reasonableness of management's estimates by considering how tax law, including statutes, regulations and case law, impacted management's judgments.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
July 30, 2020

We have served as the Company's auditor since 1983.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective.

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our consolidated financial statements; providing reasonable assurance that receipts and expenditures of company assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use, or disposition of company assets that could have a material effect on our consolidated financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our consolidated financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company’s internal control over financial reporting was effective as of June 30, 2020. There were no changes in our internal control over financial reporting during the quarter ended June 30, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Deloitte & Touche LLP has audited our internal control over financial reporting as of June 30, 2020; their report is included in Item 9A.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2020, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2020, based on the criteria established in *Internal Control — Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements and the related notes (collectively referred to as the "financial statements") as of and for the year ended June 30, 2020, of the Company and our report dated July 30, 2020, expressed an unqualified opinion on those financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
July 30, 2020

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

A list of our executive officers and biographical information appears in Part I, Item 1 of this Form 10-K. Information about our directors may be found under the caption “Our director nominees” in our Proxy Statement for the Annual Meeting of Shareholders to be held December 2, 2020 (the “Proxy Statement”). Information about our Audit Committee may be found under the caption “Board committees” in the Proxy Statement. That information is incorporated herein by reference.

We have adopted the Microsoft Finance Code of Professional Conduct (the “finance code of ethics”), a code of ethics that applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, and other finance organization employees. The finance code of ethics is publicly available on our website at https://aka.ms/FinanceCodeProfessionalConduct. If we make any substantive amendments to the finance code of ethics or grant any waiver, including any implicit waiver, from a provision of the code to our Chief Executive Officer, Chief Financial Officer, or Chief Accounting Officer, we will disclose the nature of the amendment or waiver on that website or in a report on Form 8-K.

ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions “Director compensation,” “Named executive officer compensation,” “Compensation Committee interlocks and insider participation,” and “Compensation Committee report” is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information in the Proxy Statement set forth under the captions “Stock ownership information,” “Principal shareholders” and “Equity compensation plan information” is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information set forth in the Proxy Statement under the captions “Director independence” and “Certain relationships and related transactions” is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information concerning principal accountant fees and services appears in the Proxy Statement under the headings “Fees billed by Deloitte & Touche” and “Policy on Audit Committee pre-approval of audit and permissible non-audit services of independent auditor” and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements and Schedules

The financial statements are set forth under Item 8 of this Form 10-K, as indexed below. Financial statement schedules have been omitted since they either are not required, not applicable, or the information is otherwise included.

(b) Exhibit Listing

			Incorporated by Reference			
Exhibit Number	Exhibit Description	Filed Herewith	Form	Period Ending	Exhibit	Filing Date
3.1	Amended and Restated Articles of Incorporation of Microsoft Corporation		8-K		3.1	12/1/16
3.2	Bylaws of Microsoft Corporation		8-K		3.2	6/14/17
4.1	Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee ("Base Indenture")		S-3ASR		4.1	10/29/15
4.2	Form of First Supplemental Indenture for 2.95% Notes due 2014, 4.20% Notes due 2019, and 5.20% Notes due 2039, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Base Indenture		8-K		4.2	5/15/09
4.5	Form of Second Supplemental Indenture for 0.875% Notes due 2013, 1.625% Notes due 2015, 3.00% Notes due 2020, and 4.50% Notes due 2040, dated as of September 27, 2010, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	9/27/10

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.6	Third Supplemental Indenture for 2.500% Notes due 2016, 4.000% Notes due 2021, and 5.300% Notes due 2041, dated as of February 8, 2011, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	2/8/11
4.7	Fourth Supplemental Indenture for 0.875% Notes due 2017, 2.125% Notes due 2022, and 3.500% Notes due 2042, dated as of November 7, 2012, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	11/7/12
4.8	Fifth Supplemental Indenture for 2.625% Notes due 2033, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	5/1/13
4.9	Sixth Supplemental Indenture for 1.000% Notes due 2018, 2.375% Notes due 2023, and 3.750% Notes due 2043, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	5/1/13
4.10	Seventh Supplemental Indenture for 2.125% Notes due 2021 and 3.125% Notes due 2028, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank		8-K		4.1	12/6/13

of New York Mellon Trust Company,
N.A., as Trustee

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.11	Eighth Supplemental Indenture for 1.625% Notes due 2018, 3.625% Notes due 2023, and 4.875% Notes due 2043, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	12/6/13
4.12	Ninth Supplemental Indenture for 1.850% Notes due 2020, 2.375% Notes due 2022, 2.700% Notes due 2025, 3.500% Notes due 2035, 3.750% Notes due 2045, and 4.000% Notes due 2055, dated as of February 12, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	2/12/15
4.13	Tenth Supplemental Indenture for 1.300% Notes due 2018, 2.000% Notes due 2020, 2.650% Notes due 2022, 3.125% Notes due 2025, 4.200% Notes due 2035, 4.450% Notes due 2045, and 4.750% Notes due 2055, dated as of November 3, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	11/3/15
4.14	Eleventh Supplemental Indenture for 1.100% Notes due 2019, 1.550% Notes due 2021, 2.000% Notes due 2023, 2.400% Notes due 2026, 3.450% Notes due 2036, 3.700% Notes due 2046, and 3.950% Notes due 2056, dated as of August 8, 2016, between Microsoft Corporation and U.S. Bank, National Association, as trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	8/5/16

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.15	Twelfth Supplemental Indenture for 1.850% Notes due 2020, 2.400% Notes due 2022, 2.875% Notes due 2024, 3.300% Notes due 2027, 4.100% Notes due 2037, 4.250% Notes due 2047, and 4.500% Notes due 2057, dated as of February 6, 2017, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	2/3/17
4.16	Thirteenth Supplemental Indenture for 2.525% Notes due 2050 and 2.675% Notes due 2060, dated June 1, 2020, between Microsoft Corporation and U.S. Bank National Association, as trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee.		8-K		4.1	6/1/20
4.17	Description of Securities		10-K	6/30/19	4.16	8/1/19
10.1*	Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.1	10/20/16
10.4*	Microsoft Corporation Employee Stock Purchase Plan		10-K	6/30/12	10.4	7/26/12
10.5*	Microsoft Corporation Deferred Compensation Plan		10-K	6/30/18	10.5	8/3/18
10.6*	Microsoft Corporation 2017 Stock Plan		DEF14A		Annex C	10/16/17
10.7*	Form of Stock Award Agreement Under the Microsoft Corporation 2017 Stock Plan		10-Q	3/31/2018	10.26	4/26/18
10.8*	Form of Performance Stock Award Agreement Under the Microsoft Corporation 2017 Stock Plan		10-Q	3/31/2018	10.27	4/26/18
10.12	Amended and Restated Officers' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		10-Q	9/30/16	10.12	10/20/16

10.13	Form of Indemnification Agreement and Amended and Restated Directors' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee	10-K	6/30/19	10.13	8/1/19
10.14*	Microsoft Corporation Deferred Compensation Plan for Non-Employee Directors	10-Q	12/31/17	10.14	1/31/18
10.15*	Microsoft Corporation Executive Incentive Plan	8-K		10.1	9/19/18

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
10.19*	Microsoft Corporation Executive Incentive Plan		10-Q	9/30/16	10.17	10/20/16
10.20*	Form of Executive Incentive Plan (Executive Officer SAs) Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.18	10/20/16
10.21*	Form of Executive Incentive Plan Performance Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.25	10/20/16
10.22*	Senior Executive Severance Benefit Plan		10-Q	9/30/16	10.22	10/20/16
10.23*	Offer Letter, dated February 3, 2014, between Microsoft Corporation and Satya Nadella		8-K		10.1	2/4/14
10.24*	Long-Term Performance Stock Award Agreement between Microsoft Corporation and Satya Nadella		10-Q	12/31/14	10.24	1/26/15
10.25	Assumption of Beneficiaries' Representative Obligation Under Amended and Restated Officers' Indemnification Trust	X				
10.26	Assumption of Beneficiaries' Representative Obligation Under Amended and Restated Directors' Indemnification Trust	X				
21	Subsidiaries of Registrant	X				
23.1	Consent of Independent Registered Public Accounting Firm	X				
31.1	Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2	Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
32.1**	Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
32.2**	Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
101.INS	Inline XBRL Instance Document—the instance document does not appear in the Interactive Data File	X				

	as its XBRL tags are embedded within the Inline XBRL document	
101.SCH	Inline XBRL Taxonomy Extension Schema	X

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference			
			Form	Period Ending	Exhibit	Filing Date
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase	X				
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase	X				
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase	X				
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase	X				
104	Cover page formatted as Inline XBRL and contained in Exhibit 101	X				

* *Indicates a management contract or compensatory plan or arrangement.*

** *Furnished, not filed.*

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned; thereunto duly authorized, in the City of Redmond, State of Washington, on July 30, 2020.

MICROSOFT CORPORATION

/S/ FRANK H. BROD

Frank H. Brod
Corporate Vice President, Finance and Administration;
Chief Accounting Officer (Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on July 30, 2020.

Signature	Title
/s/ JOHN W. THOMPSON John W. Thompson	Chairman
/s/ SATYA NADELLA Satya Nadella	Director and Chief Executive Officer
/s/ REID HOFFMAN Reid Hoffman	Director
/s/ HUGH F. JOHNSTON Hugh F. Johnston	Director
/s/ TERI L. LIST-STOLL Teri L. List-Stoll	Director
/s/ SANDRA E. PETERSON Sandra E. Peterson	Director
/s/ PENNY S. PRITZKER Penny S. Pritzker	Director
/s/ CHARLES W. SCHARF Charles W. Scharf	Director
/s/ ARNE M. SORENSON Arne M. Sorenson	Director
/s/ JOHN W. STANTON John W. Stanton	Director
/s/ EMMA N. WALMSLEY Emma N. Walmsley	Director
/s/ PADMASREE WARRIOR Padmasree Warrior	Director
/s/ AMY E. HOOD Amy E. Hood	Executive Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ FRANK H. BROD Frank H. Brod	Corporate Vice President, Finance and Administration; Chief Accounting Officer (Principal Accounting Officer)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended June 30, 2019

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period From to

Commission File Number 001-37845

MICROSOFT CORPORATION

WASHINGTON	**91-1144442**
(STATE OF INCORPORATION)	**(I.R.S. ID)**

ONE MICROSOFT WAY, REDMOND, WASHINGTON 98052-6399

(425) 882-8080

www.microsoft.com/investor

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of exchange on which registered
COMMON STOCK, $0.00000625 par value per share	**MSFT**	**NASDAQ**
2.125% Notes due 2021	**MSFT**	**New York Stock Exchange**
3.125% Notes due 2028	**MSFT**	**New York Stock Exchange**
2.625% Notes due 2033	**MSFT**	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒	Accelerated filer ☐
Non-accelerated filer ☐	Smaller reporting company ☐
	Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of December 31, 2018, the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant was $769.6 billion based on the closing sale price as reported on the NASDAQ National Market System. As of July 29, 2019, there were 7,635,409,400 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on December 4, 2019 are incorporated by reference into Part III.

MICROSOFT CORPORATION

FORM 10-K

For the Fiscal Year Ended June 30, 2019

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Note About Forward-Looking Statements

This report includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including the following sections: “Business” (Part I, Item 1 of this Form 10-K), “Risk Factors” (Part I, Item 1A of this Form 10-K), and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” (Part II, Item 7 of this Form 10-K). These forward-looking statements generally are identified by the words “believe,” “project,” “expect,” “anticipate,” “estimate,” “intend,” “strategy,” “future,” “opportunity,” “plan,” “may,” “should,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. We describe risks and uncertainties that could cause actual results and events to differ materially in “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Quantitative and Qualitative Disclosures about Market Risk” (Part II, Item 7A of this Form 10-K). Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date they are made. We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

PART I

ITEM 1. BUSINESS

GENERAL

Embracing Our Future

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity.

We continue to transform our business to lead in the new era of the intelligent cloud and intelligent edge. We bring technology and products together into experiences and solutions that unlock value for our customers. In this next phase of innovation, computing is more powerful and ubiquitous from the cloud to the edge. Artificial intelligence (“AI”) capabilities are rapidly advancing, fueled by data and knowledge of the world. Physical and virtual worlds are coming together with the Internet of Things (“IoT”) and mixed reality to create richer experiences that understand the context surrounding people, the things they use, the places they go, and their activities and relationships. A person’s experience with technology spans a multitude of devices and has become increasingly more natural and multi-sensory with voice, ink, and gaze interactions.

What We Offer

Founded in 1975, we develop and support software, services, devices, and solutions that deliver new value for customers and help people and businesses realize their full potential.

We offer an array of services, including cloud-based solutions that provide customers with software, services, platforms, and content, and we provide solution support and consulting services. We also deliver relevant online advertising to a global audience.

Our products include operating systems; cross-device productivity applications; server applications; business solution applications; desktop and server management tools; software development tools; and video games. We also design, manufacture, and sell devices, including PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

The Ambitions That Drive Us

To achieve our vision, our research and development efforts focus on three interconnected ambitions:

- Reinvent productivity and business processes.
- Build the intelligent cloud and intelligent edge platform.
- Create more personal computing.

Reinvent Productivity and Business Processes

We are in a unique position to empower people and organizations to succeed in a rapidly evolving workplace. Computing experiences are evolving, no longer bound to one device at a time. Instead, experiences are expanding to many devices as people move from home to work to on the go. These modern needs, habits, and expectations of our customers are motivating us to bring Microsoft Office 365, Windows platform, devices, including Microsoft Surface, and third-party applications into a more cohesive Microsoft 365 experience.

Our growth depends on securely delivering continuous innovation and advancing our leading productivity and collaboration tools and services, including Office, Microsoft Dynamics, and LinkedIn. Microsoft 365 brings together Office 365, Windows 10, and Enterprise Mobility + Security to help organizations empower their employees with AI-backed tools that unlock creativity, increase teamwork, and fuel innovation, all the while enabling compliance coverage and data protection. Microsoft Teams is core to our vision for the modern workplace as the digital hub that creates a single canvas for teamwork, conversations, meetings, and content. Microsoft Relationship Sales solution brings together LinkedIn Sales Navigator and Dynamics to transform business to business sales through social selling. Dynamics 365 for Talent with LinkedIn Recruiter and Learning gives human resource professionals a complete solution to compete for talent. Microsoft Power Platform empowers employees to build custom applications, automate workflow, and analyze data no matter their technical expertise.

These scenarios represent a move to unlock creativity and inspire teamwork, while simplifying security and management. Organizations of all sizes can now digitize business-critical functions, redefining what customers can expect from their business applications. This creates an opportunity for us to reach new customers and increase usage and engagement with existing customers.

Build the Intelligent Cloud and Intelligent Edge Platform

Companies are looking to use digital technology to fundamentally reimagine how they empower their employees, engage customers, optimize their operations, and change the very core of their products and services. Partnering with organizations on their digital transformation is one of our largest opportunities and we are uniquely positioned to become the strategic digital transformation platform and partner of choice.

Our strategy requires continued investment in datacenters and other hybrid and edge infrastructure to support our services. Microsoft Azure is a trusted cloud with comprehensive compliance coverage and AI-based security built in.

Our cloud business benefits from three economies of scale: datacenters that deploy computational resources at significantly lower cost per unit than smaller ones; datacenters that coordinate and aggregate diverse customer, geographic, and application demand patterns, improving the utilization of computing, storage, and network resources; and multi-tenancy locations that lower application maintenance labor costs.

As one of the two largest providers of cloud computing at scale, we believe we work from a position of strength. Being a global-scale cloud, Azure uniquely offers hybrid consistency, developer productivity, AI capabilities, and trusted security and compliance. We see more emerging use cases and needs for compute and security at the edge and are accelerating our innovation across the spectrum of intelligent edge devices, from IoT sensors to gateway devices and edge hardware to build, manage, and secure edge workloads. With Azure Stack, organizations can extend Azure into their own datacenters to create a consistent stack across the public cloud and the intelligent edge. Our hybrid infrastructure consistency spans identity, data, compute, management, and security, helping to support the real-world needs and evolving regulatory requirements of commercial customers and enterprises. We are accelerating our development of mixed reality solutions, with new Azure services and devices such as HoloLens 2. The opportunity to merge the physical and digital worlds, when combined with the power of Azure cloud services, unlocks the potential for entirely new workloads which we believe will shape the next era of computing.

The ability to convert data into AI drives our competitive advantage. Azure SQL Database makes it possible for customers to take Microsoft SQL Server from their on-premises datacenter to a fully managed instance in the cloud to utilize built-in AI. We are accelerating adoption of AI innovations from research to products. Our innovation helps every developer be an AI developer, with approachable new tools from Azure Machine Learning Studio for creating simple machine learning models, to the powerful Azure Machine Learning Workbench for the most advanced AI modeling and data science.

On October 25, 2018, we completed our acquisition of GitHub, Inc. (“GitHub”), a service that millions of developers around the world rely on to write code together. The acquisition is expected to empower developers to achieve more at every stage of the development lifecycle, accelerate enterprise use of GitHub, and bring Microsoft’s developer tools and services to new audiences.

Create More Personal Computing

We strive to make computing more personal by putting users at the core of the experience, enabling them to interact with technology in more intuitive, engaging, and dynamic ways. In support of this, we are bringing Office, Windows, and devices together for an enhanced and more cohesive customer experience.

Windows 10 continues to gain traction in the enterprise as the most secure and productive operating system. It empowers people with AI-first interfaces ranging from voice-activated commands through Cortana, inking, immersive 3D content storytelling, and mixed reality experiences. Windows also plays a critical role in fueling our cloud business and Microsoft 365 strategy, and it powers the growing range of devices on the “intelligent edge.” Our ambition for Windows 10 monetization opportunities includes gaming, services, subscriptions, and search advertising.

We are committed to designing and marketing first-party devices to help drive innovation, create new device categories, and stimulate demand in the Windows ecosystem. We recently expanded our Surface family of devices with the Surface Hub 2S, which brings together Microsoft Teams, Windows, and Surface hardware to power teamwork for organizations.

We are mobilizing to pursue our expansive opportunity in the gaming industry, broadening our approach to how we think about gaming end-to-end, from the way games are created and distributed to how they are played and viewed. We have a strong position with our Xbox One console, our large and growing highly engaged community of gamers on Xbox Live, and with Windows 10, the most popular operating system for PC gamers. We will continue to connect our gaming assets across PC, console, and mobile, and work to grow and engage the Xbox Live member network more deeply and frequently with services like Mixer and Xbox Game Pass. Our approach is to enable gamers to play the games they want, with the people they want, on the devices they want.

Our Future Opportunity

Customers are looking to us to accelerate their own digital transformations and to unlock new opportunity in this era of intelligent cloud and intelligent edge. We continue to develop complete, intelligent solutions for our customers that empower users to be creative and work together while safeguarding businesses and simplifying IT management. Our goal is to lead the industry in several distinct areas of technology over the long-term, which we expect will translate to sustained growth. We are investing significant resources in:

- Transforming the workplace to deliver new modern, modular business applications to improve how people communicate, collaborate, learn, work, play, and interact with one another.
- Building and running cloud-based services in ways that unleash new experiences and opportunities for businesses and individuals.
- Applying AI to drive insights and act on our customer’s behalf by understanding and interpreting their needs using natural methods of communication.
- Using Windows to fuel our cloud business and Microsoft 365 strategy, and to develop new categories of devices – both our own and third-party – on the intelligent edge.
- Inventing new gaming experiences that bring people together around their shared love for games on any devices and pushing the boundaries of innovation with console and PC gaming by creating the next wave of entertainment.

Our future growth depends on our ability to transcend current product category definitions, business models, and sales motions. We have the opportunity to redefine what customers and partners can expect and are working to deliver new solutions that reflect the best of Microsoft.

OPERATING SEGMENTS

We operate our business and report our financial performance using three segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. Our segments provide management with a comprehensive financial view of our key businesses. The segments enable the alignment of strategies and objectives across the development, sales, marketing, and services organizations, and they provide a framework for timely and rational allocation of resources within businesses.

Additional information on our operating segments and geographic and product information is contained in Note 20 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial, including Office 365 subscriptions and Office licensed on-premises, comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Skype for Business, and related Client Access Licenses ("CALs").
- Office Consumer, including Office 365 subscriptions and Office licensed on-premises, and Office Consumer Services, including Skype, Outlook.com, and OneDrive.
- LinkedIn, including Talent Solutions, Marketing Solutions, and Premium Subscriptions.
- Dynamics business solutions, including Dynamics 365, a set of cloud-based applications across ERP and CRM, Dynamics ERP on-premises, and Dynamics CRM on-premises.

Office Commercial

Office Commercial is designed to increase personal, team, and organizational productivity through a range of products and services. Growth depends on our ability to reach new users in new markets such as first-line workers, small and medium businesses, and growth markets, as well as add value to our core product and service offerings to span productivity categories such as communication, collaboration, analytics, security, and compliance. Office Commercial revenue is mainly affected by a combination of continued installed base growth and average revenue per user expansion, as well as the continued shift from Office licensed on-premises to Office 365. CALs provide certain Office Commercial products and services with access rights to our server products and CAL revenue is reported with the associated Office products and services.

Office Consumer

Office Consumer is designed to increase personal productivity through a range of products and services. Growth depends on our ability to reach new users, add value to our core product set, and continue to expand our product and service offerings into new markets. Office Consumer revenue is mainly affected by the percentage of customers that buy Office with their new devices and the continued shift from Office licensed on-premises to Office 365. Office Consumer Services revenue is mainly affected by the demand for communication and storage through Skype, Outlook.com, and OneDrive, which is largely driven by subscriptions, advertising, and the sale of minutes.

LinkedIn

LinkedIn connects the world's professionals to make them more productive and successful, and is the world's largest professional network on the Internet. LinkedIn offers services that can be used by customers to transform the way they hire, market, sell, and learn. In addition to LinkedIn’s free services, LinkedIn offers three categories of monetized solutions: Talent Solutions, Marketing Solutions, and Premium Subscriptions, which includes Sales Solutions. Talent Solutions is comprised of two elements: Hiring, and Learning and Development. Hiring provides services to recruiters that enable them to attract, recruit, and hire talent. Learning and Development provides subscriptions to enterprises and individuals to access online learning content. Marketing Solutions enables companies to advertise to LinkedIn’s member base. Premium Subscriptions enables professionals to manage their professional identity, grow their network, and connect with talent through additional services like premium search. Premium Subscriptions also includes Sales Solutions, which helps sales professionals find, qualify, and create sales opportunities and accelerate social selling capabilities. Growth will depend on our ability to increase the number of LinkedIn members and our ability to continue offering services that provide value for our members and increase their engagement. LinkedIn revenue is mainly affected by demand from enterprises and professional organizations for subscriptions to Talent Solutions and Premium Subscriptions offerings, as well as member engagement and the quality of the sponsored content delivered to those members to drive Marketing Solutions.

On November 16, 2018, LinkedIn acquired Glint, an employee engagement platform, to expand its Talent Solutions offerings.

Dynamics

Dynamics provides cloud-based and on-premises business solutions for financial management, enterprise resource planning (“ERP”), customer relationship management (“CRM”), supply chain management, and analytics applications for small and medium businesses, large organizations, and divisions of global enterprises. Dynamics revenue is driven by the number of users licensed, expansion of average revenue per user, and the continued shift to Dynamics 365, a unified set of cloud-based intelligent business applications.

Competition

Competitors to Office include software and global application vendors, such as Apple, Cisco Systems, Facebook, Google, IBM, Okta, Proofpoint, Slack, Symantec, Zoom, and numerous web-based and mobile application competitors as well as local application developers. Apple distributes versions of its pre-installed application software, such as email and calendar products, through its PCs, tablets, and phones. Cisco Systems is using its position in enterprise communications equipment to grow its unified communications business. Google provides a hosted messaging and productivity suite. Slack provides teamwork and collaboration software. Zoom offers videoconferencing and cloud phone solutions. Skype for Business and Skype also compete with a variety of instant messaging, voice, and video communication providers, ranging from start-ups to established enterprises. Okta, Proofpoint, and Symantec provide security solutions across email security, information protection, identity, and governance. Web-based offerings competing with individual applications have also positioned themselves as alternatives to our products and services. We compete by providing powerful, flexible, secure, integrated industry-specific, and easy-to-use productivity and collaboration tools and services that create comprehensive solutions and work well with technologies our customers already have both on-premises or in the cloud.

LinkedIn faces competition from online recruiting companies, talent management companies, and larger companies that are focusing on talent management and human resource services; job boards; traditional recruiting firms; and companies that provide learning and development products and services. Marketing Solutions competes with online and offline outlets that generate revenue from advertisers and marketers.

Dynamics competes with vendors such as Infor, NetSuite, Oracle, Salesforce.com, SAP, and The Sage Group to provide cloud-based and on-premise business solutions for small, medium, and large organizations.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business. This segment primarily comprises:

- Server products and cloud services, including SQL Server, Windows Server, Visual Studio, System Center, and related CALs, GitHub, and Azure.
- Enterprise Services, including Premier Support Services and Microsoft Consulting Services.

Server Products and Cloud Services

Our server products are designed to make IT professionals, developers, and their systems more productive and efficient. Server software is integrated server infrastructure and middleware designed to support software applications built on the Windows Server operating system. This includes the server platform, database, business intelligence, storage, management and operations, virtualization, service-oriented architecture platform, security, and identity software. We also license standalone and software development lifecycle tools for software architects, developers, testers, and project managers. GitHub provides a collaboration platform and code hosting service for developers. Server products revenue is mainly affected by purchases through volume licensing programs, licenses sold to original equipment manufacturers ("OEM"), and retail packaged products. CALs provide access rights to certain server products, including SQL Server and Windows Server, and revenue is reported along with the associated server product.

Azure is a comprehensive set of cloud services that offer developers, IT professionals, and enterprises freedom to build, deploy, and manage applications on any platform or device. Customers can use Azure through our global network of datacenters for computing, networking, storage, mobile and web application services, AI, IoT, cognitive services, and machine learning. Azure enables customers to devote more resources to development and use of applications that benefit their organizations, rather than managing on-premises hardware and software. Azure revenue is mainly affected by infrastructure-as-a-service and platform-as-a-service consumption-based services, and per user-based services such as Enterprise Mobility + Security.

Enterprise Services

Enterprise Services, including Premier Support Services and Microsoft Consulting Services, assist customers in developing, deploying, and managing Microsoft server and desktop solutions and provide training and certification to developers and IT professionals on various Microsoft products.

Competition

Our server products face competition from a wide variety of server operating systems and applications offered by companies with a range of market approaches. Vertically integrated computer manufacturers such as Hewlett-Packard, IBM, and Oracle offer their own versions of the Unix operating system preinstalled on server hardware. Nearly all computer manufacturers offer server hardware for the Linux operating system and many contribute to Linux operating system development. The competitive position of Linux has also benefited from the large number of compatible applications now produced by many commercial and non-commercial software developers. A number of companies, such as Red Hat, supply versions of Linux.

We compete to provide enterprise-wide computing solutions and point solutions with numerous commercial software vendors that offer solutions and middleware technology platforms, software applications for connectivity (both Internet and intranet), security, hosting, database, and e-business servers. IBM and Oracle lead a group of companies focused on the Java Platform Enterprise Edition that competes with our enterprise-wide computing solutions. Commercial competitors for our server applications for PC-based distributed client-server environments include CA Technologies, IBM, and Oracle. Our web application platform software competes with open source software such as Apache, Linux, MySQL, and PHP. In middleware, we compete against Java vendors.

Our database, business intelligence, and data warehousing solutions offerings compete with products from IBM, Oracle, SAP, and other companies. Our system management solutions compete with server management and server virtualization platform providers, such as BMC, CA Technologies, Hewlett-Packard, IBM, and VMware. Our products for software developers compete against offerings from Adobe, IBM, Oracle, and other companies, and also against open-source projects, including Eclipse (sponsored by CA Technologies, IBM, Oracle, and SAP), PHP, and Ruby on Rails.

We believe our server products provide customers with advantages in performance, total costs of ownership, and productivity by delivering superior applications, development tools, compatibility with a broad base of hardware and software applications, security, and manageability.

Azure faces diverse competition from companies such as Amazon, Google, IBM, Oracle, Salesforce.com, VMware, and open source offerings. Our Enterprise Mobility + Security offerings also compete with products from a range of competitors including identity vendors, security solution vendors, and numerous other security point solution vendors. Azure's competitive advantage includes enabling a hybrid cloud, allowing deployment of existing datacenters with our public cloud into a single, cohesive infrastructure, and the ability to run at a scale that meets the needs of businesses of all sizes and complexities. We believe our cloud's global scale, coupled with our broad portfolio of identity and security solutions, allows us to effectively solve complex cybersecurity challenges for our customers and differentiates us from the competition.

Our Enterprise Services business competes with a wide range of companies that provide strategy and business planning, application development, and infrastructure services, including multinational consulting firms and small niche businesses focused on specific technologies.

More Personal Computing

Our More Personal Computing segment consists of products and services geared towards harmonizing the interests of end users, developers, and IT professionals across all devices. This segment primarily comprises:

- Windows, including Windows OEM licensing ("Windows OEM") and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; Windows IoT; and MSN advertising.
- Devices, including Surface, PC accessories, and other intelligent devices.
- Gaming, including Xbox hardware and Xbox software and services, comprising Xbox Live transactions, subscriptions, cloud services, and advertising ("Xbox Live"), video games, and third-party video game royalties.
- Search.

Windows

The Windows operating system is designed to deliver a more personal computing experience for users by enabling consistency of experience, applications, and information across their devices. Windows OEM revenue is impacted significantly by the number of Windows operating system licenses purchased by OEMs, which they pre-install on the devices they sell. In addition to computing device market volume, Windows OEM revenue is impacted by:

- The mix of computing devices based on form factor and screen size.
- Differences in device market demand between developed markets and growth markets.
- Attachment of Windows to devices shipped.
- Customer mix between consumer, small and medium businesses, and large enterprises.
- Changes in inventory levels in the OEM channel.
- Pricing changes and promotions, pricing variation that occurs when the mix of devices manufactured shifts from local and regional system builders to large multinational OEMs, and different pricing of Windows versions licensed.
- Constraints in the supply chain of device components.
- Piracy.

Windows Commercial revenue, which includes volume licensing of the Windows operating system and Windows cloud services such as Microsoft Defender Advanced Threat Protection, is affected mainly by the demand from commercial customers for volume licensing and Software Assurance ("SA"), as well as advanced security offerings. Windows Commercial revenue often reflects the number of information workers in a licensed enterprise and is relatively independent of the number of PCs sold in a given year.

Patent licensing includes our programs to license patents we own for use across a broad array of technology areas, including mobile devices and cloud offerings.

Windows IoT extends the power of Windows and the cloud to intelligent systems by delivering specialized operating systems, tools, and services for use in embedded devices.

MSN advertising includes both native and display ads.

Devices

We design, manufacture, and sell devices, including Surface, PC accessories, and other intelligent devices. Our devices are designed to enable people and organizations to connect to the people and content that matter most using Windows and integrated Microsoft products and services. Surface is designed to help organizations, students, and consumers be more productive.

Gaming

Our gaming platform is designed to provide a unique variety of entertainment using our devices, peripherals, applications, online services, and content. We released Xbox One S and Xbox One X in August 2016 and November 2017, respectively. With the launch of the Mixer service in May 2017, offering interactive live streaming, and Xbox Game Pass in June 2017, providing unlimited access to over 100 Xbox titles, we continue to open new opportunities for customers to engage both on- and off-console. With our acquisition of PlayFab in January 2018, we enable worldwide game developers to utilize game services, LiveOps, and analytics for player acquisition, engagement, and retention. We have also made these services available for developers outside of the gaming industry.

Xbox Live enables people to connect and share online gaming experiences and is accessible on Xbox consoles, Windows-enabled devices, and other devices. Xbox Live is designed to benefit users by providing access to a network of certified applications and services and to benefit our developer and partner ecosystems by providing access to a large customer base. Xbox Live revenue is mainly affected by subscriptions and sales of Xbox Live enabled content, as well as advertising. We also continue to design and sell gaming content to showcase our unique platform capabilities for Xbox consoles, Windows-enabled devices, and other devices. Growth of our Gaming business is determined by the overall active user base through Xbox Live enabled content, availability of games, providing exclusive game content that gamers seek, the computational power and reliability of the devices used to access our content and services, and the ability to create new experiences via online services including game streaming, downloadable content, and peripherals.

Search

Our Search business, including Bing and Microsoft Advertising, is designed to deliver relevant online advertising to a global audience. We have several partnerships with other companies, including Verizon Media Group, through which we provide and monetize search queries. Growth depends on our ability to attract new users, understand intent, and match intent with relevant content and advertiser offerings.

Competition

Windows faces competition from various software products and from alternative platforms and devices, mainly from Apple and Google. We believe Windows competes effectively by giving customers choice, value, flexibility, security, an easy-to-use interface, and compatibility with a broad range of hardware and software applications, including those that enable productivity.

Devices face competition from various computer, tablet, and hardware manufacturers who offer a unique combination of high-quality industrial design and innovative technologies across various price points. These manufacturers, many of which are also current or potential partners and customers, include Apple and our Windows OEMs.

Our gaming platform competes with console platforms from Nintendo and Sony, both of which have a large, established base of customers. The lifecycle for gaming and entertainment consoles averages five to ten years. Nintendo released its latest generation console in March 2017 and Sony released its latest generation console in November 2013. We also compete with other providers of entertainment services through online marketplaces. We believe our gaming platform is effectively positioned against competitive products and services based on significant innovation in hardware architecture, user interface, developer tools, online gaming and entertainment services, and continued strong exclusive content from our own game franchises as well as other digital content offerings. Our video games competitors include Electronic Arts and Activision Blizzard. Xbox Live and our cloud gaming services face competition from various online marketplaces, including those operated by Amazon, Apple, and Google.

Our search business competes with Google and a wide array of websites, social platforms like Facebook, and portals that provide content and online offerings to end users.

OPERATIONS

We have operations centers that support operations in their regions, including customer contract and order processing, credit and collections, information processing, and vendor management and logistics. The regional center in Ireland supports the European, Middle Eastern, and African region; the center in Singapore supports the Japan, India, Greater China, and Asia-Pacific region; and the centers in Fargo, North Dakota, Fort Lauderdale, Florida, Puerto Rico, Redmond, Washington, and Reno, Nevada support Latin America and North America. In addition to the operations centers, we also operate datacenters throughout the Americas, Europe, Australia, and Asia, as well as in the Middle East and Africa.

To serve the needs of customers around the world and to improve the quality and usability of products in international markets, we localize many of our products to reflect local languages and conventions. Localizing a product may require modifying the user interface, altering dialog boxes, and translating text.

Our devices are primarily manufactured by third-party contract manufacturers. We generally have the ability to use other manufacturers if a current vendor becomes unavailable or unable to meet our requirements.

RESEARCH AND DEVELOPMENT

Product and Service Development, and Intellectual Property

We develop most of our products and services internally through the following engineering groups.

- *Cloud and AI*, focuses on making IT professionals, developers, and their systems more productive and efficient through development of cloud infrastructure, server, database, CRM, ERP, management and development tools, AI cognitive services, and other business process applications and services for enterprises.
- *Experiences and Devices*, focuses on instilling a unifying product ethos across our end-user experiences and devices, including Office, Windows, Enterprise Mobility and Management, and Surface.
- *AI and Research*, focuses on our AI innovations and other forward-looking research and development efforts spanning infrastructure, services, applications, and search.
- *LinkedIn*, focuses on our services that transform the way customers hire, market, sell, and learn.
- *Gaming*, focuses on connecting gaming assets across the range of devices to grow and engage the Xbox Live member network through game experiences, streaming content, and social interaction.

Internal development allows us to maintain competitive advantages that come from product differentiation and closer technical control over our products and services. It also gives us the freedom to decide which modifications and enhancements are most important and when they should be implemented. We strive to obtain information as early as possible about changing usage patterns and hardware advances that may affect software and hardware design. Before releasing new software platforms, and as we make significant modifications to existing platforms, we provide application vendors with a range of resources and guidelines for development, training, and testing. Generally, we also create product documentation internally.

We protect our intellectual property investments in a variety of ways. We work actively in the U.S. and internationally to ensure the enforcement of copyright, trademark, trade secret, and other protections that apply to our software and hardware products, services, business plans, and branding. We are a leader among technology companies in pursuing patents and currently have a portfolio of over 61,000 U.S. and international patents issued and over 26,000 pending. While we employ much of our internally-developed intellectual property exclusively in our products and services, we also engage in outbound licensing of specific patented technologies that are incorporated into licensees' products. From time to time, we enter into broader cross-license agreements with other technology companies covering entire groups of patents. We also purchase or license technology that we incorporate into our products and services. At times, we make select intellectual property broadly available at no or low cost to achieve a strategic objective, such as promoting industry standards, advancing interoperability, or attracting and enabling our external development community. Our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations.

While it may be necessary in the future to seek or renew licenses relating to various aspects of our products, services, and business methods, we believe, based upon past experience and industry practice, such licenses generally can be obtained on commercially reasonable terms. We believe our continuing research and product development are not materially dependent on any single license or other agreement with a third party relating to the development of our products.

Investing in the Future

Our success is based on our ability to create new and compelling products, services, and experiences for our users, to initiate and embrace disruptive technology trends, to enter new geographic and product markets, and to drive broad adoption of our products and services. We invest in a range of emerging technology trends and breakthroughs that we believe offer significant opportunities to deliver value to our customers and growth for the Company. Based on our assessment of key technology trends, we maintain our long-term commitment to research and development across a wide spectrum of technologies, tools, and platforms spanning digital work and life experiences, cloud computing, AI, devices, and operating systems.

While our main research and development facilities are located in Redmond, Washington, we also operate research and development facilities in other parts of the U.S. and around the world, including Canada, China, Czech Republic, India, Ireland, Israel, and the United Kingdom. This global approach helps us remain competitive in local markets and enables us to continue to attract top talent from across the world. We generally fund research at the corporate level to ensure that we are looking beyond immediate product considerations to opportunities further in the future. We also fund research and development activities at the operating segment level. Much of our segment level research and development is coordinated with other segments and leveraged across the Company.

In addition to our main research and development operations, we also operate Microsoft Research. Microsoft Research is one of the world's largest corporate research organizations and works in close collaboration with top universities around the world to advance the state-of-the-art in computer science and a broad range of other disciplines, providing us a unique perspective on future trends and contributing to our innovation.

We plan to continue to make significant investments in a broad range of research and development efforts.

DISTRIBUTION, SALES, AND MARKETING

We market and distribute our products and services through the following channels: OEMs, direct, and distributors and resellers. Our sales force performs a variety of functions, including working directly with enterprises and public-sector organizations worldwide to identify and meet their technology requirements; managing OEM relationships; and supporting system integrators, independent software vendors, and other partners who engage directly with our customers to perform sales, consulting, and fulfillment functions for our products and services.

OEMs

We distribute our products and services through OEMs that pre-install our software on new devices and servers they sell. The largest component of the OEM business is the Windows operating system pre-installed on devices. OEMs also sell devices pre-installed with other Microsoft products and services, including applications such as Office and the capability to subscribe to Office 365.

There are two broad categories of OEMs. The largest category of OEMs are direct OEMs as our relationship with them is managed through a direct agreement between Microsoft and the OEM. We have distribution agreements covering one or more of our products with virtually all the multinational OEMs, including Acer, ASUS, Dell, Fujitsu, Hewlett-Packard, Lenovo, Samsung, Sharp, Toshiba, and with many regional and local OEMs. The second broad category of OEMs are system builders consisting of lower-volume PC manufacturers, which source Microsoft software for pre-installation and local redistribution primarily through the Microsoft distributor channel rather than through a direct agreement or relationship with Microsoft.

Direct

Many organizations that license our products and services transact directly with us through Enterprise Agreements and Enterprise Services contracts, with sales support from system integrators, independent software vendors, web agencies, and partners that advise organizations on licensing our products and services ("Enterprise Agreement Software Advisors" or "ESA"). Microsoft offers direct sales programs targeted to reach small, medium, and corporate customers, in addition to those offered through the reseller channel. A large network of partner advisors support many of these sales.

We also sell commercial and consumer products and services directly to customers, such as cloud services, search, and gaming, through our digital marketplaces, online stores, and retail stores.

Distributors and Resellers

Organizations also license our products and services indirectly, primarily through licensing solution partners ("LSP"), distributors, value-added resellers ("VAR"), and retailers. Although each type of reselling partner may reach organizations of all sizes, LSPs are primarily engaged with large organizations, distributors resell primarily to VARs, and VARs typically reach small and medium organizations. ESAs are also typically authorized as LSPs and operate as resellers for our other volume licensing programs. Microsoft Cloud Solution Provider is our main partner program for reselling cloud services.

We distribute our retail packaged products primarily through independent non-exclusive distributors, authorized replicators, resellers, and retail outlets. Individual consumers obtain these products primarily through retail outlets. We distribute our devices through third-party retailers. We have a network of field sales representatives and field support personnel that solicit orders from distributors and resellers, and provide product training and sales support.

Our Dynamics business solutions are also licensed to enterprises through a global network of channel partners providing vertical solutions and specialized services.

LICENSING OPTIONS

We offer options for organizations that want to purchase our cloud services, on-premises software, and Software Assurance. We license software to organizations under volume licensing agreements to allow the customer to acquire multiple licenses of products and services instead of having to acquire separate licenses through retail channels. We use different programs designed to provide flexibility for organizations of various sizes. While these programs may differ in various parts of the world, generally they include those discussed below.

SA conveys rights to new software and upgrades for perpetual licenses released over the contract period. It also provides support, tools, and training to help customers deploy and use software efficiently. SA is included with certain volume licensing agreements and is an optional purchase with others.

Volume Licensing Programs

Enterprise Agreement

Enterprise Agreements offer large organizations a manageable volume licensing program that gives them the flexibility to buy cloud services and software licenses under one agreement. Enterprise Agreements are designed for medium or large organizations that want to license cloud services and on-premises software organization-wide over a three-year period. Organizations can elect to purchase perpetual licenses or subscribe to licenses. SA is included.

Microsoft Product and Services Agreement

Microsoft Product and Services Agreements are designed for medium and large organizations that want to license cloud services and on-premises software as needed, with no organization-wide commitment, under a single, non-expiring agreement. Organizations purchase perpetual licenses or subscribe to licenses. SA is optional for customers that purchase perpetual licenses.

Open

Open agreements are a simple, cost-effective way to acquire the latest Microsoft technology. Open agreements are designed for small and medium organizations that want to license cloud services and on-premises software over a one- to three-year period. Under the Open agreements, organizations purchase perpetual licenses and SA is optional. Under Open Value agreements, organizations can elect to purchase perpetual licenses or subscribe to licenses and SA is included.

Select Plus

Select Plus agreements are designed for government and academic organizations to acquire on-premises licenses at any affiliate or department level, while realizing advantages as one organization. Organizations purchase perpetual licenses and SA is optional.

Microsoft Online Subscription Agreement

Microsoft Online Subscription Agreements are designed for small and medium organizations that want to subscribe to, activate, provision, and maintain cloud services seamlessly and directly via the web. The agreement allows customers to acquire monthly or annual subscriptions for cloud-based services.

Partner Programs

The Microsoft Cloud Solution Provider program offers customers an easy way to license the cloud services they need in combination with the value-added services offered by their systems integrator, hosting partner, or cloud reseller partner. Partners in this program can easily package their own products and services to directly provision, manage, and support their customer subscriptions.

The Microsoft Services Provider License Agreement allows service providers and independent software vendors who want to license eligible Microsoft software products to provide software services and hosted applications to their end customers. Partners license software over a three-year period and are billed monthly based on consumption.

The Independent Software Vendor Royalty program enables partners to integrate Microsoft products into other applications and then license the unified business solution to their end users.

CUSTOMERS

Our customers include individual consumers, small and medium organizations, large global enterprises, public-sector institutions, Internet service providers, application developers, and OEMs. Our practice is to ship our products promptly upon receipt of purchase orders from customers; consequently, backlog is not significant.

EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers as of July 31, 2019 were as follows:

Name	Age	Position with the Company
Satya Nadella	51	Chief Executive Officer
Christopher C. Capossela	49	Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer
Jean-Philippe Courtois	58	Executive Vice President and President, Microsoft Global Sales, Marketing and Operations
Kathleen T. Hogan	53	Executive Vice President, Human Resources
Amy E. Hood	47	Executive Vice President, Chief Financial Officer
Margaret L. Johnson	57	Executive Vice President, Business Development
Bradford L. Smith	60	President and Chief Legal Officer

Mr. Nadella was appointed Chief Executive Officer in February 2014. He served as Executive Vice President, Cloud and Enterprise from July 2013 until that time. From 2011 to 2013, Mr. Nadella served as President, Server and Tools. From 2009 to 2011, he was Senior Vice President, Online Services Division. From 2008 to 2009, he was Senior Vice President, Search, Portal, and Advertising. Since joining Microsoft in 1992, Mr. Nadella's roles also included Vice President of the Business Division. Mr. Nadella also serves on the Board of Directors of Starbucks Corporation.

Mr. Capossela was appointed Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer in July 2016. He had served as Executive Vice President, Chief Marketing Officer since March 2014. Previously, he served as the worldwide leader of the Consumer Channels Group, responsible for sales and marketing activities with OEMs, operators, and retail partners. In his more than 25 years at Microsoft, Mr. Capossela has held a variety of marketing leadership roles in the Microsoft Office Division. He was responsible for marketing productivity solutions including Microsoft Office, Office 365, SharePoint, Exchange, Skype for Business, Project, and Visio.

Mr. Courtois was appointed Executive Vice President and President, Microsoft Global Sales, Marketing and Operations in July 2016. Before that he was President of Microsoft International since 2005. He was Chief Executive Officer, Microsoft Europe, Middle East, and Africa from 2003 to 2005. He was Senior Vice President and President, Microsoft Europe, Middle East, and Africa from 2000 to 2003. He was Corporate Vice President, Worldwide Customer Marketing from 1998 to 2000. Mr. Courtois joined Microsoft in 1984.

Ms. Hogan was appointed Executive Vice President, Human Resources in November 2014. Prior to that Ms. Hogan was Corporate Vice President of Microsoft Services. She also served as Corporate Vice President of Customer Service and Support. Ms. Hogan joined Microsoft in 2003.

Ms. Hood was appointed Executive Vice President and Chief Financial Officer in July 2013, subsequent to her appointment as Chief Financial Officer in May 2013. From 2010 to 2013, Ms. Hood was Chief Financial Officer of the Microsoft Business Division. From 2006 through 2009, Ms. Hood was General Manager, Microsoft Business Division Strategy. Since joining Microsoft in 2002, Ms. Hood has also held finance-related positions in the Server and Tools Business and the corporate finance organization. Ms. Hood also serves on the Board of Directors of 3M Corporation.

Ms. Johnson was appointed Executive Vice President, Business Development in September 2014. Prior to that Ms. Johnson spent 24 years at Qualcomm in various leadership positions across engineering, sales, marketing and business development. She most recently served as Executive Vice President of Qualcomm Technologies, Inc. Ms. Johnson also serves on the Board of Directors of BlackRock, Inc.

Mr. Smith was appointed President and Chief Legal Officer in September 2015. He served as Executive Vice President, General Counsel, and Secretary from 2011 to 2015, and served as Senior Vice President, General Counsel, and Secretary from 2001 to 2011. Mr. Smith was also named Chief Compliance Officer in 2002. Since joining Microsoft in 1993, he was Deputy General Counsel for Worldwide Sales and previously was responsible for managing the European Law and Corporate Affairs Group, based in Paris. Mr. Smith also serves on the Board of Directors of Netflix, Inc.

EMPLOYEES

As of June 30, 2019, we employed approximately 144,000 people on a full-time basis, 85,000 in the U.S. and 59,000 internationally. Of the total employed people, 47,000 were in operations, including manufacturing, distribution, product support, and consulting services; 47,000 were in product research and development; 38,000 were in sales and marketing; and 12,000 were in general and administration. Certain of our employees are subject to collective bargaining agreements.

AVAILABLE INFORMATION

Our Internet address is www.microsoft.com. At our Investor Relations website, www.microsoft.com/investor, we make available free of charge a variety of information for investors. Our goal is to maintain the Investor Relations website as a portal through which investors can easily find or navigate to pertinent information about us, including:

- Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file that material with or furnish it to the Securities and Exchange Commission ("SEC") at www.sec.gov.
- Information on our business strategies, financial results, and metrics for investors.
- Announcements of investor conferences, speeches, and events at which our executives talk about our product, service, and competitive strategies. Archives of these events are also available.
- Press releases on quarterly earnings, product and service announcements, legal developments, and international news.
- Corporate governance information including our articles of incorporation, bylaws, governance guidelines, committee charters, codes of conduct and ethics, global corporate social responsibility initiatives, and other governance-related policies.
- Other news and announcements that we may post from time to time that investors might find useful or interesting.
- Opportunities to sign up for email alerts to have information pushed in real time.

The information found on our website is not part of this or any other report we file with, or furnish to, the SEC. In addition to these channels, we use social media to communicate to the public. It is possible that the information we post on social media could be deemed to be material to investors. We encourage investors, the media, and others interested in Microsoft to review the information we post on the social media channels listed on our Investor Relations website.

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described below, that could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock.

We face intense competition across all markets for our products and services, which may lead to lower revenue or operating margins.

Competition in the technology sector

Our competitors range in size from diversified global companies with significant research and development resources to small, specialized firms whose narrower product lines may let them be more effective in deploying technical, marketing, and financial resources. Barriers to entry in many of our businesses are low and many of the areas in which we compete evolve rapidly with changing and disruptive technologies, shifting user needs, and frequent introductions of new products and services. Our ability to remain competitive depends on our success in making innovative products, devices, and services that appeal to businesses and consumers.

Competition among platform-based ecosystems

An important element of our business model has been to create platform-based ecosystems on which many participants can build diverse solutions. A well-established ecosystem creates beneficial network effects among users, application developers, and the platform provider that can accelerate growth. Establishing significant scale in the marketplace is necessary to achieve and maintain attractive margins. We face significant competition from firms that provide competing platforms.

- A competing vertically-integrated model, in which a single firm controls the software and hardware elements of a product and related services, has succeeded with some consumer products such as personal computers, tablets, phones, gaming consoles, wearables, and other endpoint devices. Competitors pursuing this model also earn revenue from services integrated with the hardware and software platform, including applications and content sold through their integrated marketplaces. They may also be able to claim security and performance benefits from their vertically integrated offer. We also offer some vertically-integrated hardware and software products and services. To the extent we shift a portion of our business to a vertically integrated model we increase our cost of revenue and reduce our operating margins.
- We derive substantial revenue from licenses of Windows operating systems on personal computers. We face significant competition from competing platforms developed for new devices and form factors such as smartphones and tablet computers. These devices compete on multiple bases including price and the perceived utility of the device and its platform. Users are increasingly turning to these devices to perform functions that in the past were performed by personal computers. Even if many users view these devices as complementary to a personal computer, the prevalence of these devices may make it more difficult to attract application developers to our PC operating system platforms. Competing with operating systems licensed at low or no cost may decrease our PC operating system margins. Popular products or services offered on competing platforms could increase their competitive strength. In addition, some of our devices compete with products made by our original equipment manufacturer (“OEM”) partners, which may affect their commitment to our platform.
- Competing platforms have content and application marketplaces with scale and significant installed bases. The variety and utility of content and applications available on a platform are important to device purchasing decisions. Users may incur costs to move data and buy new content and applications when switching platforms. To compete, we must successfully enlist developers to write applications for our platform and ensure that these applications have high quality, security, customer appeal, and value. Efforts to compete with competitors’ content and application marketplaces may increase our cost of revenue and lower our operating margins.

Business model competition

Companies compete with us based on a growing variety of business models.

- Even as we transition more of our business to infrastructure-, platform-, and software-as-a-service business model, the license-based proprietary software model generates a substantial portion of our software revenue. We bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from licensing our products. Many of our competitors also develop and sell software to businesses and consumers under this model.
- Other competitors develop and offer free applications, online services and content, and make money by selling third-party advertising. Advertising revenue funds development of products and services these competitors provide to users at no or little cost, competing directly with our revenue-generating products.
- Some companies compete with us by modifying and then distributing open source software at little or no cost to end-users, and earning revenue on advertising or integrated products and services. These firms do not bear the full costs of research and development for the open source software. Some open source software mimics the features and functionality of our products.

The competitive pressures described above may cause decreased sales volumes, price reductions, and/or increased operating costs, such as for research and development, marketing, and sales incentives. This may lead to lower revenue, gross margins, and operating income.

Our increasing focus on cloud-based services presents execution and competitive risks. A growing part of our business involves cloud-based services available across the spectrum of computing devices. Our strategic vision is to compete and grow by building best-in-class platforms and productivity services for an intelligent cloud and an intelligent edge infused with artificial intelligence (“AI”). At the same time, our competitors are rapidly developing and deploying cloud-based services for consumers and business customers. Pricing and delivery models are evolving. Devices and form factors influence how users access services in the cloud and sometimes the user’s choice of which cloud-based services to use. We are devoting significant resources to develop and deploy our cloud-based strategies. The Windows ecosystem must continue to evolve with this changing environment. We are undertaking cultural and organizational changes to drive accountability and eliminate obstacles to innovation. Our intelligent cloud and intelligent edge worldview is connected with the growth of the Internet of Things (“IoT”). Our success in the IoT will depend on the level of adoption of our offerings such as Microsoft Azure, Azure Stack, Azure IoT Edge, and Azure Sphere. We may not establish market share sufficient to achieve scale necessary to achieve our business objectives.

Besides software development costs, we are incurring costs to build and maintain infrastructure to support cloud computing services. These costs will reduce the operating margins we have previously achieved. Whether we succeed in cloud-based services depends on our execution in several areas, including:

- Continuing to bring to market compelling cloud-based experiences that generate increasing traffic and market share.
- Maintaining the utility, compatibility, and performance of our cloud-based services on the growing array of computing devices, including PCs, smartphones, tablets, gaming consoles, and other devices, as well as sensors and other endpoints.
- Continuing to enhance the attractiveness of our cloud platforms to third-party developers.
- Ensuring our cloud-based services meet the reliability expectations of our customers and maintain the security of their data.
- Making our suite of cloud-based services platform-agnostic, available on a wide range of devices and ecosystems, including those of our competitors.

It is uncertain whether our strategies will attract the users or generate the revenue required to succeed. If we are not effective in executing organizational and technical changes to increase efficiency and accelerate innovation, or if we fail to generate sufficient usage of our new products and services, we may not grow revenue in line with the infrastructure and development investments described above. This may negatively impact gross margins and operating income.

We make significant investments in products and services that may not achieve expected returns. We will continue to make significant investments in research, development, and marketing for existing products, services, and technologies, including the Windows operating system, Microsoft 365, Office, Bing, Microsoft SQL Server, Windows Server, Azure, Office 365, Xbox Live, Mixer, LinkedIn, and other products and services. We also invest in the development and acquisition of a variety of hardware for productivity, communication, and entertainment including PCs, tablets, gaming devices, and HoloLens. Investments in new technology are speculative. Commercial success depends on many factors, including innovativeness, developer support, and effective distribution and marketing. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of new software and hardware products or upgrades, unfavorably affecting revenue. We may not achieve significant revenue from new product, service, and distribution channel investments for several years, if at all. New products and services may not be profitable, and even if they are profitable, operating margins for some new products and businesses will not be as high as the margins we have experienced historically. We may not get engagement in certain features, like Microsoft Edge and Bing, that drive post-sale monetization opportunities. Our data handling practices across our products and services will continue to be under scrutiny and perceptions of mismanagement, driven by regulatory activity or negative public reaction to our practices or product experiences, which could negatively impact product and feature adoption, product design, and product quality.

Developing new technologies is complex. It can require long development and testing periods. Significant delays in new releases or significant problems in creating new products or services could adversely affect our revenue.

Acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business. We expect to continue making acquisitions and entering into joint ventures and strategic alliances as part of our long-term business strategy. In December 2016, we completed our acquisition of LinkedIn Corporation (“LinkedIn”) for $27.0 billion, and in October 2018, we completed our acquisition of GitHub, Inc. for $7.5 billion. These acquisitions and other transactions and arrangements involve significant challenges and risks, including that they do not advance our business strategy, that we get an unsatisfactory return on our investment, that we have difficulty integrating and retaining new employees, business systems, and technology, or that they distract management from our other businesses. If an arrangement fails to adequately anticipate changing circumstances and interests of a party, it may result in early termination or renegotiation of the arrangement. The success of these transactions and arrangements will depend in part on our ability to leverage them to enhance our existing products and services or develop compelling new ones. It may take longer than expected to realize the full benefits from these transactions and arrangements such as increased revenue or enhanced efficiencies, or the benefits may ultimately be smaller than we expected. These events could adversely affect our consolidated financial statements.

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings. We acquire other companies and intangible assets and may not realize all the economic benefit from those acquisitions, which could cause an impairment of goodwill or intangibles. We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment at least annually. Factors that may be a change in circumstances, indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable, include a decline in our stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in industry segments in which we participate. We have in the past recorded, and may in the future be required to record a significant charge on our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively affecting our results of operations. Our acquisition of LinkedIn resulted in a significant increase in our goodwill and intangible asset balances.

Cyberattacks and security vulnerabilities could lead to reduced revenue, increased costs, liability claims, or harm to our reputation or competitive position.

Security of our information technology

Threats to IT security can take a variety of forms. Individual and groups of hackers and sophisticated organizations, including state-sponsored organizations or nation-states, continuously undertake attacks that pose threats to our customers and our IT. These actors may use a wide variety of methods, which may include developing and deploying malicious software or exploiting vulnerabilities in hardware, software, or other infrastructure in order to attack our products and services or gain access to our networks and datacenters, using social engineering techniques to induce our employees, users, partners, or customers to disclose passwords or other sensitive information or take other actions to gain access to our data or our users' or customers' data, or acting in a coordinated manner to launch distributed denial of service or other coordinated attacks. Inadequate account security practices may also result in unauthorized access to confidential data. For example, system administrators may fail to timely remove employee account access when no longer appropriate. Employees or third parties may intentionally compromise our or our users' security or systems, or reveal confidential information.

Cyberthreats are constantly evolving, increasing the difficulty of detecting and successfully defending against them. We may have no current capability to detect certain vulnerabilities, which may allow them to persist in the environment over long periods of time. Cyberthreats can have cascading impacts that unfold with increasing speed across our internal networks and systems and those of our partners and customers. Breaches of our facilities, network, or data security could disrupt the security of our systems and business applications, impair our ability to provide services to our customers and protect the privacy of their data, result in product development delays, compromise confidential or technical business information harming our reputation or competitive position, result in theft or misuse of our intellectual property or other assets, require us to allocate more resources to improved technologies, or otherwise adversely affect our business.

In addition, our internal IT environment continues to evolve. Often, we are early adopters of new devices and technologies. We embrace new ways of sharing data and communicating internally and with partners and customers using methods such as social networking and other consumer-oriented technologies. Our business policies and internal security controls may not keep pace with these changes as new threats emerge.

Security of our products, services, devices, and customers' data

The security of our products and services is important in our customers' decisions to purchase or use our products or services. Security threats are a significant challenge to companies like us whose business is providing technology products and services to others. Threats to our own IT infrastructure can also affect our customers. Customers using our cloud-based services rely on the security of our infrastructure, including hardware and other elements provided by third parties, to ensure the reliability of our services and the protection of their data. Adversaries tend to focus their efforts on the most popular operating systems, programs, and services, including many of ours, and we expect that to continue. Adversaries that acquire user account information at other companies can use that information to compromise our users' accounts where accounts share the same attributes like passwords. Inadequate account security practices may also result in unauthorized access. We are also increasingly incorporating open source software into our products. There may be vulnerabilities in open source software that may make our products susceptible to cyberattacks.

To defend against security threats to our internal IT systems, our cloud-based services, and our customers' systems, we must continuously engineer more secure products and services, enhance security and reliability features, improve the deployment of software updates to address security vulnerabilities in our own products as well as those provided by others, develop mitigation technologies that help to secure customers from attacks even when software updates are not deployed, maintain the digital security infrastructure that protects the integrity of our network, products, and services, and provide security tools such as firewalls and anti-virus software and information about the need to deploy security measures and the impact of doing so.

The cost of these steps could reduce our operating margins. If we fail to do these things well, actual or perceived security vulnerabilities in our products and services, data corruption issues, or reduced performance could harm our reputation and lead customers to reduce or delay future purchases of products or subscriptions to services, or to use competing products or services. Customers may also spend more on protecting their existing computer systems from attack, which could delay adoption of additional products or services. Customers may fail to update their systems, continue to run software or operating systems we no longer support, or may fail timely to install or enable security patches. Any of these could adversely affect our reputation and revenue. Actual or perceived vulnerabilities may lead to claims against us. Our license agreements typically contain provisions that eliminate or limit our exposure to liability, but there is no assurance these provisions will withstand legal challenges. At times, to achieve commercial objectives, we may enter into agreements with larger liability exposure to customers.

As illustrated by the Spectre and Meltdown threats, our products operate in conjunction with and are dependent on products and components across a broad ecosystem of third parties. If there is a security vulnerability in one of these components, and if there is a security exploit targeting it, we could face increased costs, liability claims, reduced revenue, or harm to our reputation or competitive position.

Disclosure and misuse of personal data could result in liability and harm our reputation. As we continue to grow the number and scale of our cloud-based offerings, we store and process increasingly large amounts of personally identifiable information of our customers and users. The continued occurrence of high-profile data breaches provides evidence of an external environment increasingly hostile to information security. Despite our efforts to improve the security controls across our business groups and geographies, it is possible our security controls over personal data, our training of employees and third parties on data security, and other practices we follow may not prevent the improper disclosure or misuse of customer or user data we or our vendors store and manage. In addition, third parties who have limited access to our customer or user data may use this data in unauthorized ways. Improper disclosure or misuse could harm our reputation, lead to legal exposure to customers or users, or subject us to liability under laws that protect personal data, resulting in increased costs or loss of revenue. Our software products and services also enable our customers and users to store and process personal data on-premises or, increasingly, in a cloud-based environment we host. Government authorities can sometimes require us to produce customer or user data in response to valid legal orders. In the U.S. and elsewhere, we advocate for transparency concerning these requests and appropriate limitations on government authority to compel disclosure. Despite our efforts to protect customer and user data, perceptions that the collection, use, and retention of personal information is not satisfactorily protected could inhibit sales of our products or services, and could limit adoption of our cloud-based solutions by consumers, businesses, and government entities. Additional security measures we may take to address customer or user concerns, or constraints on our flexibility to determine where and how to operate datacenters in response to customer or user expectations or governmental rules or actions, may cause higher operating expenses or hinder growth of our products and services.

We may not be able to protect information in our products and services from use by others. LinkedIn and other Microsoft products and services contain valuable information and content protected by contractual restrictions or technical measures. In certain cases, we have made commitments to our members and users to limit access to or use of this information. Changes in the law or interpretations of the law may weaken our ability to prevent third parties from scraping or gathering information or content through use of bots or other measures and using it for their own benefit, thus diminishing the value of our products and services.

Abuse of our platforms may harm our reputation or user engagement.

Advertising, professional, and social platform abuses

For LinkedIn, Microsoft Advertising, MSN, Xbox Live, and other products and services that provide content or host ads that come from or can be influenced by third parties, our reputation or user engagement may be negatively affected by activity that is hostile or inappropriate. This activity may come from users impersonating other people or organizations, use of our products or services to spread terrorist or violent extremist content or to disseminate information that may be viewed as misleading or intended to manipulate the opinions of our users, or the use of our products or services that violates our terms of service or otherwise for objectionable or illegal ends. Preventing or responding to these actions may require us to make substantial investments in people and technology and these investments may not be successful, adversely affecting our business and consolidated financial statements.

Harmful content online

Our hosted consumer services as well as our enterprise services may be used by third parties to disseminate harmful or illegal content in violation of our terms or applicable law. We may not proactively discover such content due to scale and the limitations of existing technologies, and when discovered by users, such content may negatively affect our reputation, our brands, and user engagement. Regulations and other initiatives to make platforms responsible for preventing or eliminating harmful content online are gaining momentum and we expect this to continue. We may be subject to enhanced regulatory oversight, substantial liability, or reputational damage if we fail to comply with content moderation regulations, adversely affecting our business and consolidated financial statements.

The development of the IoT presents security, privacy, and execution risks. To support the growth of the intelligent cloud and the intelligent edge, we are developing products, services, and technologies to power the IoT, a network of distributed and interconnected devices employing sensors, data, and computing capabilities including AI. The IoT's great potential also carries substantial risks. IoT products and services may contain defects in design, manufacture, or operation, that make them insecure or ineffective for their intended purposes. An IoT solution has multiple layers of hardware, sensors, processors, software, and firmware, several of which we may not develop or control. Each layer, including the weakest layer, can impact the security of the whole system. Many IoT devices have limited interfaces and ability to be updated or patched. IoT solutions may collect large amounts of data, and our handling of IoT data may not satisfy customers or regulatory requirements. IoT scenarios may increasingly affect personal health and safety. If IoT solutions that include our technologies do not work as intended, violate the law, or harm individuals or businesses, we may be subject to legal claims or enforcement actions. These risks, if realized, may increase our costs, damage our reputation or brands, or negatively impact our revenues or margins.

Issues in the use of AI in our offerings may result in reputational harm or liability. We are building AI into many of our offerings and we expect this element of our business to grow. We envision a future in which AI operating in our devices, applications, and the cloud helps our customers be more productive in their work and personal lives. As with many disruptive innovations, AI presents risks and challenges that could affect its adoption, and therefore our business. AI algorithms may be flawed. Datasets may be insufficient or contain biased information. Inappropriate or controversial data practices by Microsoft or others could impair the acceptance of AI solutions. These deficiencies could undermine the decisions, predictions, or analysis AI applications produce, subjecting us to competitive harm, legal liability, and brand or reputational harm. Some AI scenarios present ethical issues. If we enable or offer AI solutions that are controversial because of their impact on human rights, privacy, employment, or other social issues, we may experience brand or reputational harm.

We may have excessive outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure. Our increasing user traffic, growth in services, and the complexity of our products and services demand more computing power. We spend substantial amounts to build, purchase, or lease datacenters and equipment and to upgrade our technology and network infrastructure to handle more traffic on our websites and in our datacenters. These demands continue to increase as we introduce new products and services and support the growth of existing services such as Bing, Azure, Microsoft Account services, Office 365, Microsoft Teams, Dynamics 365, OneDrive, SharePoint Online, Skype, Xbox Live, and Outlook.com. We are rapidly growing our business of providing a platform and back-end hosting for services provided by third parties to their end users. Maintaining, securing, and expanding this infrastructure is expensive and complex. It requires that we maintain an Internet connectivity infrastructure that is robust and reliable within competitive and regulatory constraints that continue to evolve. Inefficiencies or operational failures, including temporary or permanent loss of customer data or insufficient Internet connectivity, could diminish the quality of our products, services, and user experience resulting in contractual liability, claims by customers and other third parties, regulatory actions, damage to our reputation, and loss of current and potential users, subscribers, and advertisers, each of which may adversely impact our consolidated financial statements.

We may experience quality or supply problems. Our hardware products such as Xbox consoles, Surface devices, and other devices we design, manufacture, and market are highly complex and can have defects in design, manufacture, or associated software. We could incur significant expenses, lost revenue, and reputational harm as a result of recalls, safety alerts, or product liability claims if we fail to prevent, detect, or address such issues through design, testing, or warranty repairs.

Our software products and services also may experience quality or reliability problems. The highly sophisticated software we develop may contain bugs and other defects that interfere with their intended operation. Our customers increasingly rely on us for critical functions, potentially magnifying the impact of quality or reliability issues. Any defects we do not detect and fix in pre-release testing could cause reduced sales and revenue, damage to our reputation, repair or remediation costs, delays in the release of new products or versions, or legal liability. Although our license agreements typically contain provisions that eliminate or limit our exposure to liability, there is no assurance these provisions will withstand legal challenge.

We acquire some device and datacenter components from sole suppliers. Our competitors use some of the same suppliers and their demand for hardware components can affect the capacity available to us. If a component from a sole-source supplier is delayed or becomes unavailable, whether because of supplier capacity constraint, industry shortages, legal or regulatory changes, or other reasons, we may not obtain timely replacement supplies, resulting in reduced sales or inadequate datacenter capacity. Component shortages, excess or obsolete inventory, or price reductions resulting in inventory adjustments may increase our cost of revenue. Xbox consoles, Surface devices, datacenter servers, and other hardware are assembled in Asia and other geographies that may be subject to disruptions in the supply chain, resulting in shortages that would affect our revenue and operating margins. These same risks would apply to any other hardware and software products we may offer.

We may not be able to protect our source code from copying if there is an unauthorized disclosure. Source code, the detailed program commands for our operating systems and other software programs, is critical to our business. Although we license portions of our application and operating system source code to several licensees, we take significant measures to protect the secrecy of large portions of our source code. If our source code leaks, we might lose future trade secret protection for that code. It may then become easier for third parties to compete with our products by copying functionality, which could adversely affect our revenue and operating margins. Unauthorized disclosure of source code also could increase the security risks described in the next paragraph.

Legal changes, our evolving business model, piracy, and other factors may decrease the value of our intellectual property. Protecting our intellectual property rights and combating unlicensed copying and use of our software and other intellectual property on a global basis is difficult. While piracy adversely affects U.S. revenue, the impact on revenue from outside the U.S. is more significant, particularly countries in which the legal system provides less protection for intellectual property rights. Our revenue in these markets may grow more slowly than the underlying device market. Similarly, the absence of harmonized patent laws makes it more difficult to ensure consistent respect for patent rights. Throughout the world, we educate users about the benefits of licensing genuine products and obtaining indemnification benefits for intellectual property risks, and we educate lawmakers about the advantages of a business climate where intellectual property rights are protected. Reductions in the legal protection for software intellectual property rights could adversely affect revenue.

We expend significant resources to patent the intellectual property we create with the expectation that we will generate revenues by incorporating that intellectual property in our products or services or, in some instances, by licensing our patents to others in return for a royalty. Changes in the law may continue to weaken our ability to prevent the use of patented technology or collect revenue for licensing our patents. These include legislative changes and regulatory actions that make it more difficult to obtain injunctions, and the increasing use of legal process to challenge issued patents. Similarly, licensees of our patents may fail to satisfy their obligations to pay us royalties, or may contest the scope and extent of their obligations. The royalties we can obtain to monetize our intellectual property may decline because of the evolution of technology, selling price changes in products using licensed patents, or the difficulty of discovering infringements. Finally, our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations and may negatively impact revenue.

Third parties may claim we infringe their intellectual property rights. From time to time, others claim we infringe their intellectual property rights. The number of these claims may grow because of constant technological change in the markets in which we compete, the extensive patent coverage of existing technologies, the rapid rate of issuance of new patents, and our offering of first-party devices, such as Microsoft Surface. To resolve these claims, we may enter into royalty and licensing agreements on terms that are less favorable than currently available, stop selling or redesign affected products or services, or pay damages to satisfy indemnification commitments with our customers. These outcomes may cause operating margins to decline. Besides money damages, in some jurisdictions plaintiffs can seek injunctive relief that may limit or prevent importing, marketing, and selling our products or services that have infringing technologies. In some countries, such as Germany, an injunction can be issued before the parties have fully litigated the validity of the underlying patents. We have paid significant amounts to settle claims related to the use of technology and intellectual property rights and to procure intellectual property rights as part of our strategy to manage this risk, and may continue to do so.

We have claims and lawsuits against us that may result in adverse outcomes. We are subject to a variety of claims and lawsuits. These claims may arise from a wide variety of business practices and initiatives, including major new product releases such as Windows 10, significant business transactions, warranty or product claims, and employment practices. Adverse outcomes in some or all of these claims may result in significant monetary damages or injunctive relief that could adversely affect our ability to conduct our business. The litigation and other claims are subject to inherent uncertainties and management's view of these matters may change in the future. A material adverse impact on our consolidated financial statements could occur for the period in which the effect of an unfavorable outcome becomes probable and reasonably estimable.

Government litigation and regulatory activity relating to competition rules may limit how we design and market our products. As a leading global software and device maker, government agencies closely scrutinize us under U.S. and foreign competition laws. Governments are actively enforcing competition laws and regulations, and this includes scrutiny in potentially large markets such as the European Union ("EU"), the U.S., and China. Some jurisdictions also allow competitors or consumers to assert claims of anti-competitive conduct. U.S. federal and state antitrust authorities have previously brought enforcement actions and continue to scrutinize our business.

The European Commission ("the Commission") closely scrutinizes the design of high-volume Microsoft products and the terms on which we make certain technologies used in these products, such as file formats, programming interfaces, and protocols, available to other companies. Flagship product releases such as Windows 10 can receive significant scrutiny under competition laws. For example, in 2004, the Commission ordered us to create new versions of our Windows operating system that do not include certain multimedia technologies and to provide our competitors with specifications for how to implement certain proprietary Windows communications protocols in their own products. In 2009, the Commission accepted a set of commitments we offered to address the Commission's concerns relating to competition in web browsing software, including an undertaking to address Commission concerns relating to interoperability. The web browsing commitments expired in 2014. The remaining obligations may limit our ability to innovate in Windows or other products in the future, diminish the developer appeal of the Windows platform, and increase our product development costs. The availability of licenses related to protocols and file formats may enable competitors to develop software products that better mimic the functionality of our products, which could hamper sales of our products.

Our portfolio of first-party devices continues to grow; at the same time our OEM partners offer a large variety of devices for our platforms. As a result, increasingly we both cooperate and compete with our OEM partners, creating a risk that we fail to do so in compliance with competition rules. Regulatory scrutiny in this area may increase. Certain foreign governments, particularly in China and other countries in Asia, have advanced arguments under their competition laws that exert downward pressure on royalties for our intellectual property.

Government regulatory actions and court decisions such as these may result in fines, or hinder our ability to provide the benefits of our software to consumers and businesses, reducing the attractiveness of our products and the revenue that come from them. New competition law actions could be initiated, potentially using previous actions as precedent. The outcome of such actions, or steps taken to avoid them, could adversely affect us in a variety of ways, including:

- We may have to choose between withdrawing products from certain geographies to avoid fines or designing and developing alternative versions of those products to comply with government rulings, which may entail a delay in a product release and removing functionality that customers want or on which developers rely.

- We may be required to make available licenses to our proprietary technologies on terms that do not reflect their fair market value or do not protect our associated intellectual property.
- We are subject to a variety of ongoing commitments because of court or administrative orders, consent decrees, or other voluntary actions we have taken. If we fail to comply with these commitments, we may incur litigation costs and be subject to substantial fines or other remedial actions.
- Our ability to realize anticipated Windows 10 post-sale monetization opportunities may be limited.

Our global operations subject us to potential liability under anti-corruption, trade protection, and other laws and regulations. The Foreign Corrupt Practices Act ("FCPA") and other anti-corruption laws and regulations ("Anti-Corruption Laws") prohibit corrupt payments by our employees, vendors, or agents, and the accounting provisions of the FCPA require us to maintain accurate books and records and adequate internal controls. From time to time, we receive inquiries from authorities in the U.S. and elsewhere which may be based on reports from employees and others about our business activities outside the U.S. and our compliance with Anti-Corruption Laws. Periodically, we receive such reports directly and investigate them. On July 22, 2019, our Hungarian subsidiary entered into a non-prosecution agreement ("NPA") with the U.S. Department of Justice ("DOJ") and we agreed to the terms of a cease and desist order with the Securities and Exchange Commission. These agreements required us to pay $25.3 million in monetary penalties, disgorgement, and interest pertaining to activities at Microsoft's subsidiary in Hungary. The NPA, which has a three-year term, also contains certain ongoing compliance requirements, including the obligations to disclose to the DOJ issues that may implicate the FCPA and to cooperate in any inquiries. Most countries in which we operate also have competition laws that prohibit competitors from colluding or otherwise attempting to reduce competition between themselves. While we devote substantial resources to our U.S. and international compliance programs and have implemented policies, training, and internal controls designed to reduce the risk of corrupt payments and collusive activity, our employees, vendors, or agents may violate our policies. Our failure to comply with Anti-Corruption Laws or competition laws could result in significant fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation. Operations outside the U.S. may be affected by changes in trade protection laws, policies, sanctions, and other regulatory requirements affecting trade and investment. We may be subject to legal liability and reputational damage if we sell goods or services in violation of U.S. trade sanctions on restricted entities or countries such as Iran, North Korea, Cuba, Sudan, and Syria.

Other regulatory areas that may apply to our products and online services offerings include user privacy, telecommunications, data storage and protection, and online content. For example, some regulators are taking the position that our offerings such as Skype are covered by existing laws regulating telecommunications services, and some new laws are defining more of our services as regulated telecommunications services. This trend may continue and will result in these offerings being subjected to additional data protection, security, and law enforcement surveillance obligations. Data protection authorities may assert that our collection, use, and management of customer data is inconsistent with their laws and regulations. Legislative or regulatory action relating to cybersecurity requirements may increase the costs to develop, implement, or secure our products and services. Legislative or regulatory action could also emerge in the area of AI and content moderation, increasing costs or restricting opportunity. Applying these laws and regulations to our business is often unclear, subject to change over time, and sometimes may conflict from jurisdiction to jurisdiction. Additionally, these laws and governments' approach to their enforcement, and our products and services, are continuing to evolve. Compliance with these types of regulation may involve significant costs or require changes in products or business practices that result in reduced revenue. Noncompliance could result in the imposition of penalties or orders we stop the alleged noncompliant activity.

We strive to empower all people and organizations to achieve more, and accessibility of our products is an important aspect of this goal. There is increasing pressure from advocacy groups, regulators, competitors, customers, and other stakeholders to make technology more accessible. If our products do not meet customer expectations or emerging global accessibility requirements, we could lose sales opportunities or face regulatory actions

Laws and regulations relating to the handling of personal data may impede the adoption of our services or result in increased costs, legal claims, fines against us, or reputational damage. The growth of our Internet- and cloud-based services internationally relies increasingly on the movement of data across national boundaries. Legal requirements relating to the collection, storage, handling, and transfer of personal data continue to evolve. For example, the EU and the U.S. formally entered into a new framework in July 2016 that provides a mechanism for companies to transfer data from EU member states to the U.S. This framework, called the Privacy Shield, is intended to address shortcomings identified by the European Court of Justice in a predecessor mechanism. The Privacy Shield and other mechanisms are currently subject to challenges in European courts, which may lead to uncertainty about the legal basis for data transfers across the Atlantic. The Privacy Shield and other potential rules on the flow of data across borders could increase the cost and complexity of delivering our products and services in some markets. In May 2018, a new EU law governing data practices and privacy, the General Data Protection Regulation ("GDPR"), became effective. The law, which applies to all of our activities conducted from an establishment in the EU or related to products and services offered in the EU, imposes a range of new compliance obligations regarding the handling of personal data. Engineering efforts to build new capabilities to facilitate compliance with the law have entailed substantial expense and the diversion of engineering resources from other projects and may continue to do so. We might experience reduced demand for our offerings if we are unable to engineer products that meet our legal duties or help our customers meet their obligations under the GDPR or other data regulations, or if the changes we implement to comply with the GDPR make our offerings less attractive. The GDPR imposes significant new obligations and compliance with these obligations depends in part on how particular regulators interpret and apply them. If we fail to comply with the GDPR, or if regulators assert we have failed to comply with the GDPR, it may lead to regulatory enforcement actions, which can result in monetary penalties of up to 4% of worldwide revenue, private lawsuits, or reputational damage. In the U.S., California has adopted and several states are considering adopting laws and regulations imposing obligations regarding the handling of personal data.

The Company's investment in gaining insights from data is becoming central to the value of the services we deliver to customers, to our operational efficiency and key opportunities in monetization, customer perceptions of quality, and operational efficiency. Our ability to use data in this way may be constrained by regulatory developments that impede realizing the expected return from this investment. Ongoing legal reviews by regulators may result in burdensome or inconsistent requirements, including data sovereignty and localization requirements, affecting the location and movement of our customer and internal employee data as well as the management of that data. Compliance with applicable laws and regulations regarding personal data may require changes in services, business practices, or internal systems that result in increased costs, lower revenue, reduced efficiency, or greater difficulty in competing with foreign-based firms. Compliance with data regulations might limit our ability to innovate or offer certain features and functionality in some jurisdictions where we operate. Failure to comply with existing or new rules may result in significant penalties or orders to stop the alleged noncompliant activity, as well as negative publicity and diversion of management time and effort.

We may have additional tax liabilities. We are subject to income taxes in the U.S. and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. For example, compliance with the 2017 United States Tax Cuts and Jobs Act ("TCJA") may require the collection of information not regularly produced within the Company, the use of estimates in our consolidated financial statements, and the exercise of significant judgment in accounting for its provisions. As regulations and guidance evolve with respect to the TCJA, and as we gather more information and perform more analysis, our results may differ from previous estimates and may materially affect our consolidated financial statements.

We regularly are under audit by tax authorities in different jurisdictions. Although we believe that our provision for income taxes and our tax estimates are reasonable, tax authorities may disagree with certain positions we have taken. In addition, economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes favorably more difficult. We are currently under Internal Revenue Service audit for prior tax years, with the primary unresolved issues relating to transfer pricing. The final resolution of those audits, and other audits or litigation, may differ from the amounts recorded in our consolidated financial statements and may materially affect our consolidated financial statements in the period or periods in which that determination is made.

We earn a significant amount of our operating income outside the U.S. A change in the mix of earnings and losses in countries with differing statutory tax rates, changes in our business or structure, or the expiration of or disputes about certain tax agreements in a particular country may result in higher effective tax rates for the Company. In addition, changes in U.S. federal and state or international tax laws applicable to corporate multinationals, other fundamental law changes currently being considered by many countries, including in the U.S., and changes in taxing jurisdictions' administrative interpretations, decisions, policies, and positions may materially adversely impact our consolidated financial statements.

If our reputation or our brands are damaged, our business and operating results may be harmed. Our reputation and brands are globally recognized and are important to our business. Our reputation and brands affect our ability to attract and retain consumer, business, and public-sector customers. There are numerous ways our reputation or brands could be damaged. These include product safety or quality issues, or our environmental impact and sustainability, supply chain practices, or human rights record. We may experience backlash from customers, government entities, advocacy groups, employees, and other stakeholders that disagree with our product offering decisions or public policy positions. Damage to our reputation or our brands may occur from, among other things:

- The introduction of new features, products, services, or terms of service that customers, users, or partners do not like.
- Public scrutiny of our decisions regarding user privacy, data practices, or content.
- Data security breaches, compliance failures, or actions of partners or individual employees.

The proliferation of social media may increase the likelihood, speed, and magnitude of negative brand events. If our brands or reputation are damaged, it could negatively impact our revenues or margins, or ability to attract the most highly qualified employees.

Our global business exposes us to operational and economic risks. Our customers are located throughout the world and a significant part of our revenue comes from international sales. The global nature of our business creates operational and economic risks. Our results of operations may be affected by global, regional, and local economic developments, monetary policy, inflation, and recession, as well as political and military disputes. In addition, our international growth strategy includes certain markets, the developing nature of which presents several risks, including deterioration of social, political, labor, or economic conditions in a country or region, and difficulties in staffing and managing foreign operations. Emerging nationalist trends in specific countries may significantly alter the trade environment. Changes to trade policy or agreements as a result of populism, protectionism, or economic nationalism may result in higher tariffs, local sourcing initiatives, or other developments that make it more difficult to sell our products in foreign countries. Disruptions of these kinds in developed or emerging markets could negatively impact demand for our products and services or increase operating costs. Although we hedge a portion of our international currency exposure, significant fluctuations in foreign exchange rates between the U.S. dollar and foreign currencies may adversely affect our results of operations.

Adverse economic or market conditions may harm our business. Worsening economic conditions, including inflation, recession, or other changes in economic conditions, may cause lower IT spending and adversely affect our revenue. If demand for PCs, servers, and other computing devices declines, or consumer or business spending for those products declines, our revenue will be adversely affected. Substantial revenue comes from our U.S. government contracts. An extended federal government shutdown resulting from failing to pass budget appropriations, adopt continuing funding resolutions or raise the debt ceiling, and other budgetary decisions limiting or delaying federal government spending, could reduce government IT spending on our products and services and adversely affect our revenue.

Our product distribution system relies on an extensive partner and retail network. OEMs building devices that run our software have also been a significant means of distribution. The impact of economic conditions on our partners, such as the bankruptcy of a major distributor, OEM, or retailer, could cause sales channel disruption.

Challenging economic conditions also may impair the ability of our customers to pay for products and services they have purchased. As a result, allowances for doubtful accounts and write-offs of accounts receivable may increase.

We maintain an investment portfolio of various holdings, types, and maturities. These investments are subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by market downturns or events that affect global financial markets. A significant part of our investment portfolio comprises U.S. government securities. If global financial markets decline for long periods, or if there is a downgrade of the U.S. government credit rating due to an actual or threatened default on government debt, our investment portfolio may be adversely affected and we could determine that more of our investments have experienced an other-than-temporary decline in fair value, requiring impairment charges that could adversely affect our consolidated financial statements.

Catastrophic events or geopolitical conditions may disrupt our business. A disruption or failure of our systems or operations because of a major earthquake, weather event, cyberattack, terrorist attack, or other catastrophic event could cause delays in completing sales, providing services, or performing other critical functions. Our corporate headquarters, a significant portion of our research and development activities, and certain other essential business operations are in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are seismically active regions. A catastrophic event that results in the destruction or disruption of any of our critical business or IT systems, or the infrastructure or systems they rely on, such as power grids, could harm our ability to conduct normal business operations. Providing our customers with more services and solutions in the cloud puts a premium on the resilience of our systems and strength of our business continuity management plans, and magnifies the potential impact of prolonged service outages on our consolidated financial statements.

Abrupt political change, terrorist activity, and armed conflict pose a risk of general economic disruption in affected countries, which may increase our operating costs. These conditions also may add uncertainty to the timing and budget for technology investment decisions by our customers, and may cause supply chain disruptions for hardware manufacturers. Geopolitical change may result in changing regulatory requirements that could impact our operating strategies, access to global markets, hiring, and profitability. Geopolitical instability may lead to sanctions and impact our ability to do business in some markets or with some public-sector customers. Any of these changes may negatively impact our revenues.

The long-term effects of climate change on the global economy or the IT industry in particular are unclear. Environmental regulations or changes in the supply, demand or available sources of energy or other natural resources may affect the availability or cost of goods and services, including natural resources, necessary to run our business. Changes in weather where we operate may increase the costs of powering and cooling computer hardware we use to develop software and provide cloud-based services.

Our business depends on our ability to attract and retain talented employees. Our business is based on successfully attracting and retaining talented employees representing diverse backgrounds, experiences, and skill sets. The market for highly skilled workers and leaders in our industry is extremely competitive. Maintaining our brand and reputation, as well as a diverse and inclusive work environment that enables all our employees to thrive, are important to our ability to recruit and retain employees. We are also limited in our ability to recruit internationally by restrictive domestic immigration laws. Changes to U.S. immigration policies that restrain the flow of technical and professional talent may inhibit our ability to adequately staff our research and development efforts. If we are less successful in our recruiting efforts, or if we cannot retain highly skilled workers and key leaders, our ability to develop and deliver successful products and services may be adversely affected. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees could hinder our strategic planning and execution. How employment-related laws are interpreted and applied to our workforce practices may result in increased operating costs and less flexibility in how we meet our workforce needs.

ITEM 1B. UNRESOLVED STAFF COMMENTS

We have received no written comments regarding our periodic or current reports from the staff of the Securities and Exchange Commission that were issued 180 days or more preceding the end of our fiscal year 2019 that remain unresolved.

ITEM 2. PROPERTIES

Our corporate headquarters are located in Redmond, Washington. We have approximately 15 million square feet of space located in King County, Washington that is used for engineering, sales, marketing, and operations, among other general and administrative purposes. These facilities include approximately 10 million square feet of owned space situated on approximately 520 acres of land we own at our corporate headquarters, and approximately five million square feet of space we lease. In addition, we own and lease space domestically that includes office, datacenter, and retail space.

We also own and lease facilities internationally. The largest owned properties include: our research and development centers in China and India; our datacenters in Ireland, the Netherlands, and Singapore; and our operations and facilities in Ireland and the United Kingdom. The largest leased properties include space in the following locations: Australia, Canada, China, Germany, India, Japan, and the United Kingdom.

In addition to the above locations, we have various product development facilities, both domestically and internationally, as described under Research and Development (Part I, Item 1 of this Form 10-K).

The table below shows a summary of the square footage of our office, datacenter, retail, and other facilities owned and leased domestically and internationally as of June 30, 2019:

(Square feet in millions)

Location	Owned	Leased	Total
U.S.	**18**	**14**	**32**
International	**6**	**14**	**20**
Total	**24**	**28**	**52**

ITEM 3. LEGAL PROCEEDINGS

While not material to the Company, the Company makes the following annual report of the general activities of the Company’s Antitrust Compliance Office as required by the Final Order and Judgment in *Barovic v. Ballmer et al,* United States District Court for the Western District of Washington (“Final Order”). For more information see http://aka.ms/MSLegalNotice2015. These annual reports will continue through 2020. During fiscal year 2019, the Antitrust Compliance Office (a) monitored the Company’s compliance with the European Commission Decision of March 24, 2004, (“2004 Decision”) and with the Company’s Public Undertaking to the European Commission dated December 16, 2009 (“2009 Undertaking”); (b) monitored, in the manner required by the Final Order, employee, customer, competitor, regulator, or other third-party complaints regarding compliance with the 2004 Decision, the 2009 Undertaking, or other EU or U.S. laws or regulations governing tying, bundling, and exclusive dealing contracts; and, (c) monitored, in the manner required by the Final Order, the training of the Company’s employees regarding the Company’s antitrust compliance polices. In addition, the Antitrust Compliance Officer reports to the Regulatory and Public Policy Committee of the Board at each of its regularly scheduled meetings and to the full Board annually.

Refer to Note 16 – Contingencies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for information regarding legal proceedings in which we are involved.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

MARKET AND STOCKHOLDERS

Our common stock is traded on the NASDAQ Stock Market under the symbol MSFT. On July 29, 2019, there were 94,069 registered holders of record of our common stock.

SHARE REPURCHASES AND DIVIDENDS

Following are our monthly share repurchases for the fourth quarter of fiscal year 2019:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet be Purchased under the Plans or Programs
				(In millions)
April 1, 2019 – April 30, 2019	**8,547,612**	**$ 122.85**	**8,547,612**	**$ 14,551**
May 1, 2019 – May 31, 2019	**14,029,339**	**126.32**	**14,029,339**	**12,778**
June 1, 2019 – June 30, 2019	**10,469,682**	**131.59**	**10,469,682**	**11,401**
	33,046,633		**33,046,633**	

All share repurchases were made using cash resources. Our share repurchases may occur through open market purchases or pursuant to a Rule 10b5-1 trading plan. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards.

Our Board of Directors declared the following dividends during the fourth quarter of fiscal year 2019:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
				(In millions)
June 12, 2019	**August 15, 2019**	**September 12, 2019**	**$ 0.46**	**$ 3,516**

We returned $7.7 billion to shareholders in the form of share repurchases and dividends in the fourth quarter of fiscal year 2019. Refer to Note 17 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion regarding share repurchases and dividends.

ITEM 6. SELECTED FINANCIAL DATA

FINANCIAL HIGHLIGHTS

(In millions, except per share amounts)

Year Ended June 30,	**2019**[a]	**2018**	**2017**[d][e]	**2016**[d]	**2015**
Revenue	**$ 125,843**	$ 110,360	$ 96,571	$ 91,154	$ 93,580
Gross margin	**82,933**	72,007	62,310	58,374	60,542
Operating income	**42,959**	35,058	29,025[f]	26,078[g]	18,161[h]
Net income	**39,240**[b]	16,571[c]	25,489[f]	20,539[g]	12,193[h]
Diluted earnings per share	**5.06**[b]	2.13[c]	3.25[f]	2.56[g]	1.48[h]
Cash dividends declared per share	**1.84**	1.68	1.56	1.44	1.24
Cash, cash equivalents, and short-term investments	**133,819**	133,768	132,981	113,240	96,526
Total assets	**286,556**	258,848	250,312	202,897	174,303
Long-term obligations	**114,806**	117,642	106,856	66,705	44,574
Stockholders' equity	**102,330**	82,718	87,711	83,090	80,083

(a) *GitHub has been included in our consolidated results of operations starting on the October 25, 2018 acquisition date*.

(b) *Includes a $2.6 billion net income tax benefit related to intangible property transfers and a $157 million net charge related to the enactment of the Tax Cuts and Jobs Act ("TCJA"), which together increased net income and diluted earnings per share ("EPS") by $2.4 billion and $0.31, respectively. Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.*

(c) *Includes a $13.7 billion net charge related to the enactment of the TCJA, which decreased net income and diluted EPS by $13.7 billion and $1.75, respectively. Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.*

(d) *Reflects the impact of the adoption of new accounting standards in fiscal year 2018 related to revenue recognition and leases.*

(e) *LinkedIn has been included in our consolidated results of operations starting on the December 8, 2016 acquisition date.*

(f) *Includes $306 million of employee severance expenses primarily related to our sales and marketing restructuring plan, which decreased operating income, net income, and diluted EPS by $306 million, $243 million, and $0.04, respectively.*

(g) *Includes $630 million of asset impairment charges related to our Phone business and $480 million of restructuring charges associated with our Phone business restructuring plans, which together decreased operating income, net income, and diluted EPS by $1.1 billion, $895 million, and $0.11, respectively.*

(h) *Includes $7.5 billion of goodwill and asset impairment charges related to our Phone business and $2.5 billion of integration and restructuring expenses, primarily associated with our Phone business restructuring plans, which together decreased operating income, net income, and diluted EPS by $10.0 billion, $9.5 billion, and $1.15, respectively.*

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the results of operations and financial condition of Microsoft Corporation. MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity.

We generate revenue by offering a wide range of cloud-based and other services to people and businesses; licensing and supporting an array of software products; designing, manufacturing, and selling devices; and delivering relevant online advertising to a global audience. Our most significant expenses are related to compensating employees; designing, manufacturing, marketing, and selling our products and services; datacenter costs in support of our cloud-based services; and income taxes.

Highlights from fiscal year 2019 compared with fiscal year 2018 included:

- Commercial cloud revenue, which includes Microsoft Office 365 Commercial, Microsoft Azure, the commercial portion of LinkedIn, Microsoft Dynamics 365, and other commercial cloud properties, increased 43% to $38.1 billion.
- Office Commercial revenue increased 13%, driven by Office 365 Commercial growth of 33%.
- Office Consumer revenue increased 7%, and Office 365 Consumer subscribers increased to 34.8 million.
- LinkedIn revenue increased 28%, with record levels of engagement highlighted by LinkedIn sessions growth of 27%.
- Dynamics revenue increased 15%, driven by Dynamics 365 growth of 47%.
- Server products and cloud services revenue, including GitHub, increased 25%, driven by Azure growth of 72%.
- Enterprise Services revenue increased 5%.
- Windows original equipment manufacturer licensing ("Windows OEM") revenue increased 4%.
- Windows Commercial revenue increased 14%.
- Microsoft Surface revenue increased 23%.
- Gaming revenue increased 10%, driven by Xbox software and services growth of 19%.
- Search advertising revenue, excluding traffic acquisition costs, increased 13%.

We have recast certain prior period commercial cloud metrics to include the commercial portion of LinkedIn to provide a comparable view of our commercial cloud business performance. The commercial portion of LinkedIn includes LinkedIn Recruiter, Sales Navigator, premium business subscriptions, and other services for organizations.

On October 25, 2018, we acquired GitHub, Inc. ("GitHub") in a $7.5 billion stock transaction (inclusive of total cash payments of $1.3 billion in respect of vested GitHub equity awards and an indemnity escrow). The financial results of GitHub have been included in our consolidated financial statements since the date of the acquisition. GitHub is reported as part of our Intelligent Cloud segment. Refer to Note 8 – Business Combinations of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted into law, which significantly changed existing U.S. tax law and included numerous provisions that affect our business. We recorded a provisional net charge related to the enactment of the TCJA of $13.7 billion in fiscal year 2018, and adjusted our provisional net charge by recording additional tax expense of $157 million in the second quarter of fiscal year 2019. In the fourth quarter of fiscal year 2019, in response to the TCJA and recently issued regulations, we transferred certain intangible properties held by our foreign subsidiaries to the U.S. and Ireland, which resulted in a $2.6 billion net income tax benefit. Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Industry Trends

Our industry is dynamic and highly competitive, with frequent changes in both technologies and business models. Each industry shift is an opportunity to conceive new products, new technologies, or new ideas that can further transform the industry and our business. At Microsoft, we push the boundaries of what is possible through a broad range of research and development activities that seek to identify and address the changing demands of customers and users, industry trends, and competitive forces.

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, and influence how users access services in the cloud, and in some cases, the user's choice of which suite of cloud-based services to use. We must continue to evolve and adapt over an extended time in pace with this changing environment. The investments we are making in infrastructure and devices will continue to increase our operating costs and may decrease our operating margins.

Our success is highly dependent on our ability to attract and retain qualified employees. We hire a mix of university and industry talent worldwide. We compete for talented individuals globally by offering an exceptional working environment, broad customer reach, scale in resources, the ability to grow one's career across many different products and businesses, and competitive compensation and benefits. Aggregate demand for our software, services, and devices is correlated to global macroeconomic and geopolitical factors, which remain dynamic.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. Strengthening of foreign currencies relative to the U.S. dollar throughout fiscal year 2018 positively impacted reported revenue and increased reported expenses from our international operations. Strengthening of the U.S. dollar relative to certain foreign currencies did not significantly impact reported revenue or expenses from our international operations in the first and second quarters of fiscal year 2019, and reduced reported revenue and expenses from our international operations in the third and fourth quarters of fiscal year 2019.

Refer to Risk Factors (Part I, Item 1A of this Form 10-K) for a discussion of these factors and other risks.

Seasonality

Our revenue fluctuates quarterly and is generally higher in the second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.

Reportable Segments

We report our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. The segment amounts included in MD&A are presented on a basis consistent with our internal management reporting. All differences between our internal management reporting basis and accounting principles generally accepted in the United States of America ("GAAP"), along with certain corporate-level and other activity, are included in Corporate and Other.

Additional information on our reportable segments is contained in Note 20 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

SUMMARY RESULTS OF OPERATIONS

(In millions, except percentages and per share amounts)	2019	2018	2017	Percentage Change 2019 Versus 2018	Percentage Change 2018 Versus 2017
Revenue	**$ 125,843**	$ 110,360	$ 96,571	14%	14%
Gross margin	**82,933**	72,007	62,310	15%	16%
Operating income	**42,959**	35,058	29,025	23%	21%
Net income	**39,240**	16,571	25,489	137%	(35)%
Diluted earnings per share	**5.06**	2.13	3.25	138%	(34)%
Non-GAAP operating income	**42,959**	35,058	29,331	23%	20%
Non-GAAP net income	**36,830**	30,267	25,732	22%	18%
Non-GAAP diluted earnings per share	**4.75**	3.88	3.29	22%	18%

Non-GAAP operating income, net income, and diluted earnings per share (“EPS”) exclude the net tax impact of transfer of intangible properties, the net tax impact of the TCJA, and restructuring expenses. Refer to the Non-GAAP Financial Measures section below for a reconciliation of our financial results reported in accordance with GAAP to non-GAAP financial results.

Fiscal Year 2019 Compared with Fiscal Year 2018

Revenue increased $15.5 billion or 14%, driven by growth across each of our segments. Intelligent Cloud revenue increased, driven by server products and cloud services. Productivity and Business Processes revenue increased, driven by Office and LinkedIn. More Personal Computing revenue increased, driven by Surface, Gaming, and Windows.

Gross margin increased $10.9 billion or 15%, driven by growth across each of our segments. Gross margin percentage increased slightly, due to gross margin percentage improvement across each of our segments and favorable segment sales mix. Gross margin included a 5 percentage point improvement in commercial cloud, primarily from Azure.

Operating income increased $7.9 billion or 23%, driven by growth across each of our segments.

Key changes in expenses were:

- Cost of revenue increased $4.6 billion or 12%, driven by growth in commercial cloud, Surface, and Gaming.
- Research and development expenses increased $2.2 billion or 15%, driven by investments in cloud and artificial intelligence (“AI”) engineering, Gaming, LinkedIn, and GitHub.
- Sales and marketing expenses increased $744 million or 4%, driven by investments in commercial sales capacity, LinkedIn, and GitHub, offset in part by a decrease in marketing. Sales and marketing expenses included a favorable foreign currency impact of 2%.

Current year net income included a $2.6 billion net income tax benefit related to intangible property transfers and a $157 million net charge related to the enactment of the TCJA, which together resulted in an increase to net income and diluted EPS of $2.4 billion and $0.31, respectively. Prior year net income and diluted EPS were negatively impacted by the net charge related to the enactment of the TCJA, which resulted in a decrease to net income and diluted EPS of $13.7 billion and $1.75, respectively.

Fiscal Year 2018 Compared with Fiscal Year 2017

Revenue increased $13.8 billion or 14%, driven by growth across each of our segments. Productivity and Business Processes revenue increased, driven by LinkedIn and higher revenue from Office. Intelligent Cloud revenue increased, primarily due to higher revenue from server products and cloud services. More Personal Computing revenue increased, driven by higher revenue from Gaming, Windows, Search advertising, and Surface, offset in part by lower revenue from Phone.

Gross margin increased $9.7 billion or 16%, due to growth across each of our segments. Gross margin percentage increased slightly, driven by favorable segment sales mix and gross margin percentage improvement in More Personal Computing. Gross margin included a 7 percentage point improvement in commercial cloud, primarily from Azure.

Operating income increased $6.0 billion or 21%, driven by growth across each of our segments. LinkedIn operating loss increased $63 million to $987 million, including $1.5 billion of amortization of intangible assets. Operating income included a favorable foreign currency impact of 2%.

Key changes in expenses were:

- Cost of revenue increased $4.1 billion or 12%, mainly due to growth in our commercial cloud, Gaming, LinkedIn, and Search advertising, offset in part by a reduction in Phone cost of revenue.
- Sales and marketing expenses increased $2.0 billion or 13%, primarily due to LinkedIn expenses and investments in commercial sales capacity, offset in part by a decrease in Windows marketing expenses.
- Research and development expenses increased $1.7 billion or 13%, primarily due to investments in cloud engineering and LinkedIn expenses.
- General and administrative expenses increased $273 million or 6%, primarily due to LinkedIn expenses.

Fiscal year 2018 net income and diluted EPS were negatively impacted by the net charge related to the enactment of the TCJA, which resulted in a decrease to net income and diluted earnings per share of $13.7 billion and $1.75, respectively. Fiscal year 2017 operating income, net income, and diluted EPS were negatively impacted by restructuring expenses, which resulted in a decrease to operating income, net income, and diluted EPS of $306 million, $243 million, and $0.04, respectively.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	2019	2018	2017	Percentage Change 2019 Versus 2018	Percentage Change 2018 Versus 2017
Revenue					
Productivity and Business Processes	**$ 41,160**	$ 35,865	$ 29,870	15%	20%
Intelligent Cloud	**38,985**	32,219	27,407	21%	18%
More Personal Computing	**45,698**	42,276	39,294	8%	8%
Total	**$ 125,843**	$ 110,360	$ 96,571	14%	14%
Operating Income (Loss)					
Productivity and Business Processes	**$ 16,219**	$ 12,924	$ 11,389	25%	13%
Intelligent Cloud	**13,920**	11,524	9,127	21%	26%
More Personal Computing	**12,820**	10,610	8,815	21%	20%
Corporate and Other	**0**	0	(306)	*	*
Total	**$ 42,959**	$ 35,058	$ 29,025	23%	21%

* *Not meaningful.*

Reportable Segments

Fiscal Year 2019 Compared with Fiscal Year 2018

Productivity and Business Processes

Revenue increased $5.3 billion or 15%.

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Office Commercial revenue increased $3.2 billion or 13%, driven by Office 365 Commercial, offset in part by lower revenue from products licensed on-premises, reflecting a continued shift to cloud offerings. Office 365 Commercial grew 33%, due to growth in seats and higher average revenue per user.

- Office Consumer revenue increased $286 million or 7%, driven by Office 365 Consumer, due to recurring subscription revenue and transactional strength in Japan.
- LinkedIn revenue increased $1.5 billion or 28%, driven by growth across each line of business.
- Dynamics revenue increased 15%, driven by Dynamics 365 growth.

Operating income increased $3.3 billion or 25%, including an unfavorable foreign currency impact of 2%.

- Gross margin increased $4.1 billion or 15%, driven by growth in Office Commercial and LinkedIn. Gross margin percentage increased slightly, due to gross margin percentage improvement in LinkedIn and Office 365 Commercial, offset in part by an increased mix of cloud offerings.
- Operating expenses increased $806 million or 6%, driven by investments in LinkedIn and cloud engineering, offset in part by a decrease in marketing.

Intelligent Cloud

Revenue increased $6.8 billion or 21%.

- Server products and cloud services revenue, including GitHub, increased $6.5 billion or 25%, driven by Azure. Azure revenue growth was 72%, due to higher infrastructure-as-a-service and platform-as-a-service consumption-based and per user-based services. Server products revenue increased 6%, due to continued demand for premium versions and hybrid solutions, GitHub, and demand ahead of end-of-support for SQL Server 2008 and Windows Server 2008.
- Enterprise Services revenue increased $278 million or 5%, driven by growth in Premier Support Services and Microsoft Consulting Services.

Operating income increased $2.4 billion or 21%.

- Gross margin increased $4.8 billion or 22%, driven by growth in server products and cloud services revenue and cloud services scale and efficiencies. Gross margin percentage increased slightly, due to gross margin percentage improvement in Azure, offset in part by an increased mix of cloud offerings.
- Operating expenses increased $2.4 billion or 22%, driven by investments in cloud and AI engineering, GitHub, and commercial sales capacity.

More Personal Computing

Revenue increased $3.4 billion or 8%.

- Windows revenue increased $877 million or 4%, driven by growth in Windows Commercial and Windows OEM, offset in part by a decline in patent licensing. Windows Commercial revenue increased 14%, driven by an increased mix of multi-year agreements that carry higher in-quarter revenue recognition. Windows OEM revenue increased 4%. Windows OEM Pro revenue grew 10%, ahead of the commercial PC market, driven by healthy Windows 10 demand. Windows OEM non-Pro revenue declined 7%, below the consumer PC market, driven by continued pressure in the entry level category.
- Surface revenue increased $1.1 billion or 23%, with strong growth across commercial and consumer.
- Gaming revenue increased $1.0 billion or 10%, driven by Xbox software and services growth of 19%, primarily due to third-party title strength and subscriptions growth, offset in part by a decline in Xbox hardware of 13% primarily due to a decrease in volume of consoles sold.
- Search advertising revenue increased $616 million or 9%. Search advertising revenue, excluding traffic acquisition costs, increased 13%, driven by higher revenue per search.

Operating income increased $2.2 billion or 21%, including an unfavorable foreign currency impact of 2%.

- Gross margin increased $2.0 billion or 9%, driven by growth in Windows, Gaming, and Search. Gross margin percentage increased slightly, due to a sales mix shift to higher gross margin businesses in Windows and Gaming.
- Operating expenses decreased $172 million or 1%.

Fiscal Year 2018 Compared with Fiscal Year 2017

Productivity and Business Processes

Revenue increased $6.0 billion or 20%.

- LinkedIn revenue increased $3.0 billion to $5.3 billion. Fiscal year 2018 included a full period of results, whereas fiscal year 2017 only included results from the date of acquisition on December 8, 2016. LinkedIn revenue primarily consisted of revenue from Talent Solutions.
- Office Commercial revenue increased $2.4 billion or 11%, driven by Office 365 Commercial revenue growth, mainly due to growth in subscribers and average revenue per user, offset in part by lower revenue from products licensed on-premises, reflecting a continued shift to Office 365 Commercial.
- Office Consumer revenue increased $382 million or 11%, driven by Office 365 Consumer revenue growth, mainly due to growth in subscribers.
- Dynamics revenue increased 13%, driven by Dynamics 365 revenue growth.

Operating income increased $1.5 billion or 13%, including a favorable foreign currency impact of 2%.

- Gross margin increased $4.4 billion or 19%, driven by LinkedIn and growth in Office Commercial. Gross margin percentage decreased slightly, due to an increased mix of cloud offerings, offset in part by gross margin percentage improvement in Office 365 Commercial and LinkedIn. LinkedIn cost of revenue increased $818 million to $1.7 billion, including $888 million of amortization for acquired intangible assets.
- Operating expenses increased $2.9 billion or 25%, driven by LinkedIn expenses and investments in commercial sales capacity and cloud engineering. LinkedIn operating expenses increased $2.2 billion to $4.5 billion, including $617 million of amortization of acquired intangible assets.

Intelligent Cloud

Revenue increased $4.8 billion or 18%.

- Server products and cloud services revenue increased $4.5 billion or 21%, driven by Azure and server products licensed on-premises revenue growth. Azure revenue grew 91%, due to higher infrastructure-as-a-service and platform-as-a-service consumption-based and per user-based services. Server products licensed on-premises revenue increased 5%, mainly due to a higher mix of premium licenses for Windows Server and Microsoft SQL Server.
- Enterprise Services revenue increased $304 million or 5%, driven by higher revenue from Premier Support Services and Microsoft Consulting Services, offset in part by a decline in revenue from custom support agreements.

Operating income increased $2.4 billion or 26%.

- Gross margin increased $3.1 billion or 16%, driven by growth in server products and cloud services revenue and cloud services scale and efficiencies. Gross margin percentage decreased, due to an increased mix of cloud offerings, offset in part by gross margin percentage improvement in Azure.
- Operating expenses increased $683 million or 7%, driven by investments in commercial sales capacity and cloud engineering.

More Personal Computing

Revenue increased $3.0 billion or 8%.

- Windows revenue increased $925 million or 5%, driven by growth in Windows Commercial and Windows OEM, offset by a decline in patent licensing revenue. Windows Commercial revenue increased 12%, driven by multi-year agreement revenue growth. Windows OEM revenue increased 5%. Windows OEM Pro revenue grew 11%, ahead of a strengthening commercial PC market. Windows OEM non-Pro revenue declined 4%, below the consumer PC market, driven by continued pressure in the entry-level price category.

- Gaming revenue increased $1.3 billion or 14%, driven by Xbox software and services revenue growth of 20%, mainly from third-party title strength.

- Search advertising revenue increased $793 million or 13%. Search advertising revenue, excluding traffic acquisition costs, increased 16%, driven by growth in Bing, due to higher revenue per search and search volume.
- Surface revenue increased $625 million or 16%, driven by a higher mix of premium devices and an increase in volumes sold, due to the latest editions of Surface.
- Phone revenue decreased $525 million.

Operating income increased $1.8 billion or 20%, including a favorable foreign currency impact of 2%.

- Gross margin increased $2.2 billion or 11%, driven by growth in Windows, Surface, Search, and Gaming. Gross margin percentage increased, primarily due to gross margin percentage improvement in Surface.
- Operating expenses increased $391 million or 3%, driven by investments in Search, AI, and Gaming engineering and commercial sales capacity, offset in part by a decrease in Windows marketing expenses.

Corporate and Other

Corporate and Other includes corporate-level activity not specifically allocated to a segment, including restructuring expenses.

Fiscal Year 2019 Compared with Fiscal Year 2018

We did not incur Corporate and Other activity in fiscal years 2019 or 2018.

Fiscal Year 2018 Compared with Fiscal Year 2017

Corporate and Other operating loss decreased $306 million, due to a reduction in restructuring expenses, driven by employee severance expenses primarily related to our sales and marketing restructuring plan in fiscal year 2017.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)	2019	2018	2017	Percentage Change 2019 Versus 2018	Percentage Change 2018 Versus 2017
Research and development	**$ 16,876**	$ 14,726	$ 13,037	15%	13%
As a percent of revenue	**13%**	13%	13%	0ppt	0ppt

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content.

Fiscal Year 2019 Compared with Fiscal Year 2018

Research and development expenses increased $2.2 billion or 15%, driven by investments in cloud and AI engineering, Gaming, LinkedIn, and GitHub.

Fiscal Year 2018 Compared with Fiscal Year 2017

Research and development expenses increased $1.7 billion or 13%, primarily due to investments in cloud engineering and LinkedIn expenses. LinkedIn expenses increased $762 million to $1.5 billion.

Sales and Marketing

(In millions, except percentages)	2019	2018	2017	Percentage Change 2019 Versus 2018	Percentage Change 2018 Versus 2017
Sales and marketing	**$ 18,213**	$ 17,469	$ 15,461	4%	13%
As a percent of revenue	**14%**	16%	16%	(2)ppt	0ppt

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs.

Fiscal Year 2019 Compared with Fiscal Year 2018

Sales and marketing expenses increased $744 million or 4%, driven by investments in commercial sales capacity, LinkedIn, and GitHub, offset in part by a decrease in marketing. Expenses included a favorable foreign currency impact of 2%.

Fiscal Year 2018 Compared with Fiscal Year 2017

Sales and marketing expenses increased $2.0 billion or 13%, primarily due to LinkedIn expenses and investments in commercial sales capacity, offset in part by a decrease in Windows marketing expenses. LinkedIn expenses increased $1.2 billion to $2.5 billion, including $617 million of amortization of acquired intangible assets.

General and Administrative

(In millions, except percentages)	2019	2018	2017	Percentage Change 2019 Versus 2018	Percentage Change 2018 Versus 2017
General and administrative	**$ 4,885**	$ 4,754	$ 4,481	3%	6%
As a percent of revenue	**4%**	4%	5%	0ppt	(1)ppt

General and administrative expenses include payroll, employee benefits, stock-based compensation expense, severance expense, and other headcount-related expenses associated with finance, legal, facilities, certain human resources and other administrative personnel, certain taxes, and legal and other administrative fees.

Fiscal Year 2019 Compared with Fiscal Year 2018

General and administrative expenses increased $131 million or 3%.

Fiscal Year 2018 Compared with Fiscal Year 2017

General and administrative expenses increased $273 million or 6%, primarily due to LinkedIn expenses. LinkedIn expenses increased $234 million to $528 million.

RESTRUCTURING EXPENSES

Restructuring expenses include employee severance expenses and other costs associated with the consolidation of facilities and manufacturing operations related to restructuring activities.

Fiscal Year 2019 Compared with Fiscal Year 2018

We did not incur restructuring expenses in fiscal years 2019 or 2018.

Fiscal Year 2018 Compared with Fiscal Year 2017

During fiscal year 2017, we recorded $306 million of employee severance expenses, primarily related to our sales and marketing restructuring plan.

OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Interest and dividends income	**$ 2,762**	$ 2,214	$ 1,387
Interest expense	**(2,686)**	(2,733)	(2,222)
Net recognized gains on investments	**648**	2,399	2,583
Net gains (losses) on derivatives	**144**	(187)	(510)
Net losses on foreign currency remeasurements	**(82)**	(218)	(111)
Other, net	**(57)**	(59)	(251)
Total	**$ 729**	$ 1,416	$ 876

We use derivative instruments to: manage risks related to foreign currencies, equity prices, interest rates, and credit; enhance investment returns; and facilitate portfolio diversification. Gains and losses from changes in fair values of derivatives that are not designated as hedging instruments are primarily recognized in other income (expense), net.

Fiscal Year 2019 Compared with Fiscal Year 2018

Interest and dividends income increased primarily due to higher yields on fixed-income securities. Interest expense decreased primarily driven by a decrease in outstanding long-term debt due to debt maturities, offset in part by higher finance lease expense. Net recognized gains on investments decreased primarily due to lower gains on sales of equity investments. Net gains on derivatives includes gains on foreign exchange and interest rate derivatives in the current period as compared to losses in the prior period.

Fiscal Year 2018 Compared with Fiscal Year 2017

Dividends and interest income increased primarily due to higher average portfolio balances and yields on fixed-income securities. Interest expense increased primarily due to higher average outstanding long-term debt and higher finance lease expense. Net recognized gains on investments decreased primarily due to higher losses on sales of fixed-income securities, offset in part by higher gains on sales of equity securities. Net losses on derivatives decreased primarily due to lower losses on equity, foreign exchange, and commodity derivatives, offset in part by losses on interest rate derivatives in the current period as compared to gains in the prior period.

INCOME TAXES

Effective Tax Rate

Fiscal Year 2019 Compared with Fiscal Year 2018

Our effective tax rate for fiscal years 2019 and 2018 was 10% and 55%, respectively. The decrease in our effective tax rate for fiscal year 2019 compared to fiscal year 2018 was primarily due to the net charge related to the enactment of the TCJA in the second quarter of fiscal year 2018 and a $2.6 billion net income tax benefit in the fourth quarter of fiscal year 2019 related to intangible property transfers. Our effective tax rate was lower than the U.S. federal statutory rate, primarily due to the tax benefit related to intangible property transfers, and earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland, Singapore, and Puerto Rico.

The mix of income before income taxes between the U.S. and foreign countries impacted our effective tax rate as a result of the geographic distribution of, and customer demand for, our products and services. In fiscal year 2019, our U.S. income before income taxes was $15.8 billion and our foreign income before income taxes was $27.9 billion. In fiscal year 2018, our U.S. income before income taxes was $11.5 billion and our foreign income before income taxes was $24.9 billion.

Fiscal Year 2018 Compared with Fiscal Year 2017

Our effective tax rate for fiscal years 2018 and 2017 was 55% and 15%, respectively. The increase in our effective tax rate for fiscal year 2018 compared to fiscal year 2017 was primarily due to the net charge related to the enactment of the TCJA in fiscal year 2018 and the realization of tax benefits attributable to previous Phone business losses in fiscal year 2017. Our effective tax rate was higher than the U.S. federal statutory rate primarily due to the net charge related to the enactment of the TCJA, offset in part by earnings taxed at lower rates in foreign jurisdictions resulting from our foreign regional operations centers in Ireland, Singapore, and Puerto Rico.

The mix of income before income taxes between the U.S. and foreign countries impacted our effective tax rate as a result of the geographic distribution of, and customer demand for, our products and services. In fiscal year 2018, our U.S. income before income taxes was $11.5 billion and our foreign income before income taxes was $24.9 billion. In fiscal year 2017, our U.S. income before income taxes was $6.8 billion and our foreign income before income taxes was $23.1 billion.

Tax Cuts and Jobs Act

On December 22, 2017, the TCJA was enacted into law, which significantly changed existing U.S. tax law and included numerous provisions that affect our business, such as imposing a one-time transition tax on deemed repatriation of deferred foreign income, reducing the U.S. federal statutory tax rate, and adopting a territorial tax system. In fiscal year 2018, the TCJA required us to incur a transition tax on deferred foreign income not previously subject to U.S. income tax at a rate of 15.5% for foreign cash and certain other net current assets, and 8% on the remaining income. The TCJA reduced the U.S. federal statutory tax rate from 35% to 21% effective January 1, 2018. In addition, the TCJA subjected us to a tax on our global intangible low-taxed income (“GILTI”) effective July 1, 2018.

Under GAAP, we can make an accounting policy election to either treat taxes due on the GILTI inclusion as a current period expense or factor such amounts into our measurement of deferred taxes. We elected the deferred method, under which we recorded the corresponding deferred tax assets and liabilities on our consolidated balance sheets.

During fiscal year 2018, we recorded a net charge of $13.7 billion related to the enactment of the TCJA, due to the impact of the one-time transition tax on the deemed repatriation of deferred foreign income of $17.9 billion, offset in part by the impact of changes in the tax rate of $4.2 billion, primarily on deferred tax assets and liabilities. During the second quarter of fiscal year 2019, we recorded additional tax expense of $157 million, which related to completing our provisional accounting for GILTI deferred taxes pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 118.

In the fourth quarter of fiscal year 2019, in response to the TCJA and recently issued regulations, we transferred certain intangible properties held by our foreign subsidiaries to the U.S. and Ireland. The transfers of intangible properties resulted in a $2.6 billion net income tax benefit recorded in the fourth quarter of fiscal year 2019, as the value of future tax deductions exceeded the current tax liability from foreign jurisdictions and U.S. GILTI tax.

Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Uncertain Tax Positions

We settled a portion of the Internal Revenue Service ("IRS") audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. We remain under audit for tax years 2004 to 2013. We expect the IRS to begin an examination of tax years 2014 to 2017 within the next 12 months.

As of June 30, 2019, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact on our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2018, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NON-GAAP FINANCIAL MEASURES

Non-GAAP operating income, net income, and diluted EPS are non-GAAP financial measures which exclude the net tax impact of transfer of intangible properties, the net tax impact of the TCJA, and restructuring expenses. We believe these non-GAAP measures aid investors by providing additional insight into our operational performance and help clarify trends affecting our business. For comparability of reporting, management considers non-GAAP measures in conjunction with GAAP financial results in evaluating business performance. These non-GAAP financial measures presented should not be considered a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP.

The following table reconciles our financial results reported in accordance with GAAP to non-GAAP financial results:

(In millions, except percentages and per share amounts)	2019	2018	2017	Percentage Change 2019 Versus 2018	Percentage Change 2018 Versus 2017
Operating income	**$ 42,959**	$ 35,058	$ 29,025	23%	21%
Net tax impact of transfer of intangible properties	**0**	0	0	*	*
Net tax impact of the TCJA	**0**	0	0	*	*
Restructuring expenses	**0**	0	306	*	*
Non-GAAP operating income	**$ 42,959**	$ 35,058	$ 29,331	23%	20%
Net income	**$ 39,240**	$ 16,571	$ 25,489	137%	(35)%
Net tax impact of transfer of intangible properties	**(2,567)**	0	0	*	*
Net tax impact of the TCJA	**157**	13,696	0	*	*
Restructuring expenses	**0**	0	243	*	*
Non-GAAP net income	**$ 36,830**	$ 30,267	$ 25,732	22%	18%
Diluted earnings per share	**$ 5.06**	$ 2.13	$ 3.25	138%	(34)%
Net tax impact of transfer of intangible properties	**(0.33)**	0	0	*	*
Net tax impact of the TCJA	**0.02**	1.75	0	*	*
Restructuring expenses	**0**	0	0.04	*	*

Non-GAAP diluted earnings per share	**$ 4.75**	$ 3.88	$ 3.29	22%	18%

* *Not meaningful.*

FINANCIAL CONDITION

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $133.8 billion as of both June 30, 2019 and 2018. Equity investments were $2.6 billion and $1.9 billion as of June 30, 2019 and 2018, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Valuation

In general, and where applicable, we use quoted prices in active markets for identical assets or liabilities to determine the fair value of our financial instruments. This pricing methodology applies to our Level 1 investments, such as U.S. government securities, common and preferred stock, and mutual funds. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then we use quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. This pricing methodology applies to our Level 2 investments, such as commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Level 3 investments are valued using internally-developed models with unobservable inputs. Assets and liabilities measured at fair value on a recurring basis using unobservable inputs are an immaterial portion of our portfolio.

A majority of our investments are priced by pricing vendors and are generally Level 1 or Level 2 investments as these vendors either provide a quoted market price in an active market or use observable inputs for their pricing without applying significant adjustments. Broker pricing is used mainly when a quoted price is not available, the investment is not priced by our pricing vendors, or when a broker price is more reflective of fair values in the market in which the investment trades. Our broker-priced investments are generally classified as Level 2 investments because the broker prices these investments based on similar assets without applying significant adjustments. In addition, all our broker-priced investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments. Our fair value processes include controls that are designed to ensure appropriate fair values are recorded. These controls include model validation, review of key model inputs, analysis of period-over-period fluctuations, and independent recalculation of prices where appropriate.

Cash Flows

Fiscal Year 2019 Compared with Fiscal Year 2018

Cash from operations increased $8.3 billion to $52.2 billion for fiscal year 2019, mainly due to an increase in cash received from customers, offset in part by an increase in cash paid to suppliers and employees and an increase in cash paid for income taxes. Cash used in financing increased $3.3 billion to $36.9 billion for fiscal year 2019, mainly due to an $8.8 billion increase in common stock repurchases and a $1.1 billion increase in dividends paid, offset in part by a $6.2 billion decrease in repayments of debt, net of proceeds from issuance of debt. Cash used in investing increased $9.7 billion to $15.8 billion for fiscal year 2019, mainly due to a $6.0 billion decrease in cash from net investment purchases, sales, and maturities, a $2.3 billion increase in additions to property and equipment, and a $1.5 billion increase in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets.

Fiscal Year 2018 Compared with Fiscal Year 2017

Cash from operations increased $4.4 billion to $43.9 billion for fiscal year 2018, mainly due to an increase in cash received from customers, offset in part by an increase in cash paid to employees, net cash paid for income taxes, cash paid for interest on debt, and cash paid to suppliers. Cash used in financing was $33.6 billion for fiscal year 2018, compared to cash from financing of $8.4 billion for fiscal year 2017. The change was mainly due to a $41.7 billion decrease in proceeds from issuance of debt, net of repayments of debt, offset in part by a $1.1 billion decrease in cash used for common stock repurchases. Cash used in investing decreased $40.7 billion to $6.1 billion for fiscal year 2018, mainly due to a $25.1 billion decrease in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets, and a $19.1 billion increase in cash from net investment purchases, sales, and maturities.

Debt

We issue debt to take advantage of favorable pricing and liquidity in the debt markets, reflecting our credit rating and the low interest rate environment. The proceeds of these issuances were or will be used for general corporate purposes, which may include, among other things, funding for working capital, capital expenditures, repurchases of capital stock, acquisitions, and repayment of existing debt. Refer to Note 11 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Unearned Revenue

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include Software Assurance ("SA") and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service. Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

The following table outlines the expected future recognition of unearned revenue as of June 30, 2019:

(In millions)

Three Months Ending,	
September 30, 2019	**$12,353**
December 31, 2019	**9,807**
March 31, 2020	**6,887**
June 30, 2020	**3,629**
Thereafter	**4,530**
Total	**$37,206**

If our customers choose to license cloud-based versions of our products and services rather than licensing transaction-based products and services, the associated revenue will shift from being recognized at the time of the transaction to being recognized over the subscription period or upon consumption, as applicable.

Share Repurchases

For fiscal years 2019, 2018, and 2017, we repurchased 150 million shares, 99 million shares, and 170 million shares of our common stock for $16.8 billion, $8.6 billion, and $10.3 billion, respectively, through our share repurchase programs. All repurchases were made using cash resources. Refer to Note 17 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Dividends

Refer to Note 17 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Off-Balance Sheet Arrangements

We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products and certain other matters. Additionally, we have agreed to cover damages resulting from breaches of certain security and privacy commitments in our cloud business. In evaluating estimated losses on these obligations, we consider factors such as the degree of probability of an unfavorable outcome and our ability to make a reasonable estimate of the amount of loss. These obligations did not have a material impact on our consolidated financial statements during the periods presented.

Contractual Obligations

The following table summarizes the payments due by fiscal year for our outstanding contractual obligations as of June 30, 2019:

(In millions)	2020	2021-2022	2023-2024	Thereafter	Total
Long-term debt: (a)					
Principal payments	$ 5,518	$ 11,744	$ 8,000	$ 47,519	$ 72,781
Interest payments	2,299	4,309	3,818	29,383	39,809
Construction commitments (b)	3,443	515	0	0	3,958
Operating leases, including imputed interest (c)	1,790	3,144	2,413	3,645	10,992
Finance leases, including imputed interest (c)	797	2,008	2,165	9,872	14,842
Transition tax (d)	1,180	2,900	4,168	8,155	16,403
Purchase commitments (e)	17,478	1,185	159	339	19,161
Other long-term liabilities (f)	0	72	29	324	425
Total	$ 32,505	$ 25,877	$ 20,752	$ 99,237	$ 178,371

(a) *Refer to Note 11 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(b) *Refer to Note 7 – Property and Equipment of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(c) *Refer to Note 15 – Leases of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(d) *Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(e) *Amounts represent purchase commitments, including open purchase orders and take-or-pay contracts that are not presented as construction commitments above.*

(f) *We have excluded long-term tax contingencies, other tax liabilities, and deferred income taxes of $14.2 billion from the amounts presented as the timing of these obligations is uncertain. We have also excluded unearned revenue and non-cash items.*

Other Planned Uses of Capital

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as continue making acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings. We have operating and finance leases for datacenters, corporate offices, research and development facilities, retail stores, and certain equipment. We have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of capital resources.

Liquidity

As a result of the TCJA, we are required to pay a one-time transition tax on deferred foreign income not previously subject to U.S. income tax. Under the TCJA, the transition tax is payable interest free over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. We have paid transition tax of approximately $2.0 billion, which included $1.5 billion for fiscal year 2019. The first installment of the transition tax was paid in fiscal year 2019, and the remaining transition tax of $16.4 billion is payable over the next seven years with a final payment in fiscal year 2026. During the first quarter of fiscal year 2020, we expect to pay $1.2 billion related to the second installment of the transition tax, and $3.5 billion related to the transfer of intangible properties in the fourth quarter of fiscal year 2019.

We expect existing cash, cash equivalents, short-term investments, cash flows from operations, and access to capital markets to continue to be sufficient to fund our operating activities and cash commitments for investing and financing activities, such as dividends, share repurchases, debt maturities, material capital expenditures, and the transition tax related to the TCJA, for at least the next 12 months and thereafter for the foreseeable future.

RECENT ACCOUNTING GUIDANCE

Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies. Critical accounting policies for us include revenue recognition, impairment of investment securities, goodwill, research and development costs, contingencies, income taxes, and inventories.

Revenue Recognition

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the stand-alone selling price ("SSP") for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Impairment of Investment Securities

We review debt investments quarterly for indicators of other-than-temporary impairment. This determination requires significant judgment. In making this judgment, we employ a systematic methodology quarterly that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the duration and extent to which the fair value is less than cost. We also evaluate whether we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery. In addition, we consider specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Equity investments without readily determinable fair values are written down to fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than carrying value. We perform a qualitative assessment on a quarterly basis. We are required to estimate the fair value of the investment to determine the amount of the impairment loss. Once an investment is determined to be impaired, an impairment charge is recorded in other income (expense), net.

Goodwill

We allocate goodwill to reporting units based on the reporting unit expected to benefit from the business combination. We evaluate our reporting units on an annual basis and, if necessary, reassign goodwill using a relative fair value allocation approach. Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated primarily through the use of a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur, and determination of our weighted average cost of capital.

The estimates used to calculate the fair value of a reporting unit change from year to year based on operating results, market conditions, and other factors. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit.

Research and Development Costs

Costs incurred internally in researching and developing a computer software product are charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, software costs are capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our software products is reached after all high-risk development issues have been resolved through coding and testing. Generally, this occurs shortly before the products are released to production. The amortization of these costs is included in cost of revenue over the estimated life of the products.

Legal and Other Contingencies

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our consolidated financial statements.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year, and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting literature also provides guidance on derecognition of income tax assets and liabilities, classification of deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized on our consolidated financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our consolidated financial statements.

The TCJA significantly changes existing U.S. tax law and includes numerous provisions that affect our business. Refer to Note 12 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

Management is responsible for the preparation of the consolidated financial statements and related information that are presented in this report. The consolidated financial statements, which include amounts based on management's estimates and judgments, have been prepared in conformity with accounting principles generally accepted in the United States of America.

The Company designs and maintains accounting and internal control systems to provide reasonable assurance at reasonable cost that assets are safeguarded against loss from unauthorized use or disposition, and that the financial records are reliable for preparing consolidated financial statements and maintaining accountability for assets. These systems are augmented by written policies, an organizational structure providing division of responsibilities, careful selection and training of qualified personnel, and a program of internal audits.

The Company engaged Deloitte & Touche LLP, an independent registered public accounting firm, to audit and render an opinion on the consolidated financial statements and internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Board of Directors, through its Audit Committee, consisting solely of independent directors of the Company, meets periodically with management, internal auditors, and our independent registered public accounting firm to ensure that each is meeting its responsibilities and to discuss matters concerning internal controls and financial reporting. Deloitte & Touche LLP and the internal auditors each have full and free access to the Audit Committee.

Satya Nadella
Chief Executive Officer

Amy E. Hood
Executive Vice President and Chief Financial Officer

Frank H. Brod
Corporate Vice President, Finance and Administration;
Chief Accounting Officer

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

RISKS

We are exposed to economic risk from foreign exchange rates, interest rates, credit risk, and equity prices. We use derivatives instruments to manage these risks, however, they may still impact our consolidated financial statements.

Foreign Currency

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency positions. Principal currencies hedged include the euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of the fixed-income portfolio to achieve economic returns that correlate to certain global fixed-income indices.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We manage credit exposures relative to broad-based indices and to facilitate portfolio diversification.

Equity

Securities held in our equity investments portfolio are subject to price risk.

SENSITIVITY ANALYSIS

The following table sets forth the potential loss in future earnings or fair values, including associated derivatives, resulting from hypothetical changes in relevant market rates or prices:

(In millions)

Risk Categories	**Hypothetical Change**	**June 30, 2019**	**Impact**
Foreign currency - Revenue	10% decrease in foreign exchange rates	**$ (3,402)**	Earnings
Foreign currency - Investments	10% decrease in foreign exchange rates	**(120)**	Fair Value
Interest rate	100 basis point increase in U.S. treasury interest rates	**(2,909)**	Fair Value
Credit	100 basis point increase in credit spreads	**(224)**	Fair Value
Equity	10% decrease in equity market prices	**(244)**	Earnings

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INCOME STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	2019	2018	2017
Revenue:			
Product	**$ 66,069**	$ 64,497	$ 63,811
Service and other	**59,774**	45,863	32,760
Total revenue	**125,843**	110,360	96,571
Cost of revenue:			
Product	**16,273**	15,420	15,175
Service and other	**26,637**	22,933	19,086
Total cost of revenue	**42,910**	38,353	34,261
Gross margin	**82,933**	72,007	62,310
Research and development	**16,876**	14,726	13,037
Sales and marketing	**18,213**	17,469	15,461
General and administrative	**4,885**	4,754	4,481
Restructuring	**0**	0	306
Operating income	**42,959**	35,058	29,025
Other income, net	**729**	1,416	876
Income before income taxes	**43,688**	36,474	29,901
Provision for income taxes	**4,448**	19,903	4,412
Net income	**$ 39,240**	$ 16,571	$ 25,489
Earnings per share:			
Basic	**$ 5.11**	$ 2.15	$ 3.29
Diluted	**$ 5.06**	$ 2.13	$ 3.25
Weighted average shares outstanding:			
Basic	**7,673**	7,700	7,746
Diluted	**7,753**	7,794	7,832

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Net income	**$ 39,240**	$ 16,571	$ 25,489
Other comprehensive income (loss), net of tax:			
Net change related to derivatives	**(173)**	39	(218)
Net change related to investments	**2,405**	(2,717)	(1,116)
Translation adjustments and other	**(318)**	(178)	167
Other comprehensive income (loss)	**1,914**	(2,856)	(1,167)
Comprehensive income	**$ 41,154**	$ 13,715	$ 24,322

Refer to accompanying notes. Refer to Note 18 – Accumulated Other Comprehensive Income (Loss) for further information.

BALANCE SHEETS

(In millions)

June 30,	**2019**	**2018**
Assets		
Current assets:		
Cash and cash equivalents	**$ 11,356**	$ 11,946
Short-term investments	**122,463**	121,822
Total cash, cash equivalents, and short-term investments	**133,819**	133,768
Accounts receivable, net of allowance for doubtful accounts of **$411** and $377	**29,524**	26,481
Inventories	**2,063**	2,662
Other	**10,146**	6,751
Total current assets	**175,552**	169,662
Property and equipment, net of accumulated depreciation of **$35,330** and $29,223	**36,477**	29,460
Operating lease right-of-use assets	**7,379**	6,686
Equity investments	**2,649**	1,862
Goodwill	**42,026**	35,683
Intangible assets, net	**7,750**	8,053
Other long-term assets	**14,723**	7,442
Total assets	**$ 286,556**	$ 258,848
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**$ 9,382**	$ 8,617
Current portion of long-term debt	**5,516**	3,998
Accrued compensation	**6,830**	6,103
Short-term income taxes	**5,665**	2,121
Short-term unearned revenue	**32,676**	28,905
Other	**9,351**	8,744
Total current liabilities	**69,420**	58,488
Long-term debt	**66,662**	72,242
Long-term income taxes	**29,612**	30,265
Long-term unearned revenue	**4,530**	3,815
Deferred income taxes	**233**	541
Operating lease liabilities	**6,188**	5,568
Other long-term liabilities	**7,581**	5,211
Total liabilities	**184,226**	176,130
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,643** and 7,677	**78,520**	71,223
Retained earnings	**24,150**	13,682
Accumulated other comprehensive loss	**(340)**	(2,187)
Total stockholders' equity	**102,330**	82,718
Total liabilities and stockholders' equity	**$ 286,556**	$ 258,848

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Operations			
Net income	**$ 39,240**	$ 16,571	$ 25,489
Adjustments to reconcile net income to net cash from operations:			
Depreciation, amortization, and other	**11,682**	10,261	8,778
Stock-based compensation expense	**4,652**	3,940	3,266
Net recognized gains on investments and derivatives	**(792)**	(2,212)	(2,073)
Deferred income taxes	**(6,463)**	(5,143)	(829)
Changes in operating assets and liabilities:			
Accounts receivable	**(2,812)**	(3,862)	(1,216)
Inventories	**597**	(465)	50
Other current assets	**(1,718)**	(952)	1,028
Other long-term assets	**(1,834)**	(285)	(917)
Accounts payable	**232**	1,148	81
Unearned revenue	**4,462**	5,922	3,820
Income taxes	**2,929**	18,183	1,792
Other current liabilities	**1,419**	798	356
Other long-term liabilities	**591**	(20)	(118)
Net cash from operations	**52,185**	43,884	39,507
Financing			
Repayments of short-term debt, maturities of 90 days or less, net	**0**	(7,324)	(4,963)
Proceeds from issuance of debt	**0**	7,183	44,344
Repayments of debt	**(4,000)**	(10,060)	(7,922)
Common stock issued	**1,142**	1,002	772
Common stock repurchased	**(19,543)**	(10,721)	(11,788)
Common stock cash dividends paid	**(13,811)**	(12,699)	(11,845)
Other, net	**(675)**	(971)	(190)
Net cash from (used in) financing	**(36,887)**	(33,590)	8,408
Investing			
Additions to property and equipment	**(13,925)**	(11,632)	(8,129)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(2,388)**	(888)	(25,944)
Purchases of investments	**(57,697)**	(137,380)	(176,905)
Maturities of investments	**20,043**	26,360	28,044
Sales of investments	**38,194**	117,577	136,350
Securities lending payable	**0**	(98)	(197)
Net cash used in investing	**(15,773)**	(6,061)	(46,781)
Effect of foreign exchange rates on cash and cash equivalents	**(115)**	50	19
Net change in cash and cash equivalents	**(590)**	4,283	1,153
Cash and cash equivalents, beginning of period	**11,946**	7,663	6,510
Cash and cash equivalents, end of period	**$ 11,356**	$ 11,946	$ 7,663

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions)

Year Ended June 30,	2019	2018	2017
Common stock and paid-in capital			
Balance, beginning of period	**$ 71,223**	$ 69,315	$ 68,178
Common stock issued	**6,829**	1,002	772
Common stock repurchased	**(4,195)**	(3,033)	(2,987)
Stock-based compensation expense	**4,652**	3,940	3,266
Other, net	**11**	(1)	86
Balance, end of period	**78,520**	71,223	69,315
Retained earnings			
Balance, beginning of period	**13,682**	17,769	13,118
Net income	**39,240**	16,571	25,489
Common stock cash dividends	**(14,103)**	(12,917)	(12,040)
Common stock repurchased	**(15,346)**	(7,699)	(8,798)
Cumulative effect of accounting changes	**677**	(42)	0
Balance, end of period	**24,150**	13,682	17,769
Accumulated other comprehensive income (loss)			
Balance, beginning of period	**(2,187)**	627	1,794
Other comprehensive income (loss)	**1,914**	(2,856)	(1,167)
Cumulative effect of accounting changes	**(67)**	42	0
Balance, end of period	**(340)**	(2,187)	627
Total stockholders' equity	**$ 102,330**	$ 82,718	$ 87,711
Cash dividends declared per common share	**$ 1.84**	$ 1.68	$ 1.56

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP").

We have recast certain prior period amounts related to investments, derivatives, and fair value measurements to conform to the current period presentation based on our adoption of the new accounting standard for financial instruments. We have recast prior period commercial cloud revenue to include the commercial portion of LinkedIn to provide a comparable view of our commercial cloud business performance. The commercial portion of LinkedIn includes LinkedIn Recruiter, Sales Navigator, premium business subscriptions, and other services for organizations. We have also recast components of the prior period deferred income tax assets and liabilities to conform to the current period presentation. The recast of these prior period amounts had no impact on our consolidated balance sheets, consolidated income statements, or net cash from or used in operating, financing, or investing on our consolidated cash flows statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Microsoft Corporation and its subsidiaries. Intercompany transactions and balances have been eliminated.

Estimates and Assumptions

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates and assumptions include: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price ("SSP") of performance obligations, variable consideration, and other obligations such as product returns and refunds; loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized on our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management's estimates and assumptions.

Foreign Currencies

Assets and liabilities recorded in foreign currencies are translated at the exchange rate on the balance sheet date. Revenue and expenses are translated at average rates of exchange prevailing during the year. Translation adjustments resulting from this process are recorded to other comprehensive income ("OCI").

Revenue

Product Revenue and Service and Other Revenue

Product revenue includes sales from operating systems; cross-device productivity applications; server applications; business solution applications; desktop and server management tools; software development tools; video games; and hardware such as PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

Service and other revenue includes sales from cloud-based solutions that provide customers with software, services, platforms, and content such as Microsoft Office 365, Microsoft Azure, Microsoft Dynamics 365, and Xbox Live; solution support; and consulting services. Service and other revenue also includes sales from online advertising and LinkedIn.

Revenue Recognition

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Nature of Products and Services

Licenses for on-premises software provide the customer with a right to use the software as it exists when made available to the customer. Customers may purchase perpetual licenses or subscribe to licenses, which provide customers with the same functionality and differ mainly in the duration over which the customer benefits from the software. Revenue from distinct on-premises licenses is recognized upfront at the point in time when the software is made available to the customer. In cases where we allocate revenue to software updates, primarily because the updates are provided at no additional charge, revenue is recognized as the updates are provided, which is generally ratably over the estimated life of the related device or license.

Certain volume licensing programs, including Enterprise Agreements, include on-premises licenses combined with Software Assurance (“SA”). SA conveys rights to new software and upgrades released over the contract period and provides support, tools, and training to help customers deploy and use products more efficiently. On-premises licenses are considered distinct performance obligations when sold with SA. Revenue allocated to SA is generally recognized ratably over the contract period as customers simultaneously consume and receive benefits, given that SA comprises distinct performance obligations that are satisfied over time.

Cloud services, which allow customers to use hosted software over the contract period without taking possession of the software, are provided on either a subscription or consumption basis. Revenue related to cloud services provided on a subscription basis is recognized ratably over the contract period. Revenue related to cloud services provided on a consumption basis, such as the amount of storage used in a period, is recognized based on the customer utilization of such resources. When cloud services require a significant level of integration and interdependency with software and the individual components are not considered distinct, all revenue is recognized over the period in which the cloud services are provided.

Revenue from search advertising is recognized when the advertisement appears in the search results or when the action necessary to earn the revenue has been completed. Revenue from consulting services is recognized as services are provided.

Our hardware is generally highly dependent on, and interrelated with, the underlying operating system and cannot function without the operating system. In these cases, the hardware and software license are accounted for as a single performance obligation and revenue is recognized at the point in time when ownership is transferred to resellers or directly to end customers through retail stores and online marketplaces.

Refer to Note 20 – Segment Information and Geographic Data for further information, including revenue by significant product and service offering.

Significant Judgments

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the SSP for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Contract Balances

Timing of revenue recognition may differ from the timing of invoicing to customers. We record a receivable when revenue is recognized prior to invoicing, or unearned revenue when revenue is recognized subsequent to invoicing. For multi-year agreements, we generally invoice customers annually at the beginning of each annual coverage period. We record a receivable related to revenue recognized for multi-year on-premises licenses as we have an unconditional right to invoice and receive payment in the future related to those licenses.

As of June 30, 2019 and 2018, long-term accounts receivable, net of allowance for doubtful accounts, was $2.2 billion and $1.8 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

Activity in the allowance for doubtful accounts was as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Balance, beginning of period	**$ 397**	$ 361	$ 409
Charged to costs and other	**153**	134	58
Write-offs	**(116)**	(98)	(106)
Balance, end of period	**$ 434**	$ 397	$ 361

Allowance for doubtful accounts included in our consolidated balance sheets:

(In millions)

June 30,	**2019**	**2018**	**2017**
Accounts receivable, net of allowance for doubtful accounts	**$ 411**	$ 377	$ 345
Other long-term assets	**23**	20	16
Total	**$ 434**	$ 397	$ 361

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include SA and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for consulting services to be performed in the future; LinkedIn subscriptions; Office 365 subscriptions; Xbox Live subscriptions; Windows 10 post-delivery support; Dynamics business solutions; Skype prepaid credits and subscriptions; and other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service.

Refer to Note 14 – Unearned Revenue for further information, including unearned revenue by segment and changes in unearned revenue during the period.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers or to provide customers with financing. Examples include invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and multi-year on-premises licenses that are invoiced annually with revenue recognized upfront.

Assets Recognized from Costs to Obtain a Contract with a Customer

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We have determined that certain sales incentive programs meet the requirements to be capitalized. Total capitalized costs to obtain a contract were immaterial during the periods presented and are included in other current and long-term assets in our consolidated balance sheets.

We apply a practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less. These costs include our internal sales force compensation program and certain partner sales incentive programs as we have determined annual compensation is commensurate with annual sales activities.

Cost of Revenue

Cost of revenue includes: manufacturing and distribution costs for products sold and programs licensed; operating costs related to product support service centers and product distribution centers; costs incurred to include software on PCs sold by original equipment manufacturers (“OEM”), to drive traffic to our websites, and to acquire online advertising space; costs incurred to support and maintain online products and services, including datacenter costs and royalties; warranty costs; inventory valuation adjustments; costs associated with the delivery of consulting services; and the amortization of capitalized software development costs. Capitalized software development costs are amortized over the estimated lives of the products.

Product Warranty

We provide for the estimated costs of fulfilling our obligations under hardware and software warranties at the time the related revenue is recognized. For hardware warranties, we estimate the costs based on historical and projected product failure rates, historical and projected repair costs, and knowledge of specific product failures (if any). The specific hardware warranty terms and conditions vary depending upon the product sold and the country in which we do business, but generally include parts and labor over a period generally ranging from 90 days to three years. For software warranties, we estimate the costs to provide bug fixes, such as security patches, over the estimated life of the software. We regularly reevaluate our estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

Research and Development

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content. Such costs related to software development are included in research and development expense until the point that technological feasibility is reached, which for our software products, is generally shortly before the products are released to production. Once technological feasibility is reached, such costs are capitalized and amortized to cost of revenue over the estimated lives of the products.

Sales and Marketing

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs. Advertising costs are expensed as incurred. Advertising expense was $1.6 billion, $1.6 billion, and $1.5 billion in fiscal years 2019, 2018, and 2017, respectively.

Stock-Based Compensation

Compensation cost for stock awards, which include restricted stock units (“RSUs”) and performance stock units (“PSUs”), is measured at the fair value on the grant date and recognized as expense, net of estimated forfeitures, over the related service or performance period. The fair value of stock awards is based on the quoted price of our common stock on the grant date less the present value of expected dividends not received during the vesting period. We measure the fair value of PSUs using a Monte Carlo valuation model. Compensation cost for RSUs is recognized using the straight-line method and for PSUs is recognized using the accelerated method.

Compensation expense for the employee stock purchase plan (“ESPP”) is measured as the discount the employee is entitled to upon purchase and is recognized in the period of purchase.

Income Taxes

Income tax expense includes U.S. and international income taxes, and interest and penalties on uncertain tax positions. Certain income and expenses are not reported in tax returns and financial statements in the same year. The tax effect of such temporary differences is reported as deferred income taxes. Deferred tax assets are reported net of a valuation allowance when it is more likely than not that a tax benefit will not be realized. All deferred income taxes are classified as long-term in our consolidated balance sheets.

Financial Instruments

Investments

We consider all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. The fair values of these investments approximate their carrying values. In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations.

Debt investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in fair value, excluding other-than-temporary impairments, are recorded in OCI. Debt investments are impaired when a decline in fair value is judged to be other-than-temporary. Fair value is calculated based on publicly available market information or other estimates determined by management. We employ a systematic methodology on a quarterly basis that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, and the duration and extent to which the fair value is less than cost. We also evaluate whether we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery. In addition, we consider specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in other income (expense), net and a new cost basis in the investment is established.

Equity investments with readily determinable fair values are measured at fair value. Equity investments without readily determinable fair values are measured using the equity method, or measured at cost with adjustments for observable changes in price or impairments (referred to as the measurement alternative). We perform a qualitative assessment on a quarterly basis and recognize an impairment if there are sufficient indicators that the fair value of the investment is less than carrying value. Changes in value are recorded in other income (expense), net.

We lend certain fixed-income and equity securities to increase investment returns. These transactions are accounted for as secured borrowings and the loaned securities continue to be carried as investments on our consolidated balance sheets. Cash and/or security interests are received as collateral for the loaned securities with the amount determined based upon the underlying security lent and the creditworthiness of the borrower. Cash received is recorded as an asset with a corresponding liability.

Derivatives

Derivative instruments are recognized as either assets or liabilities and measured at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

For derivative instruments designated as fair value hedges, gains and losses are recognized in other income (expense), net with offsetting gains and losses on the hedged items.

For derivative instruments designated as cash flow hedges, the effective portion of the gains and losses are initially reported as a component of OCI and subsequently recognized in revenue when the hedged exposure is recognized in revenue. Gains and losses on derivatives representing either hedge components excluded from the assessment of effectiveness or hedge ineffectiveness are recognized in other income (expense), net.

For derivative instruments that are not designated as hedges, gains and losses from changes in fair values are primarily recognized in other income (expense), net.

Fair Value Measurements

We account for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. We categorize each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 investments include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.

- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 investments include commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Our Level 2 derivative assets and liabilities primarily include certain over-the-counter option and swap contracts.
- *Level 3* – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 assets and liabilities include investments in corporate notes and bonds, and goodwill and intangible assets, when they are recorded at fair value due to an impairment charge. Unobservable inputs used in the models are significant to the fair values of the assets and liabilities.

We measure equity investments without readily determinable fair values on a nonrecurring basis. The fair values of these investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections.

Our other current financial assets and current financial liabilities have fair values that approximate their carrying values.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation, and depreciated using the straight-line method over the shorter of the estimated useful life of the asset or the lease term. The estimated useful lives of our property and equipment are generally as follows: computer software developed or acquired for internal use, three to seven years; computer equipment, two to three years; buildings and improvements, five to 15 years; leasehold improvements, three to 20 years; and furniture and equipment, one to 10 years. Land is not depreciated.

Leases

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities in our consolidated balance sheets. Finance leases are included in property and equipment, other current liabilities, and other long-term liabilities in our consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we generally use our incremental borrowing rate based on the estimated rate of interest for collateralized borrowing over a similar term of the lease payments at commencement date. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

We have lease agreements with lease and non-lease components, which are generally accounted for separately. For certain equipment leases, such as vehicles, we account for the lease and non-lease components as a single lease component. Additionally, for certain equipment leases, we apply a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Goodwill

Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value.

Intangible Assets

Our intangible assets are subject to amortization and are amortized using the straight-line method over their estimated period of benefit, ranging from one to 20 years. We evaluate the recoverability of intangible assets periodically by taking into account events or circumstances that may warrant revised estimates of useful lives or that indicate the asset may be impaired.

Recent Accounting Guidance

Recently Adopted Accounting Guidance

Income Taxes – Intra-Entity Asset Transfers

In October 2016, the Financial Accounting Standards Board ("FASB") issued new guidance requiring an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs, rather than when the asset has been sold to an outside party. We adopted the guidance effective July 1, 2018. Adoption of the guidance was applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. We recorded a net cumulative-effect adjustment that resulted in an increase in retained earnings of $557 million, which reversed the previous deferral of income tax consequences and recorded new deferred tax assets from intra-entity transfers involving assets other than inventory, partially offset by a U.S. deferred tax liability related to global intangible low-taxed income ("GILTI"). Adoption of the standard resulted in an increase in long-term deferred tax assets of $2.8 billion, an increase in long-term deferred tax liabilities of $2.1 billion, and a reduction in other current assets of $152 million. Adoption of the standard had no impact on cash from or used in operating, financing, or investing on our consolidated cash flows statements.

Financial Instruments – Recognition, Measurement, Presentation, and Disclosure

In January 2016, the FASB issued a new standard related to certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most prominent among the changes in the standard is the requirement for changes in the fair value of our equity investments, with certain exceptions, to be recognized through net income rather than OCI.

We adopted the standard effective July 1, 2018. Adoption of the standard was applied using a modified retrospective approach through a cumulative-effect adjustment from accumulated other comprehensive income ("AOCI") to retained earnings as of the effective date, and we elected to measure equity investments without readily determinable fair values at cost with adjustments for observable changes in price or impairments. The cumulative-effect adjustment included any previously held unrealized gains and losses held in AOCI related to our equity investments carried at fair value as well as the impact of recording the fair value of certain equity investments carried at cost. The impact on our consolidated balance sheets upon adoption was not material. Adoption of the standard had no impact on cash from or used in operating, financing, or investing on our consolidated cash flows statements.

Recent Accounting Guidance Not Yet Adopted

Financial Instruments – Targeted Improvements to Accounting for Hedging Activities

In August 2017, the FASB issued new guidance related to accounting for hedging activities. This guidance expands strategies that qualify for hedge accounting, changes how many hedging relationships are presented in the financial statements, and simplifies the application of hedge accounting in certain situations. The standard will be effective for us beginning July 1, 2019, with early adoption permitted for any interim or annual period before the effective date. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. We evaluated the impact of this standard on our consolidated financial statements, including accounting policies, processes, and systems, and do not expect the impact to be material upon adoption.

Financial Instruments – Credit Losses

In June 2016, the FASB issued a new standard to replace the incurred loss impairment methodology under current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. We will be required to use a forward-looking expected credit loss model for accounts receivables, loans, and other financial instruments. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The standard will be adopted upon the effective date for us beginning July 1, 2020. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date to align our credit loss methodology with the new standard. We are currently evaluating the impact of this standard on our consolidated financial statements, including accounting policies, processes, and systems.

NOTE 2 — EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed based on the weighted average number of shares of common stock outstanding during the period. Diluted EPS is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and stock awards.

The components of basic and diluted EPS were as follows:

(In millions, except earnings per share)

Year Ended June 30,	**2019**	**2018**	**2017**
Net income available for common shareholders (A)	**$ 39,240**	$ 16,571	$ 25,489
Weighted average outstanding shares of common stock (B)	**7,673**	7,700	7,746
Dilutive effect of stock-based awards	**80**	94	86
Common stock and common stock equivalents (C)	**7,753**	7,794	7,832
Earnings Per Share			
Basic (A/B)	**$ 5.11**	$ 2.15	$ 3.29
Diluted (A/C)	**$ 5.06**	$ 2.13	$ 3.25

Anti-dilutive stock-based awards excluded from the calculations of diluted EPS were immaterial during the periods presented.

NOTE 3 — OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Interest and dividends income	**$ 2,762**	$ 2,214	$ 1,387
Interest expense	**(2,686)**	(2,733)	(2,222)
Net recognized gains on investments	**648**	2,399	2,583
Net gains (losses) on derivatives	**144**	(187)	(510)
Net losses on foreign currency remeasurements	**(82)**	(218)	(111)
Other, net	**(57)**	(59)	(251)
Total	**$ 729**	$ 1,416	$ 876

Net Recognized Gains (Losses) on Investments

Net recognized gains (losses) on debt investments were as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Realized gains from sales of available-for-sale securities	**$ 12**	$ 27	$ 108
Realized losses from sales of available-for-sale securities	**(93)**	(987)	(162)
Other-than-temporary impairments of investments	**(16)**	(6)	(14)
Total	**$ (97)**	$ (966)	$ (68)

Net recognized gains (losses) on equity investments were as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Net realized gains on investments sold	**$ 276**	$ 3,406	$ 2,692
Net unrealized gains on investments still held	**479**	0	0
Impairments of investments	**(10)**	(41)	(41)
Total	**$ 745**	$ 3,365	$ 2,651

NOTE 4 — INVESTMENTS

Investment Components

The components of investments were as follows:

(In millions)	Fair Value Level	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2019								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 2,211	$ 0	$ 0	$ 2,211	$ 1,773	$ 438	$ 0
Certificates of deposit	Level 2	2,018	0	0	2,018	1,430	588	0
U.S. government securities	Level 1	104,925	1,854	(104)	106,675	769	105,906	0
U.S. agency securities	Level 2	988	0	0	988	698	290	0
Foreign government bonds	Level 2	6,350	4	(8)	6,346	2,506	3,840	0
Mortgage- and asset-backed securities	Level 2	3,554	10	(3)	3,561	0	3,561	0
Corporate notes and bonds	Level 2	7,437	111	(7)	7,541	0	7,541	0
Corporate notes and bonds	Level 3	15	0	0	15	0	15	0
Municipal securities	Level 2	242	48	0	290	0	290	0
Municipal securities	Level 3	7	0	0	7	0	7	0
Total debt investments		$ 127,747	$ 2,027	$ (122)	$ 129,652	$ 7,176	$ 122,476	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 973	$ 409	$ 0	$ 564
Equity investments	Other				2,085	0	0	2,085
Total equity investments					$ 3,058	$ 409	$ 0	$ 2,649
Cash					$ 3,771	$ 3,771	$ 0	$ 0
Derivatives, net (a)					(13)	0	(13)	0
Total					$ 136,468	$ 11,356	$ 122,463	$ 2,649

(In millions)	Fair Value Level	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2018								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 2,513	$ 0	$ 0	$ 2,513	$ 2,215	$ 298	$ 0
Certificates of deposit	Level 2	2,058	0	0	2,058	1,865	193	0
U.S. government securities	Level 1	108,120	62	(1,167)	107,015	2,280	104,735	0
U.S. agency securities	Level 2	1,742	0	0	1,742	1,398	344	0
Foreign government bonds	Level 1	22	0	0	22	0	22	0
Foreign government bonds	Level 2	5,063	1	(10)	5,054	0	5,054	0
Mortgage- and asset-backed securities	Level 2	3,864	4	(13)	3,855	0	3,855	0
Corporate notes and bonds	Level 2	6,929	21	(56)	6,894	0	6,894	0
Corporate notes and bonds	Level 3	15	0	0	15	0	15	0
Municipal securities	Level 2	271	37	(1)	307	0	307	0
Total debt investments		$ 130,597	$ 125	$ (1,247)	$ 129,475	$ 7,758	$ 121,717	$ 0
Equity investments	Level 1				$ 533	$ 246	$ 0	$ 287
Equity investments	Level 3				18	0	0	18
Equity investments	Other				1,558	0	1	1,557
Total equity investments					$ 2,109	$ 246	$ 1	$ 1,862
Cash					$ 3,942	$ 3,942	$ 0	$ 0
Derivatives, net (a)					104	0	104	0
Total					$ 135,630	$ 11,946	$ 121,822	$ 1,862

(a) *Refer to Note 5 – Derivatives for further information on the fair value of our derivative instruments.*

Equity investments presented as “Other” in the tables above include investments without readily determinable fair values measured using the equity method or measured at cost with adjustments for observable changes in price or impairments, and investments measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of June 30, 2019 and

2018, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $1.2 billion and $697 million, respectively.

As of June 30, 2019, we had no collateral received under agreements for loaned securities. As of June 30, 2018, collateral received under agreements for loaned securities was $1.8 billion and primarily comprised U.S. government and agency securities.

Unrealized Losses on Debt Investments

Debt investments with continuous unrealized losses for less than 12 months and 12 months or greater and their related fair values were as follows:

	Less than 12 Months		12 Months or Greater			
(In millions)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Total Fair Value**	**Total Unrealized Losses**
June 30, 2019						
U.S. government and agency securities	**$ 1,491**	**$ (1)**	**$ 39,158**	**$ (103)**	**$ 40,649**	**$ (104)**
Foreign government bonds	**25**	**0**	**77**	**(8)**	**102**	**(8)**
Mortgage- and asset-backed securities	**664**	**(1)**	**378**	**(2)**	**1,042**	**(3)**
Corporate notes and bonds	**498**	**(3)**	**376**	**(4)**	**874**	**(7)**
Total	**$ 2,678**	**$ (5)**	**$ 39,989**	**$ (117)**	**$ 42,667**	**$ (122)**

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2018						
U.S. government and agency securities	$ 82,352	$ (1,064)	$ 4,459	$ (103)	$ 86,811	$ (1,167)
Foreign government bonds	3,457	(7)	13	(3)	3,470	(10)
Mortgage- and asset-backed securities	2,072	(9)	96	(4)	2,168	(13)
Corporate notes and bonds	3,111	(43)	301	(13)	3,412	(56)
Municipal securities	45	(1)	0	0	45	(1)
Total	$ 91,037	$ (1,124)	$ 4,869	$ (123)	$ 95,906	$ (1,247)

Unrealized losses from fixed-income securities are primarily attributable to changes in interest rates. Management does not believe any remaining unrealized losses represent other-than-temporary impairments based on our evaluation of available evidence.

Debt Investment Maturities

(In millions)	Cost Basis	Estimated Fair Value
June 30, 2019		
Due in one year or less	**$ 53,200**	**$ 53,124**
Due after one year through five years	**47,016**	**47,783**
Due after five years through 10 years	**26,658**	**27,824**
Due after 10 years	**873**	**921**
Total	**$ 127,747**	**$ 129,652**

NOTE 5 — DERIVATIVES

We use derivative instruments to manage risks related to foreign currencies, equity prices, interest rates, and credit; to enhance investment returns; and to facilitate portfolio diversification. Our objectives for holding derivatives include reducing, eliminating, and efficiently managing the economic impact of these exposures as effectively as possible. Our derivative programs include strategies that both qualify and do not qualify for hedge accounting treatment.

Foreign Currency

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions. Option and forward contracts are used to hedge a portion of forecasted international revenue and are designated as cash flow hedging instruments. Principal currencies hedged include the euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

Foreign currency risks related to certain non-U.S. dollar denominated securities are hedged using foreign exchange forward contracts that are designated as fair value hedging instruments.

Certain options and forwards not designated as hedging instruments are also used to manage the variability in foreign exchange rates on certain balance sheet amounts and to manage other foreign currency exposures.

Equity

Securities held in our equity investments portfolio are subject to market price risk. Market price risk is managed relative to broad-based global and domestic equity indices using certain convertible preferred investments, options, futures, and swap contracts not designated as hedging instruments. In the past, to hedge our price risk, we also used and designated equity derivatives as hedging instruments, including puts, calls, swaps, and forwards.

Other

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using exchange-traded option and futures contracts, and over-the-counter swap and option contracts, none of which are designated as hedging instruments.

In addition, we use "To Be Announced" forward purchase commitments of mortgage-backed assets to gain exposure to agency mortgage-backed securities. These meet the definition of a derivative instrument in cases where physical delivery of the assets is not taken at the earliest available delivery date.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts, not designated as hedging instruments, to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. We use credit default swaps as they are a low-cost method of managing exposure to individual credit risks or groups of credit risks.

Credit-Risk-Related Contingent Features

Certain of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of June 30, 2019, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

The following table presents the notional amounts of our outstanding derivative instruments measured in U.S. dollar equivalents:

(In millions)	**June 30, 2019**	**June 30, 2018**
Designated as Hedging Instruments		
Foreign exchange contracts sold	**$ 6,034**	$ 11,101
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**14,889**	9,425
Foreign exchange contracts sold	**15,614**	13,374
Equity contracts purchased	**680**	49
Equity contracts sold	**5**	5
Other contracts purchased	**1,327**	878
Other contracts sold	**451**	472

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		June 30, 2019		June 30, 2018
Changes in Fair Value Recorded in Other Comprehensive Income				
Designated as Hedging Instruments				
Foreign exchange contracts	**$ 0**	**$ 0**	$ 174	$ 0
Changes in Fair Value Recorded in Net Income				
Designated as Hedging Instruments				
Foreign exchange contracts	**0**	**(93)**	95	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**204**	**(172)**	256	(197)
Equity contracts	**38**	**0**	2	(7)
Other contracts	**8**	**(7)**	11	(3)
Gross amounts of derivatives	**250**	**(272)**	538	(207)
Gross amounts of derivatives offset in the balance sheet	**(113)**	**114**	(152)	153
Cash collateral received	**0**	**(78)**	0	(235)
Net amounts of derivatives	**$ 137**	**$ (236)**	$ 386	$ (289)
Reported as				
Short-term investments	**$ (13)**	**$ 0**	$ 104	$ 0
Other current assets	**146**	**0**	260	0
Other long-term assets	**4**	**0**	22	0
Other current liabilities	**0**	**(221)**	0	(288)
Other long-term liabilities	**0**	**(15)**	0	(1)
Total	**$ 137**	**$ (236)**	$ 386	$ (289)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $247 million and $272 million, respectively, as of June 30, 2019, and $533 million and $207 million, respectively, as of June 30, 2018.

The following table presents the fair value of our derivatives instruments on a gross basis:

(In millions)	Level 1	Level 2	Level 3	Total
June 30, 2019				
Derivative assets	**$ 0**	**$ 247**	**$ 3**	**$ 250**
Derivative liabilities	**0**	**(272)**	**0**	**(272)**
June 30, 2018				
Derivative assets	1	535	2	538
Derivative liabilities	(1)	(206)	0	(207)

Fair Value Hedge Gains (Losses)

We recognized in other income (expense), net the following gains (losses) on contracts designated as fair value hedges and their related hedged items:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Foreign Exchange Contracts			
Derivatives	**$ 38**	$ 25	$ 441
Hedged items	**130**	78	(386)
Total amount of ineffectiveness	**$ 168**	$ 103	$ 55
Equity Contracts			
Derivatives	**$ 0**	$ (324)	$ (74)
Hedged items	**0**	324	74
Total amount of ineffectiveness	**$ 0**	$ 0	$ 0
Amount of equity contracts excluded from effectiveness assessment	**$ 0**	$ 80	$ (80)

Cash Flow Hedge Gains (Losses)

We recognized the following gains (losses) on foreign exchange contracts designated as cash flow hedges:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Effective Portion			
Gains recognized in other comprehensive income (loss), net of tax of **$1**, $11, and $4	**$ 159**	$ 219	$ 328
Gains reclassified from accumulated other comprehensive income (loss) into revenue	**341**	185	555
Amount Excluded from Effectiveness Assessment and Ineffective Portion			
Losses recognized in other income (expense), net	**(64)**	(255)	(389)

We do not have any net derivative gains included in AOCI as of June 30, 2019 that will be reclassified into earnings within the following 12 months. No significant amounts of gains (losses) were reclassified from AOCI into earnings as a result of forecasted transactions that failed to occur during fiscal year 2019.

Non-designated Derivative Gains (Losses)

We recognized in other income (expense), net the following gains (losses) on derivatives not designated as hedging instruments:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Foreign exchange contracts	**$ (97)**	$ (33)	$ (117)
Equity contracts	**3**	(87)	(114)
Other contracts	**35**	(17)	(3)
Total	**$ (59)**	$ (137)	$ (234)

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)

June 30,	2019	2018
Raw materials	**$ 399**	$ 655
Work in process	**53**	54
Finished goods	**1,611**	1,953
Total	**$ 2,063**	$ 2,662

NOTE 7 — PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

(In millions)

June 30,	2019	2018
Land	**$ 1,540**	$ 1,254
Buildings and improvements	**26,288**	20,604
Leasehold improvements	**5,316**	4,735
Computer equipment and software	**33,823**	27,633
Furniture and equipment	**4,840**	4,457
Total, at cost	**71,807**	58,683
Accumulated depreciation	**(35,330)**	(29,223)
Total, net	**$ 36,477**	$ 29,460

During fiscal years 2019, 2018, and 2017, depreciation expense was $9.7 billion, $7.7 billion, and $6.1 billion, respectively. We have committed $4.0 billion for the construction of new buildings, building improvements, and leasehold improvements as of June 30, 2019.

NOTE 8 — BUSINESS COMBINATIONS

GitHub, Inc.

On October 25, 2018, we acquired GitHub, Inc. ("GitHub"), a software development platform, in a $7.5 billion stock transaction (inclusive of total cash payments of $1.3 billion in respect of vested GitHub equity awards and an indemnity escrow). The acquisition is expected to empower developers to achieve more at every stage of the development lifecycle, accelerate enterprise use of GitHub, and bring Microsoft's developer tools and services to new audiences. The financial results of GitHub have been included in our consolidated financial statements since the date of the acquisition. GitHub is reported as part of our Intelligent Cloud segment.

The allocation of the purchase price to goodwill was completed as of June 30, 2019. The major classes of assets and liabilities to which we allocated the purchase price were as follows:

(In millions)	
Cash, cash equivalents, and short-term investments	$ 234
Goodwill	5,497
Intangible assets	1,267
Other assets	143
Other liabilities	(217)
Total	$ 6,924

The goodwill recognized in connection with the acquisition is primarily attributable to anticipated synergies from future growth and is not expected to be deductible for tax purposes. We assigned the goodwill to our Intelligent Cloud segment.

Following are the details of the purchase price allocated to the intangible assets acquired:

(In millions)	Amount	Weighted Average Life
Customer-related	$ 648	8 years
Technology-based	447	5 years
Marketing-related	170	10 years
Contract-based	2	2 years
Total	$ 1,267	7 years

Transactions recognized separately from the purchase price allocation were approximately $600 million, primarily related to equity awards recognized as expense over the related service period.

LinkedIn Corporation

On December 8, 2016, we completed our acquisition of all issued and outstanding shares of LinkedIn Corporation ("LinkedIn"), the world's largest professional network on the Internet, for a total purchase price of $27.0 billion. The purchase price consisted primarily of cash of $26.9 billion. The acquisition is expected to accelerate the growth of LinkedIn, Office 365, and Dynamics 365. The financial results of LinkedIn have been included in our consolidated financial statements since the date of the acquisition.

The allocation of the purchase price to goodwill was completed as of June 30, 2017. The major classes of assets and liabilities to which we allocated the purchase price were as follows:

(In millions)

Cash and cash equivalents	$ 1,328
Short-term investments	2,110
Other current assets	697
Property and equipment	1,529
Intangible assets	7,887
Goodwill (a)	16,803
Short-term debt (b)	(1,323)
Other current liabilities	(1,117)
Deferred income taxes	(774)
Other	(131)
Total purchase price	$ 27,009

(a) *Goodwill was assigned to our Productivity and Business Processes segment. The goodwill was primarily attributed to increased synergies that are expected to be achieved from the integration of LinkedIn. None of the goodwill is expected to be deductible for income tax purposes.*

(b) *Convertible senior notes issued by LinkedIn on November 12, 2014, substantially all of which were redeemed after our acquisition of LinkedIn. The remaining $18 million of notes are not redeemable and are included in long-term debt in our consolidated balance sheets. Refer to Note 11 – Debt for further information.*

Following are the details of the purchase price allocated to the intangible assets acquired:

(In millions)	**Amount**	**Weighted Average Life**
Customer-related	$ 3,607	7 years
Marketing-related (trade names)	2,148	20 years
Technology-based	2,109	3 years
Contract-based	23	5 years
Fair value of intangible assets acquired	$ 7,887	9 years

Our consolidated income statements include the following revenue and operating loss attributable to LinkedIn since the date of acquisition:

(In millions)

Year Ended June 30,	**2017**
Revenue	$ 2,271
Operating loss	(924)

Following are the supplemental consolidated financial results of Microsoft Corporation on an unaudited pro forma basis, as if the acquisition had been consummated on July 1, 2015:

(In millions, except per share amounts)

Year Ended June 30,	**2017**	**2016**
Revenue	$ 98,291	$ 94,490
Net income	25,179	19,128
Diluted earnings per share	3.21	2.38

These pro forma results were based on estimates and assumptions, which we believe are reasonable. They are not the results that would have been realized had we been a combined company during the periods presented and are not necessarily indicative of our consolidated results of operations in future periods. The pro forma results include adjustments related to purchase accounting, primarily amortization of intangible assets. Acquisition costs and other nonrecurring charges were immaterial and are included in the earliest period presented.

Other

During fiscal year 2019, we completed 19 additional acquisitions for $1.6 billion, substantially all of which were paid in cash. These entities have been included in our consolidated results of operations since their respective acquisition dates.

NOTE 9 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	June 30, 2017	Acquisitions	Other	June 30, 2018	Acquisitions	Other	June 30, 2019
Productivity and Business Processes	$ 23,739	$ 72	$ 12	**$ 23,823**	**$ 514**	**$ (60)**	**$ 24,277**
Intelligent Cloud	5,555	164	(16)	**5,703**	**5,605** (a)	**43** (a)	**11,351**
More Personal Computing	5,828	394	(65)	**6,157**	**289**	**(48)**	**6,398**
Total	$ 35,122	$ 630	$ (69)	**$ 35,683**	**$ 6,408**	**$ (65)**	**$ 42,026**

(a) *Includes goodwill of $5.5 billion related to GitHub. See Note 8 – Business Combinations for further information.*

The measurement periods for the valuation of assets acquired and liabilities assumed end as soon as information on the facts and circumstances that existed as of the acquisition dates becomes available, but do not exceed 12 months. Adjustments in purchase price allocations may require a change in the amounts allocated to goodwill during the periods in which the adjustments are determined.

Any change in the goodwill amounts resulting from foreign currency translations and purchase accounting adjustments are presented as "Other" in the table above. Also included in "Other" are business dispositions and transfers between segments due to reorganizations, as applicable.

Goodwill Impairment

We test goodwill for impairment annually on May 1 at the reporting unit level, primarily using a discounted cash flow methodology with a peer-based, risk-adjusted weighted average cost of capital. We believe use of a discounted cash flow approach is the most reliable indicator of the fair values of the businesses.

No instances of impairment were identified in our May 1, 2019, May 1, 2018, or May 1, 2017 tests. As of June 30, 2019 and 2018, accumulated goodwill impairment was $11.3 billion.

NOTE 10 — INTANGIBLE ASSETS

The components of intangible assets, all of which are finite-lived, were as follows:

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
June 30,			2019			2018
Technology-based	**$ 7,691**	**$ (5,771)**	**$ 1,920**	$ 7,220	$ (5,018)	$ 2,202
Customer-related	**4,709**	**(1,785)**	**2,924**	4,031	(1,205)	2,826
Marketing-related	**4,165**	**(1,327)**	**2,838**	4,006	(1,071)	2,935
Contract-based	**574**	**(506)**	**68**	679	(589)	90
Total	**$ 17,139** (a)	**$ (9,389)**	**$ 7,750**	$ 15,936	$ (7,883)	$ 8,053

(a) *Includes intangible assets of $1.3 billion related to GitHub. See Note 8 – Business Combinations for further information.*

No material impairments of intangible assets were identified during fiscal years 2019, 2018, or 2017. We estimate that we have no significant residual value related to our intangible assets.

The components of intangible assets acquired during the periods presented were as follows:

(In millions)		Amount	Weighted Average Life		Amount	Weighted Average Life
Year Ended June 30,		**2019**			**2018**	
Technology-based	**$**	**814**	**5 years**	$	178	4 years
Marketing-related		**177**	**10 years**		14	5 years
Contract-based		**7**	**3 years**		14	4 years
Customer-related		**710**	**8 years**		13	5 years
Total	**$**	**1,708**	**7 years**	$	219	5 years

Intangible assets amortization expense was $1.9 billion, $2.2 billion, and $1.7 billion for fiscal years 2019, 2018, and 2017, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of June 30, 2019:

(In millions)		
Year Ending June 30,		
2020	**$**	**1,488**
2021		**1,282**
2022		**1,187**
2023		**1,053**
2024		**737**
Thereafter		**2,003**
Total	**$**	**7,750**

NOTE 11 — DEBT

Short-term Debt

As of June 30, 2019 and 2018, we had no commercial paper issued or outstanding. Effective August 31, 2018, we terminated our credit facilities, which served as back-up for our commercial paper program.

Long-term Debt

As of June 30, 2019, the total carrying value and estimated fair value of our long-term debt, including the current portion, were $72.2 billion and $78.9 billion, respectively. As of June 30, 2018, the total carrying value and estimated fair value of our long-term debt, including the current portion, were $76.2 billion and $77.5 billion, respectively. These estimated fair values are based on Level 2 inputs.

The components of our long-term debt, including the current portion, and the associated interest rates were as follows:

(In millions, except interest rates)	Face Value June 30, 2019	Face Value June 30, 2018	Stated Interest Rate	Effective Interest Rate
Notes				
November 3, 2018	**$ 0**	$ 1,750	**1.300%**	**1.396%**
December 6, 2018	**0**	1,250	**1.625%**	**1.824%**
June 1, 2019	**0**	1,000	**4.200%**	**4.379%**
August 8, 2019	**2,500**	2,500	**1.100%**	**1.203%**
November 1, 2019	**18**	18	**0.500%**	**0.500%**
February 6, 2020	**1,500**	1,500	**1.850%**	**1.952%**
February 12, 2020	**1,500**	1,500	**1.850%**	**1.935%**
October 1, 2020	**1,000**	1,000	**3.000%**	**3.137%**
November 3, 2020	**2,250**	2,250	**2.000%**	**2.093%**
February 8, 2021	**500**	500	**4.000%**	**4.082%**
August 8, 2021	**2,750**	2,750	**1.550%**	**1.642%**
December 6, 2021 (a)	**1,994**	2,044	**2.125%**	**2.233%**
February 6, 2022	**1,750**	1,750	**2.400%**	**2.520%**
February 12, 2022	**1,500**	1,500	**2.375%**	**2.466%**
November 3, 2022	**1,000**	1,000	**2.650%**	**2.717%**
November 15, 2022	**750**	750	**2.125%**	**2.239%**
May 1, 2023	**1,000**	1,000	**2.375%**	**2.465%**
August 8, 2023	**1,500**	1,500	**2.000%**	**2.101%**
December 15, 2023	**1,500**	1,500	**3.625%**	**3.726%**
February 6, 2024	**2,250**	2,250	**2.875%**	**3.041%**
February 12, 2025	**2,250**	2,250	**2.700%**	**2.772%**
November 3, 2025	**3,000**	3,000	**3.125%**	**3.176%**
August 8, 2026	**4,000**	4,000	**2.400%**	**2.464%**
February 6, 2027	**4,000**	4,000	**3.300%**	**3.383%**
December 6, 2028 (a)	**1,993**	2,044	**3.125%**	**3.218%**
May 2, 2033 (a)	**626**	642	**2.625%**	**2.690%**
February 12, 2035	**1,500**	1,500	**3.500%**	**3.604%**
November 3, 2035	**1,000**	1,000	**4.200%**	**4.260%**
August 8, 2036	**2,250**	2,250	**3.450%**	**3.510%**
February 6, 2037	**2,500**	2,500	**4.100%**	**4.152%**
June 1, 2039	**750**	750	**5.200%**	**5.240%**
October 1, 2040	**1,000**	1,000	**4.500%**	**4.567%**
February 8, 2041	**1,000**	1,000	**5.300%**	**5.361%**
November 15, 2042	**900**	900	**3.500%**	**3.571%**
May 1, 2043	**500**	500	**3.750%**	**3.829%**
December 15, 2043	**500**	500	**4.875%**	**4.918%**
February 12, 2045	**1,750**	1,750	**3.750%**	**3.800%**
November 3, 2045	**3,000**	3,000	**4.450%**	**4.492%**
August 8, 2046	**4,500**	4,500	**3.700%**	**3.743%**
February 6, 2047	**3,000**	3,000	**4.250%**	**4.287%**
February 12, 2055	**2,250**	2,250	**4.000%**	**4.063%**
November 3, 2055	**1,000**	1,000	**4.750%**	**4.782%**
August 8, 2056	**2,250**	2,250	**3.950%**	**4.033%**
February 6, 2057	**2,000**	2,000	**4.500%**	**4.528%**
Total	**$ 72,781**	$76,898		

(a) *Euro-denominated debt securities.*

The notes in the table above are senior unsecured obligations and rank equally with our other senior unsecured debt outstanding. Interest on these notes is paid semi-annually, except for the euro-denominated debt securities on which interest is paid annually. Cash paid for interest on our debt for fiscal years 2019, 2018, and 2017 was $2.4 billion, $2.4 billion, and $1.6 billion, respectively. As of June 30, 2019 and 2018, the aggregate debt issuance costs and unamortized discount associated with our long-term debt, including the current portion, were $603 million and $658 million, respectively.

Maturities of our long-term debt for each of the next five years and thereafter are as follows:

(In millions)

Year Ending June 30,	
2020	**$ 5,518**
2021	**3,750**
2022	**7,994**
2023	**2,750**
2024	**5,250**
Thereafter	**47,519**
Total	**$ 72,781**

NOTE 12 — INCOME TAXES

Tax Cuts and Jobs Act

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted into law, which significantly changed existing U.S. tax law and included numerous provisions that affect our business, such as imposing a one-time transition tax on deemed repatriation of deferred foreign income, reducing the U.S. federal statutory tax rate, and adopting a territorial tax system. In fiscal year 2018, the TCJA required us to incur a transition tax on deferred foreign income not previously subject to U.S. income tax at a rate of 15.5% for foreign cash and certain other net current assets, and 8% on the remaining income. The TCJA reduced the U.S. federal statutory tax rate from 35% to 21% effective January 1, 2018. In addition, the TCJA subjected us to a tax on our GILTI effective July 1, 2018.

Under GAAP, we can make an accounting policy election to either treat taxes due on the GILTI inclusion as a current period expense or factor such amounts into our measurement of deferred taxes. We elected the deferred method, under which we recorded the corresponding deferred tax assets and liabilities on our consolidated balance sheets.

During fiscal year 2018, we recorded a net charge of $13.7 billion related to the enactment of the TCJA, due to the impact of the one-time transition tax on the deemed repatriation of deferred foreign income of $17.9 billion, offset in part by the impact of changes in the tax rate of $4.2 billion, primarily on deferred tax assets and liabilities. During the second quarter of fiscal year 2019, we recorded additional tax expense of $157 million, which related to completing our provisional accounting for GILTI deferred taxes pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 118.

In the fourth quarter of fiscal year 2019, in response to the TCJA and recently issued regulations, we transferred certain intangible properties held by our foreign subsidiaries to the U.S. and Ireland. The transfers of intangible properties resulted in a $2.6 billion net income tax benefit recorded in the fourth quarter of fiscal year 2019, as the value of future tax deductions exceeded the current tax liability from foreign jurisdictions and U.S. GILTI tax.

Provision for Income Taxes

The components of the provision for income taxes were as follows:

(In millions)

Year Ended June 30,	2019	2018	2017
Current Taxes			
U.S. federal	**$ 4,718**	$ 19,764	$ 2,739
U.S. state and local	**662**	934	30
Foreign	**5,531**	4,348	2,472
Current taxes	**$ 10,911**	$ 25,046	$ 5,241
Deferred Taxes			
U.S. federal	**$ (5,647)**	$ (4,292)	$ (554)
U.S. state and local	**(1,010)**	(458)	269
Foreign	**194**	(393)	(544)
Deferred taxes	**$ (6,463)**	$ (5,143)	$ (829)
Provision for income taxes	**$ 4,448**	$ 19,903	$ 4,412

U.S. and foreign components of income before income taxes were as follows:

(In millions)

Year Ended June 30,	2019	2018	2017
U.S.	**$ 15,799**	$ 11,527	$ 6,843
Foreign	**27,889**	24,947	23,058
Income before income taxes	**$ 43,688**	$ 36,474	$ 29,901

Effective Tax Rate

The items accounting for the difference between income taxes computed at the U.S. federal statutory rate and our effective rate were as follows:

Year Ended June 30,	2019	2018	2017
Federal statutory rate	**21.0%**	28.1%	35.0%
Effect of:			
Foreign earnings taxed at lower rates	**(4.1)%**	(7.8)%	(11.6)%
Impact of the enactment of the TCJA	**0.4%**	37.7%	0%
Phone business losses	**0%**	0%	(5.7)%
Impact of intangible property transfers	**(5.9)%**	0%	0%
Foreign-derived intangible income deduction	**(1.4)%**	0%	0%
Research and development credit	**(1.1)%**	(1.3)%	(0.9)%
Excess tax benefits relating to stock-based compensation	**(2.2)%**	(2.5)%	(2.1)%
Interest, net	**1.0%**	1.2%	1.4%
Other reconciling items, net	**2.5%**	(0.8)%	(1.3)%
Effective rate	**10.2%**	54.6%	14.8%

The decrease from the federal statutory rate in fiscal year 2019 is primarily due to a $2.6 billion net income tax benefit related to intangible property transfers, and earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland, Singapore, and Puerto Rico. The increase from the federal statutory rate in fiscal year 2018 is primarily due to the net charge related to the enactment of the TCJA in the second quarter of fiscal year 2018, offset in part by earnings taxed at lower rates in foreign jurisdictions. The decrease from the federal statutory rate in fiscal year 2017 is primarily due to earnings taxed at lower rates in foreign jurisdictions. Our foreign regional operating centers in Ireland, Singapore and Puerto Rico, which are taxed at rates lower than the U.S. rate, generated 82%, 87%, and 76% of our foreign income before tax in fiscal years 2019, 2018, and 2017, respectively. Other reconciling items, net consists primarily of tax credits, GILTI, and U.S. state income taxes. In fiscal years 2019, 2018, and 2017, there were no individually significant other reconciling items.

The decrease in our effective tax rate for fiscal year 2019 compared to fiscal year 2018 was primarily due to the net charge related to the enactment of the TCJA in the second quarter of fiscal year 2018, and a $2.6 billion net income tax benefit in the fourth quarter of fiscal year 2019 related to intangible property transfers. The increase in our effective tax rate for fiscal year 2018 compared to fiscal year 2017 was primarily due to the net charge related to the enactment of the TCJA and the realization of tax benefits attributable to previous Phone business losses in fiscal year 2017.

The components of the deferred income tax assets and liabilities were as follows:

(In millions)

June 30,	**2019**	**2018**
Deferred Income Tax Assets		
Stock-based compensation expense	**$ 406**	$ 460
Accruals, reserves, and other expenses	**2,287**	1,832
Loss and credit carryforwards	**3,518**	3,369
Depreciation and amortization	**7,046**	351
Leasing liabilities	**1,594**	1,427
Unearned revenue	**475**	0
Other	**367**	56
Deferred income tax assets	**15,693**	7,495
Less valuation allowance	**(3,214)**	(3,186)
Deferred income tax assets, net of valuation allowance	**$ 12,479**	$ 4,309
Deferred Income Tax Liabilities		
Unrealized gain on investments and debt	**$ (738)**	$ 0
Unearned revenue	**(30)**	(639)
Depreciation and amortization	**0**	(1,164)
Leasing assets	**(1,510)**	(1,366)
Deferred GILTI tax liabilities	**(2,607)**	(61)
Other	**(291)**	(251)
Deferred income tax liabilities	**$ (5,176)**	$ (3,481)
Net deferred income tax assets (liabilities)	**$ 7,303**	$ 828
Reported As		
Other long-term assets	**$ 7,536**	$ 1,369
Long-term deferred income tax liabilities	**(233)**	(541)
Net deferred income tax assets (liabilities)	**$ 7,303**	$ 828

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when the taxes are paid or recovered.

As of June 30, 2019, we had federal, state and foreign net operating loss carryforwards of $978 million, $770 million, and $11.6 billion, respectively. The federal and state net operating loss carryforwards will expire in various years from fiscal 2020 through 2039, if not utilized. The majority of our foreign net operating loss carryforwards do not expire. Certain acquired net operating loss carryforwards are subject to an annual limitation, but are expected to be realized with the exception of those which have a valuation allowance.

The valuation allowance disclosed in the table above relates to the foreign net operating loss carryforwards and other net deferred tax assets that may not be realized.

Income taxes paid, net of refunds, were $8.4 billion, $5.5 billion, and $2.4 billion in fiscal years 2019, 2018, and 2017, respectively.

Uncertain Tax Positions

Gross unrecognized tax benefits related to uncertain tax positions as of June 30, 2019, 2018, and 2017, were $13.1 billion, $12.0 billion, and $11.7 billion, respectively, which were primarily included in long-term income taxes in our consolidated balance sheets. If recognized, the resulting tax benefit would affect our effective tax rates for fiscal years 2019, 2018, and 2017 by $12.0 billion, $11.3 billion, and $10.2 billion, respectively.

As of June 30, 2019, 2018, and 2017, we had accrued interest expense related to uncertain tax positions of $3.4 billion, $3.0 billion, and $2.3 billion, respectively, net of income tax benefits. The provision for (benefit from) income taxes for fiscal years 2019, 2018, and 2017 included interest expense related to uncertain tax positions of $515 million, $688 million, and $399 million, respectively, net of income tax benefits.

The aggregate changes in the gross unrecognized tax benefits related to uncertain tax positions were as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Beginning unrecognized tax benefits	**$ 11,961**	$ 11,737	$ 10,164
Decreases related to settlements	**(316)**	(193)	(4)
Increases for tax positions related to the current year	**2,106**	1,445	1,277
Increases for tax positions related to prior years	**508**	151	397
Decreases for tax positions related to prior years	**(1,113)**	(1,176)	(49)
Decreases due to lapsed statutes of limitations	**0**	(3)	(48)
Ending unrecognized tax benefits	**$ 13,146**	$ 11,961	$ 11,737

We settled a portion of the Internal Revenue Service (“IRS”) audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. We remain under audit for tax years 2004 to 2013. We expect the IRS to begin an examination of tax years 2014 to 2017 within the next 12 months.

As of June 30, 2019, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact on our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2018, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 13 — RESTRUCTURING CHARGES

In June 2017, management approved a sales and marketing restructuring plan. In fiscal year 2017, we recorded employee severance expenses of $306 million primarily related to this sales and marketing restructuring plan. The actions associated with this restructuring plan were completed as of June 30, 2018.

NOTE 14 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

June 30,	2019	2018
Productivity and Business Processes	**$ 16,831**	$ 14,864
Intelligent Cloud	**16,988**	14,706
More Personal Computing	**3,387**	3,150
Total	**$ 37,206**	$ 32,720

Changes in unearned revenue were as follows:

(In millions)

Year Ended June 30, 2019	
Balance, beginning of period	**$ 32,720**
Deferral of revenue	**69,493**
Recognition of unearned revenue	**(65,007)**
Balance, end of period	**$ 37,206**

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized ("contracted not recognized revenue"), which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods. Contracted not recognized revenue was $91 billion as of June 30, 2019, of which we expect to recognize approximately 50% of the revenue over the next 12 months and the remainder thereafter. Many customers are committing to our products and services for longer contract terms, which is increasing the percentage of contracted revenue that will be recognized beyond the next 12 months.

NOTE 15 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, retail stores, and certain equipment. Our leases have remaining lease terms of 1 year to 20 years, some of which include options to extend the leases for up to 5 years, and some of which include options to terminate the leases within 1 year.

The components of lease expense were as follows:

(In millions)

Year Ended June 30,	2019	2018	2017
Operating lease cost	**$ 1,707**	$ 1,585	$ 1,412
Finance lease cost:			
Amortization of right-of-use assets	**$ 370**	$ 243	$ 104
Interest on lease liabilities	**247**	175	68
Total finance lease cost	**$ 617**	$ 418	$ 172

Supplemental cash flow information related to leases was as follows:

(In millions)

Year Ended June 30,	2019	2018	2017
Cash paid for amounts included in the measurement of lease liabilities:			
Operating cash flows from operating leases	**$ 1,670**	$ 1,522	$ 1,157
Operating cash flows from finance leases	**247**	175	68
Financing cash flows from finance leases	**221**	144	46
Right-of-use assets obtained in exchange for lease obligations:			
Operating leases	**2,303**	1,571	1,270
Finance leases	**2,532**	1,933	1,773

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

June 30,	2019	2018
Operating Leases		
Operating lease right-of-use assets	**$ 7,379**	$ 6,686
Other current liabilities	**$ 1,515**	$ 1,399
Operating lease liabilities	**6,188**	5,568
Total operating lease liabilities	**$ 7,703**	$ 6,967
Finance Leases		
Property and equipment, at cost	**$ 7,041**	$ 4,543
Accumulated depreciation	**(774)**	(404)
Property and equipment, net	**$ 6,267**	$ 4,139
Other current liabilities	**$ 317**	$ 176
Other long-term liabilities	**6,257**	4,125
Total finance lease liabilities	**$ 6,574**	$ 4,301
Weighted Average Remaining Lease Term		
Operating leases	**7 years**	7 years
Finance leases	**13 years**	13 years
Weighted Average Discount Rate		
Operating leases	**3.0%**	2.7%
Finance leases	**4.6%**	5.2%

Maturities of lease liabilities were as follows:

(In millions)

Year Ending June 30,	Operating Leases	Finance Leases
2020	**$ 1,678**	**$ 591**
2021	**1,438**	**616**
2022	**1,235**	**626**
2023	**1,036**	**631**
2024	**839**	**641**

Thereafter	2,438	5,671
Total lease payments	8,664	8,776
Less imputed interest	(961)	(2,202)
Total	$ 7,703	$ 6,574

As of June 30, 2019, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $2.3 billion and $6.1 billion, respectively. These operating and finance leases will commence between fiscal year 2020 and fiscal year 2022 with lease terms of 1 year to 15 years.

NOTE 16 — CONTINGENCIES

Patent and Intellectual Property Claims

There were 44 patent infringement cases pending against Microsoft as of June 30, 2019, none of which are material individually or in aggregate.

Antitrust, Unfair Competition, and Overcharge Class Actions

Antitrust and unfair competition class action lawsuits were filed against us in British Columbia, Ontario, and Quebec, Canada. All three have been certified on behalf of Canadian indirect purchasers who acquired licenses for Microsoft operating system software and/or productivity application software between 1998 and 2010.

The trial of the British Columbia action commenced in May 2016. Following a mediation, the parties agreed to a global settlement of all three Canadian actions, and submitted the proposed settlement agreement to the courts in all three jurisdictions for approval. The final settlement has been approved by the courts in British Columbia, Ontario, and Quebec, and the claims administration process will commence.

Other Antitrust Litigation and Claims

China State Administration for Industry and Commerce Investigation

In 2014, Microsoft was informed that China's State Agency for Market Regulation ("SAMR") (formerly State Administration for Industry and Commerce) had begun a formal investigation relating to China's Anti-Monopoly Law, and the SAMR conducted onsite inspections of Microsoft offices in Beijing, Shanghai, Guangzhou, and Chengdu. The SAMR has presented its preliminary views as to certain possible violations of China's Anti-Monopoly Law, and discussions are expected to continue.

Product-Related Litigation

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 40 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which the defendants have moved to strike. In August 2018, the trial court issued an order striking portions of the plaintiffs' expert reports. A hearing is expected to be scheduled in the second half of calendar year 2019.

Employment-Related Litigation

Moussouris v. Microsoft

Current and former female Microsoft employees in certain engineering and information technology roles brought this class action in federal court in Seattle in 2015, alleging systemic gender discrimination in pay and promotions. The plaintiffs moved to certify the class in October 2017. Microsoft filed an opposition in January 2018, attaching an expert report showing no statistically significant disparity in pay and promotions between similarly situated men and women. In June 2018, the court denied the plaintiffs' motion for class certification. Plaintiffs sought an interlocutory appeal to the U.S. Court of Appeals for the Ninth Circuit, which was granted in September 2018. Oral argument is scheduled for October 2019.

Other Contingencies

We also are subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in aggregate, will not have a material adverse impact on our consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future.

As of June 30, 2019, we accrued aggregate legal liabilities of $386 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $1.0 billion in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact on our consolidated financial statements for the period in which the effects become reasonably estimable.

NOTE 17 — STOCKHOLDERS' EQUITY

Shares Outstanding

Shares of common stock outstanding were as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Balance, beginning of year	**7,677**	7,708	7,808
Issued	**116**	68	70
Repurchased	**(150)**	(99)	(170)
Balance, end of year	**7,643**	7,677	7,708

Share Repurchases

On September 16, 2013, our Board of Directors approved a share repurchase program ("2013 Share Repurchase Program") authorizing up to $40.0 billion in share repurchases. The 2013 Share Repurchase Program became effective on October 1, 2013, and was completed on December 22, 2016.

On September 20, 2016, our Board of Directors approved a share repurchase program authorizing up to an additional $40.0 billion in share repurchases ("2016 Share Repurchase Program"). This share repurchase program commenced on December 22, 2016 following completion of the 2013 Share Repurchase Program, has no expiration date, and may be suspended or discontinued at any time without notice. As of June 30, 2019, $11.4 billion remained of the 2016 Share Repurchase Program.

We repurchased the following shares of common stock under the share repurchase programs:

(In millions)	Shares	Amount	Shares	Amount	Shares	Amount
Year Ended June 30,		2019		2018		2017
First Quarter	**24**	**$ 2,600**	22	$ 1,600	63	$ 3,550
Second Quarter	**57**	**6,100**	22	1,800	59	3,533
Third Quarter	**36**	**3,899**	34	3,100	25	1,600
Fourth Quarter	**33**	**4,200**	21	2,100	23	1,600
Total	**150**	**$ 16,799**	99	$ 8,600	170	$ 10,283

Shares repurchased in the first and second quarter of fiscal year 2017 were under the 2013 Share Repurchase Program. All other shares repurchased were under the 2016 Share Repurchase Program. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $2.7 billion, $2.1 billion, and $1.5 billion for fiscal years 2019, 2018, and 2017, respectively. All share repurchases were made using cash resources.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2019				(In millions)
September 18, 2018	**November 15, 2018**	**December 13, 2018**	**$ 0.46**	**$ 3,544**
November 28, 2018	**February 21, 2019**	**March 14, 2019**	**0.46**	**3,526**
March 11, 2019	**May 16, 2019**	**June 13, 2019**	**0.46**	**3,521**
June 12, 2019	**August 15, 2019**	**September 12, 2019**	**0.46**	**3,516**
Total			**$ 1.84**	**$ 14,107**
Fiscal Year 2018				
September 19, 2017	November 16, 2017	December 14, 2017	$ 0.42	$ 3,238
November 29, 2017	February 15, 2018	March 8, 2018	0.42	3,232
March 12, 2018	May 17, 2018	June 14, 2018	0.42	3,226
June 13, 2018	August 16, 2018	September 13, 2018	0.42	3,220
Total			$ 1.68	$ 12,916

The dividend declared on June 12, 2019 was included in other current liabilities as of June 30, 2019.

NOTE 18 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes in accumulated other comprehensive income (loss) by component:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Derivatives			
Balance, beginning of period	**$ 173**	$ 134	$ 352
Unrealized gains, net of tax of **$2**, $11, and $4	**160**	218	328
Reclassification adjustments for gains included in revenue	**(341)**	(185)	(555)
Tax expense included in provision for income taxes	**8**	6	9
Amounts reclassified from accumulated other comprehensive income (loss)	**(333)**	(179)	(546)
Net change related to derivatives, net of tax of **$(6),** $5, and $(5)	**(173)**	39	(218)
Balance, end of period	**$ 0**	$ 173	$ 134
Investments			
Balance, beginning of period	**$ (850)**	$ 1,825	$ 2,941
Unrealized gains (losses), net of tax of **$616**, $(427), and $267	**2,331**	(1,146)	517
Reclassification adjustments for (gains) losses included in other income (expense), net	**93**	(2,309)	(2,513)
Tax expense (benefit) included in provision for income taxes	**(19)**	738	880
Amounts reclassified from accumulated other comprehensive income (loss)	**74**	(1,571)	(1,633)
Net change related to investments, net of tax of **$635**, $(1,165), and $(613)	**2,405**	(2,717)	(1,116)
Cumulative effect of accounting changes	**(67)**	42	0
Balance, end of period	**$ 1,488**	$ (850)	$ 1,825
Translation Adjustments and Other			
Balance, beginning of period	**$ (1,510)**	$ (1,332)	$ (1,499)
Translation adjustments and other, net of tax effects of **$(1)**, $0, and $9	**(318)**	(178)	167
Balance, end of period	**$ (1,828)**	$ (1,510)	$ (1,332)
Accumulated other comprehensive income (loss), end of period	**$ (340)**	$ (2,187)	$ 627

NOTE 19 — EMPLOYEE STOCK AND SAVINGS PLANS

We grant stock-based compensation to employees and directors. As of June 30, 2019, an aggregate of 327 million shares were authorized for future grant under our stock plans. Awards that expire or are canceled without delivery of shares generally become available for issuance under the plans. We issue new shares of Microsoft common stock to satisfy vesting of awards granted under our stock plans. We also have an ESPP for all eligible employees.

Stock-based compensation expense and related income tax benefits were as follows:

(In millions)

Year Ended June 30,	2019	2018	2017
Stock-based compensation expense	**$ 4,652**	$ 3,940	$ 3,266
Income tax benefits related to stock-based compensation	**816**	823	1,066

Stock Plans

Stock awards entitle the holder to receive shares of Microsoft common stock as the award vests. Stock awards generally vest over a four or five-year service period.

Executive Incentive Plan

Under the Executive Incentive Plan, the Compensation Committee approves stock awards to executive officers and certain senior executives. RSUs generally vest ratably over a four-year service period. PSUs generally vest over a three-year performance period. The number of shares the PSU holder receives is based on the extent to which the corresponding performance goals have been achieved.

Activity for All Stock Plans

The fair value of stock awards was estimated on the date of grant using the following assumptions:

Year Ended June 30,	2019	2018	2017
Dividends per share (quarterly amounts)	**$0.42 - $0.46**	$0.39 - $0.42	$0.36 - $0.39
Interest rates	**1.8% - 3.1%**	1.7% - 2.9%	1.2% - 2.2%

During fiscal year 2019, the following activity occurred under our stock plans:

	Shares	Weighted Average Grant-Date Fair Value
	(In millions)	
Stock Awards		
Nonvested balance, beginning of year	**174**	**$ 57.85**
Granted (a)	**63**	**107.02**
Vested	**(77)**	**57.08**
Forfeited	**(13)**	**69.35**
Nonvested balance, end of year	**147**	**$ 78.49**

(a) *Includes 2 million, 3 million, and 2 million of PSUs granted at target and performance adjustments above target levels for fiscal years 2019, 2018, and 2017, respectively.*

As of June 30, 2019, there was approximately $8.6 billion of total unrecognized compensation costs related to stock awards. These costs are expected to be recognized over a weighted average period of 3 years. The weighted average grant-date fair value of stock awards granted was $107.02, $75.88, and $55.64 for fiscal years 2019, 2018, and 2017, respectively. The fair value of stock awards vested was $8.7 billion, $6.6 billion, and $4.8 billion, for fiscal years 2019, 2018, and 2017, respectively.

Employee Stock Purchase Plan

We have an ESPP for all eligible employees. Shares of our common stock may be purchased by employees at three-month intervals at 90% of the fair market value on the last trading day of each three-month period. Employees may purchase shares having a value not exceeding 15% of their gross compensation during an offering period. Employees purchased the following shares during the periods presented:

(Shares in millions)

Year Ended June 30,	2019	2018	2017
Shares purchased	**11**	13	13
Average price per share	**$ 104.85**	$ 76.40	$ 56.36

As of June 30, 2019, 105 million shares of our common stock were reserved for future issuance through the ESPP.

Savings Plan

We have savings plans in the U.S. that qualify under Section 401(k) of the Internal Revenue Code, and a number of savings plans in international locations. Eligible U.S. employees may contribute a portion of their salary into the savings plans, subject to certain limitations. We contribute fifty cents for each dollar a participant contributes into the plans, with a maximum employer contribution of 50% of the IRS contribution limit for the calendar year. Employer-funded retirement benefits for all plans were $877 million, $807 million, and $734 million in fiscal years 2019, 2018, and 2017, respectively, and were expensed as contributed.

NOTE 20 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

In its operation of the business, management, including our chief operating decision maker, who is also our Chief Executive Officer, reviews certain financial information, including segmented internal profit and loss statements prepared on a basis not consistent with GAAP. During the periods presented, we reported our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing.

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial, including Office 365 subscriptions and Office licensed on-premises, comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, and Skype for Business, and related Client Access Licenses (“CALs”).
- Office Consumer, including Office 365 subscriptions and Office licensed on-premises, and Office Consumer Services, including Skype, Outlook.com, and OneDrive.
- LinkedIn, including Talent Solutions, Marketing Solutions, and Premium Subscriptions.
- Dynamics business solutions, including Dynamics 365, a set of cloud-based applications across ERP and CRM, Dynamics ERP on-premises, and Dynamics CRM on-premises.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business. This segment primarily comprises:

- Server products and cloud services, including Microsoft SQL Server, Windows Server, Visual Studio, System Center, and related CALs, GitHub, and Azure.
- Enterprise Services, including Premier Support Services and Microsoft Consulting Services.

More Personal Computing

Our More Personal Computing segment consists of products and services geared towards harmonizing the interests of end users, developers, and IT professionals across all devices. This segment primarily comprises:

- Windows, including Windows OEM licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; Windows Internet of Things (“IoT”); and MSN advertising.
- Devices, including Microsoft Surface, PC accessories, and other intelligent devices.
- Gaming, including Xbox hardware and Xbox software and services, comprising Xbox Live transactions, subscriptions, cloud services, and advertising (“Xbox Live”), video games, and third-party video game royalties.
- Search.

Revenue and costs are generally directly attributed to our segments. However, due to the integrated structure of our business, certain revenue recognized and costs incurred by one segment may benefit other segments. Revenue from certain contracts is allocated among the segments based on the relative value of the underlying products and services, which can include allocation based on actual prices charged, prices when sold separately, or estimated costs plus a profit margin. Cost of revenue is allocated in certain cases based on a relative revenue methodology. Operating expenses that are allocated primarily include those relating to marketing of products and services from which multiple segments benefit and are generally allocated based on relative gross margin.

In addition, certain costs incurred at a corporate level that are identifiable and that benefit our segments are allocated to them. These allocated costs include costs of: legal, including settlements and fines; information technology; human resources; finance; excise taxes; field selling; shared facilities services; and customer service and support. Each allocation is measured differently based on the specific facts and circumstances of the costs being allocated. Certain corporate-level activity is not allocated to our segments, including restructuring expenses.

Segment revenue and operating income were as follows during the periods presented:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Revenue			
Productivity and Business Processes	**$ 41,160**	$ 35,865	$ 29,870
Intelligent Cloud	**38,985**	32,219	27,407
More Personal Computing	**45,698**	42,276	39,294
Total	**$ 125,843**	$ 110,360	$ 96,571
Operating Income (Loss)			
Productivity and Business Processes	**$ 16,219**	$ 12,924	$ 11,389
Intelligent Cloud	**13,920**	11,524	9,127
More Personal Computing	**12,820**	10,610	8,815
Corporate and Other	**0**	0	(306)
Total	**$ 42,959**	$ 35,058	$ 29,025

Corporate and Other operating loss comprised restructuring expenses.

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for fiscal years 2019, 2018, or 2017. Revenue, classified by the major geographic areas in which our customers were located, was as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
United States (a)	**$ 64,199**	$ 55,926	$ 51,078
Other countries	**61,644**	54,434	45,493
Total	**$ 125,843**	$ 110,360	$ 96,571

(a) *Includes billings to OEMs and certain multinational organizations because of the nature of these businesses and the impracticability of determining the geographic source of the revenue.*

Revenue from external customers, classified by significant product and service offerings, was as follows:

(In millions)

Year Ended June 30,	2019	2018	2017
Server products and cloud services	**$ 32,622**	$ 26,129	$ 21,649
Office products and cloud services	**31,769**	28,316	25,573
Windows	**20,395**	19,518	18,593
Gaming	**11,386**	10,353	9,051
Search advertising	**7,628**	7,012	6,219
LinkedIn	**6,754**	5,259	2,271
Enterprise Services	**6,124**	5,846	5,542
Devices	**6,095**	5,134	5,062
Other	**3,070**	2,793	2,611
Total	**$ 125,843**	$ 110,360	$ 96,571

Our commercial cloud revenue, which includes Office 365 Commercial, Azure, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was $38.1 billion, $26.6 billion and $16.2 billion in fiscal years 2019, 2018, and 2017, respectively. These amounts are primarily included in Office products and cloud services, Server products and cloud services, and LinkedIn in the table above.

Assets are not allocated to segments for internal reporting presentations. A portion of amortization and depreciation is included with various other costs in an overhead allocation to each segment; it is impracticable for us to separately identify the amount of amortization and depreciation by segment that is included in the measure of segment profit or loss.

Long-lived assets, excluding financial instruments and tax assets, classified by the location of the controlling statutory company and with countries over 10% of the total shown separately, were as follows:

(In millions)

June 30,	2019	2018	2017
United States	**$ 55,252**	$ 44,501	$ 42,730
Ireland	**12,958**	12,843	12,889
Other countries	**25,422**	22,538	19,898
Total	**$ 93,632**	$ 79,882	$ 75,517

NOTE 21 — QUARTERLY INFORMATION (UNAUDITED)

(In millions, except per share amounts)

Quarter Ended	**September 30**	**December 31**	**March 31**	**June 30**	**Total**
Fiscal Year 2019					
Revenue	**$ 29,084**	**$ 32,471**	**$ 30,571**	**$ 33,717**	**$ 125,843**
Gross margin	**19,179**	**20,048**	**20,401**	**23,305**	**82,933**
Operating income	**9,955**	**10,258**	**10,341**	**12,405**	**42,959**
Net income (a)	**8,824**	**8,420**	**8,809**	**13,187**	**39,240**
Basic earnings per share	**1.15**	**1.09**	**1.15**	**1.72**	**5.11**
Diluted earnings per share (b)	**1.14**	**1.08**	**1.14**	**1.71**	**5.06**
Fiscal Year 2018					
Revenue	$ 24,538	$ 28,918	$ 26,819	$ 30,085	$ 110,360
Gross margin	16,260	17,854	17,550	20,343	72,007
Operating income	7,708	8,679	8,292	10,379	35,058
Net income (loss) (c)	6,576	(6,302)	7,424	8,873	16,571
Basic earnings (loss) per share	0.85	(0.82)	0.96	1.15	2.15
Diluted earnings (loss) per share (d)	0.84	(0.82)	0.95	1.14	2.13

(a) *Reflects the $157 million net charge related to the enactment of the TCJA for the second quarter and the $2.6 billion net income tax benefit related to the intangible property transfers for the fourth quarter, which together increased net income by $2.4 billion for fiscal year 2019. See Note 12 – Income Taxes for further information.*

(b) *Reflects the net charge related to the enactment of the TCJA and the net income tax benefit related to the intangible property transfers, which decreased (increased) diluted EPS $0.02 for the second quarter, $(0.34) for the fourth quarter, and $(0.31) for fiscal year 2019.*

(c) *Reflects the net charge (benefit) related to the enactment of the TCJA of $13.8 billion for the second quarter, $(104) million for the fourth quarter, and $13.7 billion for fiscal year 2018.*

(d) *Reflects the net charge (benefit) related to the enactment of the TCJA, which decreased (increased) diluted EPS $1.78 for the second quarter, $(0.01) for the fourth quarter, and $1.75 for fiscal year 2018.*

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2019 and 2018, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows, for each of the three years in the period ended June 30, 2019, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2019, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of June 30, 2019, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 1, 2019, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current-period audit of the financial statements that were communicated or required to be communicated to the Company's Audit Committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Revenue Recognition — Refer to Note 1 to the Financial Statements

Critical Audit Matter Description

The Company recognizes revenue upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. The Company offers customers the ability to acquire multiple licenses of software products and services, including cloud-based services, in its customer agreements through its volume licensing programs.

Significant judgment is exercised by the Company in determining revenue recognition for these customer agreements, and includes the following:

- Determination of whether products and services are considered distinct performance obligations that should be accounted for separately versus together, such as software licenses and related services that are sold with cloud-based services.
- Determination of stand-alone selling prices for each distinct performance obligation and for products and services that are not sold separately.
- The pattern of delivery (i.e., timing of when revenue is recognized) for each distinct performance obligation.
- Estimation of variable consideration when determining the amount of revenue to recognize (e.g., customer credits, incentives, and in certain instances, estimation of customer usage of products and services).

Given these factors, the related audit effort in evaluating management's judgments in determining revenue recognition for these customer agreements was extensive and required a high degree of auditor judgment.

How the Critical Audit Matter Was Addressed in the Audit

Our principal audit procedures related to the Company's revenue recognition for these customer agreements included the following:

- We tested the effectiveness of internal controls related to the identification of distinct performance obligations, the determination of the timing of revenue recognition, and the estimation of variable consideration.
- We evaluated management's significant accounting policies related to these customer agreements for reasonableness.
- We selected a sample of customer agreements and performed the following procedures:
  - Obtained and read contract source documents for each selection, including master agreements, and other documents that were part of the agreement.
  - Tested management's identification of significant terms for completeness, including the identification of distinct performance obligations and variable consideration.
  - Assessed the terms in the customer agreement and evaluated the appropriateness of management's application of their accounting policies, along with their use of estimates, in the determination of revenue recognition conclusions.
- We evaluated the reasonableness of management's estimate of stand-alone selling prices for products and services that are not sold separately.
- We tested the mathematical accuracy of management's calculations of revenue and the associated timing of revenue recognized in the financial statements.

Income Taxes — Uncertain Tax Positions — Refer to Note 12 to the Financial Statements

Critical Audit Matter Description

The Company’s long-term income taxes liability includes uncertain tax positions related to transfer pricing issues that remain unresolved with the Internal Revenue Service (“IRS”). The Company remains under IRS audit, or subject to IRS audit, for tax years subsequent to 2003. While the Company has settled a portion of the IRS audits, resolution of the remaining matters could have a material impact on the Company’s financial statements.

Conclusions on recognizing and measuring uncertain tax positions involve significant estimates and management judgment and include complex considerations of the Internal Revenue Code, related regulations, tax case laws, and prior-year audit settlements. Given the complexity and the subjective nature of the transfer pricing issues that remain unresolved with the IRS, evaluating management’s estimates relating to their determination of uncertain tax positions required extensive audit effort and a high degree of auditor judgment, including involvement of our tax specialists.

How the Critical Audit Matter Was Addressed in the Audit

Our principal audit procedures to evaluate management’s estimates of uncertain tax positions related to unresolved transfer pricing issues included the following:

- We evaluated the appropriateness and consistency of management’s methods and assumptions used in the identification, recognition, measurement, and disclosure of uncertain tax positions, which included testing the effectiveness of the related internal controls.
- We read and evaluated management’s documentation, including relevant accounting policies and information obtained by management from outside tax specialists, that detailed the basis of the uncertain tax positions.
- We tested the reasonableness of management’s judgments regarding the future resolution of the uncertain tax positions, including an evaluation of the technical merits of the uncertain tax positions.
- For those uncertain tax positions that had not been effectively settled, we evaluated whether management had appropriately considered new information that could significantly change the recognition, measurement or disclosure of the uncertain tax positions.
- We evaluated the reasonableness of management’s estimates by considering how tax law, including statutes, regulations and case law, impacted management’s judgments.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
August 1, 2019

We have served as the Company’s auditor since 1983.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective.

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our consolidated financial statements; providing reasonable assurance that receipts and expenditures of company assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use, or disposition of company assets that could have a material effect on our consolidated financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our consolidated financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the Company’s internal control over financial reporting was effective as of June 30, 2019. There were no changes in our internal control over financial reporting during the quarter ended June 30, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Deloitte & Touche LLP has audited our internal control over financial reporting as of June 30, 2019; their report is included in Item 9A.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2019, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2019, based on the criteria established in *Internal Control — Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated financial statements and the related notes (collectively referred to as the "financial statements") as of and for the year ended June 30, 2019, of the Company and our report dated August 1, 2019, expressed an unqualified opinion on those financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
August 1, 2019

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

A list of our executive officers and biographical information appears in Part I, Item 1 of this Form 10-K. Information about our directors may be found under the caption “Our director nominees” in our Proxy Statement for the Annual Meeting of Shareholders to be held December 4, 2019 (the “Proxy Statement”). Information about our Audit Committee may be found under the caption “Board committees” in the Proxy Statement. That information is incorporated herein by reference.

We have adopted the Microsoft Finance Code of Professional Conduct (the “finance code of ethics”), a code of ethics that applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, and other finance organization employees. The finance code of ethics is publicly available on our website at https://aka.ms/FinanceCodeProfessionalConduct. If we make any substantive amendments to the finance code of ethics or grant any waiver, including any implicit waiver, from a provision of the code to our Chief Executive Officer, Chief Financial Officer, or Chief Accounting Officer, we will disclose the nature of the amendment or waiver on that website or in a report on Form 8-K.

ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions “Director compensation,” “Named executive officer compensation,” “Compensation Committee interlocks and insider participation,” and “Compensation Committee report” is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information in the Proxy Statement set forth under the captions “Stock ownership information,” “Principal shareholders” and “Equity compensation plan information” is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information set forth in the Proxy Statement under the captions “Director independence” and “Certain relationships and related transactions” is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information concerning principal accountant fees and services appears in the Proxy Statement under the headings “Fees billed by Deloitte & Touche” and “Policy on Audit Committee pre-approval of audit and permissible non-audit services of independent auditor” and is incorporated herein by reference.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements and Schedules

The financial statements are set forth under Item 8 of this Form 10-K, as indexed below. Financial statement schedules have been omitted since they either are not required, not applicable, or the information is otherwise included.

(b) Exhibit Listing

			Incorporated by Reference			
Exhibit Number	Exhibit Description	Filed Herewith	Form	Period Ending	Exhibit	Filing Date
3.1	Amended and Restated Articles of Incorporation of Microsoft Corporation		8-K		3.1	12/1/16
3.2	Bylaws of Microsoft Corporation		8-K		3.2	6/14/17
4.1	Form of Indenture between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee ("Base Indenture")		S-3ASR		4.1	11/20/08
4.2	Form of First Supplemental Indenture for 2.95% Notes due 2014, 4.20% Notes due 2019, and 5.20% Notes due 2039, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Base Indenture		8-K		4.2	5/15/09
4.5	Form of Second Supplemental Indenture for 0.875% Notes due 2013, 1.625% Notes due 2015, 3.00% Notes due 2020, and 4.50% Notes due 2040, dated as of September 27, 2010, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	9/27/10

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.6	Third Supplemental Indenture for 2.500% Notes due 2016, 4.000% Notes due 2021, and 5.300% Notes due 2041, dated as of February 8, 2011, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	2/8/11
4.7	Fourth Supplemental Indenture for 0.875% Notes due 2017, 2.125% Notes due 2022, and 3.500% Notes due 2042, dated as of November 7, 2012, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	11/7/12
4.8	Fifth Supplemental Indenture for 2.625% Notes due 2033, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	5/1/13
4.9	Sixth Supplemental Indenture for 1.000% Notes due 2018, 2.375% Notes due 2023, and 3.750% Notes due 2043, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	5/1/13
4.10	Seventh Supplemental Indenture for 2.125% Notes due 2021 and 3.125% Notes due 2028, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	12/6/13

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference			
			Form	Period Ending	Exhibit	Filing Date
4.11	Eighth Supplemental Indenture for 1.625% Notes due 2018, 3.625% Notes due 2023, and 4.875% Notes due 2043, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	12/6/13
4.12	Ninth Supplemental Indenture for 1.850% Notes due 2020, 2.375% Notes due 2022, 2.700% Notes due 2025, 3.500% Notes due 2035, 3.750% Notes due 2045, and 4.000% Notes due 2055, dated as of February 12, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	2/12/15
4.13	Tenth Supplemental Indenture for 1.300% Notes due 2018, 2.000% Notes due 2020, 2.650% Notes due 2022, 3.125% Notes due 2025, 4.200% Notes due 2035, 4.450% Notes due 2045, and 4.750% Notes due 2055, dated as of November 3, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	11/3/15
4.14	Eleventh Supplemental Indenture for 1.100% Notes due 2019, 1.550% Notes due 2021, 2.000% Notes due 2023, 2.400% Notes due 2026, 3.450% Notes due 2036, 3.700% Notes due 2046, and 3.950% Notes due 2056, dated as of August 8, 2016, between Microsoft Corporation and U.S. Bank, National Association, as trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	8/5/16

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.15	Twelfth Supplemental Indenture for 1.850% Notes due 2020, 2.400% Notes due 2022, 2.875% Notes due 2024, 3.300% Notes due 2027, 4.100% Notes due 2037, 4.250% Notes due 2047, and 4.500% Notes due 2057, dated as of February 6, 2017, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	2/3/17
4.16	Description of Securities	X				
10.1*	Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.1	10/20/16
10.4*	Microsoft Corporation Employee Stock Purchase Plan		10-K	6/30/12	10.4	7/26/12
10.5*	Microsoft Corporation Deferred Compensation Plan		10-K	6/30/18	10.5	8/3/18
10.6*	Microsoft Corporation 2017 Stock Plan		DEF14A		Annex C	10/16/17
10.7*	Form of Stock Award Agreement Under the Microsoft Corporation 2017 Stock Plan		10-Q	3/31/2018	10.26	4/26/18
10.8*	Form of Performance Stock Award Agreement Under the Microsoft Corporation 2017 Stock Plan		10-Q	3/31/2018	10.27	4/26/18
10.12	Amended and Restated Officers' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		10-Q	9/30/16	10.12	10/20/16
10.13	Form of Indemnification Agreement and Amended and Restated Directors' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee	X				
10.14*	Microsoft Corporation Deferred Compensation Plan for Non-Employee Directors		10-Q	12/31/17	10.14	1/31/18
10.15*	Microsoft Corporation Executive Incentive Plan		8-K		10.1	9/19/18

10.19*	Microsoft Corporation Executive Incentive Plan	10-Q	9/30/16	10.17	10/20/16
10.20*	Form of Executive Incentive Plan (Executive Officer SAs) Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan	10-Q	9/30/16	10.18	10/20/16

10.21*	Form of Executive Incentive Plan Performance Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.25	10/20/16
10.22*	Senior Executive Severance Benefit Plan		10-Q	9/30/16	10.22	10/20/16
10.23*	Offer Letter, dated February 3, 2014, between Microsoft Corporation and Satya Nadella		8-K		10.1	2/4/14
10.24*	Long-Term Performance Stock Award Agreement between Microsoft Corporation and Satya Nadella		10-Q	12/31/14	10.24	1/26/15
21	Subsidiaries of Registrant	X				
23.1	Consent of Independent Registered Public Accounting Firm	X				
31.1	Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2	Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
32.1**	Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
32.2**	Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
101.INS	XBRL Instance Document	X				
101.SCH	XBRL Taxonomy Extension Schema	X				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase	X				
101.DEF	XBRL Taxonomy Extension Definition Linkbase	X				
101.LAB	XBRL Taxonomy Extension Label Linkbase	X				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	X				

* *Indicates a management contract or compensatory plan or arrangement.*
** *Furnished, not filed.*

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned; thereunto duly authorized, in the City of Redmond, State of Washington, on August 1, 2019.

MICROSOFT CORPORATION

/S/ FRANK H. BROD

Frank H. Brod
Corporate Vice President, Finance and Administration;
Chief Accounting Officer (Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on August 1, 2019.

Signature	Title
/s/ JOHN W. THOMPSON John W. Thompson	Chairman
/s/ SATYA NADELLA Satya Nadella	Director and Chief Executive Officer
/s/ WILLIAM H. GATES III William H. Gates III	Director
/s/ REID HOFFMAN Reid Hoffman	Director
/s/ HUGH F. JOHNSTON Hugh F. Johnston	Director
/s/ TERI L. LIST-STOLL Teri L. List-Stoll	Director
/s/ CHARLES H. NOSKI Charles H. Noski	Director
/s/ HELMUT PANKE Helmut Panke	Director
/s/ SANDRA E. PETERSON Sandra E. Peterson	Director
/s/ PENNY S. PRITZKER Penny S. Pritzker	Director
/s/ CHARLES W. SCHARF Charles W. Scharf	Director
/s/ ARNE M. SORENSON Arne M. Sorenson	Director
/s/ JOHN W. STANTON John W. Stanton	Director
/s/ PADMASREE WARRIOR Padmasree Warrior	Director
/s/ AMY E. HOOD Amy E. Hood	Executive Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ FRANK H. BROD Frank H. Brod	Corporate Vice President, Finance and Administration; Chief Accounting Officer (Principal Accounting Officer)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Fiscal Year Ended June 30, 2018

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period From to

Commission File Number 001-37845

MICROSOFT CORPORATION

WASHINGTON	**91-1144442**
(STATE OF INCORPORATION)	**(I.R.S. ID)**

ONE MICROSOFT WAY, REDMOND, WASHINGTON 98052-6399

(425) 882-8080

www.microsoft.com/investor

Securities registered pursuant to Section 12(b) of the Act:

COMMON STOCK, $0.00000625 par value per share **NASDAQ**

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒	Accelerated filer ☐
Non-accelerated filer ☐ (Do not check if a smaller reporting company)	Smaller reporting company ☐
Emerging growth company ☐	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of December 31, 2017, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $650.1 billion based on the closing sale price as reported on the NASDAQ National Market System. As of July 31, 2018, there were 7,668,217,316 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on November 28, 2018 are incorporated by reference into Part III.

MICROSOFT CORPORATION

FORM 10-K

For the Fiscal Year Ended June 30, 2018

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Note About Forward-Looking Statements

This report includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including the following sections: "Business" (Part I, Item 1 of this Form 10-K), "Risk Factors" (Part I, Item 1A of this Form 10-K), and "Management's Discussion and Analysis of Financial Condition and Results of Operations" (Part II, Item 7 of this Form 10-K). These forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "future," "opportunity," "plan," "may," "should," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. We describe risks and uncertainties that could cause actual results and events to differ materially in "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Quantitative and Qualitative Disclosures about Market Risk" (Part II, Item 7A of this Form 10-K). Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date they are made. We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

PART I

ITEM 1. BUSINESS

GENERAL

Embracing Our Future

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity.

We continue to transform our business to lead in the new era of the intelligent cloud and intelligent edge. We bring technology and products together into experiences and solutions that unlock value for our customers. In this next phase of innovation, computing is more powerful and ubiquitous from the cloud to the edge. Artificial intelligence ("AI") capabilities are rapidly advancing, fueled by data and knowledge of the world. Physical and virtual worlds are coming together to create richer experiences that understand the context surrounding people, the things they use, the places they go, and their activities and relationships. A person's experience with technology spans a multitude of devices and has become increasingly more natural and multi-sensory with voice, ink, and gaze interactions.

What We Offer

Founded in 1975, we develop and support software, services, devices, and solutions that deliver new value for customers and help people and businesses realize their full potential.

Our products include operating systems; cross-device productivity applications; server applications; business solution applications; desktop and server management tools; software development tools; and video games. We also design, manufacture, and sell devices, including PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

We offer an array of services, including cloud-based solutions that provide customers with software, services, platforms, and content, and we provide solution support and consulting services. We also deliver relevant online advertising to a global audience.

The Ambitions That Drive Us

To achieve our vision, our research and development efforts focus on three interconnected ambitions:

- Reinvent productivity and business processes.
- Build the intelligent cloud platform.
- Create more personal computing.

Reinvent Productivity and Business Processes

We are in a unique position to empower people and organizations to succeed in a rapidly evolving workplace. Computing experiences are evolving, no longer bound to one device at a time. Instead, experiences are expanding to many devices as people move from home to work to on the go. These modern needs, habits, and expectations of our customers are motivating us to bring Microsoft Office 365, Windows platform, devices, including Microsoft Surface, and third-party applications into a more cohesive Microsoft 365 experience.

Our growth depends on securely delivering continuous innovation and advancing our leading productivity and collaboration tools and services, including Office, Microsoft Dynamics, and LinkedIn. Microsoft 365 brings together Office 365, Windows 10, and Enterprise Mobility + Security to help organizations empower their employees with AI-backed tools that unlock creativity, increase teamwork, and fuel innovation, all the while enabling compliance coverage and data protection. Microsoft Teams is core to our vision for the modern workplace as the digital hub that creates a single canvas for teamwork, conversations, meetings, and content. Microsoft Relationship Sales solution brings together LinkedIn Sales Navigator and Dynamics to transform business to business sales through social selling. Dynamics 365 for Talent with LinkedIn Recruiter and Learning gives human resource professionals a complete solution to compete for talent.

These scenarios represent a move to unlock creativity and inspire teamwork, while simplifying security and management. Organizations of all sizes can now digitize business-critical functions, redefining what customers can expect from their business applications. This creates an opportunity for us to reach new customers and increase usage and engagement with existing customers.

Build the Intelligent Cloud Platform

Companies are looking to use digital technology to fundamentally reimagine how they empower their employees, engage customers, optimize their operations, and change the very core of their products and services. Partnering with organizations on their digital transformation is one of our largest opportunities and we are uniquely positioned to become the strategic digital transformation platform and partner of choice.

Our strategy requires continued investment in datacenters and other infrastructure to support our services. Microsoft Azure is a trusted cloud with comprehensive compliance coverage and AI-based security built in.

Our cloud business benefits from three economies of scale: datacenters that deploy computational resources at significantly lower cost per unit than smaller ones; datacenters that coordinate and aggregate diverse customer, geographic, and application demand patterns, improving the utilization of computing, storage, and network resources; and multi-tenancy locations that lower application maintenance labor costs.

As one of the two largest providers of cloud computing at scale, we believe we work from a position of strength. Being a global, hyper-scale cloud, Azure uniquely offers hybrid consistency, developer productivity, AI capabilities, and trusted security and compliance. Moreover, with Azure Stack, organizations can extend Azure into their own datacenters to create a consistent stack across the public cloud and the intelligent edge. Our hybrid infrastructure consistency spans identity, data, compute, management, and security, helping to support the real-world needs and evolving regulatory requirements of commercial customers and enterprises.

The ability to convert data into AI drives our competitive advantage. Azure SQL Database makes it possible for customers to take Microsoft SQL Server from their on-premises datacenter to a fully managed instance in the cloud to utilize built-in AI. We are accelerating adoption of AI innovations from research to products. Our innovation helps every developer be an AI developer, with approachable new tools from

Azure Machine Learning Studio for creating simple machine learning models, to the powerful Azure Machine Learning Workbench for the most advanced AI modeling and data science.

On June 4, 2018, Microsoft announced plans to acquire GitHub, Inc., a service that millions of developers around the world rely on to write code together. The acquisition is expected to close by the end of the calendar year.

Create More Personal Computing

We strive to make computing more personal by putting users at the core of the experience, enabling them to interact with technology in more intuitive, engaging, and dynamic ways. Windows 10 is the cornerstone of our ambition, providing a foundation for the secure, modern workplace, and designed to foster innovation through rich and consistent experiences across the range of existing devices and entirely new device categories. Windows 10 empowers people with AI-first interfaces ranging from voice-activated commands through Cortana, inking, immersive 3D content storytelling, and mixed reality experiences. Cloud sharing and co-authoring experiences are now natively enabled with OneDrive files on demand. Windows 10 is more accessible for everyone with new features like Eye Control, which gives people the ability to operate a PC using just their eyes.

Our ambition for Windows 10 is to broaden our economic opportunity through three key levers: an original equipment manufacturer (“OEM”) ecosystem that creates exciting new hardware designs for Windows 10; our commitment to our first-party premium device portfolio; and monetization opportunities such as gaming, services, subscriptions, and search advertising.

We are working to create a broad developer opportunity by unifying the Windows installed base on Windows 10 and enabling universal Windows applications to run across devices so developers and OEMs can contribute to a thriving Windows ecosystem. Additionally, we are committed to designing and marketing first-party devices, such as the Surface Laptop, Surface Book 2, and Surface Pro to help drive innovation, create new device categories, and stimulate demand in the Windows ecosystem.

We are mobilizing to pursue our expansive opportunity in the gaming industry, broadening our approach to how we think about gaming end-to-end, from the way games are created and distributed to how they are played and viewed. We have a strong position with our Xbox One console, our large and growing highly engaged community of gamers on Xbox Live, and with Windows 10, the most popular operating system for PC gamers. And we will continue to connect our gaming assets across PC, console, and mobile, and work to grow and engage the Xbox Live member network more deeply and frequently with new services like Mixer and Xbox Game Pass. Our approach is to enable gamers to play the games they want, with the people they want, on the devices they want.

Our Future Opportunity

Customers are looking to us to accelerate their own digital transformations and to unlock new opportunity in this era of intelligent cloud and intelligent edge. We continue to develop complete, intelligent solutions for our customers that empower users to be creative and work together while safeguarding businesses and simplifying IT management. Our goal is to lead the industry in several distinct areas of technology over the long-term, which we expect will translate to sustained growth. We are investing significant resources in:

- Transforming the workplace to deliver new modern, modular business applications to improve how people communicate, collaborate, learn, work, play, and interact with one another.
- Building and running cloud-based services in ways that unleash new experiences and opportunities for businesses and individuals.
- Applying AI to drive insights and act on our customer’s behalf by understanding and interpreting their needs using natural methods of communication.
- Using Windows to develop new categories of devices – both our own and third-party – as a person’s experience with technology becomes more natural, personal, and predictive with multi-sensory breakthroughs in voice, ink, gaze interactions, and augmented reality holograms.
- Inventing new gaming experiences that bring people together around their shared love for games on any devices and pushing the boundaries of innovation with console and PC gaming by creating the next wave of entertainment.

Our future growth depends on our ability to transcend current product category definitions, business models, and sales motions. We have the opportunity to redefine what customers and partners can expect and are working to deliver new solutions that reflect the best of Microsoft.

OPERATING SEGMENTS

We operate our business and report our financial performance using three segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. Our segments provide management with a comprehensive financial view of our key businesses. The segments enable the alignment of strategies and objectives across the development, sales, marketing, and services organizations, and they provide a framework for timely and rational allocation of resources within businesses.

Additional information on our operating segments and geographic and product information is contained in Note 21 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial, including Office 365 subscriptions and Office licensed on-premises, comprising Office, Exchange, SharePoint, Skype for Business, and Microsoft Teams, and related Client Access Licenses (“CALs”).
- Office Consumer, including Office 365 subscriptions and Office licensed on-premises, and Office Consumer Services, including Skype, Outlook.com, and OneDrive.
- LinkedIn, including Talent Solutions, Marketing Solutions, and Premium Subscriptions.
- Dynamics business solutions, including Dynamics ERP on-premises, Dynamics CRM on-premises, and Dynamics 365, a set of cloud-based applications across ERP and CRM.

Office Commercial

Office Commercial is designed to increase personal, team, and organizational productivity through a range of products and services. Growth depends on our ability to reach new users in new markets such as first-line workers, small and medium businesses, and growth markets, as well as add value to our core product and service offerings to span productivity categories such as communication, collaboration, analytics, and security. Office Commercial revenue is mainly affected by a combination of continued installed base growth and average revenue per user expansion, as well as the continued shift from Office licensed on-premises to Office 365. CALs provide certain Office Commercial products and services with access rights to our server products and CAL revenue is reported with the associated Office products and services.

Office Consumer

Office Consumer is designed to increase personal productivity through a range of products and services. Growth depends on our ability to reach new users, add value to our core product set, and continue to expand our product and service offerings into new markets. Office Consumer revenue is mainly affected by the percentage of customers that buy Office with their new devices and the continued shift from Office licensed on-premises to Office 365. Office Consumer Services revenue is mainly affected by the demand for communication and storage through Skype, Outlook.com, and OneDrive, which is largely driven by subscriptions, advertising, and the sale of minutes.

LinkedIn

LinkedIn connects the world's professionals to make them more productive and successful, and is the world's largest professional network on the Internet. LinkedIn offers services that can be used by customers to transform the way they hire, market, sell, and learn. In addition to LinkedIn’s free services, LinkedIn offers three categories of monetized solutions: Talent Solutions, Marketing Solutions, and Premium Subscriptions, which includes Sales Solutions. Talent Solutions is comprised of two elements: Hiring, and Learning and Development. Hiring provides services to recruiters that enable them to attract, recruit, and hire talent. Learning and Development provides subscriptions to enterprises and individuals to access online learning content. Marketing Solutions enables companies to advertise to LinkedIn’s member base. Premium Subscriptions enables professionals to manage their professional identity, grow their network, and connect with talent through additional services like premium search. Premium Subscriptions also includes Sales Solutions, which helps sales professionals find, qualify, and create sales opportunities and accelerate social selling capabilities. Growth will depend on our ability to increase the number of LinkedIn members and our ability to continue offering services that provide value for our members and increase their engagement. LinkedIn revenue is mainly affected by demand from enterprises and professional organizations for subscriptions to Talent Solutions and Premium Subscriptions offerings, as well as member engagement and the quality of the sponsored content delivered to those members to drive Marketing Solutions.

Dynamics

Dynamics provides on-premises and cloud-based business solutions for financial management, enterprise resource planning (“ERP”), customer relationship management (“CRM”), supply chain management, and analytics applications for small and medium businesses, large organizations, and divisions of global enterprises. Dynamics revenue is largely driven by the number of users licensed and the continued shift to Dynamics 365, a unified set of cloud-based intelligent business applications.

Competition

Competitors to Office include software and global application vendors, such as Apple, Cisco Systems, Facebook, Google, IBM, and Slack, and numerous web-based and mobile application competitors as well as local application developers. Apple distributes versions of its pre-installed application software, such as email and calendar products, through its PCs, tablets, and phones. Cisco Systems is using its position in enterprise communications equipment to grow its unified communications business. Google provides a hosted messaging and productivity suite. Skype for Business and Skype also compete with a variety of instant messaging, voice, and video communication providers, ranging from start-ups to established enterprises. Web-based offerings competing with individual applications have also positioned themselves as alternatives to our products and services. We compete by providing powerful, flexible, secure, and easy-to-use productivity and collaboration tools and services that create comprehensive solutions and work well with technologies our customers already have both on-premises or in the cloud.

LinkedIn faces competition from online recruiting companies, talent management companies, and larger companies that are focusing on talent management and human resource services; job boards; traditional recruiting firms; and companies that provide learning and development products and services. Marketing Solutions competes with online and offline outlets that generate revenue from advertisers and marketers.

Dynamics competes with vendors such as Infor, Oracle, NetSuite. Salesforce.com, SAP, and The Sage Group to provide on-premise and cloud-based business solutions for small, medium, and large organizations.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business. This segment primarily comprises:

- Server products and cloud services, including SQL Server, Windows Server, Visual Studio, System Center, and related CALs, and Azure.
- Enterprise Services, including Premier Support Services and Microsoft Consulting Services.

Server Products and Cloud Services

Our server products are designed to make IT professionals, developers, and their systems more productive and efficient. Server software is integrated server infrastructure and middleware designed to support software applications built on the Windows Server operating system. This includes the server platform, database, business intelligence, storage, management and operations, virtualization, service-oriented architecture platform, security, and identity software. We also license standalone and software development lifecycle tools for software architects, developers, testers, and project managers. Server products revenue is mainly affected by purchases through volume licensing programs, licenses sold to OEMs, and retail packaged products. CALs provide access rights to certain server products, including SQL Server and Windows Server, and revenue is reported along with the associated server product.

Azure is a comprehensive set of cloud services that offer developers, IT professionals, and enterprises freedom to build, deploy, and manage applications on any platform or device. Customers can use Azure through our global network of datacenters for basic computing, networking, storage, mobile and web app services, AI, Internet of Things (“IoT”), cognitive services, and machine learning. Azure enables customers to devote more resources to development and use of applications that benefit their organizations, rather than managing on-premises hardware and software. Azure revenue is mainly affected by infrastructure-as-a-service and platform-as-a-service consumption-based services, and per user-based services such as Enterprise Mobility + Security.

Enterprise Services

Enterprise Services, including Premier Support Services and Microsoft Consulting Services, assist customers in developing, deploying, and managing Microsoft server and desktop solutions and provide training and certification to developers and IT professionals on various Microsoft products.

Competition

Our server products face competition from a wide variety of server operating systems and applications offered by companies with a range of market approaches. Vertically integrated computer manufacturers such as Hewlett-Packard, IBM, and Oracle offer their own versions of the Unix operating system preinstalled on server hardware. Nearly all computer manufacturers offer server hardware for the Linux operating system and many contribute to Linux operating system development. The competitive position of Linux has also benefited from the large number of compatible applications now produced by many commercial and non-commercial software developers. A number of companies, such as Red Hat, supply versions of Linux.

We compete to provide enterprise-wide computing solutions and point solutions with numerous commercial software vendors that offer solutions and middleware technology platforms, software applications for connectivity (both Internet and intranet), security, hosting, database, and e-business servers. IBM and Oracle lead a group of companies focused on the Java Platform Enterprise Edition that competes with our enterprise-wide computing solutions. Commercial competitors for our server applications for PC-based distributed client-server environments include CA Technologies, IBM, and Oracle. Our web application platform software competes with open source software such as Apache, Linux, MySQL, and PHP. In middleware, we compete against Java vendors.

Our database, business intelligence, and data warehousing solutions offerings compete with products from IBM, Oracle, SAP, and other companies. Our system management solutions compete with server management and server virtualization platform providers, such as BMC, CA Technologies, Hewlett-Packard, IBM, and VMware. Our products for software developers compete against offerings from Adobe, IBM, Oracle, and other companies, and also against open-source projects, including Eclipse (sponsored by CA Technologies, IBM, Oracle, and SAP), PHP, and Ruby on Rails.

We believe our server products provide customers with advantages in performance, total costs of ownership, and productivity by delivering superior applications, development tools, compatibility with a broad base of hardware and software applications, security, and manageability.

Azure faces diverse competition from companies such as Amazon, Google, IBM, Oracle, Salesforce.com, VMware, and open source offerings. Azure’s competitive advantage includes enabling a hybrid cloud, allowing deployment of existing datacenters with our public cloud into a single, cohesive infrastructure, and the ability to run at a scale that meets the needs of businesses of all sizes and complexities.

Our Enterprise Services business competes with a wide range of companies that provide strategy and business planning, application development, and infrastructure services, including multinational consulting firms and small niche businesses focused on specific technologies.

More Personal Computing

Our More Personal Computing segment consists of products and services geared towards harmonizing the interests of end users, developers, and IT professionals across all devices. This segment primarily comprises:

- Windows, including Windows OEM licensing (“Windows OEM”) and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; Windows IoT; and MSN advertising.
- Devices, including Surface, PC accessories, and other intelligent devices.
- Gaming, including Xbox hardware and Xbox software and services, comprising Xbox Live transactions, subscriptions, and advertising (“Xbox Live”), video games, and third-party video game royalties.
- Search.

Windows

The Windows operating system is designed to deliver a more personal computing experience for users by enabling consistency of experience, applications, and information across their devices. Windows OEM revenue is impacted significantly by the number of Windows operating system licenses purchased by OEMs, which they pre-install on the devices they sell. In addition to computing device market volume, Windows OEM revenue is impacted by:

- The mix of computing devices based on form factor and screen size.
- Differences in device market demand between developed markets and growth markets.
- Attachment of Windows to devices shipped.
- Customer mix between consumer, small and medium businesses, and large enterprises.
- Changes in inventory levels in the OEM channel.
- Pricing changes and promotions, pricing variation that occurs when the mix of devices manufactured shifts from local and regional system builders to large multinational OEMs, and different pricing of Windows versions licensed.
- Piracy.

Windows Commercial revenue, which includes volume licensing of the Windows operating system and Windows cloud services such as Windows Defender Advanced Threat Protection, is affected mainly by the demand from commercial customers for volume licensing and Software Assurance (“SA”), as well as advanced security offerings. Windows Commercial revenue often reflects the number of information workers in a licensed enterprise and is relatively independent of the number of PCs sold in a given year.

Patent licensing includes our programs to license patents we own for use across a broad array of technology areas, including mobile devices and cloud offerings.

Windows IoT extends the power of Windows and the cloud to intelligent systems by delivering specialized operating systems, tools, and services for use in embedded devices.

MSN advertising includes both native and display ads.

Devices

We design, manufacture, and sell devices, including Surface, PC accessories, and other intelligent devices, such as Surface Hub and HoloLens. Our devices are designed to enable people and organizations to connect to the people and content that matter most using Windows and integrated Microsoft products and services. Surface is designed to help organizations, students, and consumers be more productive.

In May 2016, we announced plans to streamline our smartphone hardware business. In November 2016, we completed the sale of our feature Phone business.

Gaming

Our gaming platform is designed to provide a unique variety of entertainment using our devices, peripherals, applications, online services, and content. We released Xbox One S and Xbox One X in August 2016 and November 2017, respectively. With the launch of the Mixer service in May 2017, offering interactive live game streaming, and Xbox Game Pass in June 2017, providing unlimited access to over 100 Xbox titles, we continue to open new opportunities for customers to engage both on- and off-console.

Xbox Live enables people to connect and share online gaming experiences and is accessible on Xbox consoles, Windows-enabled devices, and other devices. Xbox Live is designed to benefit users by providing access to a network of certified applications and services and to benefit our developer and partner ecosystems by providing access to a large customer base. Xbox Live revenue is mainly affected by subscriptions and sales of Xbox Live enabled content, as well as advertising. We also continue to design and sell gaming content to showcase our unique platform capabilities for Xbox consoles, Windows-enabled devices, and other devices. Growth of our Gaming business is determined by the overall active user base through Xbox Live enabled content, availability of games, providing exclusive game content that gamers seek, the computational power and reliability of the devices used to access our content and services, and the ability to create new experiences via online services, downloadable content, and peripherals.

Search

Our Search business, including Bing and Bing Ads, is designed to deliver relevant online advertising to a global audience. We have several partnerships with other companies, including Oath (formerly Yahoo! and AOL) which is owned by Verizon, through which we provide and monetize search queries. Growth depends on our ability to attract new users, understand intent, and match intent with relevant content and advertiser offerings.

Competition

Windows faces competition from various software products and from alternative platforms and devices, mainly from Apple and Google. We believe Windows competes effectively by giving customers choice, value, flexibility, security, an easy-to-use interface, and compatibility with a broad range of hardware and software applications, including those that enable productivity.

Devices face competition from various computer, tablet, and hardware manufacturers who offer a unique combination of high-quality industrial design and innovative technologies across various price points. These manufacturers, many of which are also current or potential partners and customers, include Apple and our Windows OEMs.

Our gaming platform competes with console platforms from Nintendo and Sony, both of which have a large, established base of customers. The lifecycle for gaming and entertainment consoles averages five to ten years. Nintendo released its latest generation console in March 2017 and Sony released its latest generation console in November 2013. We also compete with other providers of entertainment services through online marketplaces. We believe our gaming platform is effectively positioned against competitive products and services based on significant innovation in hardware architecture, user interface, developer tools, online gaming and entertainment services, and continued strong exclusive content from our own game franchises as well as other digital content offerings. Our video games competitors include Electronic Arts and Activision Blizzard. Xbox Live faces competition from various online marketplaces, including those operated by Amazon, Apple, and Google.

Our search business competes with Google and a wide array of websites, social platforms like Facebook, and portals that provide content and online offerings to end users.

OPERATIONS

We have operations centers that support operations in their regions, including customer contract and order processing, credit and collections, information processing, and vendor management and logistics. The regional center in Ireland supports the European, Middle Eastern, and African region; the center in Singapore supports the Japan, India, Greater China, and Asia-Pacific region; and the centers in Fargo, North Dakota, Fort Lauderdale, Florida, Puerto Rico, Redmond, Washington, and Reno, Nevada support

Latin America and North America. In addition to the operations centers, we also operate datacenters throughout the Americas, Australia, Europe, and Asia.

To serve the needs of customers around the world and to improve the quality and usability of products in international markets, we localize many of our products to reflect local languages and conventions. Localizing a product may require modifying the user interface, altering dialog boxes, and translating text.

Our devices are primarily manufactured by third-party contract manufacturers. We generally have the ability to use other manufacturers if a current vendor becomes unavailable or unable to meet our requirements.

RESEARCH AND DEVELOPMENT

During fiscal years 2018, 2017, and 2016, research and development expense was $14.7 billion, $13.0 billion, and $12.0 billion, respectively. These amounts represented 13% of revenue in fiscal years 2018, 2017, and 2016. We plan to continue to make significant investments in a broad range of research and development efforts.

Product and Service Development, and Intellectual Property

We develop most of our products and services internally through the following engineering groups.

- *Cloud and AI Platform*, focuses on making IT professionals, developers, and their systems more productive and efficient through development of cloud infrastructure, server, database, CRM, ERP, management and development tools, AI cognitive services, and other business process applications and services for enterprises.
- *Experiences and Devices*, focuses on instilling a unifying product ethos across our end-user experiences and devices, including Office, Windows, Enterprise Mobility and Management, and devices.
- *AI and Research*, focuses on our AI innovations and other forward-looking research and development efforts spanning infrastructure, services, applications, and search.
- *LinkedIn*, focuses on our services that transform the way customers hire, market, sell, and learn.
- *Gaming*, focuses on connecting gaming assets across the range of devices to grow and engage the Xbox Live member network through game experiences, streaming content, and social interaction.

Internal development allows us to maintain competitive advantages that come from product differentiation and closer technical control over our products and services. It also gives us the freedom to decide which modifications and enhancements are most important and when they should be implemented. We strive to obtain information as early as possible about changing usage patterns and hardware advances that may affect software and hardware design. Before releasing new software platforms, and as we make significant modifications to existing platforms, we provide application vendors with a range of resources and guidelines for development, training, and testing. Generally, we also create product documentation internally.

We protect our intellectual property investments in a variety of ways. We work actively in the U.S. and internationally to ensure the enforcement of copyright, trademark, trade secret, and other protections that apply to our software and hardware products, services, business plans, and branding. We are a leader among technology companies in pursuing patents and currently have a portfolio of over 53,000 U.S. and international patents issued and over 29,000 pending. While we employ much of our internally developed intellectual property exclusively in our products and services, we also engage in outbound licensing of specific patented technologies that are incorporated into licensees' products. From time to time, we enter into broader cross-license agreements with other technology companies covering entire groups of patents. We also purchase or license technology that we incorporate into our products and services. At times, we make select intellectual property broadly available at no or low cost to achieve a strategic objective, such as promoting industry standards, advancing interoperability, or attracting and enabling our external development community. Our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations.

While it may be necessary in the future to seek or renew licenses relating to various aspects of our products, services, and business methods, we believe, based upon past experience and industry practice, such licenses generally can be obtained on commercially reasonable terms. We believe our continuing research and product development are not materially dependent on any single license or other agreement with a third party relating to the development of our products.

Investing in the Future

Our success is based on our ability to create new and compelling products, services, and experiences for our users, to initiate and embrace disruptive technology trends, to enter new geographic and product markets, and to drive broad adoption of our products and services. We invest in a range of emerging technology trends and breakthroughs that we believe offer significant opportunities to deliver value to our customers and growth for the company. Based on our assessment of key technology trends, we maintain our long-term commitment to research and development across a wide spectrum of technologies, tools, and platforms spanning digital work and life experiences, cloud computing, AI, devices, and operating systems.

While our main research and development facilities are located in Redmond, Washington, we also operate research and development facilities in other parts of the U.S. and around the world, including Canada, China, India, Ireland, Israel, and the United Kingdom. This global approach helps us remain competitive in local markets and enables us to continue to attract top talent from across the world. We generally fund research at the corporate level to ensure that we are looking beyond immediate product considerations to opportunities further in the future. We also fund research and development activities at the operating segment level. Much of our segment level research and development is coordinated with other segments and leveraged across the company.

In addition to our main research and development operations, we also operate Microsoft Research. Microsoft Research is one of the world’s largest corporate research organizations and works in close collaboration with top universities around the world to advance the state-of-the-art in computer science and a broad range of other disciplines, providing us a unique perspective on future trends and contributing to our innovation.

DISTRIBUTION, SALES, AND MARKETING

We market and distribute our products and services through the following channels: OEMs, direct, and distributors and resellers. Our sales force performs a variety of functions, including working directly with enterprises and public-sector organizations worldwide to identify and meet their technology requirements; managing OEM relationships; and supporting system integrators, independent software vendors, and other partners who engage directly with our customers to perform sales, consulting, and fulfillment functions for our products and services.

OEMs

We distribute our products and services through OEMs that pre-install our software on new devices and servers they sell. The largest component of the OEM business is the Windows operating system pre-installed on devices. OEMs also sell devices pre-installed with other Microsoft products and services, including applications such as Office and the capability to subscribe to Office 365.

There are two broad categories of OEMs. The largest category of OEMs are direct OEMs as our relationship with them is managed through a direct agreement between Microsoft and the OEM. We have distribution agreements covering one or more of our products with virtually all the multinational OEMs, including Acer, ASUS, Dell, Fujitsu, Hewlett-Packard, Lenovo, Samsung, Toshiba, and with many regional and local OEMs. The second broad category of OEMs are system builders consisting of lower-volume PC manufacturers, which source Microsoft software for pre-installation and local redistribution primarily through the Microsoft distributor channel rather than through a direct agreement or relationship with Microsoft.

Direct

Many organizations that license our products and services transact directly with us through Enterprise Agreements and Enterprise Services contracts, with sales support from system integrators, independent software vendors, web agencies, and partners that advise organizations on licensing our products and services (“Enterprise Agreement Software Advisors”, or “ESA”). Microsoft offers direct sales programs targeted to reach small, medium, and corporate customers, in addition to those offered through the reseller channel. A large network of partner advisors support many of these sales.

We also sell commercial and consumer products and services directly to customers, such as cloud services, search, and gaming, through our digital marketplaces, online stores, and retail stores.

Distributors and Resellers

Organizations also license our products and services indirectly, primarily through licensing solution partners (“LSP”), distributors, value-added resellers (“VAR”), and retailers. Although each type of reselling partner may reach organizations of all sizes, LSPs are primarily engaged with large organizations, distributors resell primarily to VARs, and VARs typically reach small and medium organizations. ESAs are also typically authorized as LSPs and operate as resellers for our other volume licensing programs. Microsoft Cloud Solution Provider is our main partner program for reselling cloud services.

We distribute our retail packaged products primarily through independent non-exclusive distributors, authorized replicators, resellers, and retail outlets. Individual consumers obtain these products primarily through retail outlets. We distribute our devices through third-party retailers. We have a network of field sales representatives and field support personnel that solicit orders from distributors and resellers, and provide product training and sales support.

Our Dynamics business solutions are also licensed to enterprises through a global network of channel partners providing vertical solutions and specialized services.

LICENSING OPTIONS

We offer options for organizations that want to purchase our cloud services, on-premises software, and Software Assurance. We license software to organizations under volume licensing agreements to allow the customer to acquire multiple licenses of products and services instead of having to acquire separate licenses through retail channels. We use different programs designed to provide flexibility for organizations of various sizes. While these programs may differ in various parts of the world, generally they include those discussed below.

SA conveys rights to new software and upgrades for perpetual licenses released over the contract period. It also provides support, tools, and training to help customers deploy and use software efficiently. SA is included with certain volume licensing agreements and is an optional purchase with others.

Volume Licensing Programs

Enterprise Agreement

Enterprise Agreements offer large organizations a manageable volume licensing program that gives them the flexibility to buy cloud services and software licenses under one agreement. Enterprise Agreements are designed for medium or large organizations that want to license cloud services and on-premises software organization-wide over a three-year period. Organizations can elect to purchase perpetual licenses or subscribe to licenses. SA is included.

Microsoft Product and Services Agreement

Microsoft Product and Services Agreements are designed for medium and large organizations that want to license cloud services and on-premises software as needed, with no organization-wide commitment, under a single, non-expiring agreement. Organizations purchase perpetual licenses or subscribe to licenses. SA is optional for customers that purchase perpetual licenses.

Open

Open agreements are a simple, cost-effective way to acquire the latest Microsoft technology. Open agreements are designed for small and medium organizations that want to license cloud services and on-premises software over a one- to three-year period. Under the Open agreements, organizations purchase perpetual licenses and SA is optional. Under Open Value agreements, organizations can elect to purchase perpetual licenses or subscribe to licenses and SA is included.

Select Plus

Select Plus agreements are designed for government and academic organizations to acquire on-premises licenses at any affiliate or department level, while realizing advantages as one organization. Organizations purchase perpetual licenses and SA is optional.

In July 2014, we announced the retirement over a two-year period of Select Plus agreements for commercial organizations. Beginning July 2015, no new Select Plus agreements were signed with commercial organizations.

Microsoft Online Subscription Agreement

Microsoft Online Subscription Agreements are designed for small and medium organizations that want to subscribe to, activate, provision, and maintain cloud services seamlessly and directly via the web. The agreement allows customers to acquire monthly or annual subscriptions for cloud-based services.

Partner Programs

The Microsoft Cloud Solution Provider program offers customers an easy way to license the cloud services they need in combination with the value-added services offered by their systems integrator, hosting partner, or cloud reseller partner. Partners in this program can easily package their own products and services to directly provision, manage, and support their customer subscriptions.

The Microsoft Services Provider License Agreement allows service providers and independent software vendors who want to license eligible Microsoft software products to provide software services and hosted applications to their end customers. Partners license software over a three-year period and are billed monthly based on consumption.

The Independent Software Vendor Royalty program enables partners to integrate Microsoft products into other applications and then license the unified business solution to their end users.

CUSTOMERS

Our customers include individual consumers, small and medium organizations, large global enterprises, public-sector institutions, internet service providers, application developers, and OEMs. No sales to an individual customer accounted for more than 10% of revenue in fiscal years 2018, 2017, or 2016. Our practice is to ship our products promptly upon receipt of purchase orders from customers; consequently, backlog is not significant.

EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers as of August 3, 2018 were as follows:

Name	Age	Position with the Company
Satya Nadella	50	Chief Executive Officer
Christopher C. Capossela	48	Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer
Jean-Philippe Courtois	57	Executive Vice President and President, Microsoft Global Sales, Marketing and Operations
Kathleen T. Hogan	52	Executive Vice President, Human Resources
Amy E. Hood	46	Executive Vice President, Chief Financial Officer
Margaret L. Johnson	56	Executive Vice President, Business Development
Bradford L. Smith	59	President and Chief Legal Officer

Mr. Nadella was appointed Chief Executive Officer in February 2014. He served as Executive Vice President, Cloud and Enterprise from July 2013 until that time. From 2011 to 2013, Mr. Nadella served as President, Server and Tools. From 2009 to 2011, he was Senior Vice President, Online Services Division. From 2008 to 2009, he was Senior Vice President, Search, Portal, and Advertising. Since joining Microsoft in 1992, Mr. Nadella's roles also included Vice President of the Business Division. Mr. Nadella also serves on the Board of Directors of Starbucks Corporation.

Mr. Capossela was appointed Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer in July 2016. He had served as Executive Vice President, Chief Marketing Officer since March 2014. Previously, he served as the worldwide leader of the Consumer Channels Group, responsible for sales and marketing activities with OEMs, operators, and retail partners. In his more than 25 years at Microsoft, Mr. Capossela has held a variety of marketing leadership roles in the Microsoft Office Division. He was responsible for marketing productivity solutions including Microsoft Office, Office 365, SharePoint, Exchange, Skype for Business, Project, and Visio.

Mr. Courtois was named Executive Vice President and President, Microsoft Global Sales, Marketing and Operations in July 2016. Before that he was President of Microsoft International since 2005. He was Chief Executive Officer, Microsoft Europe, Middle East, and Africa from 2003 to 2005.He was Senior Vice President and President, Microsoft Europe, Middle East, and Africa from 2000 to 2003. He was Corporate Vice President, Worldwide Customer Marketing from 1998 to 2000. Mr. Courtois joined Microsoft in 1984.

Ms. Hogan was appointed Executive Vice President, Human Resources in November 2014. Prior to that Ms. Hogan was Corporate Vice President of Microsoft Services. She also served as Corporate Vice President of Customer Service and Support. Ms. Hogan joined Microsoft in 2003.

Ms. Hood was appointed Executive Vice President and Chief Financial Officer in July 2013, subsequent to her appointment as Chief Financial Officer in May 2013. From 2010 to 2013, Ms. Hood was Chief Financial Officer of the Microsoft Business Division. From 2006 through 2009, Ms. Hood was General Manager, Microsoft Business Division Strategy. Since joining Microsoft in 2002, Ms. Hood has also held finance-related positions in the Server and Tools Business and the corporate finance organization. Ms. Hood also serves on the Board of Directors of 3M Corporation.

Ms. Johnson was appointed Executive Vice President, Business Development in September 2014. Prior to that Ms. Johnson spent 24 years at Qualcomm in various leadership positions across engineering, sales, marketing and business development. She most recently served as Executive Vice President of Qualcomm Technologies, Inc. Ms. Johnson also serves on the Board of Directors of BlackRock, Inc.

Mr. Smith was appointed President and Chief Legal Officer in September 2015. He served as Executive Vice President, General Counsel, and Secretary from 2011 to 2015, and served as Senior Vice President, General Counsel, and Secretary from 2001 to 2011. Mr. Smith was also named Chief Compliance Officer in 2002. Since joining Microsoft in 1993, he was Deputy General Counsel for Worldwide Sales and previously was responsible for managing the European Law and Corporate Affairs Group, based in Paris. Mr. Smith also serves on the Board of Directors of Netflix, Inc.

EMPLOYEES

As of June 30, 2018, we employed approximately 131,000 people on a full-time basis, 78,000 in the U.S. and 53,000 internationally. Of the total employed people, 42,000 were in operations, including manufacturing, distribution, product support, and consulting services; 42,000 were in product research and development; 36,000 were in sales and marketing; and 11,000 were in general and administration. Certain of our employees are subject to collective bargaining agreements.

AVAILABLE INFORMATION

Our Internet address is www.microsoft.com. At our Investor Relations website, www.microsoft.com/investor, we make available free of charge a variety of information for investors. Our goal is to maintain the Investor Relations website as a portal through which investors can easily find or navigate to pertinent information about us, including:

- Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file that material with or furnish it to the Securities and Exchange Commission (“SEC”).
- Information on our business strategies, financial results, and metrics for investors.
- Announcements of investor conferences, speeches, and events at which our executives talk about our product, service, and competitive strategies. Archives of these events are also available.
- Press releases on quarterly earnings, product and service announcements, legal developments, and international news.
- Corporate governance information including our articles of incorporation, bylaws, governance guidelines, committee charters, codes of conduct and ethics, global corporate social responsibility initiatives, and other governance-related policies.
- Other news and announcements that we may post from time to time that investors might find useful or interesting.
- Opportunities to sign up for email alerts to have information pushed in real time.

The information found on our website is not part of this or any other report we file with, or furnish to, the SEC. In addition to these channels, we use social media to communicate to the public. It is possible that the information we post on social media could be deemed to be material to investors. We encourage investors, the media, and others interested in Microsoft to review the information we post on the social media channels listed on our Investor Relations website.

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described below, that could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock.

We face intense competition across all markets for our products and services, which may lead to lower revenue or operating margins.

Competition in the technology sector

Our competitors range in size from diversified global companies with significant research and development resources to small, specialized firms whose narrower product lines may let them be more effective in deploying technical, marketing, and financial resources. Barriers to entry in many of our businesses are low and many of the areas in which we compete evolve rapidly with changing and disruptive technologies, shifting user needs, and frequent introductions of new products and services. Our ability to remain competitive depends on our success in making innovative products, devices, and services that appeal to businesses and consumers.

Competition among platform-based ecosystems

An important element of our business model has been to create platform-based ecosystems on which many participants can build diverse solutions. A well-established ecosystem creates beneficial network effects among users, application developers, and the platform provider that can accelerate growth. Establishing significant scale in the marketplace is necessary to achieve and maintain attractive margins. We face significant competition from firms that provide competing platforms.

- A competing vertically-integrated model, in which a single firm controls the software and hardware elements of a product and related services, has succeeded with some consumer products such as personal computers, tablets, phones, gaming consoles, and wearables. Competitors pursuing this model also earn revenue from services integrated with the hardware and software platform, including applications and content sold through their integrated marketplaces. They may also be able to claim security and performance benefits from their vertically integrated offer. We also offer some vertically-integrated hardware and software products and services. To the extent we shift a portion of our business to a vertically integrated model we increase our cost of revenue and reduce our operating margins.
- We derive substantial revenue from licenses of Windows operating systems on personal computers. We face significant competition from competing platforms developed for new devices and form factors such as smartphones and tablet computers. These devices compete on multiple bases including price and the perceived utility of the device and its platform. Users are increasingly turning to these devices to perform functions that in the past were performed by personal computers. Even if many users view these devices as complementary to a personal computer, the prevalence of these devices may make it more difficult to attract application developers to our PC operating system platforms. Competing with operating systems licensed at low or no cost may decrease our PC operating system margins. Popular products or services offered on competing platforms could increase their competitive strength. In addition, some of our devices compete with products made by our original equipment manufacturer ("OEM") partners, which may affect their commitment to our platform.
- Competing platforms have content and application marketplaces with scale and significant installed bases. The variety and utility of content and applications available on a platform are important to device purchasing decisions. Users sometimes incur costs to move data and buy new content and applications when switching platforms. To compete, we must successfully enlist developers to write applications for our platform and ensure that these applications have high quality, security, customer appeal, and value. Efforts to compete with competitors' content and application marketplaces may increase our cost of revenue and lower our operating margins.

Business model competition

Companies compete with us based on a growing variety of business models.

- Even as we transition more of our business to infrastructure-, platform-, and software-as-a-service business model, the license-based proprietary software model generates a substantial portion of our software revenue. We bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from licensing our products. Many of our competitors also develop and sell software to businesses and consumers under this model.
- Other competitors develop and offer free applications, online services and content, and make money by selling third-party advertising. Advertising revenue funds development of products and services these competitors provide to users at no or little cost, competing directly with our revenue-generating products.
- Some companies compete with us using an open source business model by modifying and then distributing open source software at nominal cost to end-users, and earning revenue on advertising or complementary services and products. These firms do not bear the full costs of research and development for the software. Some open source software vendors develop software that mimics the features and functionality of our products.

The competitive pressures described above may cause decreased sales volumes, price reductions, and/or increased operating costs, such as for research and development, marketing, and sales incentives. This may lead to lower revenue, gross margins, and operating income.

Our increasing focus on cloud-based services presents execution and competitive risks. A growing part of our business involves cloud-based services available across the spectrum of computing devices. Our strategic vision is to compete and grow by building best-in-class platforms and productivity services for an intelligent cloud and an intelligent edge infused with artificial intelligence (“AI”). At the same time, our competitors are rapidly developing and deploying cloud-based services for consumers and business customers. Pricing and delivery models are evolving. Devices and form factors influence how users access services in the cloud and sometimes the user’s choice of which suite of cloud-based services to use. We are devoting significant resources to develop and deploy our cloud-based strategies. The Windows ecosystem must continue to evolve with this changing environment. We are undertaking cultural and organizational changes to drive accountability and eliminate obstacles to innovation. Our intelligent cloud and intelligent edge worldview is connected with the growth of the internet of things (“IoT”). Our success in the IoT will depend on the level of adoption of our offerings such as Microsoft Azure, Azure Stack, Azure IoT Edge, and Azure Sphere. We may not establish market share sufficient to achieve scale necessary to achieve our business objectives.

Besides software development costs, we are incurring costs to build and maintain infrastructure to support cloud computing services. These costs will reduce the operating margins we have previously achieved. Whether we succeed in cloud-based services depends on our execution in several areas, including:

- Continuing to bring to market compelling cloud-based experiences that generate increasing traffic and market share.
- Maintaining the utility, compatibility, and performance of our cloud-based services on the growing array of computing devices, including PCs, smartphones, tablets, gaming consoles, and other devices, as well as sensors and other endpoints.
- Continuing to enhance the attractiveness of our cloud platforms to third-party developers.
- Ensuring our cloud-based services meet the reliability expectations of our customers and maintain the security of their data.
- Making our suite of cloud-based services platform-agnostic, available on a wide range of devices and ecosystems, including those of our competitors.

It is uncertain whether our strategies will attract the users or generate the revenue required to succeed. If we are not effective in executing organizational and technical changes to increase efficiency and accelerate innovation, or if we fail to generate sufficient usage of our new products and services, we may not grow revenue in line with the infrastructure and development investments described above. This may negatively impact gross margins and operating income.

We make significant investments in new products and services that may not achieve expected returns. We will continue to make significant investments in research, development, and marketing for existing products, services, and technologies, including the Windows operating system, Microsoft 365, Office, Bing, Microsoft SQL Server, Windows Server, the Windows Store, Azure, Office 365, Xbox Live, Mixer, LinkedIn, and other cloud-based offerings. We also invest in the development and acquisition of a variety of hardware for productivity, communication, and entertainment including PCs, tablets, gaming devices, and HoloLens. Investments in new technology are speculative. Commercial success depends on many factors, including innovativeness, developer support, and effective distribution and marketing. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of new software and hardware products or upgrades, unfavorably affecting revenue. We may not achieve significant revenue from new product, service, and distribution channel investments for several years, if at all. New products and services may not be profitable, and even if they are profitable, operating margins for some new products and businesses will not be as high as the margins we have experienced historically. We may not get engagement in certain features, like Windows Store, Microsoft Edge, and Bing, that drive post-license monetization opportunities. Our data handling practices across our products and services will continue to be under scrutiny and perceptions of mismanagement, driven by regulatory activity or negative public reaction to our practices or product experiences, which could negatively impact product and feature adoption, product design, and product quality.

Developing new technologies is complex. It can require long development and testing periods. Significant delays in new releases or significant problems in creating new products or services could adversely affect our revenue.

Acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business. We expect to continue making acquisitions and entering into joint ventures and strategic alliances as part of our long-term business strategy. In December 2016, we completed our acquisition of LinkedIn Corporation for $27.0 billion. In June 2018, we announced an agreement to acquire GitHub, Inc. for $7.5 billion. These acquisitions and other transactions and arrangements involve significant challenges and risks, including that they do not advance our business strategy, that we get an unsatisfactory return on our investment, that we have difficulty integrating and retaining new employees, business systems, and technology, or that they distract management from our other businesses. If an arrangement fails to adequately anticipate changing circumstances and interests of a party, it may result in early termination or renegotiation of the arrangement. The success of these transactions and arrangements will depend in part on our ability to leverage them to enhance our existing products and services or develop compelling new ones. It may take longer than expected to realize the full benefits from these transactions and arrangements, such as increased revenue, enhanced efficiencies, or increased market share, or the benefits may ultimately be smaller than we expected. These events could adversely affect our operating results or financial condition.

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings. We acquire other companies and intangible assets and may not realize all the economic benefit from those acquisitions, which could cause an impairment of goodwill or intangibles. We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment at least annually. Factors that may be a change in circumstances, indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable, include a decline in our stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in industry segments in which we participate. We have in the past recorded, and may in the future be required to record a significant charge in our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively affecting our results of operations. Our acquisition of LinkedIn resulted in a significant increase in our goodwill and intangible asset balances.

We may not earn the revenues we expect from our intellectual property rights.

We may not be able to adequately protect our intellectual property rights

Protecting our intellectual property rights and combating unlicensed copying and use of our software and other intellectual property on a global basis is difficult. While piracy adversely affects U.S. revenue, the impact on revenue from outside the U.S. is more significant, particularly countries in which the legal system provides less protection for intellectual property rights. Our revenue in these markets may grow more slowly than the underlying device market. Similarly, the absence of harmonized patent laws makes it more difficult to ensure consistent respect for patent rights. Throughout the world, we educate users about the benefits of licensing genuine products and obtaining indemnification benefits for intellectual property risks, and we educate lawmakers about the advantages of a business climate where intellectual property rights are protected. Reductions in the legal protection for software intellectual property rights could adversely affect revenue.

We may not receive expected royalties from our patent licenses

We expend significant resources to patent the intellectual property we create with the expectation that we will generate revenues by incorporating that intellectual property in our products or services or, in some instances, by licensing our patents to others in return for a royalty. Changes in the law may continue to weaken our ability to prevent the use of patented technology or collect revenue for licensing our patents. These include legislative changes and regulatory actions that make it more difficult to obtain injunctions, and the increasing use of legal process to challenge issued patents. Similarly, licensees of our patents may fail to satisfy their obligations to pay us royalties, or may contest the scope and extent of their obligations. Finally, the royalties we can obtain to monetize our intellectual property may decline because of the evolution of technology, selling price changes in products using licensed patents, or the difficulty of discovering infringements. Finally, our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations and may negatively impact revenue.

Third parties may claim we infringe their intellectual property rights. From time to time, others claim we infringe their intellectual property rights. The number of these claims may grow because of constant technological change in the markets in which we compete, the extensive patent coverage of existing technologies, the rapid rate of issuance of new patents, and our offering of first-party devices, such as Microsoft Surface. To resolve these claims, we may enter into royalty and licensing agreements on terms that are less favorable than currently available, stop selling or redesign affected products or services, or pay damages to satisfy indemnification commitments with our customers. These outcomes may cause operating margins to decline. Besides money damages, in some jurisdictions plaintiffs can seek injunctive relief that may limit or prevent importing, marketing, and selling our products or services that have infringing technologies. In some countries, such as Germany, an injunction can be issued before the parties have fully litigated the validity of the underlying patents. We have paid significant amounts to settle claims related to the use of technology and intellectual property rights and to procure intellectual property rights as part of our strategy to manage this risk, and may continue to do so.

We may not be able to protect our source code from copying if there is an unauthorized disclosure. Source code, the detailed program commands for our operating systems and other software programs, is critical to our business. Although we license portions of our application and operating system source code to several licensees, we take significant measures to protect the secrecy of large portions of our source code. If our source code leaks, we might lose future trade secret protection for that code. It may then become easier for third parties to compete with our products by copying functionality, which could adversely affect our revenue and operating margins. Unauthorized disclosure of source code also could increase the security risks described in the next paragraph.

Cyberattacks and security vulnerabilities could lead to reduced revenue, increased costs, liability claims, or harm to our reputation or competitive position.

Security of our information technology

Threats to IT security can take a variety of forms. Individual and groups of hackers and sophisticated organizations, including state-sponsored organizations or nation-states, continuously undertake attacks that pose threats to our customers and our IT. These actors may use a wide variety of methods, which may include developing and deploying malicious software or exploiting vulnerabilities in hardware, software, or other infrastructure in order to attack our products and services or gain access to our networks and datacenters, using social engineering techniques to induce our employees, users, partners, or customers to disclose passwords or other sensitive information or take other actions to gain access to our data or our users' or customers' data, or acting in a coordinated manner to launch distributed denial of service or other coordinated attacks. Inadequate account security practices may also result in unauthorized access to confidential data. For example, system administrators may fail to timely remove employee account access when no longer appropriate. Employees or third parties may intentionally compromise our or our users' security or systems, or reveal confidential information.

Cyberthreats are constantly evolving, increasing the difficulty of detecting and successfully defending against them. We may have no current capability to detect certain vulnerabilities, which may allow them to persist in the environment over long periods of time. Cyberthreats can have cascading impacts that unfold with increasing speed across our internal networks and systems and those of our partners and customers. Breaches of our facilities, network, or data security could disrupt the security of our systems and business applications, impair our ability to provide services to our customers and protect the privacy of their data, result in product development delays, compromise confidential or technical business information harming our reputation or competitive position, result in theft or misuse of our intellectual property or other assets, require us to allocate more resources to improved technologies, or otherwise adversely affect our business.

In addition, our internal IT environment continues to evolve. Often, we are early adopters of new devices and technologies. We embrace new ways of sharing data and communicating internally and with partners and customers using methods such as social networking and other consumer-oriented technologies. Our business policies and internal security controls may not keep pace with these changes as new threats emerge.

Security of our products, services, devices, and customers' data

The security of our products and services is important in our customers' decisions to purchase or use our products or services. Security threats are a significant challenge to companies like us whose business is providing technology products and services to others. Threats to our own IT infrastructure can also affect our customers. Customers using our cloud-based services rely on the security of our infrastructure, including hardware and other elements provided by third parties, to ensure the reliability of our services and the protection of their data. Adversaries tend to focus their efforts on the most popular operating systems, programs, and services, including many of ours, and we expect that to continue. Adversaries that acquire user account information at other companies can use that information to compromise our users' accounts where accounts share the same attributes like passwords. Inadequate account security practices may also result in unauthorized access. We are also increasingly incorporating open source software into our products. There may be vulnerabilities in open source software that may make our products susceptible to cyberattacks.

To defend against security threats to our internal IT systems, our cloud-based services, and our customers' systems, we must continuously engineer more secure products and services, enhance security and reliability features, improve the deployment of software updates to address security vulnerabilities in our own products as well as those provided by others, develop mitigation technologies that help to secure customers from attacks even when software updates are not deployed, maintain the digital security infrastructure that protects the integrity of our network, products, and services, and provide customers security tools such as firewalls and anti-virus software and information about the need to deploy security measures and the impact of doing so.

The cost of these steps could reduce our operating margins. If we fail to do these things well, actual or perceived security vulnerabilities in our products and services, data corruption issues, or reduced performance could harm our reputation and lead customers to reduce or delay future purchases of products or subscriptions to services, or to use competing products or services. Customers may also spend more on protecting their existing computer systems from attack, which could delay adoption of additional products or services. Customers may fail to update their systems, continue to run software or operating systems we no longer support, or may fail timely to install or enable security patches. Any of these actions by customers could adversely affect our reputation and revenue. Actual or perceived vulnerabilities may lead to claims against us. Our license agreements typically contain provisions that eliminate or limit our exposure to liability, but there is no assurance these provisions will withstand legal challenges. At times, to achieve commercial objectives, we may enter into agreements with larger liability exposure to customers.

As illustrated by the recent Spectre and Meltdown threats, our products operate in conjunction with and are dependent on products and components across a broad ecosystem. If there is a security vulnerability in one of these components, and if there is a security exploit targeting it, we could face increased costs, liability claims, reduced revenue, or harm to our reputation or competitive position.

Disclosure and misuse of personal data could result in liability and harm our reputation. As we continue to grow the number and scale of our cloud-based offerings, we store and process increasingly large amounts of personally identifiable information of our customers and users. The continued occurrence of high-profile data breaches provides evidence of an external environment increasingly hostile to information security. Despite our efforts to improve the security controls across our business groups and geographies, it is possible our security controls over personal data, our training of employees and vendors on data security, and other practices we follow may not prevent the improper disclosure of customer or user data we or our vendors store and manage. In addition, third parties who have limited access to our customer or user data may use this data in unauthorized ways. Improper disclosure or misuse could harm our reputation, lead to legal exposure to customers or users, or subject us to liability under laws that protect personal data, resulting in increased costs or loss of revenue. Our software products and services also enable our customers and users to store and process personal data on-premises or, increasingly, in a cloud-based environment we host. Government authorities can sometimes require us to produce customer or user data in response to valid legal orders. In the U.S. and elsewhere, we advocate for transparency concerning these requests and appropriate limitations on government authority to compel disclosure. Despite our efforts to protect customer and user data, perceptions that the collection, use, and retention of personal information is not satisfactorily protected could inhibit sales of our products or services, and could limit adoption of our cloud-based solutions by consumers, businesses, and government entities. Additional security measures we may take to address customer or user concerns, or constraints on our flexibility to determine where and how to operate datacenters in response to customer or user expectations or governmental rules or actions, may cause higher operating expenses or hinder growth of our products and services.

We may not be able to protect information in our products and services from use by others. LinkedIn and other Microsoft products and services contain valuable information and content protected by contractual restrictions or technical measures. In certain cases, we have made commitments to our members and users to limit access to or use of this information. Changes in the law or interpretations of the law may weaken our ability to prevent third parties from scraping or gathering information or content through use of bots or other measures and using it for their own benefit, thus diminishing the value of our products and services.

Abuse of our advertising or social platforms may harm our reputation or user engagement. For LinkedIn, Bing Ads, and other products and services that provide content or host ads that come from or can be influenced by third parties, our reputation or user engagement may be negatively affected by activity that is hostile or inappropriate to other people, by users impersonating other people or organizations, by use of our products or services to disseminate information that may be viewed as misleading or intended to manipulate the opinions of our users, or by the use of our products or services that violates our terms of service or otherwise for objectionable or illegal ends. Preventing these actions may require us to make substantial investments in people and technology and these investments may not be successful, adversely affecting our business and financial results.

We may have excessive outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure. Our increasing user traffic, growth in services, and the complexity of our products and services demand more computing power. We spend substantial amounts to build, purchase, or lease datacenters and equipment and to upgrade our technology and network infrastructure to handle more traffic on our websites and in our datacenters. These demands continue to increase as we introduce new products and services and support the growth of existing services such as Bing, Exchange Online, Azure, Microsoft account services, Office 365, OneDrive, SharePoint Online, Skype, Xbox Live, Outlook.com, and Windows Stores. We are rapidly growing our business of providing a platform and back-end hosting for services provided by third parties to their end users. Maintaining, securing, and expanding this infrastructure is expensive and complex. It requires that we maintain an Internet connectivity infrastructure that is robust and reliable within competitive and regulatory constraints that continue to evolve. Inefficiencies or operational failures, including temporary or permanent loss of customer data or insufficient Internet connectivity, could diminish the quality of our products, services, and user experience resulting in contractual liability, claims by customers and other third parties, regulatory actions, damage to our reputation, and loss of current and potential users, subscribers, and advertisers, each of which may harm our operating results and financial condition.

Government litigation and regulatory activity relating to competition rules may limit how we design and market our products. As a leading global software and device maker, government agencies closely scrutinize us under U.S. and foreign competition laws. An increasing number of governments are actively enforcing competition laws and regulations and this includes increased scrutiny in potentially large markets such as the European Union ("EU"), the U.S., and China. Some jurisdictions also allow competitors or consumers to assert claims of anti-competitive conduct. U.S. federal and state antitrust authorities have previously brought enforcement actions and continue to scrutinize our business.

The European Commission ("the Commission") closely scrutinizes the design of high-volume Microsoft products and the terms on which we make certain technologies used in these products, such as file formats, programming interfaces, and protocols, available to other companies. Flagship product releases such as Windows 10 can receive significant scrutiny under competition laws. For example, in 2004, the Commission ordered us to create new versions of our Windows operating system that do not include certain multimedia technologies and to provide our competitors with specifications for how to implement certain proprietary Windows communications protocols in their own products. In 2009, the Commission accepted a set of commitments we offered to address the Commission's concerns relating to competition in web browsing software, including an undertaking to address Commission concerns relating to interoperability. The web browsing commitments expired in 2014. The remaining obligations may limit our ability to innovate in Windows or other products in the future, diminish the developer appeal of the Windows platform, and increase our product development costs. The availability of licenses related to protocols and file formats may enable competitors to develop software products that better mimic the functionality of our products, which could hamper sales of our products.

Our portfolio of first-party devices continues to grow; at the same time our OEM partners offer a large variety of devices on our platforms. As a result, increasingly we both cooperate and compete with our OEM partners, creating a risk that we fail to do so in compliance with competition rules. Regulatory scrutiny in this area may increase. Certain foreign governments, particularly in China and other countries in Asia, have advanced arguments under their competition laws that exert downward pressure on royalties for our intellectual property.

Government regulatory actions and court decisions such as these may result in fines, or hinder our ability to provide the benefits of our software to consumers and businesses, reducing the attractiveness of our products and the revenue that come from them. New competition law actions could be initiated, potentially using previous actions as precedent. The outcome of such actions, or steps taken to avoid them, could adversely affect us in a variety of ways, including:

- We may have to choose between withdrawing products from certain geographies to avoid fines or designing and developing alternative versions of those products to comply with government rulings, which may entail a delay in a product release and removing functionality that customers want or on which developers rely.
- We may be required to make available licenses to our proprietary technologies on terms that do not reflect their fair market value or do not protect our associated intellectual property.
- We are subject to a variety of ongoing commitments because of court or administrative orders, consent decrees, or other voluntary actions we have taken. If we fail to comply with these commitments, we may incur litigation costs and be subject to substantial fines or other remedial actions.
- Our ability to realize anticipated Windows 10 post-sale monetization opportunities may be limited.

Our global operations subject us to potential liability under anti-corruption, trade protection, and other laws and regulations. The Foreign Corrupt Practices Act and other anti-corruption laws and regulations ("Anti-Corruption Laws") prohibit corrupt payments by our employees, vendors, or agents. From time to time, we receive inquiries from authorities in the U.S. and elsewhere and reports from employees and others about our business activities outside the U.S. and our compliance with Anti-Corruption Laws. Specifically, we have been cooperating with authorities in the U.S. in connection with reports concerning our compliance with the Foreign Corrupt Practices Act in various countries. Most countries in which we operate also have competition laws that prohibit competitors from colluding or otherwise attempting to reduce competition between themselves. While we devote substantial resources to our global compliance programs and have implemented policies, training, and internal controls designed to reduce the risk of corrupt payments and collusive activity, our employees, vendors, or agents may violate our policies. Our failure to comply with Anti-Corruption Laws or competition laws could result in significant fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation. Operations outside the U.S. may be affected by changes in trade protection laws, policies, and measures, sanctions, and other regulatory requirements affecting trade and investment. We may be subject to legal liability and reputational damage if we sell goods or services in violation of U.S. trade sanctions on countries such as Iran, North Korea, Cuba, Sudan, and Syria.

Other regulatory areas that may apply to our products and online services offerings include user privacy, telecommunications, data storage and protection, and online content. For example, regulators may take the position that our offerings such as Skype are covered by existing laws regulating telecommunications services and new laws may define more of our services as regulated telecommunications services. Data protection authorities may assert that our collection, use, and management of customer data is inconsistent with their laws and regulations. Legislative or regulatory action relating cybersecurity requirements may increase the costs to develop, implement, or secure our products and services. Legislative or regulatory action could also emerge in the area of AI, increasing costs or restricting opportunity. Applying these laws and regulations to our business is often unclear, subject to change over time, and sometimes may conflict from jurisdiction to jurisdiction. Additionally, these laws and governments' approach to their enforcement, and our products and services, are continuing to evolve. Compliance with these types of regulation may involve significant costs or require changes in products or business practices that result in reduced revenue. Noncompliance could result in the imposition of penalties or orders we stop the alleged noncompliant activity.

We strive to empower all people and organizations to achieve more, and accessibility of our products is an important aspect of this goal. There is increasing pressure from advocacy groups, regulators, competitors, and customers to make technology more accessible. If our products do not meet customer expectations or emerging global accessibility requirements, we could lose sales opportunities or face regulatory actions

Laws and regulations relating to the handling of personal data may impede the adoption of our services or result in increased costs, legal claims, fines against us, or reputational damage. The growth of our Internet- and cloud-based services internationally relies increasingly on the movement of data across national boundaries. Legal requirements relating to the collection, storage, handling, and transfer of personal data continue to evolve. For example, the EU and the U.S. formally entered into a new framework in July 2016 that provides a mechanism for companies to transfer data from EU member states to the U.S. This framework, called the Privacy Shield, is intended to address shortcomings identified by the European Court of Justice in a predecessor mechanism. The Privacy Shield and other mechanisms are currently subject to challenges in European courts, which may lead to uncertainty about the legal basis for data transfers across the Atlantic. The Privacy Shield and other potential rules on the flow of data across borders could increase the cost and complexity of delivering our products and services in some markets. In May 2018, a new EU law governing data practices and privacy, the General Data Protection Regulation ("GDPR"), became effective. The law, which applies to all of our activities conducted from an establishment in the EU or related to products and services offered in the EU, imposes a range of new compliance obligations regarding the handling of personal data. Engineering efforts to build new capabilities to facilitate compliance with the law have entailed substantial expense and the diversion of engineering resources from other projects and may continue to do so. We might experience reduced demand for our offerings if we are unable to engineer products that meet our legal duties or help our customers meet their obligations under the GDPR or other data regulations, or if the changes we implement to comply with the GDPR make our offerings less attractive. The GDPR imposes significant new obligations and compliance with these obligations depends in part on how particular regulators apply and interpret them. If we fail to comply with the GDPR, or if regulators assert we have failed to comply with the GDPR, it may lead to regulatory enforcement actions, which can result in monetary penalties of up to 4% of worldwide revenue, private lawsuits, or reputational damage.

The Company's investment in gaining insights from data is becoming central to the value of the services we deliver to customers, to our operational efficiency and key opportunities in monetization, customer perceptions of quality, and operational efficiency. Our ability to use data in this way may be constrained by regulatory developments that impede realizing the expected return from this investment. Ongoing legal reviews by regulators may result in burdensome or inconsistent requirements, including data sovereignty and localization requirements, affecting the location and movement of our customer and internal employee data as well as the management of that data. Compliance with applicable laws and regulations regarding personal data may require changes in services, business practices, or internal systems that result in increased costs, lower revenue, reduced efficiency, or greater difficulty in competing with foreign-based firms. Compliance with data regulations might limit our ability to innovate or offer certain features and functionality in some jurisdictions where we operate. Failure to comply with existing or new rules may result in significant penalties or orders to stop the alleged noncompliant activity, as well as negative publicity and diversion of management time and effort.

Our business depends on our ability to attract and retain talented employees. Our business is based on successfully attracting and retaining talented employees. The market for highly skilled workers and leaders in our industry is extremely competitive. Maintaining our brand and reputation are important to our ability to recruit and retain employees. We are also limited in our ability to recruit internationally by restrictive domestic immigration laws. Changes to U.S. immigration policies that restrain the flow of technical and professional talent may inhibit our ability to adequately staff our research and development efforts. If we are less successful in our recruiting efforts, or if we cannot retain highly skilled workers and key leaders, our ability to develop and deliver successful products and services may be adversely affected. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees could hinder our strategic planning and execution. How employment-related laws are interpreted and applied to our workforce practices may result in increased operating costs and less flexibility in how we meet our workforce needs.

We have claims and lawsuits against us that may result in adverse outcomes. We are subject to a variety of claims and lawsuits. These claims may arise from a wide variety of business practices and initiatives, including major new product releases such as Windows 10, significant business transactions, warranty or product claims, and employment practices. Adverse outcomes in some or all of these claims may result in significant monetary damages or injunctive relief that could adversely affect our ability to conduct our business. The litigation and other claims are subject to inherent uncertainties and management's view of these matters may change in the future. A material adverse impact in our consolidated financial statements could occur for the period in which the effect of an unfavorable outcome becomes probable and reasonably estimable.

We may have additional tax liabilities. We are subject to income taxes in the U.S. and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. For example, compliance with the 2017 United States Tax Cut and Jobs Act ("TCJA") may require the collection of information not regularly produced within the Company, the use of estimates in our financial statements, and the exercise of significant judgment in accounting for its provisions. As regulations and guidance evolve with respect to TCJA, and as we gather more information and perform more analysis, our results may differ from previous estimates and may materially affect our financial position.

We regularly are under audit by tax authorities in different jurisdictions. Economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes favorably more difficult. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation in the jurisdictions where we are subject to taxation could be materially different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material effect in our consolidated financial statements in the period or periods in which that determination is made.

We earn a significant amount of our operating income outside the U.S. A change in the mix of earnings and losses in countries with differing statutory tax rates, changes in our business or structure, or the expiration of or disputes about certain tax agreements in a particular country may result in higher effective tax rates for the Company. In addition, changes in U.S. federal and state or international tax laws applicable to corporate multinationals, other fundamental law changes currently being considered by many countries, including in the U.S., and changes in taxing jurisdictions' administrative interpretations, decisions, policies, and positions may materially adversely impact our tax expense and cash flows.

We may experience quality or supply problems. Our hardware products such as Xbox consoles, Surface devices, and other devices we design, manufacture, and market are highly complex and can have defects in design, manufacture, or associated software. We could incur significant expenses, lost revenue, and reputational harm as a result of recalls, safety alerts, or product liability claims if we fail to prevent, detect, or address such issues through design, testing, or warranty repairs.

Our software products also may experience quality or reliability problems. The highly-sophisticated software products we develop may contain bugs and other defects that interfere with their intended operation. Any defects we do not detect and fix in pre-release testing could cause reduced sales and revenue, damage to our reputation, repair or remediation costs, delays in the release of new products or versions, or legal liability. Although our license agreements typically contain provisions that eliminate or limit our exposure to liability, there is no assurance these provisions will withstand legal challenge.

We acquire some device and datacenter components from sole suppliers. Our competitors use some of the same suppliers and their demand for hardware components can affect the capacity available to us. If a component from a sole-source supplier is delayed or becomes unavailable, whether because of supplier capacity constraint, industry shortages, legal or regulatory changes, or other reasons, we may not obtain timely replacement supplies, resulting in reduced sales or inadequate datacenter capacity. Component shortages, excess or obsolete inventory, or price reductions resulting in inventory adjustments may increase our cost of revenue. Xbox consoles, Surface devices, datacenter servers, and other hardware are assembled in Asia and other geographies that may be subject to disruptions in the supply chain, resulting in shortages that would affect our revenue and operating margins. These same risks would apply to any other hardware and software products we may offer.

Our global business exposes us to operational and economic risks. Our customers are located in over 200 countries and a significant part of our revenue comes from international sales. The global nature of our business creates operational and economic risks. Our results of operations may be affected by global, regional, and local economic developments, monetary policy, inflation, and recession, as well as political and military disputes. In addition, our international growth strategy includes certain markets, the developing nature of which presents several risks, including deterioration of social, political, labor, or economic conditions in a country or region, and difficulties in staffing and managing foreign operations. Emerging nationalist trends in specific countries may significantly alter the trade environment. Changes to trade policy or agreements as a result of populism, protectionism, or economic nationalism may result in higher tariffs, local sourcing initiatives, or other developments that make it more difficult to sell our products in foreign countries. Disruptions of these kinds in developed or emerging markets could negatively impact demand for our products and services or increase operating costs. Although we hedge a portion of our international currency exposure, significant fluctuations in foreign exchange rates between the U.S. dollar and foreign currencies may adversely affect our revenue.

Catastrophic events or geopolitical conditions may disrupt our business. A disruption or failure of our systems or operations because of a major earthquake, weather event, cyberattack, terrorist attack, or other catastrophic event could cause delays in completing sales, providing services, or performing other critical functions. Our corporate headquarters, a significant portion of our research and development activities, and certain other essential business operations are in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are seismically active regions. A catastrophic event that results in the destruction or disruption of any of our critical business or IT systems could harm our ability to conduct normal business operations. Providing our customers with more services and solutions in the cloud puts a premium on the resilience of our systems and strength of our business continuity management plans, and magnifies the potential impact of prolonged service outages on our operating results.

Abrupt political change, terrorist activity, and armed conflict pose a risk of general economic disruption in affected countries, which may increase our operating costs. These conditions also may add uncertainty to the timing and budget for technology investment decisions by our customers, and may cause supply chain disruptions for hardware manufacturers. Geopolitical change may result in changing regulatory requirements that could impact our operating strategies, access to global markets, hiring, and profitability. Geopolitical instability may lead to sanctions and impact our ability to do business in some markets or with some public-sector customers. Any of these changes may negatively impact our revenues.

The long-term effects of climate change on the global economy or the IT industry in particular are unclear. Environmental regulations or changes in the supply, demand or available sources of energy or other natural resources may affect the availability or cost of goods and services, including natural resources, necessary to run our business. Changes in weather where we operate may increase the costs of powering and cooling computer hardware we use to develop software and provide cloud-based services.

Adverse economic or market conditions may harm our business. Worsening economic conditions, including inflation, recession, or other changes in economic conditions, may cause lower IT spending and adversely affect our revenue. If demand for PCs, servers, and other computing devices declines, or consumer or business spending for those products declines, our revenue will be adversely affected. Substantial revenue comes from our U.S. government contracts. An extended federal government shutdown resulting from failing to pass budget appropriations, adopt continuing funding resolutions or raise the debt ceiling, and other budgetary decisions limiting or delaying federal government spending, could reduce government IT spending on our products and services and adversely affect our revenue.

Our product distribution system relies on an extensive partner and retail network. OEMs building devices that run our software have also been a significant means of distribution. The impact of economic conditions on our partners, such as the bankruptcy of a major distributor, OEM, or retailer, could cause sales channel disruption.

Challenging economic conditions also may impair the ability of our customers to pay for products and services they have purchased. As a result, allowances for doubtful accounts and write-offs of accounts receivable may increase.

We maintain an investment portfolio of various holdings, types, and maturities. These investments are subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by market downturns or events that affect global financial markets. A significant part of our investment portfolio comprises U.S. government securities. If global financial markets decline for long periods, or if there is a downgrade of the U.S. government credit rating due to an actual or threatened default on government debt, our investment portfolio may be adversely affected and we could determine that more of our investments have experienced an other-than-temporary decline in fair value, requiring impairment charges that could adversely affect our financial results.

Changes in our sales organization may impact revenues. In July 2017, we announced plans to reorganize our global sales organization to help enable customers' digital transformation, add greater technical ability to our sales force, and create pooled resources that can be used across countries and industries. The reorganization is the most significant change in our global sales organization in our history, involving employees changing roles, adding additional talent, realigning teams, and onboarding new partners. Successfully executing these changes will be a significant factor in enabling future revenue growth. As we continue to navigate through this transition, sales, profitability, and cash flow could be adversely impacted.

The development of the internet of things presents security, privacy, and execution risks. To support the growth of the intelligent cloud and the intelligent edge, we are developing products, services, and technologies to power the IoT, a network of distributed and interconnected devices employing sensors, data, and computing capabilities including AI. The IoT's great potential also carries substantial risks. IoT products and services may contain defects in design, manufacture, or operation, that make them insecure or ineffective for their intended purposes. An IoT solution has multiple layers of hardware, sensors, processors, software, and firmware, several of which we may not develop or control. Each layer, including the weakest layer, can impact the security of the whole system. Many IoT devices have limited interfaces and ability to be updated or patched. IoT solutions may collect large amounts of data, and our handling of IoT data may not satisfy customers or regulatory requirements. IoT scenarios may increasingly affect personal health and safety. If IoT solutions that include our technologies do not work as intended, violate the law, or harm individuals or businesses, we may be subject to legal claims or enforcement actions. These risks, if realized, may increase our costs, damage our reputation or brands, or negatively impact our revenues or margins.

Issues in the use of artificial intelligence in our offerings may result in reputational harm or liability. We are building AI into many of our offerings and we expect this element of our business to grow. We envision a future in which AI operating in our devices, applications, and the cloud helps our customers be more productive in their work and personal lives. As with many disruptive innovations, AI presents risks and challenges that could affect its adoption, and therefore our business. AI algorithms may be flawed. Datasets may be insufficient or contain biased information. Inappropriate or controversial data practices by Microsoft or others could impair the acceptance of AI solutions. These deficiencies could undermine the decisions, predictions, or analysis AI applications produce, subjecting us to competitive harm, legal liability, and brand or reputational harm. Some AI scenarios present ethical issues. If we enable or offer AI solutions that are controversial because of their impact on human rights, privacy, employment, or other social issues, we may experience brand or reputational harm.

If our reputation or our brands are damaged, our business and operating results may be harmed. Our reputation and brands are globally recognized and are important to our business. Our reputation and brands affect our ability to attract and retain consumer, business, and public-sector customers. There are numerous ways our reputation or brands could be damaged. These include product safety or quality issues, or our environmental impact, supply chain practices, or human rights record. We may experience backlash from customers, government entities, advocacy groups, employees, and other stakeholders that disagree with our product offering decisions or public policy positions. Damage to our reputation or our brands may occur from, among other things:

- The introduction of new features, products, services, or terms of service that customers, users, or partners do not like.
- Public scrutiny of our decisions regarding user privacy, data practices, or content.
- Data security breaches, compliance failures, or actions of partners or individual employees.

The proliferation of social media may increase the likelihood, speed, and magnitude of negative brand events. If our brands or reputation are damaged, it could negatively impact our revenues or margins, or ability to attract the most highly qualified employees.

ITEM 1B. UNRESOLVED STAFF COMMENTS

We have received no written comments regarding our periodic or current reports from the staff of the Securities and Exchange Commission that were issued 180 days or more preceding the end of our fiscal year 2018 that remain unresolved.

ITEM 2. PROPERTIES

Our corporate headquarters are located in Redmond, Washington. We have approximately 15 million square feet of space located in King County, Washington that is used for engineering, sales, marketing, and operations, among other general and administrative purposes. These facilities include approximately 10 million square feet of owned space situated on approximately 540 acres of land we own at our corporate headquarters, and approximately five million square feet of space we lease. In addition, we own and lease space domestically that includes office, datacenter, and retail space.

We also own and lease facilities internationally. The largest owned properties include: our research and development centers in China and India; our datacenters in Ireland, Singapore, and the Netherlands; and our operations and facilities in Ireland and the United Kingdom. The largest leased properties include space in the following locations: India, China, France, the United Kingdom, Canada, Australia, Germany, and Japan.

In addition to the above locations, we have various product development facilities, both domestically and internationally, as described under Research and Development (Part I, Item 1 of this Form 10-K).

The table below shows a summary of the square footage of our office, datacenter, retail, and other facilities owned and leased domestically and internationally as of June 30, 2018:

(Square feet in millions)

Location	Owned	Leased	Total
U.S.	18	13	31
International	6	13	19
Total	24	26	50

ITEM 3. LEGAL PROCEEDINGS

While not material to the Company, the Company makes the following annual report of the general activities of the Company's Antitrust Compliance Office as required by the Final Order and Judgment in *Barovic v. Ballmer et al,* United States District Court for the Western District of Washington ("Final Order"). For more information see http://aka.ms/MSLegalNotice2015. These annual reports will continue through 2020. During fiscal year 2018, the Antitrust Compliance Office (a) monitored the Company's compliance with the European Commission Decision of March 24, 2004, ("2004 Decision") and with the Company's Public Undertaking to the European Commission dated December 16, 2009 ("2009 Undertaking"); (b) monitored, in the manner required by the Final Order, employee, customer, competitor, regulator, or other third-party complaints regarding compliance with the 2004 Decision, the 2009 Undertaking, or other EU or U.S. laws or regulations governing tying, bundling, and exclusive dealing contracts; and, (c) monitored, in the manner required by the Final Order, the training of the Company's employees regarding the Company's antitrust compliance polices. In addition, the Antitrust Compliance Officer reports to the Regulatory and Public Policy Committee of the Board at each of its regularly scheduled meetings and to the full Board annually.

Refer to Note 17 – Contingencies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for information regarding legal proceedings in which we are involved.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

MARKET AND STOCKHOLDERS

Our common stock is traded on the NASDAQ Stock Market under the symbol MSFT. On July 31, 2018, there were 97,535 registered holders of record of our common stock. The high and low common stock sales prices per share were as follows:

Quarter Ended	September 30	December 31	March 31	June 30	Fiscal Year
Fiscal Year 2018					
High	**$ 75.97**	**$ 87.50**	**$ 97.24**	**$ 102.69**	**$ 102.69**
Low	**68.02**	**73.71**	**83.83**	**87.51**	**68.02**
Fiscal Year 2017					
High	$ 58.70	$ 64.10	$ 66.19	$ 72.89	$ 72.89
Low	50.39	56.32	61.95	64.85	50.39

DIVIDENDS AND SHARE REPURCHASES

Refer to Note 18 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion regarding dividends and share repurchases. Following are our monthly stock repurchases for the fourth quarter of fiscal year 2018:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet be Purchased under the Plans or Programs
				(in millions)
April 1, 2018 – April 30, 2018	10,320,190	$ 93.11	10,320,190	$ 29,339
May 1, 2018 – May 31, 2018	0	0	0	29,339
June 1, 2018 – June 30, 2018	11,335,224	100.49	11,335,224	28,200
	21,655,414		21,655,414	

All repurchases were made using cash resources. Our stock repurchases may occur through open market purchases or pursuant to a Rule 10b5-1 trading plan. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards.

ITEM 6. SELECTED FINANCIAL DATA

FINANCIAL HIGHLIGHTS

(In millions, except per share data)

Year Ended June 30,	**2018**	**2017[b][c]**	**2016[b]**	**2015**	**2014[h]**
Revenue	**$ 110,360**	$ 96,571	$ 91,154	$ 93,580	$ 86,833
Gross margin	**72,007**	62,310	58,374	60,542	59,755
Operating income	**35,058**	29,025[d]	26,078[e]	18,161[g]	27,759
Net income	**16,571[a]**	25,489[d]	20,539[e]	12,193[g]	22,074
Diluted earnings per share	**2.13[a]**	3.25[d]	2.56[e]	1.48[g]	2.63
Cash dividends declared per share	**1.68**	1.56	1.44	1.24	1.12
Cash, cash equivalents, and short-term investments	**133,768**	132,981	113,240	96,526	85,709
Total assets	**258,848**	250,312	202,897[f]	174,303[f]	170,569[f]
Long-term obligations	**117,642**	106,856	66,705[f]	44,574[f]	35,285[f]
Stockholders' equity	**82,718**	87,711	83,090	80,083	89,784

(a) *Includes a $13.7 billion net charge related to the Tax Cuts and Jobs Act, which decreased net income and diluted earnings per share ("EPS") by $13.7 billion and $1.75, respectively. Refer to Note 13 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.*

(b) *Reflects the impact of the adoption of new accounting standards in fiscal year 2018 related to revenue recognition and leases. Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.*

(c) *On December 8, 2016, we acquired LinkedIn Corporation. LinkedIn has been included in our consolidated results of operations starting on the acquisition date.*

(d) *Includes $306 million of employee severance expenses primarily related to our sales and marketing restructuring plan, which decreased operating income, net income, and diluted EPS by $306 million, $243 million, and $0.04, respectively.*

(e) *Includes $630 million of asset impairment charges related to our Phone business, and $480 million of restructuring charges associated with our Phone business restructuring plans, which together decreased operating income, net income, and diluted EPS by $1.1 billion, $895 million, and $0.11, respectively.*

(f) *Reflects the impact of the adoption of the new accounting standard in fiscal year 2017 related to balance sheet classification of debt issuance costs.*

(g) *Includes $7.5 billion of goodwill and asset impairment charges related to our Phone business, and $2.5 billion of integration and restructuring expenses, primarily associated with our Phone business restructuring plans, which together decreased operating income, net income, and diluted EPS by $10.0 billion, $9.5 billion, and $1.15, respectively.*

(h) *On April 25, 2014, we acquired substantially all of Nokia Corporation's Devices and Services business ("NDS"). NDS has been included in our consolidated results of operations starting on the acquisition date.*

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the results of operations and financial condition of Microsoft Corporation. MD&A is provided as a supplement to, and should be read in conjunction with, our financial statements and the accompanying Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity.

We generate revenue by licensing and supporting an array of software products; offering a wide range of cloud-based and other services to people and businesses; designing, manufacturing, and selling devices; and delivering relevant online advertising to a global audience. Our most significant expenses are related to compensating employees; designing, manufacturing, marketing, and selling our products and services; datacenter costs in support of our cloud-based services; and income taxes.

Highlights from fiscal year 2018 compared with fiscal year 2017 included:

- Commercial cloud revenue, which primarily comprises Microsoft Office 365 commercial, Microsoft Azure, Microsoft Dynamics 365, and other cloud properties, increased 56% to $23.2 billion.
- Office Commercial revenue increased 11%, driven by Office 365 commercial revenue growth of 41%.
- Office Consumer revenue increased 11% and Office 365 consumer subscribers increased to 31.4 million.
- LinkedIn contributed revenue of $5.3 billion, driven by strong momentum across all business lines.
- Dynamics revenue increased 13%, driven by Dynamics 365 revenue growth of 65%.
- Server products and cloud services revenue increased 21%, driven by Azure revenue growth of 91%.
- Enterprise Services revenue increased 5%.
- Windows original equipment manufacturer licensing ("Windows OEM") revenue increased 5%, driven by OEM Pro revenue growth of 11%.
- Windows Commercial revenue increased 12%, driven by an increased volume of multi-year agreements.
- Gaming revenue increased 14%, driven by Xbox software and services revenue growth of 20%, mainly from third-party title strength.
- Microsoft Surface revenue increased 16%, driven by a higher mix of premium devices and an increase in volumes sold, due to the latest editions of Surface.
- Search advertising revenue, excluding traffic acquisition costs, increased 16%, driven by higher revenue per search and search volume.

On June 4, 2018, we entered into a definitive agreement to acquire GitHub, Inc. for $7.5 billion in an all-stock transaction, which is expected to close by the end of the calendar year. On December 8, 2016, we completed our acquisition of LinkedIn Corporation for a total purchase price of $27.0 billion. LinkedIn has been included in our consolidated results of operations since the date of acquisition. Refer to Note 9 – Business Combinations of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted into law, which significantly changes existing U.S. tax law and includes numerous provisions that affect our business. During fiscal year 2018, we recorded a net charge of $13.7 billion related to the TCJA. Refer to Note 13 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

We adopted the new accounting standards for revenue recognition and leases effective July 1, 2017. These new standards had a material impact in our consolidated financial statements. Beginning in fiscal year 2018, our financial results reflect adoption of the standards with prior periods restated accordingly. Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Industry Trends

Our industry is dynamic and highly competitive, with frequent changes in both technologies and business models. Each industry shift is an opportunity to conceive new products, new technologies, or new ideas that can further transform the industry and our business. At Microsoft, we push the boundaries of what is possible through a broad range of research and development activities that seek to identify and address the changing demands of customers and users, industry trends, and competitive forces.

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, and influence how users access services in the cloud, and in some cases, the user's choice of which suite of cloud-based services to use. We must continue to evolve and adapt over an extended time in pace with this changing environment. The investments we are making in infrastructure and devices will continue to increase our operating costs and may decrease our operating margins.

Our success is highly dependent on our ability to attract and retain qualified employees. We hire a mix of university and industry talent worldwide. We compete for talented individuals globally by offering an exceptional working environment, broad customer reach, scale in resources, the ability to grow one's career across many different products and businesses, and competitive compensation and benefits. Aggregate demand for our software, services, and devices is correlated to global macroeconomic and geopolitical factors, which remain dynamic.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. Strengthening of the U.S. dollar relative to certain foreign currencies throughout fiscal year 2017 negatively impacted reported revenue and reduced reported expenses from our international operations. This trend reversed in fiscal year 2018. Strengthening of foreign currencies relative to the U.S. dollar positively impacted reported revenue and increased reported expenses from our international operations.

Refer to Risk Factors (Part I, Item 1A of this Form 10-K) for a discussion of these factors and other risks.

Seasonality

We expect our revenue to fluctuate quarterly and to be higher in the second and fourth quarters of our fiscal year. Second quarter revenue is driven by corporate year-end spending trends in our major markets and holiday season spending by consumers, and fourth quarter revenue is driven by the volume of multi-year on-premises contracts executed during the period.

Reportable Segments

We report our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. The segment amounts included in MD&A are presented on a basis consistent with our internal management reporting. All differences between our internal management reporting basis and accounting principles generally accepted in the United States of America ("GAAP"), along with certain corporate-level and other activity, are included in Corporate and Other.

Additional information on our reportable segments is contained in Note 21 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

SUMMARY RESULTS OF OPERATIONS

(In millions, except percentages and per share amounts)	2018	2017	2016	Percentage Change 2018 Versus 2017	Percentage Change 2017 Versus 2016
Revenue	**$ 110,360**	$ 96,571	$ 91,154	14%	6%
Gross margin	**72,007**	62,310	58,374	16%	7%
Operating income	**35,058**	29,025	26,078	21%	11%
Net Income	**16,571**	25,489	20,539	(35)%	24%
Diluted earnings per share	**2.13**	3.25	2.56	(34)%	27%
Adjusted operating income	**35,058**	29,331	27,188	20%	8%
Adjusted net income	**30,267**	25,732	21,434	18%	20%
Adjusted diluted earnings per share	**3.88**	3.29	2.67	18%	23%

Consolidated results of operations include LinkedIn results since the date of acquisition on December 8, 2016. Fiscal year 2018 includes a full period of LinkedIn results, whereas fiscal year 2017 only includes results from the date of acquisition.

Adjusted operating income, net income, and adjusted diluted earnings per share (“EPS”) exclude the net charge related to the TCJA, and impairment and restructuring expenses. Refer to the Non-GAAP Financial Measures section below for a reconciliation of our financial results reported in accordance with GAAP to non-GAAP financial results.

Fiscal Year 2018 Compared with Fiscal Year 2017

Revenue increased $13.8 billion or 14%, driven by growth across each of our segments. Productivity and Business Processes revenue increased, driven by LinkedIn and higher revenue from Office. Intelligent Cloud revenue increased, primarily due to higher revenue from server products and cloud services. More Personal Computing revenue increased, driven by higher revenue from Gaming, Windows, Search advertising, and Surface, offset in part by lower revenue from Phone.

Gross margin increased $9.7 billion or 16%, due to growth across each of our segments. Gross margin percentage increased slightly, driven by favorable segment sales mix and gross margin percentage improvement in More Personal Computing. Gross margin included a 7 percentage point improvement in commercial cloud, primarily from Azure.

Operating income increased $6.0 billion or 21%, driven by growth across each of our segments. LinkedIn operating loss increased $63 million to $987 million, including $1.5 billion of amortization of intangible assets. Operating income included a favorable foreign currency impact of 2%.

Key changes in expenses were:

- Cost of revenue increased $4.1 billion or 12%, mainly due to growth in our commercial cloud, Gaming, LinkedIn, and Search advertising, offset in part by a reduction in Phone cost of revenue.
- Sales and marketing expenses increased $2.0 billion or 13%, primarily due to LinkedIn expenses and investments in commercial sales capacity, offset in part by a decrease in Windows marketing expenses.
- Research and development expenses increased $1.7 billion or 13%, primarily due to investments in cloud engineering and LinkedIn expenses.
- General and administrative expenses increased $273 million or 6%, primarily due to LinkedIn expenses.

Current year net income and diluted EPS were negatively impacted by the net charge related to TCJA, which resulted in a decrease to net income and diluted earnings per share of $13.7 billion and $1.75, respectively. Prior year diluted EPS was negatively impacted by restructuring expenses, which resulted in a decrease in operating income, net income, and diluted EPS of $306 million, $243 million, and $0.04, respectively.

Fiscal Year 2017 Compared with Fiscal Year 2016

Revenue increased $5.4 billion or 6%, driven by growth in Productivity and Business Processes and Intelligent Cloud, offset in part by lower revenue from More Personal Computing. Productivity and Business Processes revenue increased, driven by the acquisition of LinkedIn and higher revenue from Microsoft Office. Intelligent Cloud revenue increased, primarily due to higher revenue from server products and cloud services. More Personal Computing revenue decreased, mainly due to lower revenue from Devices, offset in part by higher revenue from Windows and Search advertising.

Gross margin increased $3.9 billion or 7%, due to growth across each of our segments, including the acquisition of LinkedIn, driven by higher revenue. Gross margin percentage increased slightly due to a margin percent increase in More Personal Computing and segment sales mix, offset in part by margin percent declines in Productivity and Business Processes and Intelligent Cloud. Gross margin percentage includes a 5 percentage point improvement in commercial cloud gross margin primarily across Azure and Office 365.

Operating income increased $2.9 billion or 11%, primarily due to higher gross margin and lower impairment and restructuring expenses, offset in part by an increase in research and development and sales and marketing expenses. Operating income included an operating loss of $924 million related to the acquisition of LinkedIn, including $866 million of amortization of intangible assets. Operating income also included an unfavorable foreign currency impact of 3%. Key changes in expenses were:

- Cost of revenue increased $1.5 billion or 5%, mainly due to growth in our commercial cloud, the acquisition of LinkedIn, and higher Search advertising traffic acquisition costs, offset in part by a reduction in Phone sales and Gaming cost of revenue.
- Research and development expenses increased $1.0 billion or 9%, primarily due to LinkedIn expenses and increased investments in cloud engineering, offset in part by a reduction in Phone expenses.
- Sales and marketing expenses increased $826 million or 6%, primarily due to LinkedIn expenses and increased investments in sales capacity for our commercial cloud, offset in part by a reduction in Phone and marketing expenses.
- Impairment and restructuring expenses decreased $804 million, driven by asset impairment charges and restructuring charges related to our Phone business in fiscal year 2016, offset in part by employee severance expenses primarily related to our sales and marketing restructuring plan in fiscal year 2017.

Diluted EPS was $3.25 for fiscal year 2017, and was negatively impacted by restructuring expenses, which resulted in a decrease of $0.04. Diluted EPS was $2.56 for fiscal year 2016, and was negatively impacted by impairment and restructuring expenses, which resulted in a decrease of $0.11.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	2018	2017	2016	Percentage Change 2018 Versus 2017	Percentage Change 2017 Versus 2016
Revenue					
Productivity and Business Processes	**$ 35,865**	$ 29,870	$ 25,792	20%	16%
Intelligent Cloud	**32,219**	27,407	24,952	18%	10%
More Personal Computing	**42,276**	39,294	40,410	8%	(3)%
Total	**$ 110,360**	$ 96,571	$ 91,154	14%	6%
Operating Income (Loss)					
Productivity and Business Processes	**$ 12,924**	$ 11,389	$ 11,756	13%	(3)%
Intelligent Cloud	**11,524**	9,127	9,249	26%	(1)%
More Personal Computing	**10,610**	8,815	6,183	20%	43%
Corporate and Other	**0**	(306)	(1,110)	*	*
Total	**$ 35,058**	$ 29,025	$ 26,078	21%	11%

*   *Not meaningful*

Reportable Segments

Fiscal Year 2018 Compared with Fiscal Year 2017

Productivity and Business Processes

Revenue increased $6.0 billion or 20%.

- LinkedIn revenue increased $3.0 billion to $5.3 billion. Fiscal year 2018 includes a full period of results, whereas fiscal year 2017 only includes results from the date of acquisition on December 8, 2016. LinkedIn revenue primarily consisted of revenue from Talent Solutions.
- Office Commercial revenue increased $2.4 billion or 11%, driven by Office 365 commercial revenue growth, mainly due to growth in subscribers and average revenue per user, offset in part by lower revenue from products licensed on-premises, reflecting a continued shift to Office 365 commercial.
- Office Consumer revenue increased $382 million or 11%, driven by Office 365 consumer revenue growth, mainly due to growth in subscribers.
- Dynamics revenue increased 13%, driven by Dynamics 365 revenue growth.

Operating income increased $1.5 billion or 13%, including a favorable foreign currency impact of 2%.

- Gross margin increased $4.4 billion or 19%, driven by LinkedIn and growth in Office commercial. Gross margin percentage decreased slightly, due to an increased mix of cloud offerings, offset in part by gross margin percentage improvement in Office 365 commercial and LinkedIn. LinkedIn cost of revenue increased $818 million to $1.7 billion, including $888 million of amortization for acquired intangible assets.
- Operating expenses increased $2.9 billion or 25%, driven by LinkedIn expenses and investments in commercial sales capacity and cloud engineering. LinkedIn operating expenses increased $2.2 billion to $4.5 billion, including $617 million of amortization of acquired intangible assets.

Intelligent Cloud

Revenue increased $4.8 billion or 18%.

- Server products and cloud services revenue increased $4.5 billion or 21%, driven by Azure and server products licensed on-premises revenue growth. Azure revenue growth of 91%, due to higher infrastructure-as-a-service and platform-as-a-service consumption-based and per user-based services. Server products licensed on-premises revenue increased 5%, mainly due to a higher mix of premium licenses for Windows Server and Microsoft SQL Server.
- Enterprise Services revenue increased $304 million or 5%, driven by higher revenue from Premier Support Services and Microsoft Consulting Services, offset in part by a decline in revenue from custom support agreements.

Operating income increased $2.4 billion or 26%.

- Gross margin increased $3.1 billion or 16%, driven by growth in server products and cloud services revenue and cloud services scale and efficiencies. Gross margin percentage decreased, due to an increased mix of cloud offerings, offset in part by gross margin percentage improvement in Azure.
- Operating expenses increased $683 million or 7%, driven by investments in commercial sales capacity and cloud engineering.

More Personal Computing

Revenue increased $3.0 billion or 8%.

- Windows revenue increased $925 million or 5%, driven by growth in Windows Commercial and Windows OEM, offset by a decline in patent licensing revenue. Windows Commercial revenue increased 12%, driven by multi-year agreement revenue growth. Windows OEM revenue increased 5%. Windows OEM Pro revenue grew 11%, ahead of a strengthening commercial PC market. Windows OEM non-Pro revenue declined 4%, below the consumer PC market, driven by continued pressure in the entry-level price category.

- Gaming revenue increased $1.3 billion or 14%, driven by Xbox software and services revenue growth of 20%, mainly from third-party title strength.
- Search advertising revenue increased $793 million or 13%. Search advertising revenue, excluding traffic acquisition costs, increased 16%, driven by growth in Bing, due to higher revenue per search and search volume.
- Surface revenue increased $625 million or 16%, driven by a higher mix of premium devices and an increase in volumes sold, due to the latest editions of Surface.
- Phone revenue decreased $525 million.

Operating income increased $1.8 billion or 20%, including a favorable foreign currency impact of 2%.

- Gross margin increased $2.2 billion or 11%, driven by growth in Windows, Surface, Search, and Gaming. Gross margin percentage increased, primarily due to gross margin percentage improvement in Surface.
- Operating expenses increased $391 million or 3%, driven by investments in Search, artificial intelligence, and Gaming engineering and commercial sales capacity, offset in part by a decrease in Windows marketing expenses.

Fiscal Year 2017 Compared with Fiscal Year 2016

Productivity and Business Processes

Revenue increased $4.1 billion or 16%.

- LinkedIn revenue was $2.3 billion, primarily comprised of revenue from Talent Solutions.
- Office Commercial revenue increased $1.4 billion or 7%, driven by higher revenue from Office 365 commercial, mainly due to growth in subscribers, offset in part by lower revenue from products licensed on-premises, reflecting a continued shift to Office 365 commercial.
- Office Consumer revenue increased $351 million or 11%, driven by higher revenue from Office 365 consumer, mainly due to growth in subscribers.
- Dynamics revenue increased 5%, primarily due to higher revenue from Dynamics 365.

Operating income decreased $367 million or 3%, including an unfavorable foreign currency impact of 2%.

- Operating expenses increased $2.3 billion or 26%, mainly due to LinkedIn and cloud engineering expenses. Operating expenses included $2.3 billion related to our acquisition of LinkedIn, including $359 million of amortization of acquired intangible assets. Sales and marketing expenses increased $1.2 billion or 24%, research and development expenses increased $955 million or 35%, and general and administrative expenses increased $212 million or 14%.
- Gross margin increased $2.0 billion or 9%, primarily due to our acquisition of LinkedIn. Gross margin percentage decreased, due to an increased mix of cloud offerings and amortization of acquired intangible assets related to LinkedIn. Cost of revenue included $918 million related to our acquisition of LinkedIn, including $507 million of amortization of acquired intangible assets.

Intelligent Cloud

Revenue increased $2.5 billion or 10%.

- Server products and cloud services revenue grew $2.6 billion or 14%, driven by Azure revenue growth of 98% and server products licensed on-premises revenue growth of 5%.
- Enterprise Services revenue decreased 2%, driven by a decline in revenue from custom support agreements, offset in part by higher revenue from Premier Support Services and Microsoft Consulting Services.

Operating income decreased $122 million or 1%, including an unfavorable foreign currency impact of 2%.

- Operating expenses increased $975 million or 11%, driven by investments in sales capacity, cloud engineering, and developer engagement. Sales and marketing expenses increased $549 million or 13%, research and development expenses increased $468 million or 14%, and general and administrative expenses decreased $42 million or 3%.
- Gross margin increased $853 million or 5%, driven by growth in server products and cloud services revenue and cloud services scale and efficiencies, offset in part by a decline in Enterprise Services gross margin. Gross margin percentage decreased, due to an increased mix of cloud offerings and lower Enterprise Services gross margin percent, offset by improvement in Azure gross margin percent.

More Personal Computing

Revenue decreased $1.1 billion or 3%.

- Windows revenue increased $1.0 billion or 6%, mainly due to higher revenue from Windows Commercial and Windows OEM. Windows Commercial revenue grew 14%, driven by multi-year agreement revenue. Windows OEM revenue increased 3%. Windows OEM Pro revenue grew 4%, outperforming the commercial PC market, primarily due to a higher mix of premium licenses sold. Windows OEM non-Pro revenue grew 3%, outperforming the consumer PC market, primarily due to a higher mix of premium devices sold.
- Search advertising revenue increased $791 million or 15%. Search advertising revenue, excluding traffic acquisition costs, increased 9%, primarily driven by growth in Bing, due to higher revenue per search and search volume.
- Gaming revenue decreased slightly, primarily due to lower Xbox hardware revenue, offset in part by higher revenue from Xbox software and services. Xbox hardware revenue decreased 21%, mainly due to lower prices of consoles sold and a decline in volume of consoles sold. Xbox software and services revenue increased 11%, driven by a higher volume of Xbox Live transactions and revenue per transaction.
- Surface revenue decreased $82 million or 2%, primarily due to a reduction in volumes sold, offset in part by a higher mix of premium devices.
- Phone revenue decreased $2.8 billion.

Operating income increased $2.6 billion or 43%, including an unfavorable foreign currency impact of 3%.

- Operating expenses decreased $1.5 billion or 12%, driven by a reduction in Phone expenses and Surface launch-related expenses in the prior year. Sales and marketing expenses decreased $893 million or 16%, research and development expenses decreased $374 million or 6%, and general and administrative expenses decreased $252 million or 16%.
- Gross margin increased $1.1 billion or 6%, driven by growth in Windows, Search advertising, and Gaming, offset in part by a decline in Phone and Surface. Gross margin percentage increased, due to favorable sales mix and gross margin percent improvements across Windows, Gaming, and Search advertising, offset by a gross margin percent decline in Devices.

Corporate and Other

Corporate and Other operating loss is comprised of corporate-level activity not specifically allocated to a segment, including impairment and restructuring expenses.

Fiscal Year 2018 Compared with Fiscal Year 2017

Corporate and Other operating loss decreased $306 million, due to a reduction in impairment and restructuring expenses, driven by employee severance expenses primarily related to our sales and marketing restructuring plan in fiscal year 2017.

Fiscal Year 2017 Compared with Fiscal Year 2016

Corporate and Other operating loss decreased $804 million, primarily due to a reduction in impairment and restructuring expenses, driven by asset impairment charges and restructuring charges related to our Phone business in fiscal year 2016, offset in part by employee severance expenses primarily related to our sales and marketing restructuring plan in fiscal year 2017.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)	2018	2017	2016	Percentage Change 2018 Versus 2017	Percentage Change 2017 Versus 2016
Research and development	**$ 14,726**	$ 13,037	$ 11,988	13%	9%
As a percent of revenue	**13%**	13%	13%	0ppt	0ppt

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content.

Fiscal Year 2018 Compared with Fiscal Year 2017

Research and development expenses increased $1.7 billion or 13%, primarily due to investments in cloud engineering and LinkedIn expenses. LinkedIn expenses increased $762 million to $1.5 billion.

Fiscal Year 2017 Compared with Fiscal Year 2016

Research and development expenses increased $1.0 billion or 9%, primarily due to LinkedIn expenses and increased investments in cloud engineering, offset in part by a reduction in Phone expenses. Expenses included $745 million related to our acquisition of LinkedIn.

Sales and Marketing

(In millions, except percentages)	2018	2017	2016	Percentage Change 2018 Versus 2017	Percentage Change 2017 Versus 2016
Sales and marketing	**$ 17,469**	$ 15,461	$ 14,635	13%	6%
As a percent of revenue	**16%**	16%	16%	0ppt	0ppt

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs.

Fiscal Year 2018 Compared with Fiscal Year 2017

Sales and marketing expenses increased $2.0 billion or 13%, primarily due to LinkedIn expenses and investments in commercial sales capacity, offset in part by a decrease in Windows marketing expenses. LinkedIn expenses increased $1.2 billion to $2.5 billion, including $617 million of amortization of acquired intangible assets.

Fiscal Year 2017 Compared with Fiscal Year 2016

Sales and marketing expenses increased $826 million or 6%, primarily due to LinkedIn expenses and increased investments in sales capacity for our commercial cloud, offset in part by a reduction in Phone expenses and prior year marketing expenses primarily related to Surface, commercial, and Windows 10. Expenses included $1.2 billion related to our acquisition of LinkedIn, including $359 million of amortization of acquired intangible assets.

General and Administrative

(In millions, except percentages)	2018	2017	2016	Percentage Change 2018 Versus 2017	Percentage Change 2017 Versus 2016
General and administrative	**$ 4,754**	$ 4,481	$ 4,563	6%	(2)%
As a percent of revenue	**4%**	5%	5%	(1)ppt	0ppt

General and administrative expenses include payroll, employee benefits, stock-based compensation expense, severance expense, and other headcount-related expenses associated with finance, legal, facilities, certain human resources and other administrative personnel, certain taxes, and legal and other administrative fees.

Fiscal Year 2018 Compared with Fiscal Year 2017

General and administrative expenses increased $273 million or 6%, primarily due to LinkedIn expenses. LinkedIn expenses increased $234 million to $528 million.

Fiscal Year 2017 Compared with Fiscal Year 2016

General and administrative expenses decreased $82 million or 2%, primarily due to prior year investments in infrastructure supporting our business transformation, a reduction in Phone expenses, and lower employee-related expenses, offset in part by LinkedIn expenses. Expenses included $294 million related to our acquisition of LinkedIn.

IMPAIRMENT AND RESTRUCTURING EXPENSES

Impairment and restructuring expenses include costs associated with the impairment of intangible assets related to our Phone business, and employee severance expenses and other costs associated with the consolidation of facilities and manufacturing operations related to restructuring activities.

Fiscal Year 2018 Compared with Fiscal Year 2017

During fiscal year 2017, we recorded $306 million of employee severance expenses primarily related to our sales and marketing restructuring plan.

Fiscal Year 2017 Compared with Fiscal Year 2016

Impairment and restructuring expenses were $306 million for fiscal year 2017, compared to $1.1 billion for fiscal year 2016.

During fiscal year 2016, we recorded $630 million of asset impairment charges related to our Phone business. We also recorded $480 million of restructuring charges, including employee severance expenses and contract termination costs, primarily related to our previously announced Phone business restructuring plans.

OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)

Year Ended June 30,	2018	2017	2016
Dividends and interest income	**$ 2,214**	$ 1,387	$ 903
Interest expense	**(2,733)**	(2,222)	(1,243)
Net recognized gains on investments	**2,399**	2,583	668
Net losses on derivatives	**(187)**	(510)	(443)
Net losses on foreign currency remeasurements	**(218)**	(111)	(129)
Other, net	**(59)**	(251)	(195)
Total	**$ 1,416**	$ 876	$ (439)

We use derivative instruments to: manage risks related to foreign currencies, equity prices, interest rates, and credit; enhance investment returns; and facilitate portfolio diversification. Gains and losses from changes in fair values of derivatives that are not designated as hedges are primarily recognized in other income (expense), net.

Fiscal Year 2018 Compared with Fiscal Year 2017

Dividends and interest income increased primarily due to higher average portfolio balances and yields on fixed-income securities. Interest expense increased primarily due to higher average outstanding long-term debt and higher finance lease expense. Net recognized gains on investments decreased primarily due to higher losses on sales of fixed-income securities, offset in part by higher gains on sales of equity securities. Net losses on derivatives decreased primarily due to lower losses on equity, foreign exchange, and commodity derivatives, offset in part by losses on interest rate derivatives in the current period as compared to gains in the prior period.

Fiscal Year 2017 Compared with Fiscal Year 2016

Dividends and interest income increased primarily due to higher portfolio balances and yields on fixed-income securities. Interest expense increased primarily due to higher outstanding long-term debt. Net recognized gains on investments increased primarily due to higher gains on sales of equity securities. Net losses on derivatives increased due to higher losses on equity derivatives, offset in part by lower losses on commodity and foreign currency derivatives. Other, net reflects recognized losses from certain joint ventures and divestitures.

INCOME TAXES

Effective Tax Rate

Fiscal Year 2018 Compared with Fiscal Year 2017

Our effective tax rate for fiscal years 2018 and 2017 was 55% and 15%, respectively. The increase in our effective tax rate for fiscal year 2018 compared to fiscal year 2017 was primarily due to the net charge related to the enactment of the TCJA in fiscal year 2018 and the realization of tax benefits attributable to previous Phone business losses in fiscal year 2017. Our effective tax rate was higher than the U.S. federal statutory rate primarily due to the net charge related to the enactment of the TCJA, offset in part by earnings taxed at lower rates in foreign jurisdictions resulting from our foreign regional operations centers in Ireland, Singapore, and Puerto Rico.

The mix of income before income taxes between the U.S. and foreign countries impacted our effective tax rate as a result of the geographic distribution of, and customer demand for, our products and services. In fiscal year 2018, our U.S. income before income taxes was $11.5 billion and our foreign income before income taxes was $24.9 billion. In fiscal year 2017, our U.S. income before income taxes was $6.8 billion and our foreign income before income taxes was $23.1 billion.

Fiscal Year 2017 Compared with Fiscal Year 2016

Our effective tax rate for fiscal years 2017 and 2016 was 15% and 20%, respectively. The decrease in our effective tax rate for fiscal year 2017 compared to fiscal year 2016 was primarily due to the realization of tax benefits attributable to previous Phone business losses, offset in part by changes in the mix of our income before income taxes between the U.S. and foreign countries. Our effective tax rate was lower than the U.S. federal statutory rate primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from our foreign regional operations centers in Ireland, Singapore, and Puerto Rico.

The mix of income before income taxes between the U.S. and foreign countries impacted our effective tax rate as a result of the geographic distribution of, and customer demand for, our products and services. In fiscal year 2017, our U.S. income before income taxes was $6.8 billion and our foreign income before income taxes was $23.1 billion. In fiscal year 2016, our U.S. income before income taxes was $5.1 billion and our foreign income before income taxes was $20.5 billion.

Recent Tax Legislation

On December 22, 2017, the TCJA was enacted into law, which significantly changes existing U.S. tax law and includes numerous provisions that affect our business, such as imposing a one-time transition tax on deemed repatriation of deferred foreign income, reducing the U.S. federal statutory tax rate, and adopting a territorial tax system. The TCJA required us to incur a one-time transition tax on deferred foreign income not previously subject to U.S. income tax at a rate of 15.5% for foreign cash and certain other net current assets, and 8% on the remaining income. The TCJA also reduced the U.S. federal statutory tax rate from 35% to 21% effective January 1, 2018. For fiscal year 2018, our blended U.S. federal statutory tax rate is 28.1%. This is the result of using the tax rate of 35% for the first and second quarter of fiscal year 2018 and the reduced tax rate of 21% for the third and fourth quarter of fiscal year 2018. The TCJA includes a provision to tax global intangible low-taxed income ("GILTI") of foreign subsidiaries and a base erosion anti-abuse tax ("BEAT") measure that taxes certain payments between a U.S. corporation and its foreign subsidiaries. The GILTI and BEAT provisions of the TCJA will be effective for us beginning July 1, 2018.

The TCJA was effective in the second quarter of fiscal year 2018. As of June 30, 2018, we have not completed our accounting for the estimated tax effects of the TCJA. During fiscal year 2018, we recorded a provisional net charge of $13.7 billion related to the TCJA based on reasonable estimates for those tax effects. Due to the timing of the enactment and the complexity in applying the provisions of the TCJA, the provisional net charge is subject to revisions as we continue to complete our analysis of the TCJA, collect and prepare necessary data, and interpret any additional guidance issued by the U.S. Treasury Department, Internal Revenue Service ("IRS"), Financial Accounting Standards Board, and other standard-setting and regulatory bodies. Adjustments may materially impact our provision for income taxes and effective tax rate in the period in which the adjustments are made. Our accounting for the estimated tax effects of the TCJA will be completed during the measurement period, which is not expected to extend beyond one year from the enactment date.

During fiscal year 2018, we recorded an estimated net charge of $13.7 billion related to the TCJA, due to the impact of the one-time transition tax on the deemed repatriation of deferred foreign income of $17.9 billion, offset in part by the impact of changes in the tax rate of $4.2 billion, primarily on deferred tax assets and liabilities.

Uncertain Tax Positions

While we settled a portion of the IRS audit for tax years 2004 to 2006 during the third quarter of fiscal year 2011, and a portion of the IRS audit for tax years 2007 to 2009 during the first quarter of fiscal year 2016, we remain under audit for those years. In the second quarter of fiscal year 2018, we settled a portion of the IRS audit for tax years 2010 to 2013. We continue to be subject to examination by the IRS for tax years 2010 to 2017. In February 2012, the IRS withdrew its 2011 Revenue Agents Report for tax years 2004 to 2006 and reopened the audit phase of the examination. As of June 30, 2018, the primary unresolved issue relates to transfer pricing, which could have a significant impact in our consolidated financial statements if not resolved favorably. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2017, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NON-GAAP FINANCIAL MEASURES

Adjusted operating income, net income and diluted earnings per share are non-GAAP financial measures which exclude the net charge related to the TCJA, and impairment and restructuring expenses. We believe these non-GAAP measures aid investors by providing additional insight into our operational performance and help clarify trends affecting our business. For comparability of reporting, management considers non-GAAP measures in conjunction with GAAP financial results in evaluating business performance. These non-GAAP financial measures presented should not be considered a substitute for, or superior to, the measures of financial performance prepared in accordance with GAAP.

The following table reconciles our financial results reported in accordance with GAAP to non-GAAP financial results:

(In millions, except percentages and per share amounts)	2018	2017	2016	Percentage Change 2018 Versus 2017	Percentage Change 2017 Versus 2016
Operating income	**$ 35,058**	$ 29,025	$ 26,078	21%	11%
Net charge related to the TCJA	**0**	0	0		
Impairment and restructuring expenses	**0**	306	1,110		
Adjusted operating income	**$ 35,058**	$ 29,331	$ 27,188	20%	8%
Net income	**$ 16,571**	$ 25,489	$ 20,539	(35)%	24%
Net charge related to the TCJA	**13,696**	0	0		
Impairment and restructuring expenses	**0**	243	895		
Adjusted net income	**$ 30,267**	$ 25,732	$ 21,434	18%	20%
Diluted earnings per share	**$ 2.13**	$ 3.25	$ 2.56	(34)%	27%
Net charge related to the TCJA	**1.75**	0	0		
Impairment and restructuring expenses	**0**	0.04	0.11		
	$ 3.88	$ 3.29	$ 2.67	18%	23%

Adjusted diluted earnings per share

FINANCIAL CONDITION

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $133.8 billion and $133.0 billion as of June 30, 2018 and 2017, respectively. Equity and other investments were $1.9 billion and $6.0 billion as of June 30, 2018 and 2017, respectively. Our short-term investments are primarily intended to facilitate liquidity and capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

As a result of the TCJA, our cash, cash equivalents, and short-term investments held by foreign subsidiaries are no longer subject to U.S. tax on repatriation into the U.S.

Valuation

In general, and where applicable, we use quoted prices in active markets for identical assets or liabilities to determine the fair value of our financial instruments. This pricing methodology applies to our Level 1 investments, such as U.S. government securities, common and preferred stock, and mutual funds. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then we use quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. This pricing methodology applies to our Level 2 investments such as corporate notes and bonds, foreign government bonds, mortgage- and asset-backed securities, commercial paper, certificates of deposit, and U.S. agency securities. Level 3 investments are valued using internally developed models with unobservable inputs. Assets and liabilities measured at fair value on a recurring basis using unobservable inputs are an immaterial portion of our portfolio.

A majority of our investments are priced by pricing vendors and are generally Level 1 or Level 2 investments as these vendors either provide a quoted market price in an active market or use observable inputs for their pricing without applying significant adjustments. Broker pricing is used mainly when a quoted price is not available, the investment is not priced by our pricing vendors, or when a broker price is more reflective of fair values in the market in which the investment trades. Our broker-priced investments are generally classified as Level 2 investments because the broker prices these investments based on similar assets without applying significant adjustments. In addition, all our broker-priced investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments. Our fair value processes include controls that are designed to ensure appropriate fair values are recorded. These controls include model validation, review of key model inputs, analysis of period-over-period fluctuations, and independent recalculation of prices where appropriate.

Cash Flows

Fiscal Year 2018 Compared with Fiscal Year 2017

Cash from operations increased $4.4 billion to $43.9 billion for the fiscal year ended June 30, 2018, mainly due to an increase in cash received from customers, offset in part by an increase in cash paid to employees, net cash paid for income taxes, cash paid for interest on debt, and cash paid to suppliers. Cash used in financing was $33.6 billion for the fiscal year ended June 30, 2018, compared to cash from financing of $8.4 billion for the fiscal year ended June 30, 2017. The change was mainly due to a $41.7 billion decrease in proceeds from issuance of debt, net of repayments, offset in part by a $1.1 billion decrease in cash used for common stock repurchases. Cash used in investing decreased $40.7 billion to $6.1 billion for the fiscal year ended June 30, 2018, mainly due to a $25.1 billion decrease in cash used for acquisitions of companies, net of cash acquired, and purchases of intangible and other assets, and a $19.1 billion increase in cash from net investment purchases, sales, and maturities.

Fiscal Year 2017 Compared with Fiscal Year 2016

Cash from operations increased $6.2 billion to $39.5 billion during the fiscal year, mainly due to an increase in cash received from customers and an income tax refund for overpayment of estimated taxes, offset in part by an increase in cash paid to employees. Cash from financing increased $16.8 billion to $8.4 billion, mainly due to a $13.2 billion increase in proceeds from issuances of debt, net of repayments, and a $4.2 billion decrease in cash used for common stock repurchases, offset in part by an $839 million increase in dividends paid. Cash used in investing increased $22.8 billion to $46.8 billion, mainly due to a $24.6 billion increase in cash used for acquisitions of companies, net of cash acquired, and purchases of intangibles and other assets, offset in part by a $1.9 billion decrease in cash used for net investment purchases, sales, and maturities.

Debt

We issued debt to take advantage of favorable pricing and liquidity in the debt markets, reflecting our credit rating and the low interest rate environment. The proceeds of these issuances were or will be used for general corporate purposes, which may include, among other things, funding for working capital, capital expenditures, repurchases of capital stock, acquisitions, and repayment of existing debt. Refer to Note 12 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Unearned Revenue

Unearned revenue comprises mainly unearned revenue related to volume licensing programs and includes Software Assurance (“SA”) and cloud services. Unearned revenue is generally billed upfront at the beginning of each annual coverage period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service. Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

The following table outlines the expected future recognition of unearned revenue as of June 30, 2018:

(In millions)

Three Months Ending,	
September 30, 2018	$ 11,081
December 31, 2018	8,688
March 31, 2019	5,995
June 30, 2019	3,141
Thereafter	3,815
Total	$32,720

If our customers choose to license cloud-based versions of our products and services rather than licensing transaction-based products and services, the associated revenue will shift from being recognized at the time of the transaction to being recognized over the subscription period or upon consumption, as applicable.

Share Repurchases

For the fiscal years ended June 30, 2018, 2017, and 2016, we repurchased 99 million shares, 170 million shares, and 294 million shares of our common stock for $8.6 billion, $10.3 billion, and $14.8 billion, respectively, through our share repurchase programs. All repurchases were made using cash resources. Refer to Note 18 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Dividends

Refer to Note 18 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Off-Balance Sheet Arrangements

We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products and certain other matters. Additionally, we have agreed to cover damages resulting from breaches of certain security and privacy commitments in our cloud business. In evaluating estimated losses on these obligations, we consider factors such as the degree of probability of an unfavorable outcome and our ability to make a reasonable estimate of the amount of loss. These obligations did not have a material impact in our consolidated financial statements during the periods presented.

Contractual Obligations

The following table summarizes the payments due by fiscal year for our outstanding contractual obligations as of June 30, 2018:

(In millions)	**2019**	**2020-2021**	**2022-2023**	**Thereafter**	**Total**
Long-term debt: (a)					
Principal payments	$ 4,000	$ 9,268	$ 10,794	$ 52,836	$ 76,898
Interest payments	2,377	4,495	4,066	31,247	42,185
Construction commitments (b)	1,793	107	0	0	1,900
Operating leases, including imputed interest (c)	1,538	2,567	1,778	2,416	8,299
Finance leases, including imputed interest (c)	470	1,101	1,142	5,751	8,464
Transition tax (d)	1,495	2,808	2,808	10,530	17,641
Purchase commitments (e)	19,321	874	255	408	20,858
Other long-term liabilities (f)	0	76	19	313	408
Total contractual obligations	$ 30,994	$ 21,296	$ 20,862	$ 103,501	$ 176,653

(a) *Refer to Note 12 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(b) *Refer to Note 8 – Property and Equipment of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(c) *Refer to Note 16 – Leases of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(d) *Refer to Note 13 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).*

(e) *Amounts represent purchase commitments, including open purchase orders and take-or-pay contracts that are not presented as construction commitments above.*

(f) *We have excluded long-term tax contingencies, other tax liabilities, and deferred income taxes of $13.6 billion from the amounts presented as the timing of these obligations is uncertain. We have also excluded unearned revenue and non-cash items.*

Other Planned Uses of Capital

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as continue making acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings. We have operating and finance leases for datacenters, corporate offices, research and development facilities, retail stores, and certain equipment. We have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of capital resources.

Liquidity

As a result of the TCJA, we are required to pay a one-time transition tax of $17.9 billion on deferred foreign income not previously subject to U.S. income tax. In fiscal year 2018, we paid transition tax of $228 million. Under the TCJA, the remaining transition tax of $17.6 billion is payable interest-free over eight years, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight.

We expect existing cash, cash equivalents, short-term investments, cash flows from operations, and access to capital markets to continue to be sufficient to fund our operating activities and cash commitments for investing and financing activities, such as dividends, share repurchases, debt maturities, material capital expenditures, and the transition tax related to the TCJA, for at least the next 12 months and thereafter for the foreseeable future.

RECENT ACCOUNTING GUIDANCE

Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements and accompanying notes are prepared in accordance with GAAP. Preparing consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies. Critical accounting policies for us include revenue recognition, impairment of investment securities, goodwill, research and development costs, contingencies, income taxes, and inventories.

Revenue Recognition

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the stand-alone selling price (“SSP") for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

The new standard related to revenue recognition had a material impact in our consolidated financial statements. Refer to Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Impairment of Investment Securities

We review investments quarterly for indicators of other-than-temporary impairment. This determination requires significant judgment. In making this judgment, we employ a systematic methodology quarterly that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, the duration and extent to which the fair value is less than cost, and for equity securities, our intent and ability to hold, or plans to sell, the investment. For fixed-income securities, we also evaluate whether we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery. We also consider specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded to other income (expense), net and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

Goodwill

We allocate goodwill to reporting units based on the reporting unit expected to benefit from the business combination. We evaluate our reporting units on an annual basis and, if necessary, reassign goodwill using a relative fair value allocation approach. Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated primarily through the use of a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur, and determination of our weighted average cost of capital.

The estimates used to calculate the fair value of a reporting unit change from year to year based on operating results, market conditions, and other factors. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit.

Research and Development Costs

Costs incurred internally in researching and developing a computer software product are charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, all software costs are capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our software products is reached after all high-risk development issues have been resolved through coding and testing. Generally, this occurs shortly before the products are released to production. The amortization of these costs is included in cost of revenue over the estimated life of the products.

Legal and Other Contingencies

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our consolidated financial statements.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year, and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting literature also provides guidance on derecognition of income tax assets and liabilities, classification of deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our consolidated financial statements.

The TCJA significantly changes existing U.S. tax law and includes numerous provisions that affect our business. Refer to Note 13 – Income Taxes of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

Management is responsible for the preparation of the consolidated financial statements and related information that are presented in this report. The consolidated financial statements, which include amounts based on management's estimates and judgments, have been prepared in conformity with accounting principles generally accepted in the United States of America.

The Company designs and maintains accounting and internal control systems to provide reasonable assurance at reasonable cost that assets are safeguarded against loss from unauthorized use or disposition, and that the financial records are reliable for preparing consolidated financial statements and maintaining accountability for assets. These systems are augmented by written policies, an organizational structure providing division of responsibilities, careful selection and training of qualified personnel, and a program of internal audits.

The Company engaged Deloitte & Touche LLP, an independent registered public accounting firm, to audit and render an opinion on the consolidated financial statements and internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Board of Directors, through its Audit Committee, consisting solely of independent directors of the Company, meets periodically with management, internal auditors, and our independent registered public accounting firm to ensure that each is meeting its responsibilities and to discuss matters concerning internal controls and financial reporting. Deloitte & Touche LLP and the internal auditors each have full and free access to the Audit Committee.

Satya Nadella
Chief Executive Officer

Amy E. Hood
Executive Vice President and Chief Financial Officer

Frank H. Brod
Corporate Vice President, Finance and Administration;
Chief Accounting Officer

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

RISKS

We are exposed to economic risk from foreign exchange rates, interest rates, credit risk, and equity prices. We use derivatives instruments to manage these risks, however, they may still impact our consolidated financial statements.

Foreign Currency

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency positions. Principal currencies hedged include the euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of the fixed-income portfolio to achieve economic returns that correlate to certain global fixed-income indices.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We manage credit exposures relative to broad-based indices and to facilitate portfolio diversification.

Equity

Securities held in our equity and other investments portfolio are subject to market price risk.

SENSITIVITY ANALYSIS

Historically, we used a value-at-risk ("VaR") model to estimate and quantify our market risks. This included presenting one-day VaR as well as average, high, and low VaR by risk category throughout the reporting period. Given the changes in size and allocation of our portfolio of financial assets, we believe sensitivity analysis is more informative in representing the potential impact to the portfolio as a result of market movements. Therefore, we have presented a sensitivity analysis for each risk category below.

Sensitivity analysis is not intended to represent actual losses in fair value, including determinations of other-than-temporary losses in fair value in accordance with accounting principles generally accepted in the United States of America, but is used as a risk estimation and management tool.

The following table sets forth the potential loss in future earnings or fair values, including associated derivatives, resulting from hypothetical changes in relevant market rates or prices:

(In millions)

Risk Categories	Hypothetical Change	June 30, 2018	June 30, 2017	Impact
Foreign currency - Revenue	10% decrease in foreign exchange rates	**$ (2,187)**	$ (1,785)	Earnings
Foreign currency - Investments	10% decrease in foreign exchange rates	**(70)**	(92)	Fair Value
Interest rate	100 basis point increase in U.S. treasury interest rates	**(2,705)**	(2,394)	Fair Value
Credit	100 basis point increase in credit spreads	**(232)**	(167)	Fair Value
Equity	10% decrease in equity market prices	**(140)**	(323)	Fair Value

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INCOME STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	2018	2017	2016
Revenue:			
Product	**$ 64,497**	$ 63,811	$ 67,336
Service and other	**45,863**	32,760	23,818
Total revenue	**110,360**	96,571	91,154
Cost of revenue:			
Product	**15,420**	15,175	17,880
Service and other	**22,933**	19,086	14,900
Total cost of revenue	**38,353**	34,261	32,780
Gross margin	**72,007**	62,310	58,374
Research and development	**14,726**	13,037	11,988
Sales and marketing	**17,469**	15,461	14,635
General and administrative	**4,754**	4,481	4,563
Impairment and restructuring	**0**	306	1,110
Operating income	**35,058**	29,025	26,078
Other income (expense), net	**1,416**	876	(439)
Income before income taxes	**36,474**	29,901	25,639
Provision for income taxes	**19,903**	4,412	5,100
Net income	**$ 16,571**	$ 25,489	$ 20,539
Earnings per share:			
Basic	**$ 2.15**	$ 3.29	$ 2.59
Diluted	**$ 2.13**	$ 3.25	$ 2.56
Weighted average shares outstanding:			
Basic	**7,700**	7,746	7,925
Diluted	**7,794**	7,832	8,013
Cash dividends declared per common share	**$ 1.68**	$ 1.56	$ 1.44

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Net income	**$ 16,571**	$ 25,489	$ 20,539
Other comprehensive income (loss), net of tax:			
Net change related to derivatives	**39**	(218)	(238)
Net change related to investments	**(2,717)**	(1,116)	(228)
Translation adjustments and other	**(178)**	167	(262)
Other comprehensive loss	**(2,856)**	(1,167)	(728)
Comprehensive income	**$ 13,715**	$ 24,322	$ 19,811

Refer to accompanying notes. Refer to Note 19 – Accumulated Other Comprehensive Income (Loss) for further information.

BALANCE SHEETS

(In millions)

June 30,	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	**$ 11,946**	$ 7,663
Short-term investments	**121,822**	125,318
Total cash, cash equivalents, and short-term investments	**133,768**	132,981
Accounts receivable, net of allowance for doubtful accounts of **$377** and $345	**26,481**	22,431
Inventories	**2,662**	2,181
Other	**6,751**	5,103
Total current assets	**169,662**	162,696
Property and equipment, net of accumulated depreciation of **$29,223** and $24,179	**29,460**	23,734
Operating lease right-of-use assets	**6,686**	6,555
Equity and other investments	**1,862**	6,023
Goodwill	**35,683**	35,122
Intangible assets, net	**8,053**	10,106
Other long-term assets	**7,442**	6,076
Total assets	**$ 258,848**	$ 250,312
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**$ 8,617**	$ 7,390
Short-term debt	**0**	9,072
Current portion of long-term debt	**3,998**	1,049
Accrued compensation	**6,103**	5,819
Short-term income taxes	**2,121**	718
Short-term unearned revenue	**28,905**	24,013
Other	**8,744**	7,684
Total current liabilities	**58,488**	55,745
Long-term debt	**72,242**	76,073
Long-term income taxes	**30,265**	13,485
Long-term unearned revenue	**3,815**	2,643
Deferred income taxes	**541**	5,734
Operating lease liabilities	**5,568**	5,372
Other long-term liabilities	**5,211**	3,549
Total liabilities	**176,130**	162,601
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,677** and 7,708	**71,223**	69,315
Retained earnings	**13,682**	17,769
Accumulated other comprehensive income (loss)	**(2,187)**	627
Total stockholders' equity	**82,718**	87,711
Total liabilities and stockholders' equity	**$ 258,848**	$ 250,312

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions)

Year Ended June 30,	2018	2017	2016
Operations			
Net income	**$ 16,571**	$ 25,489	$ 20,539
Adjustments to reconcile net income to net cash from operations:			
Asset impairments	**0**	0	630
Depreciation, amortization, and other	**10,261**	8,778	6,622
Stock-based compensation expense	**3,940**	3,266	2,668
Net recognized gains on investments and derivatives	**(2,212)**	(2,073)	(223)
Deferred income taxes	**(5,143)**	(829)	2,479
Changes in operating assets and liabilities:			
Accounts receivable	**(3,862)**	(1,216)	562
Inventories	**(465)**	50	600
Other current assets	**(952)**	1,028	(1,212)
Other long-term assets	**(285)**	(917)	(1,110)
Accounts payable	**1,148**	81	88
Unearned revenue	**5,922**	3,820	2,565
Income taxes	**18,183**	1,792	(298)
Other current liabilities	**798**	356	(179)
Other long-term liabilities	**(20)**	(118)	(406)
Net cash from operations	**43,884**	39,507	33,325
Financing			
Proceeds from issuance (repayments) of short-term debt, maturities of 90 days or less, net	**(7,324)**	(4,963)	7,195
Proceeds from issuance of debt	**7,183**	44,344	13,884
Repayments of debt	**(10,060)**	(7,922)	(2,796)
Common stock issued	**1,002**	772	668
Common stock repurchased	**(10,721)**	(11,788)	(15,969)
Common stock cash dividends paid	**(12,699)**	(11,845)	(11,006)
Other, net	**(971)**	(190)	(369)
Net cash from (used in) financing	**(33,590)**	8,408	(8,393)
Investing			
Additions to property and equipment	**(11,632)**	(8,129)	(8,343)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(888)**	(25,944)	(1,393)
Purchases of investments	**(137,380)**	(176,905)	(129,758)
Maturities of investments	**26,360**	28,044	22,054
Sales of investments	**117,577**	136,350	93,287
Securities lending payable	**(98)**	(197)	203
Net cash used in investing	**(6,061)**	(46,781)	(23,950)
Effect of foreign exchange rates on cash and cash equivalents	**50**	19	(67)
Net change in cash and cash equivalents	**4,283**	1,153	915
Cash and cash equivalents, beginning of period	**7,663**	6,510	5,595
Cash and cash equivalents, end of period	**$ 11,946**	$ 7,663	$ 6,510

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Common stock and paid-in capital			
Balance, beginning of period	**$ 69,315**	$ 68,178	$ 68,465
Common stock issued	**1,002**	772	668
Common stock repurchased	**(3,033)**	(2,987)	(3,689)
Stock-based compensation expense	**3,940**	3,266	2,668
Other, net	**(1)**	86	66
Balance, end of period	**71,223**	69,315	68,178
Retained earnings			
Balance, beginning of period	**17,769**	13,118	16,191
Net income	**16,571**	25,489	20,539
Common stock cash dividends	**(12,917)**	(12,040)	(11,329)
Common stock repurchased	**(7,699)**	(8,798)	(12,283)
Cumulative effect of accounting change	**(42)**	0	0
Balance, end of period	**13,682**	17,769	13,118
Accumulated other comprehensive income (loss)			
Balance, beginning of period	**627**	1,794	2,522
Other comprehensive loss	**(2,856)**	(1,167)	(728)
Cumulative effect of accounting change	**42**	0	0
Balance, end of period	**(2,187)**	627	1,794
Total stockholders' equity	**$ 82,718**	$ 87,711	$ 83,090

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP").

We have recast certain prior period income tax liabilities as discussed in the Recent Tax Legislation section below. We have also recast prior period securities lending payables to other current liabilities in our consolidated balance sheets to conform to the current period presentation. These items had no impact in our consolidated income statements or net cash from or used in operating, financing, or investing in our consolidated cash flows statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Microsoft Corporation and its subsidiaries. Intercompany transactions and balances have been eliminated. Equity investments for which we are able to exercise significant influence over but do not control the investee and are not the primary beneficiary of the investee's activities are accounted for using the equity method. Investments for which we are not able to exercise significant influence over the investee and which do not have readily determinable fair values are accounted for under the cost method.

Estimates and Assumptions

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates and assumptions include: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price ("SSP") of performance obligations, variable consideration, and other obligations such as product returns and refunds; loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of future tax consequences of events that have been recognized in our consolidated financial statements or tax returns; and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from management's estimates and assumptions.

Foreign Currencies

Assets and liabilities recorded in foreign currencies are translated at the exchange rate on the balance sheet date. Revenue and expenses are translated at average rates of exchange prevailing during the year. Translation adjustments resulting from this process are recorded to other comprehensive income ("OCI").

Revenue

Product Revenue and Service and Other Revenue

Product revenue includes sales from operating systems; cross-device productivity applications; server applications; business solution applications; desktop and server management tools; software development tools; video games; and hardware such as PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories.

Service and other revenue includes sales from cloud-based solutions that provide customers with software, services, platforms, and content such as Microsoft Office 365, Microsoft Azure, Microsoft Dynamics 365, and Xbox Live; solution support; and consulting services. Service and other revenue also includes sales from online advertising and LinkedIn.

Revenue Recognition

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Nature of Products and Services

Licenses for on-premises software provide the customer with a right to use the software as it exists when made available to the customer. Customers may purchase perpetual licenses or subscribe to licenses, which provide customers with the same functionality and differ mainly in the duration over which the customer benefits from the software. Revenue from distinct on-premises licenses is recognized upfront at the point in time when the software is made available to the customer. In cases where we allocate revenue to software updates, primarily because the updates are provided at no additional charge, revenue is recognized as the updates are provided, which is generally ratably over the estimated life of the related device or license.

Certain volume licensing programs, including Enterprise Agreements, include on-premises licenses combined with Software Assurance (“SA”). SA conveys rights to new software and upgrades released over the contract period and provides support, tools, and training to help customers deploy and use products more efficiently. On-premises licenses are considered distinct performance obligations when sold with SA. Revenue allocated to SA is generally recognized ratably over the contract period as customers simultaneously consume and receive benefits, given that SA comprises distinct performance obligations that are satisfied over time.

Cloud services, which allow customers to use hosted software over the contract period without taking possession of the software, are provided on either a subscription or consumption basis. Revenue related to cloud services provided on a subscription basis is recognized ratably over the contract period. Revenue related to cloud services provided on a consumption basis, such as the amount of storage used in a period, is recognized based on the customer utilization of such resources. When cloud services require a significant level of integration and interdependency with software and the individual components are not considered distinct, all revenue is recognized over the period in which the cloud services are provided.

Revenue from search advertising is recognized when the advertisement appears in the search results or when the action necessary to earn the revenue has been completed. Revenue from consulting services is recognized as services are provided.

Our hardware is generally highly dependent on, and interrelated with, the underlying operating system and cannot function without the operating system. In these cases, the hardware and software license are accounted for as a single performance obligation and revenue is recognized at the point in time when ownership is transferred to resellers or directly to end customers through retail stores and online marketplaces.

Refer to Note 21 – Segment Information and Geographic Data for further information, including revenue by significant product and service offering.

Significant Judgments

Our contracts with customers often include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. When a cloud-based service includes both on-premises software licenses and cloud services, judgment is required to determine whether the software license is considered distinct and accounted for separately, or not distinct and accounted for together with the cloud service and recognized over time. Certain cloud services, primarily Office 365, depend on a significant level of integration, interdependency, and interrelation between the desktop applications and cloud services, and are accounted for together as one performance obligation. Revenue from Office 365 is recognized ratably over the period in which the cloud services are provided.

Judgment is required to determine the SSP for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including on-premises licenses sold with SA or software updates provided at no additional charge. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount to be allocated based on the relative SSP of the various products and services.

In instances where SSP is not directly observable, such as when we do not sell the product or service separately, we determine the SSP using information that may include market conditions and other observable inputs. We typically have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP.

Due to the various benefits from and the nature of our SA program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers.

Our products are generally sold with a right of return, we may provide other credits or incentives, and in certain instances we estimate customer usage of our products and services, which are accounted for as variable consideration when determining the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period if additional information becomes available. Changes to our estimated variable consideration were not material for the periods presented.

Contract Balances

Timing of revenue recognition may differ from the timing of invoicing to customers. We record a receivable when revenue is recognized prior to invoicing, or unearned revenue when revenue is recognized subsequent to invoicing. For multi-year agreements, we generally invoice customers annually at the beginning of each annual coverage period. We record a receivable related to revenue recognized for multi-year on-premises licenses as we have an unconditional right to invoice and receive payment in the future related to those licenses.

The opening balance of current and long-term accounts receivable, net of allowance for doubtful accounts, was $22.3 billion as of July 1, 2016.

As of June 30, 2018 and 2017, long-term accounts receivable, net of allowance for doubtful accounts, were $1.8 billion and $1.7 billion, respectively, and are included in other long-term assets in our consolidated balance sheets.

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

Activity in the allowance for doubtful accounts was as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Balance, beginning of period	**$ 361**	$ 409	$ 289
Charged to costs and other	**134**	58	175
Write-offs	**(98)**	(106)	(55)
Balance, end of period	**$ 397**	$ 361	$ 409

Allowance for doubtful accounts included in our consolidated balance sheets:

June 30,	**2018**	**2017**	**2016**
Accounts receivable, net of allowance for doubtful accounts	**$ 377**	$ 345	$ 392
Other long-term assets	**20**	16	17
Total	**$ 397**	$ 361	$ 409

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include SA and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for consulting services to be performed in the future; LinkedIn subscriptions; Office 365 subscriptions; Xbox Live subscriptions; Windows 10 post-delivery support; Dynamics business solutions; Skype prepaid credits and subscriptions; and other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service.

Refer to Note 15 – Unearned Revenue for further information, including unearned revenue by segment and changes in unearned revenue during the period.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers or to provide customers with financing. Examples include invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and multi-year on-premises licenses that are invoiced annually with revenue recognized upfront.

Assets Recognized from Costs to Obtain a Contract with a Customer

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We have determined that certain sales incentive programs meet the requirements to be capitalized. Total capitalized costs to obtain a contract were immaterial during the periods presented and are included in other current and long-term assets in our consolidated balance sheets.

We apply a practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less. These costs include our internal sales force compensation program and certain partner sales incentive programs as we have determined annual compensation is commensurate with annual sales activities.

Cost of Revenue

Cost of revenue includes: manufacturing and distribution costs for products sold and programs licensed; operating costs related to product support service centers and product distribution centers; costs incurred to include software on PCs sold by original equipment manufacturers (“OEM”), to drive traffic to our websites, and to acquire online advertising space; costs incurred to support and maintain Internet-based products and services, including datacenter costs and royalties; warranty costs; inventory valuation adjustments; costs associated with the delivery of consulting services; and the amortization of capitalized software development costs. Capitalized software development costs are amortized over the estimated lives of the products.

Product Warranty

We provide for the estimated costs of fulfilling our obligations under hardware and software warranties at the time the related revenue is recognized. For hardware warranties, we estimate the costs based on historical and projected product failure rates, historical and projected repair costs, and knowledge of specific product failures (if any). The specific hardware warranty terms and conditions vary depending upon the product sold and the country in which we do business, but generally include parts and labor over a period generally ranging from 90 days to three years. For software warranties, we estimate the costs to provide bug fixes, such as security patches, over the estimated life of the software. We regularly reevaluate our estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

Research and Development

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content. Such costs related to software development are included in research and development expense until the point that technological feasibility is reached, which for our software products, is generally shortly before the products are released to production. Once technological feasibility is reached, such costs are capitalized and amortized to cost of revenue over the estimated lives of the products.

Sales and Marketing

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs. Advertising costs are expensed as incurred. Advertising expense was $1.6 billion, $1.5 billion, and $1.6 billion in fiscal years 2018, 2017, and 2016, respectively.

Stock-Based Compensation

Compensation cost for stock awards, which include restricted stock units ("RSUs") and performance stock units ("PSUs"), is measured at the fair value on the grant date and recognized as expense, net of estimated forfeitures, over the related service or performance period. The fair value of stock awards is based on the quoted price of our common stock on the grant date less the present value of expected dividends not received during the vesting period. We measure the fair value of PSUs using a Monte Carlo valuation model. Compensation cost for RSUs is recognized using the straight-line method and for PSUs is recognized using the accelerated method.

Compensation expense for the employee stock purchase plan ("ESPP") is measured as the discount the employee is entitled to upon purchase and is recognized in the period of purchase.

Income Taxes

Income tax expense includes U.S. and international income taxes, and interest and penalties on uncertain tax positions. Certain income and expenses are not reported in tax returns and financial statements in the same year. The tax effect of such temporary differences is reported as deferred income taxes. Deferred tax assets are reported net of a valuation allowance when it is more likely than not that a tax benefit will not be realized. All deferred income taxes are classified as long-term in our consolidated balance sheets.

Fair Value Measurements

We account for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. We categorize each of our fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 non-derivative investments primarily include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.
- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 non-derivative investments consist primarily of corporate notes and bonds, foreign government bonds, mortgage- and asset-backed securities, commercial paper, certificates of deposit, and U.S. agency securities. Our Level 2 derivative assets and liabilities primarily include certain over-the-counter option and swap contracts.
- *Level 3* – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 non-derivative assets and liabilities primarily comprise investments in common and preferred stock, and goodwill and intangible assets, when they are recorded at fair value due to an impairment charge. Unobservable inputs used in the models are significant to the fair values of the assets and liabilities.

We measure certain assets, including our cost and equity method investments, at fair value on a nonrecurring basis when they are deemed to be other-than-temporarily impaired. The fair values of these investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections. An impairment charge is recorded when the cost of the investment exceeds its fair value and this condition is determined to be other-than-temporary.

Our other current financial assets and current financial liabilities have fair values that approximate their carrying values.

Financial Instruments

Investments

We consider all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. The fair values of these investments approximate their carrying values. In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. All cash equivalents and short-term investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in market value, excluding other-than-temporary impairments, are reflected in OCI.

Equity and other investments classified as long-term include both debt and equity instruments. Debt and publicly-traded equity securities are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in the market value of available-for-sale securities, excluding other-than-temporary impairments, are reflected in OCI. Common and preferred stock and other investments that are restricted for more than one year or are not publicly traded are recorded at cost or using the equity method.

We lend certain fixed-income and equity securities to increase investment returns. These transactions are accounted for as secured borrowings and the loaned securities continue to be carried as investments in our consolidated balance sheets. Cash and/or security interests are received as collateral for the loaned securities with the amount determined based upon the underlying security lent and the creditworthiness of the borrower. Cash received is recorded as an asset with a corresponding liability.

Investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. Fair value is calculated based on publicly available market information or other estimates determined by management. We employ a systematic methodology on a quarterly basis that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, the duration and extent to which the fair value is less than cost, and for equity securities, our intent and ability to hold, or plans to sell, the investment. For fixed-income securities, we also evaluate whether we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery. We also consider specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded to other income (expense), net and a new cost basis in the investment is established.

Derivatives

Derivative instruments are recognized as either assets or liabilities and are measured at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation.

For derivative instruments designated as fair value hedges, the gains (losses) are recognized in earnings in the periods of change together with the offsetting losses (gains) on the hedged items attributed to the risk being hedged. For options designated as fair value hedges, changes in the time value are excluded from the assessment of hedge effectiveness and are recognized in earnings.

For derivative instruments designated as cash flow hedges, the effective portion of the gains (losses) on the derivatives is initially reported as a component of OCI and is subsequently recognized in earnings when the hedged exposure is recognized in earnings. For options designated as cash flow hedges, changes in the time value are excluded from the assessment of hedge effectiveness and are recognized in earnings. Gains (losses) on derivatives representing either hedge components excluded from the assessment of effectiveness or hedge ineffectiveness are recognized in earnings.

For derivative instruments that are not designated as hedges, gains (losses) from changes in fair values are primarily recognized in other income (expense), net.

Inventories

Inventories are stated at average cost, subject to the lower of cost or net realizable value. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. Net realizable value is the estimated selling price less estimated costs of completion, disposal, and transportation. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation, and depreciated using the straight-line method over the shorter of the estimated useful life of the asset or the lease term. The estimated useful lives of our property and equipment are generally as follows: computer software developed or acquired for internal use, three to seven years; computer equipment, two to three years; buildings and improvements, five to 15 years; leasehold improvements, three to 20 years; and furniture and equipment, one to 10 years. Land is not depreciated.

Leases

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities in our consolidated balance sheets. Finance leases are included in property and equipment, other current liabilities, and other long-term liabilities in our consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. We use the implicit rate when readily determinable. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

We have lease agreements with lease and non-lease components, which are generally accounted for separately. For certain equipment leases, such as vehicles, we account for the lease and non-lease components as a single lease component. Additionally, for certain equipment leases, we apply a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Goodwill

Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value.

Intangible Assets

All of our intangible assets are subject to amortization and are amortized using the straight-line method over their estimated period of benefit, ranging from one to 20 years. We evaluate the recoverability of intangible assets periodically by taking into account events or circumstances that may warrant revised estimates of useful lives or that indicate the asset may be impaired.

Recent Tax Legislation

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted into law, which significantly changes existing U.S. tax law and includes numerous provisions that affect our business. Refer to Note 13 – Income Taxes for further discussion.

As a result of the TCJA, we have recast certain prior period income tax liabilities in our consolidated balance sheets to conform to the current period presentation. Previously reported balances were impacted as follows:

(In millions)		As Previously Reported		As Adjusted
Balance Sheets				**June 30, 2017**
Long-term income taxes	$	0	$	13,485
Other long-term liabilities		17,034		3,549

These adjustments had no impact in our consolidated income statements or net cash from or used in operating, financing, or investing in our consolidated cash flows statements.

Recent Accounting Guidance

Recently Adopted Accounting Guidance

Comprehensive Income – Reclassification of Certain Tax Effects

In February 2018, the Financial Accounting Standards Board ("FASB") issued new guidance to allow a reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for stranded tax effects resulting from the TCJA. In the second quarter of fiscal year 2018, we remeasured our deferred taxes related to unrealized gains on our investment balances using the reduced tax rate. As required by GAAP, we recognized the net tax benefit in the provision for income taxes in our consolidated income statements, even though the deferred taxes were initially recognized in AOCI, which resulted in stranded tax effects. We elected to early adopt the standard effective April 1, 2018 and reclassified a $42 million net tax benefit from AOCI to retained earnings in our consolidated balance sheets. Adoption of the standard had no impact to our consolidated income statements or cash flows statements.

Leases

In February 2016, the FASB issued a new standard related to leases to increase transparency and comparability among organizations by requiring the recognition of ROU assets and lease liabilities on the balance sheet. Most prominent among the changes in the standard is the recognition of ROU assets and lease liabilities by lessees for those leases classified as operating leases. Under the standard, disclosures are required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. We are also required to recognize and measure leases existing at, or entered into after, the beginning of the earliest comparative period presented using a modified retrospective approach, with certain practical expedients available.

We elected to early adopt the standard effective July 1, 2017 concurrent with our adoption of the new standard related to revenue recognition. We elected the available practical expedients and implemented internal controls and key system functionality to enable the preparation of financial information on adoption.

The standard had a material impact in our consolidated balance sheets, but did not have an impact in our consolidated income statements. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases, while our accounting for finance leases remained substantially unchanged. Adoption of the standard required us to restate certain previously reported results, including the recognition of additional ROU assets and lease liabilities for operating leases. Refer to Impacts to Previously Reported Results below for the impact of adoption of the standard in our consolidated financial statements.

Revenue from Contracts with Customers

In May 2014, the FASB issued a new standard related to revenue recognition. Under the standard, revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

We elected to early adopt the standard effective July 1, 2017, using the full retrospective method, which required us to restate each prior reporting period presented. We implemented internal controls and key system functionality to enable the preparation of financial information on adoption.

The most significant impact of the standard relates to our accounting for software license revenue. Specifically, for Windows 10, we recognize revenue predominantly at the time of billing and delivery rather than ratably over the life of the related device. For certain multi-year commercial software subscriptions that include both distinct software licenses and SA, we recognize license revenue at the time of contract execution rather than over the subscription period. Due to the complexity of certain of our commercial license subscription contracts, the actual revenue recognition treatment required under the standard depends on contract-specific terms and in some instances may vary from recognition at the time of billing. Revenue recognition related to our hardware, cloud offerings (such as Office 365), LinkedIn, and professional services remains substantially unchanged.

Adoption of the standard using the full retrospective method required us to restate certain previously reported results, including the recognition of additional revenue and an increase in the provision for income taxes, primarily due to the net change in Windows 10 revenue recognition. In addition, adoption of the standard resulted in an increase in accounts receivable and other current and long-term assets, driven by unbilled receivables from upfront recognition of revenue for certain multi-year commercial software subscriptions that include both distinct software licenses and SA; a reduction of unearned revenue, driven by the upfront recognition of license revenue from Windows 10 and certain multi-year commercial software subscriptions; and an increase in deferred income taxes, driven by the upfront recognition of revenue. Refer to Impacts to Previously Reported Results below for the impact of adoption of the standard in our consolidated financial statements.

Impacts to Previously Reported Results

Adoption of the standards related to revenue recognition and leases impacted our previously reported results as follows:

(In millions, except per share amounts)	**As Previously Reported**	**New Revenue Standard Adjustment**	**As Restated**
Income Statements			
Year Ended June 30, 2017			
Revenue	$ 89,950	$ 6,621	$ 96,571
Provision for income taxes	1,945	2,467	4,412
Net income	21,204	4,285	25,489
Diluted earnings per share	2.71	0.54	3.25
Year Ended June 30, 2016			
Revenue	$ 85,320	$ 5,834	$ 91,154
Provision for income taxes	2,953	2,147	5,100
Net income	16,798	3,741	20,539
Diluted earnings per share	2.10	0.46	2.56

(In millions)	As Previously Reported	New Revenue Standard Adjustment	New Lease Standard Adjustment	As Restated
Balance Sheets				
June 30, 2017				
Accounts receivable, net of allowance for doubtful accounts	$ 19,792	$ 2,639	$ 0	$ 22,431
Operating lease right-of-use assets	0	0	6,555	6,555
Other current and long-term assets	11,147	32	0	11,179
Unearned revenue	44,479	(17,823)	0	26,656
Deferred income taxes	531	5,203	0	5,734
Operating lease liabilities	0	0	5,372	5,372
Other current and long-term liabilities	23,464	(26)	1,183	24,621
Stockholders' equity	72,394	15,317	0	87,711

Adoption of the standards related to revenue recognition and leases had no impact to cash from or used in operating, financing, or investing in our consolidated cash flows statements.

Recent Accounting Guidance Not Yet Adopted

Financial Instruments – Targeted Improvements to Accounting for Hedging Activities

In August 2017, the FASB issued new guidance related to accounting for hedging activities. This guidance expands strategies that qualify for hedge accounting, changes how many hedging relationships are presented in the financial statements, and simplifies the application of hedge accounting in certain situations. The standard will be effective for us beginning July 1, 2019, with early adoption permitted for any interim or annual period before the effective date. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. We are currently evaluating the impact of this standard in our consolidated financial statements, including accounting policies, processes, and systems.

Income Taxes – Intra-Entity Asset Transfers

In October 2016, the FASB issued new guidance requiring an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs, rather than when the asset has been sold to an outside party. This guidance is effective for us beginning July 1, 2018, with early adoption permitted beginning July 1, 2017. We plan to adopt the guidance effective July 1, 2018. Adoption of the guidance will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. We currently expect a net cumulative-effect adjustment of approximately $550 million, which will reverse the deferral of income tax consequences from past intra-entity transfers involving assets other than inventory and new deferred tax assets for amounts not recognized under current GAAP, partially offset by a U.S. deferred tax liability related to global intangible low-taxed income ("GILTI"). Adoption of the standard is expected to result in an increase in long-term deferred tax assets of $2.8 billion, an increase in long-term deferred tax liabilities of $2.1 billion, and a reduction to other current assets of $150 million. As a result of the TCJA, we are continuing to evaluate the impact of this standard in our consolidated financial statements, including accounting policies, processes, and systems.

Financial Instruments – Credit Losses

In June 2016, the FASB issued a new standard to replace the incurred loss impairment methodology under current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. We will be required to use a forward-looking expected credit loss model for accounts receivables, loans, and other financial instruments. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The standard will be effective for us beginning July 1, 2020, with early adoption permitted beginning July 1, 2019. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date to align our credit loss methodology with the new standard. We are currently evaluating the impact of this standard in our consolidated financial statements, including accounting policies, processes, and systems.

Financial Instruments – Recognition, Measurement, Presentation, and Disclosure

In January 2016, the FASB issued a new standard related to certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most prominent among the changes in the standard is the requirement for changes in the fair value of our equity investments, with certain exceptions, to be recognized through net income rather than OCI. Under the standard, equity investments that do not have a readily determinable fair value are eligible for the measurement alternative. Using the measurement alternative, investments without readily determinable fair values will be valued at cost, with adjustments for changes in price or impairments reflected through net income.

The standard will be effective for us beginning July 1, 2018. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment from AOCI to retained earnings as of the effective date. A cumulative-effect adjustment will capture any previously held unrealized gains and losses held in AOCI related to our equity investments carried at fair value as well as the impact of recording the fair value of certain equity investments carried at cost. In preparation for adoption of this standard, we have implemented internal controls to align with the new standard and have concluded that we will elect the measurement alternative for equity investments that do not have readily determinable fair values.

The impact in our consolidated balance sheets upon adoption will not be material. Adoption of the standard will have no impact to cash from or used in operating, financing or investing in our consolidated cash flows statements.

NOTE 2 — EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed based on the weighted average number of shares of common stock outstanding during the period. Diluted EPS is computed based on the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and stock awards.

The components of basic and diluted EPS were as follows:

(In millions, except earnings per share)

Year Ended June 30,	**2018**	**2017**	**2016**
Net income available for common shareholders (A)	**$ 16,571**	$ 25,489	$ 20,539
Weighted average outstanding shares of common stock (B)	**7,700**	7,746	7,925
Dilutive effect of stock-based awards	**94**	86	88
Common stock and common stock equivalents (C)	**7,794**	7,832	8,013
Earnings Per Share			
Basic (A/B)	**$ 2.15**	$ 3.29	$ 2.59
Diluted (A/C)	**$ 2.13**	$ 3.25	$ 2.56

Anti-dilutive stock-based awards excluded from the calculations of diluted EPS were immaterial during the periods presented.

NOTE 3 — OTHER INCOME (EXPENSE), NET

The components of other income (expense), net were as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Dividends and interest income	**$ 2,214**	$ 1,387	$ 903
Interest expense	**(2,733)**	(2,222)	(1,243)
Net recognized gains on investments	**2,399**	2,583	668

Net losses on derivatives	**(187)**	(510)	(443)
Net losses on foreign currency remeasurements	**(218)**	(111)	(129)
Other, net	**(59)**	(251)	(195)
Total	**$ 1,416**	$ 876	$ (439)

Following are details of net recognized gains (losses) on investments during the periods reported:

(In millions)

Year Ended June 30,	2018	2017	2016
Other-than-temporary impairments of investments	**$ (47)**	$ (55)	$ (322)
Realized gains from sales of available-for-sale securities	**3,478**	3,064	1,376
Realized losses from sales of available-for-sale securities	**(1,032)**	(426)	(386)
Total	**$ 2,399**	$ 2,583	$ 668

NOTE 4 — INVESTMENTS

Investment Components

The components of investments, including associated derivatives, were as follows:

(In millions)	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity and Other Investments
June 30, 2018							
Cash	**$ 3,942**	**$ 0**	**$ 0**	**$ 3,942**	**$ 3,942**	**$ 0**	**$ 0**
Mutual funds	**246**	**0**	**0**	**246**	**246**	**0**	**0**
Commercial paper	**2,513**	**0**	**0**	**2,513**	**2,215**	**298**	**0**
Certificates of deposit	**2,058**	**0**	**0**	**2,058**	**1,865**	**193**	**0**
U.S. government and agency securities	**109,862**	**62**	**(1,167)**	**108,757**	**3,678**	**105,079**	**0**
Foreign government bonds	**5,182**	**1**	**(10)**	**5,173**	**0**	**5,173**	**0**
Mortgage- and asset-backed securities	**3,868**	**4**	**(13)**	**3,859**	**0**	**3,859**	**0**
Corporate notes and bonds	**6,947**	**21**	**(56)**	**6,912**	**0**	**6,912**	**0**
Municipal securities	**271**	**37**	**(1)**	**307**	**0**	**307**	**0**
Common and preferred stock	**1,220**	**95**	**(10)**	**1,305**	**0**	**0**	**1,305**
Other investments	**558**	**0**	**0**	**558**	**0**	**1**	**557**
Total	**$ 136,667**	**$ 220**	**$ (1,257)**	**$ 135,630**	**$ 11,946**	**$ 121,822**	**$ 1,862**

(In millions)	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity and Other Investments
June 30, 2017							
Cash	$ 3,624	$ 0	$ 0	$ 3,624	$ 3,624	$ 0	$ 0
Mutual funds	1,478	0	0	1,478	1,478	0	0
Commercial paper	319	0	0	319	69	250	0
Certificates of deposit	1,358	0	0	1,358	972	386	0
U.S. government and agency securities	112,119	85	(360)	111,844	16	111,828	0
Foreign government bonds	5,276	2	(13)	5,265	1,504	3,761	0
Mortgage- and asset-backed securities	3,921	14	(4)	3,931	0	3,931	0
Corporate notes and bonds	4,786	61	(12)	4,835	0	4,835	0
Municipal securities	284	43	0	327	0	327	0
	2,472	3,062	(34)	5,500	0	0	5,500

Common and preferred stock							
Other investments	523	0	0	523	0	0	523
Total	$ 136,160	$ 3,267	$ (423)	$ 139,004	$ 7,663	$ 125,318	$ 6,023

As of June 30, 2018 and 2017, the recorded bases of common and preferred stock that are restricted for more than one year or are not publicly traded were $999 million and $1.1 billion, respectively. These investments are carried at cost and are reviewed quarterly for indicators of other-than-temporary impairment. It is not practicable for us to reliably estimate the fair value of these investments.

As of June 30, 2018 and 2017, collateral received under agreements for loaned securities was $1.8 billion and $3.7 billion, respectively, and primarily comprised U.S. government and agency securities.

Unrealized Losses on Investments

Investments with continuous unrealized losses for less than 12 months and 12 months or greater and their related fair values were as follows:

	Less than 12 Months		12 Months or Greater			Total Unrealized Losses
(In millions)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Total Fair Value**	
June 30, 2018						
U.S. government and agency securities	**$ 82,352**	**$ (1,064)**	**$ 4,459**	**$ (103)**	**$ 86,811**	**$ (1,167)**
Foreign government bonds	**3,457**	**(7)**	**13**	**(3)**	**3,470**	**(10)**
Mortgage- and asset-backed securities	**2,072**	**(9)**	**96**	**(4)**	**2,168**	**(13)**
Corporate notes and bonds	**3,111**	**(43)**	**301**	**(13)**	**3,412**	**(56)**
Municipal securities	**45**	**(1)**	**0**	**0**	**45**	**(1)**
Common and preferred stock	**75**	**(6)**	**8**	**(4)**	**83**	**(10)**
Total	**$ 91,112**	**$ (1,130)**	**$ 4,877**	**$ (127)**	**$ 95,989**	**$ (1,257)**

	Less than 12 Months		12 Months or Greater			Total Unrealized Losses
(In millions)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Total Fair Value**	
June 30, 2017						
U.S. government and agency securities	$ 87,558	$ (348)	$ 371	$ (12)	$ 87,929	$ (360)
Foreign government bonds	4,006	(2)	23	(11)	4,029	(13)
Mortgage- and asset-backed securities	1,068	(3)	198	(1)	1,266	(4)
Corporate notes and bonds	669	(8)	177	(4)	846	(12)
Common and preferred stock	69	(6)	148	(28)	217	(34)
Total	$ 93,370	$ (367)	$ 917	$ (56)	$ 94,287	$ (423)

Unrealized losses from fixed-income securities are primarily attributable to changes in interest rates. Unrealized losses from domestic and international equities are due to market price movements. Management does not believe any remaining unrealized losses represent other-than-temporary impairments based on our evaluation of available evidence.

Debt Investment Maturities

(In millions)	**Cost Basis**	**Estimated Fair Value**
June 30, 2018		
Due in one year or less	$ 31,590	$ 31,451
Due after one year through five years	76,422	75,810
Due after five years through 10 years	21,765	21,396
Due after 10 years	924	922
Total	$ 130,701	$ 129,579

NOTE 5 — DERIVATIVES

We use derivative instruments to manage risks related to foreign currencies, equity prices, interest rates, and credit; to enhance investment returns; and to facilitate portfolio diversification. Our objectives for holding derivatives include reducing, eliminating, and efficiently managing the economic impact of these exposures as effectively as possible.

Our derivative programs include strategies that both qualify and do not qualify for hedge accounting treatment. All notional amounts presented below are measured in U.S. dollar equivalents.

Foreign Currency

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions. Option and forward contracts are used to hedge a portion of forecasted international revenue for up to three years in the future and are designated as cash flow hedging instruments. Principal currencies hedged include the euro, Japanese yen, British pound, Canadian dollar, and Australian dollar. As of June 30, 2018 and 2017, the total notional amounts of these foreign exchange contracts sold were $6.1 billion and $8.9 billion, respectively.

Foreign currency risks related to certain non-U.S. dollar denominated securities are hedged using foreign exchange forward contracts that are designated as fair value hedging instruments. As of June 30, 2018 and 2017, the total notional amounts of these foreign exchange contracts sold were $5.0 billion and $5.1 billion, respectively.

Certain options and forwards not designated as hedging instruments are also used to manage the variability in foreign exchange rates on certain balance sheet amounts and to manage other foreign currency exposures. As of June 30, 2018, the total notional amounts of these foreign exchange contracts purchased and sold were $9.4 billion and $13.4 billion, respectively. As of June 30, 2017, the total notional amounts of these foreign exchange contracts purchased and sold were $8.8 billion and $10.6 billion, respectively.

Equity

Securities held in our equity and other investments portfolio are subject to market price risk. Market price risk is managed relative to broad-based global and domestic equity indices using certain convertible preferred investments, options, futures, and swap contracts not designated as hedging instruments. From time to time, to hedge our price risk, we may use and designate equity derivatives as hedging instruments, including puts, calls, swaps, and forwards. As of June 30, 2018, the total notional amounts of equity contracts purchased and sold for managing market price risk were $49 million and $5 million, respectively. As of June 30, 2017, the total notional amounts of equity contracts purchased and sold for managing market price risk were $1.9 billion and $2.4 billion, respectively, of which $1.6 billion and $1.8 billion, respectively, were designated as hedging instruments.

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using exchange-traded option and futures contracts, and over-the-counter swap and option contracts, none of which are designated as hedging instruments. As of June 30, 2018, the total notional amounts of fixed-interest rate contracts purchased and sold were $306 million and $390 million, respectively. As of June 30, 2017, the total notional amounts of fixed-interest rate contracts purchased and sold were $233 million and $352 million, respectively.

In addition, we use “To Be Announced” forward purchase commitments of mortgage-backed assets to gain exposure to agency mortgage-backed securities. These meet the definition of a derivative instrument in cases where physical delivery of the assets is not taken at the earliest available delivery date. As of June 30, 2018 and 2017, the total notional derivative amounts of mortgage contracts purchased were $568 million and $567 million, respectively.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts, not designated as hedging instruments, to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. We use credit default swaps as they are a low-cost method of managing exposure to individual credit risks or groups of credit risks. As of June 30, 2018, the total notional amounts of credit contracts purchased and sold were $4 million and $82 million, respectively. As of June 30, 2017, the total notional amounts of credit contracts purchased and sold were $267 million and $63 million, respectively.

Credit-Risk-Related Contingent Features

Certain of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of June 30, 2018, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

Fair Values of Derivative Instruments

The following table presents the fair values of derivative instruments designated as hedging instruments (“designated hedge derivatives”) and not designated as hedging instruments (“non-designated hedge derivatives”). The fair values exclude the impact of netting derivative assets and liabilities when a legally enforceable master netting agreement exists and fair value adjustments related to our own credit risk and counterparty credit risk:

	Assets				Liabilities	
(In millions)	Short-term Investments	Other Current Assets	Equity and Other Investments	Other Long-term Assets	Other Current Liabilities	Other Long-term Liabilities
June 30, 2018						
Non-designated Hedge Derivatives						
Foreign exchange contracts	$ 10	$ 221	$ 0	$ 25	$ (193)	$ (4)
Equity contracts	2	0	0	0	(7)	0
Interest rate contracts	11	0	0	0	(2)	0
Credit contracts	0	0	0	0	(1)	0
Total	$ 23	$ 221	$ 0	$ 25	$ (203)	$ (4)
Designated Hedge Derivatives						
Foreign exchange contracts	$ 95	$ 174	$ 0	$ 0	$ 0	$ 0
Equity contracts	0	0	0	0	0	0
Total	$ 95	$ 174	$ 0	$ 0	$ 0	$ 0
Total gross amounts of derivatives	$ 118	$ 395	$ 0	$ 25	$ (203)	$ (4)
Gross derivatives either offset or subject to an enforceable master netting agreement	$ 113	$ 395	$ 0	$ 25	$ (203)	$ (4)
Gross amounts of derivatives offset on the balance sheet	(14)	(135)	0	(3)	150	3
Net amounts presented on the balance sheet	99	260	0	22	(53)	(1)

Gross amounts of derivatives not offset on the balance sheet	**0**	**0**	**0**	**0**	**0**	**0**
Cash collateral received	**0**	**0**	**0**	**0**	**(235)**	**0**
Net amount	**$ 99**	**$ 260**	**$ 0**	**$ 22**	**$ (288)**	**$ (1)**

(In millions)	Assets: Short-term Investments	Assets: Other Current Assets	Assets: Equity and Other Investments	Assets: Other Long-term Assets	Liabilities: Other Current Liabilities	Liabilities: Other Long-term Liabilities
June 30, 2017						
Non-designated Hedge Derivatives						
Foreign exchange contracts	$ 9	$ 203	$ 0	$ 6	$ (134)	$ (8)
Equity contracts	3	0	0	0	(6)	0
Interest rate contracts	3	0	0	0	(7)	0
Credit contracts	5	0	0	0	(1)	0
Total	$ 20	$ 203	$ 0	$ 6	$ (148)	$ (8)
Designated Hedge Derivatives						
Foreign exchange contracts	$ 80	$ 133	$ 0	$ 0	$ (3)	$ 0
Equity contracts	0	0	67	0	(186)	0
Total	$ 80	$ 133	$ 67	$ 0	$ (189)	$ 0
Total gross amounts of derivatives	$ 100	$ 336	$ 67	$ 6	$ (337)	$ (8)
Gross derivatives either offset or subject to an enforceable master netting agreement	$ 100	$ 336	$ 67	$ 6	$ (334)	$ (8)
Gross amounts of derivatives offset on the balance sheet	(20)	(132)	(67)	(8)	221	7
Net amounts presented on the balance sheet	80	204	0	(2)	(113)	(1)
Gross amounts of derivatives not offset on the balance sheet	0	0	0	0	0	0
Cash collateral received	0	0	0	0	(228)	0
Net amount	$ 80	$ 204	$ 0	$ (2)	$ (341)	$ (1)

Refer to Note 4 – Investments and Note 6 – Fair Value Measurements for further information.

Fair Value Hedge Gains (Losses)

We recognized in other income (expense), net the following gains (losses) on contracts designated as fair value hedges and their related hedged items:

(In millions)

Year Ended June 30,	2018	2017	2016
Foreign Exchange Contracts			
Derivatives	**$ 25**	$ 441	$ (797)
Hedged items	**78**	(386)	838
Total amount of ineffectiveness	**$ 103**	$ 55	$ 41
Equity Contracts			
Derivatives	**$ (324)**	$ (74)	$ (76)
Hedged items	**324**	74	76

Total amount of ineffectiveness	**$ 0**	$ 0	$ 0
Amount of equity contracts excluded from effectiveness assessment	**$ 80**	$ (80)	$ (10)

Cash Flow Hedge Gains (Losses)

We recognized the following gains (losses) on foreign exchange contracts designated as cash flow hedges:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Effective Portion			
Gains recognized in other comprehensive income (net of tax of **$11**, $4, and $24)	**$ 219**	$ 328	$ 351
Gains reclassified from accumulated other comprehensive income (loss) into revenue	**185**	555	625
Amount Excluded from Effectiveness Assessment and Ineffective Portion			
Losses recognized in other income (expense), net	**(255)**	(389)	(354)

We estimate that $179 million of net derivative gains included in AOCI as of June 30, 2018 will be reclassified into earnings within the following 12 months. No significant amounts of gains (losses) were reclassified from AOCI into earnings as a result of forecasted transactions that failed to occur during fiscal year 2018.

Non-designated Derivative Gains (Losses)

Gains (losses) from changes in fair values of derivatives that are not designated as hedges are primarily recognized in other income (expense), net. These amounts are shown in the table below, with the exception of gains (losses) on derivatives presented in income statement line items other than other income (expense), net, which were immaterial for the periods presented.

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Foreign exchange contracts	**$ (33)**	$ (117)	$ (55)
Equity contracts	**(87)**	(114)	(21)
Interest rate contracts	**(15)**	14	10
Credit contracts	**(2)**	5	(1)
Other contracts	**0**	(22)	(87)
Total	**$ (137)**	$ (234)	$ (154)

NOTE 6 — FAIR VALUE MEASUREMENTS

Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the fair value of our financial instruments that are measured at fair value on a recurring basis:

(In millions)	Level 1	Level 2	Level 3	Gross Fair Value	Netting [(a)]	Net Fair Value
June 30, 2018						
Assets						
Mutual funds	**$ 246**	**$ 0**	**$ 0**	**$ 246**	**$ 0**	**$ 246**
Commercial paper	**0**	**2,513**	**0**	**2,513**	**0**	**2,513**
Certificates of deposit	**0**	**2,058**	**0**	**2,058**	**0**	**2,058**
U.S. government and agency securities	**107,015**	**1,742**	**0**	**108,757**	**0**	**108,757**
Foreign government bonds	**22**	**5,054**	**0**	**5,076**	**0**	**5,076**
Mortgage- and asset-backed securities	**0**	**3,855**	**0**	**3,855**	**0**	**3,855**
Corporate notes and bonds	**0**	**6,894**	**15**	**6,909**	**0**	**6,909**
Municipal securities	**0**	**307**	**0**	**307**	**0**	**307**
Common and preferred stock	**287**	**0**	**18**	**305**	**0**	**305**
Derivatives	**1**	**535**	**2**	**538**	**(152)**	**386**
Total	**$ 107,571**	**$ 22,958**	**$ 35**	**$ 130,564**	**$ (152)**	**$ 130,412**
Liabilities						
Derivatives and other	**$ 1**	**$ 206**	**$ 0**	**$ 207**	**$ (153)**	**$ 54**

(In millions)	Level 1	Level 2	Level 3	Gross Fair Value	Netting [(a)]	Net Fair Value
June 30, 2017						
Assets						
Mutual funds	$ 1,478	$ 0	$ 0	$ 1,478	$ 0	$ 1,478
Commercial paper	0	319	0	319	0	319
Certificates of deposit	0	1,358	0	1,358	0	1,358
U.S. government and agency securities	109,228	2,616	0	111,844	0	111,844
Foreign government bonds	0	5,187	0	5,187	0	5,187
Mortgage- and asset-backed securities	0	3,934	0	3,934	0	3,934
Corporate notes and bonds	0	4,829	1	4,830	0	4,830
Municipal securities	0	327	0	327	0	327
Common and preferred stock	2,414	1,994	18	4,426	0	4,426
Derivatives	1	508	0	509	(227)	282
Total	$ 113,121	$ 21,072	$ 19	$ 134,212	$ (227)	$ 133,985
Liabilities						
Derivatives and other	$ 0	$ 345	$ 39	$ 384	$ (228)	$ 156

(a) *These amounts represent the impact of netting derivative assets and derivative liabilities when a legally enforceable master netting agreement exists and fair value adjustments related to our own credit risk and counterparty credit risk.*

The changes in our Level 3 financial instruments that are measured at fair value on a recurring basis were immaterial during the periods presented.

The following table reconciles the total “Net Fair Value” of assets above to the balance sheet presentation of these same assets in Note 4 – Investments.

(In millions)

June 30,	**2018**	**2017**
Net fair value of assets measured at fair value on a recurring basis	**$ 130,412**	$ 133,985
Cash	**3,942**	3,624
Common and preferred stock measured at fair value on a nonrecurring basis	**999**	1,073
Other investments measured at fair value on a nonrecurring basis	**557**	523
Less derivative net assets classified as other current and long-term assets	**(282)**	(202)
Other	**2**	1
Recorded basis of investment components	**$ 135,630**	$ 139,004

Financial Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

During fiscal year 2018 and 2017, we did not record any material other-than-temporary impairments on financial assets required to be measured at fair value on a nonrecurring basis.

NOTE 7 — INVENTORIES

The components of inventories were as follows:

(In millions)

June 30,	**2018**	**2017**
Raw materials	**$ 655**	$ 797
Work in process	**54**	145
Finished goods	**1,953**	1,239
Total	**$ 2,662**	$ 2,181

NOTE 8 — PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

(In millions)

June 30,	**2018**	**2017**
Land	**$ 1,254**	$ 1,107
Buildings and improvements	**20,604**	16,284
Leasehold improvements	**4,735**	5,064
Computer equipment and software	**27,633**	21,414
Furniture and equipment	**4,457**	4,044
Total, at cost	**58,683**	47,913
Accumulated depreciation	**(29,223)**	(24,179)
Total, net	**$ 29,460**	$ 23,734

During fiscal years 2018, 2017, and 2016, depreciation expense was $7.7 billion, $6.1 billion, and $4.9 billion, respectively. We have committed $1.9 billion for the construction of new buildings, building improvements, and leasehold improvements as of June 30, 2018.

NOTE 9 — BUSINESS COMBINATIONS

LinkedIn Corporation

On December 8, 2016, we completed our acquisition of all issued and outstanding shares of LinkedIn Corporation, the world's largest professional network on the Internet, for a total purchase price of $27.0 billion. The purchase price consisted primarily of cash of $26.9 billion. The acquisition is expected to accelerate the growth of LinkedIn, Office 365, and Dynamics 365. The financial results of LinkedIn have been included in our consolidated financial statements since the date of the acquisition.

The allocation of the purchase price to goodwill was completed as of June 30, 2017.

The major classes of assets and liabilities to which we allocated the purchase price were as follows:

(In millions)	
Cash and cash equivalents	$ 1,328
Short-term investments	2,110
Other current assets	697
Property and equipment	1,529
Intangible assets	7,887
Goodwill (a)	16,803
Short-term debt (b)	(1,323)
Other current liabilities	(1,117)
Deferred income taxes	(774)
Other	(131)
Total purchase price	$ 27,009

(a) *Goodwill was assigned to our Productivity and Business Processes segment. The goodwill was primarily attributed to increased synergies that are expected to be achieved from the integration of LinkedIn. None of the goodwill is expected to be deductible for income tax purposes.*

(b) *Convertible senior notes issued by LinkedIn on November 12, 2014, substantially all of which were redeemed after our acquisition of LinkedIn. The remaining $18 million of notes are not redeemable and are included in long-term debt in our consolidated balance sheets. Refer to Note 12 – Debt for further information.*

Following are the details of the purchase price allocated to the intangible assets acquired:

(In millions)	Amount	Weighted Average Life
Customer-related	$ 3,607	7 years
Marketing-related (trade names)	2,148	20 years
Technology-based	2,109	3 years
Contract-based	23	5 years
Fair value of intangible assets acquired	$ 7,887	9 years

Our consolidated income statements include the following revenue and operating loss attributable to LinkedIn since the date of acquisition:

(In millions)

Year Ended June 30,	2017
Revenue	$ 2,271
Operating loss	(924)

Following are the supplemental consolidated financial results of Microsoft Corporation on an unaudited pro forma basis, as if the acquisition had been consummated on July 1, 2015:

(In millions, except earnings per share)

Year Ended June 30,	2017	2016
Revenue	$ 98,291	$ 94,490
Net income	25,179	19,128
Diluted earnings per share	3.21	2.38

These pro forma results were based on estimates and assumptions, which we believe are reasonable. They are not the results that would have been realized had we been a combined company during the periods presented and are not necessarily indicative of our consolidated results of operations in future periods. The pro forma results include adjustments related to purchase accounting, primarily amortization of intangible assets. Acquisition costs and other nonrecurring charges were immaterial and are included in the earliest period presented.

GitHub Inc.

On June 4, 2018, we entered into a definitive agreement to acquire GitHub Inc. (“GitHub”) for $7.5 billion in an all-stock transaction. We expect the acquisition will close by the end of the calendar year, subject to approval by GitHub’s shareholders, satisfaction of certain regulatory approvals, and other customary closing conditions. GitHub will be included in our consolidated results of operations as of the date of acquisition.

Other

During fiscal year 2018, we completed nine acquisitions for total consideration of $948 million, substantially all of which was paid in cash. These entities have been included in our consolidated results of operations since their respective acquisition dates. Pro forma results of operations for these acquisitions have not been presented because the effects of these business combinations, individually and in aggregate, were not material to our consolidated results of operations.

NOTE 10 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	June 30, 2016	Acquisitions	Other	June 30, 2017	Acquisitions	Other	June 30, 2018
Productivity and Business Processes	$ 6,678	$ 17,072 (a)	$ (11)	$ 23,739	**$ 72**	**$ 12**	**$ 23,823**
Intelligent Cloud	5,467	49	39	5,555	**164**	**(16)**	**5,703**
More Personal Computing	5,727	115	(14)	5,828	**394**	**(65)**	**6,157**
Total	$ 17,872	$ 17,236	$ 14	$ 35,122	**$ 630**	**$ (69)**	**$ 35,683**

(a) *Includes goodwill related to LinkedIn and other acquisitions. Refer to Note 9 – Business Combinations for further information.*

The measurement periods for the valuation of assets acquired and liabilities assumed end as soon as information on the facts and circumstances that existed as of the acquisition dates becomes available, but do not exceed 12 months. Adjustments in purchase price allocations may require a change in the amounts allocated to goodwill during the periods in which the adjustments are determined.

Any change in the goodwill amounts resulting from foreign currency translations and purchase accounting adjustments are presented as “Other” in the above table. Also included in “Other” are business dispositions and transfers between segments due to reorganizations, as applicable.

As of June 30, 2018 and 2017, accumulated goodwill impairment was $11.3 billion.

Goodwill Impairment

We test goodwill for impairment annually on May 1 at the reporting unit level, primarily using a discounted cash flow methodology with a peer-based, risk-adjusted weighted average cost of capital. We believe use of a discounted cash flow approach is the most reliable indicator of the fair values of the businesses.

No instances of impairment were identified in our May 1, 2018, May 1, 2017, or May 1, 2016 tests.

NOTE 11 — INTANGIBLE ASSETS

The components of intangible assets, all of which are finite-lived, were as follows:

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
June 30,			**2018**			**2017**
Technology-based	**$ 7,220**	**$ (5,018)**	**$ 2,202**	$ 7,765	$ (4,318)	$ 3,447
Customer-related	**4,031**	**(1,205)**	**2,826**	4,045	(692)	3,353
Marketing-related	**4,006**	**(1,071)**	**2,935**	4,016	(829)	3,187
Contract-based	**679**	**(589)**	**90**	841	(722)	119
Total	**$ 15,936**	**$ (7,883)**	**$ 8,053**	$ 16,667	$ (6,561)	$ 10,106

No material impairments of intangible assets were identified during fiscal year 2018 or 2017.

During fiscal year 2016, we recorded impairment charges of $480 million related to intangible assets in the Devices reporting unit within our More Personal Computing segment. In the fourth quarter of fiscal year 2016, we tested these intangible assets for recoverability due to changes in facts and circumstances associated with the shift in strategic direction and reduced profitability expectations for our Phone business. Based on the results of our testing, we determined that the carrying value of the intangible assets was not recoverable, and an impairment charge was recorded to the extent that estimated fair value exceeded carrying value. We primarily used the income approach to determine the fair value of the intangible assets and determine the amount of impairment.

These intangible assets impairment charges were included in impairment and restructuring expenses in our consolidated income statement and reflected in Corporate and Other in our table of operating income (loss) by segment in Note 21 – Segment Information and Geographic Data.

We estimate that we have no significant residual value related to our intangible assets.

The components of intangible assets acquired during the periods presented were as follows:

(In millions)	Amount	Weighted Average Life	Amount	Weighted Average Life
Year Ended June 30,	**2018**		**2017**	
Technology-based	**$ 178**	**4 years**	$ 2,265	2 years
Marketing-related	**14**	**5 years**	2,148	19 years
Contract-based	**14**	**4 years**	63	6 years
Customer-related	**13**	**5 years**	3,607	7 years
Total	**$ 219**	**5 years**	$ 8,083	9 years

Intangible assets amortization expense was $2.2 billion, $1.7 billion, and $978 million for fiscal years 2018, 2017, and 2016, respectively. Amortization of capitalized software was $54 million, $55 million, and $69 million for fiscal years 2018, 2017, and 2016, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of June 30, 2018:

(In millions)

Year Ending June 30,	
2019	$ 1,785
2020	1,260
2021	1,043
2022	949
2023	806
Thereafter	2,210
Total	$ 8,053

NOTE 12 — DEBT

Short-term Debt

As of June 30, 2018, we had no commercial paper issued and outstanding. As of June 30, 2017, we had \$9.1 billion of commercial paper issued and outstanding, with a weighted average interest rate of 1.01% and maturities ranging from 25 days to 264 days. The estimated fair value of this commercial paper approximates its carrying value.

We have two \$5.0 billion credit facilities that expire on October 30, 2018 and October 31, 2022, respectively. These credit facilities serve as a back-up for our commercial paper program. As of June 30, 2018, we were in compliance with the only financial covenant in both credit agreements, which requires us to maintain a coverage ratio of at least three times earnings before interest, taxes, depreciation, and amortization to interest expense, as defined in the credit agreements. No amounts were drawn against these credit facilities during any of the periods presented.

Long-term Debt

As of June 30, 2018, the total carrying value and estimated fair value of our long-term debt, including the current portion, were \$76.2 billion and \$77.5 billion, respectively. As of June 30, 2017, the total carrying value and estimated fair value of our long-term debt, including the current portion, were \$77.1 billion and \$80.3 billion, respectively. These estimated fair values are based on Level 2 inputs.

The components of our long-term debt, including the current portion, and the associated interest rates were as follows:

(In millions, except interest rates)	Face Value June 30, 2018	Face Value June 30, 2017	Stated Interest Rate	Effective Interest Rate
Notes				
November 15, 2017	**$ 0**	$ 600	**0.875%**	**1.084%**
May 1, 2018	**0**	450	**1.000%**	**1.106%**
November 3, 2018	**1,750**	1,750	**1.300%**	**1.396%**
December 6, 2018	**1,250**	1,250	**1.625%**	**1.824%**
June 1, 2019	**1,000**	1,000	**4.200%**	**4.379%**
August 8, 2019	**2,500**	2,500	**1.100%**	**1.203%**
November 1, 2019	**18**	18	**0.500%**	**0.500%**
February 6, 2020	**1,500**	1,500	**1.850%**	**1.952%**
February 12, 2020	**1,500**	1,500	**1.850%**	**1.935%**
October 1, 2020	**1,000**	1,000	**3.000%**	**3.137%**
November 3, 2020	**2,250**	2,250	**2.000%**	**2.093%**
February 8, 2021	**500**	500	**4.000%**	**4.082%**
August 8, 2021	**2,750**	2,750	**1.550%**	**1.642%**
December 6, 2021 (a)	**2,044**	1,996	**2.125%**	**2.233%**
February 6, 2022	**1,750**	1,750	**2.400%**	**2.520%**
February 12, 2022	**1,500**	1,500	**2.375%**	**2.466%**
November 3, 2022	**1,000**	1,000	**2.650%**	**2.717%**
November 15, 2022	**750**	750	**2.125%**	**2.239%**
May 1, 2023	**1,000**	1,000	**2.375%**	**2.465%**
August 8, 2023	**1,500**	1,500	**2.000%**	**2.101%**
December 15, 2023	**1,500**	1,500	**3.625%**	**3.726%**
February 6, 2024	**2,250**	2,250	**2.875%**	**3.041%**
February 12, 2025	**2,250**	2,250	**2.700%**	**2.772%**
November 3, 2025	**3,000**	3,000	**3.125%**	**3.176%**
August 8, 2026	**4,000**	4,000	**2.400%**	**2.464%**
February 6, 2027	**4,000**	4,000	**3.300%**	**3.383%**
December 6, 2028 (a)	**2,044**	1,996	**3.125%**	**3.218%**
May 2, 2033 (a)	**642**	627	**2.625%**	**2.690%**
February 12, 2035	**1,500**	1,500	**3.500%**	**3.604%**
November 3, 2035	**1,000**	1,000	**4.200%**	**4.260%**
August 8, 2036	**2,250**	2,250	**3.450%**	**3.510%**
February 6, 2037	**2,500**	2,500	**4.100%**	**4.152%**
June 1, 2039	**750**	750	**5.200%**	**5.240%**
October 1, 2040	**1,000**	1,000	**4.500%**	**4.567%**
February 8, 2041	**1,000**	1,000	**5.300%**	**5.361%**
November 15, 2042	**900**	900	**3.500%**	**3.571%**
May 1, 2043	**500**	500	**3.750%**	**3.829%**
December 15, 2043	**500**	500	**4.875%**	**4.918%**
February 12, 2045	**1,750**	1,750	**3.750%**	**3.800%**
November 3, 2045	**3,000**	3,000	**4.450%**	**4.492%**
August 8, 2046	**4,500**	4,500	**3.700%**	**3.743%**
February 6, 2047	**3,000**	3,000	**4.250%**	**4.287%**
February 12, 2055	**2,250**	2,250	**4.000%**	**4.063%**
November 3, 2055	**1,000**	1,000	**4.750%**	**4.782%**
August 8, 2056	**2,250**	2,250	**3.950%**	**4.033%**
February 6, 2057	**2,000**	2,000	**4.500%**	**4.528%**
Total	**$ 76,898**	$ 77,837		

(a) *Euro-denominated debt securities.*

The notes in the table above are senior unsecured obligations and rank equally with our other senior unsecured debt outstanding. Interest on these notes is paid semi-annually, except for the euro-denominated debt securities on which interest is paid annually. Cash paid for interest on our debt for fiscal years 2018, 2017, and 2016 was $2.4 billion, $1.6 billion, and $1.1 billion, respectively. As of June 30, 2018 and 2017, the aggregate debt issuance costs and unamortized discount associated with our long-term debt, including the current portion, were $658 million and $715 million, respectively.

Maturities of our long-term debt for each of the next five years and thereafter are as follows:

(In millions)

Year Ending June 30,	
2019	$ 4,000
2020	5,518
2021	3,750
2022	8,044
2023	2,750
Thereafter	52,836
Total	$ 76,898

NOTE 13 — INCOME TAXES

Recent Tax Legislation

On December 22, 2017, the TCJA was enacted into law, which significantly changes existing U.S. tax law and includes numerous provisions that affect our business, such as imposing a one-time transition tax on deemed repatriation of deferred foreign income, reducing the U.S. federal statutory tax rate, and adopting a territorial tax system. The TCJA required us to incur a one-time transition tax on deferred foreign income not previously subject to U.S. income tax at a rate of 15.5% for foreign cash and certain other net current assets, and 8% on the remaining income. The TCJA also reduced the U.S. federal statutory tax rate from 35% to 21% effective January 1, 2018. For fiscal year 2018, our blended U.S. federal statutory tax rate is 28.1%. This is the result of using the tax rate of 35% for the first and second quarter of fiscal year 2018 and the reduced tax rate of 21% for the third and fourth quarter of fiscal year 2018. The TCJA includes a provision to tax global intangible low-taxed income (“GILTI”) of foreign subsidiaries and a base erosion anti-abuse tax (“BEAT”) measure that taxes certain payments between a U.S. corporation and its foreign subsidiaries. The GILTI and BEAT provisions of the TCJA will be effective for us beginning July 1, 2018.

The TCJA was effective in the second quarter of fiscal year 2018. As of June 30, 2018, we have not completed our accounting for the estimated tax effects of the TCJA. During fiscal year 2018, we recorded a provisional net charge of $13.7 billion related to the TCJA based on reasonable estimates for those tax effects. Due to the timing of the enactment and the complexity in applying the provisions of the TCJA, the provisional net charge is subject to revisions as we continue to complete our analysis of the TCJA, collect and prepare necessary data, and interpret any additional guidance issued by the U.S. Treasury Department, Internal Revenue Service (“IRS”), FASB, and other standard-setting and regulatory bodies. Adjustments may materially impact our provision for income taxes and effective tax rate in the period in which the adjustments are made. Our accounting for the estimated tax effects of the TCJA will be completed during the measurement period, which is not expected to extend beyond one year from the enactment date. The impacts of our estimates are described further below.

During fiscal year 2018, we recorded an estimated net charge of $13.7 billion related to the TCJA, due to the impact of the one-time transition tax on the deemed repatriation of deferred foreign income of $17.9 billion, offset in part by the impact of changes in the tax rate of $4.2 billion, primarily on deferred tax assets and liabilities.

We recorded an estimated $17.9 billion charge in fiscal year 2018 related to the transition tax, which was included in the provision for income taxes in our consolidated income statements and income taxes in our consolidated balance sheets. We have not yet completed our accounting for the transition tax as our analysis of deferred foreign income is not complete. To calculate the transition tax, we estimated our deferred foreign income for fiscal year 2018 because these tax returns are not complete or due. Fiscal year 2018 taxable income will be known once the respective tax returns are completed and filed. In addition, U.S. and foreign audit settlements may significantly impact the estimated transition tax. The impact of the U.S. and foreign audits on the transition tax will be known as the audits are concluded.

In addition, we recorded an estimated $4.2 billion benefit in fiscal year 2018 from the impact of changes in the tax rate, primarily on deferred tax assets and liabilities, which was included in provision for income taxes in our consolidated income statements and deferred income taxes and long-term income taxes in our consolidated balance sheets. We remeasured our deferred taxes to reflect the reduced rate that will apply when these deferred taxes are settled or realized in future periods.

The TCJA subjects a U.S. corporation to tax on its GILTI. Due to the complexity of the new GILTI tax rules, we are continuing to evaluate this provision of the TCJA and the application of GAAP. Under GAAP, we can make an accounting policy election to either treat taxes due on the GILTI inclusion as a current period expense or factor such amounts into our measurement of deferred taxes. We elected the deferred method, and the corresponding deferred tax assets and liabilities are included in the table of deferred income tax assets and liabilities below.

On August 1, 2018, the Internal Revenue Service published on its website proposed regulations relating to the transition tax imposed by the TCJA. Once published in the Federal Register, the proposed regulations are subject to a 60-day comment period. Final regulations are expected to be issued after consideration of comments. We are currently evaluating the impact of the proposed regulations.

Provision for Income Taxes

The components of the provision for income taxes were as follows:

(In millions)

Year Ended June 30,	2018	2017	2016
Current Taxes			
U.S. federal	**$ 19,764**	$ 2,739	$ 545
U.S. state and local	**934**	30	136
Foreign	**4,348**	2,472	1,940
Current taxes	**$ 25,046**	$ 5,241	$ 2,621
Deferred Taxes			
U.S. federal	**$ (4,292)**	$ (554)	$ 1,919
U.S. state and local	**(458)**	269	111
Foreign	**(393)**	(544)	449
Deferred taxes	**$ (5,143)**	$ (829)	$ 2,479
Provision for income taxes	**$ 19,903**	$ 4,412	$ 5,100

U.S. and foreign components of income before income taxes were as follows:

(In millions)

Year Ended June 30,	2018	2017	2016
U.S.	**$ 11,527**	$ 6,843	$ 5,125
Foreign	**24,947**	23,058	20,514
Income before income taxes	**$ 36,474**	$ 29,901	$ 25,639

Effective Tax Rate

The items accounting for the difference between income taxes computed at the U.S. federal statutory rate and our effective rate were as follows:

Year Ended June 30,	2018	2017	2016
Federal statutory rate	**28.1%**	35.0%	35.0%
Effect of:			
Foreign earnings taxed at lower rates	**(7.8)%**	(11.6)%	(14.5)%
Impacts of TCJA	**37.7%**	0%	0%
Phone business losses	**0%**	(5.7)%	1.0%
Excess tax benefits relating to stock-based compensation	**(2.5)%**	(2.1)%	(1.6)%
Interest, net	**1.2%**	1.4%	0.9%
Other reconciling items, net	**(2.1)%**	(2.2)%	(0.9)%
Effective rate	**54.6%**	14.8%	19.9%

The increase from the federal statutory rate in fiscal year 2018 is primarily due to the net charge related to the enactment of the TCJA in the second quarter of fiscal year 2018, offset in part by earnings taxed at lower rates in foreign jurisdictions. The decrease from the federal statutory rate in fiscal year 2017 and 2016 is primarily due to earnings taxed at lower rates in foreign jurisdictions. Our foreign regional operating centers in Ireland, Singapore and Puerto Rico, which are taxed at rates lower than the U.S. rate, generated 87%, 76%, and 91% of our foreign income before tax in fiscal years 2018, 2017, and 2016, respectively. Other reconciling items, net consists primarily of tax credits, U.S. state income taxes, and domestic production activities deduction. In fiscal years 2018, 2017, and 2016, there were no individually significant other reconciling items.

The increase in our effective tax rate for fiscal year 2018 compared to fiscal year 2017 was primarily due to the net charge related to the enactment of the TCJA and the realization of tax benefits attributable to previous Phone business losses in fiscal year 2017. The decrease in our effective tax rate for fiscal year 2017 compared to fiscal year 2016 was primarily due to the realization of tax benefits attributable to previous Phone business losses, offset in part by changes in the mix of our income before income taxes between the U.S. and foreign countries.

The components of the deferred income tax assets and liabilities were as follows:

(In millions)

June 30,	**2018**	**2017**
Deferred Income Tax Assets		
Stock-based compensation expense	**$ 460**	$ 777
Accruals, reserves, and other expenses	**1,832**	1,859
Loss and credit carryforwards	**3,369**	4,809
Depreciation and amortization	**351**	53
Other	**56**	255
Deferred income tax assets	**6,068**	7,753
Less valuation allowance	**(3,186)**	(3,310)
Deferred income tax assets, net of valuation allowance	**$ 2,882**	$ 4,443
Deferred Income Tax Liabilities		
Foreign earnings	**$ 0**	$ (1,134)
Unrealized gain on investments and debt	**0**	(1,384)
Unearned revenue	**(639)**	(5,760)
Depreciation and amortization	**(1,103)**	(1,630)
Other	**(312)**	(21)
Deferred income tax liabilities	**$ (2,054)**	$ (9,929)
Net deferred income tax assets (liabilities)	**$ 828**	$ (5,486)
Reported As		
Other long-term assets	**$ 1,369**	$ 248
Long-term deferred income tax liabilities	**(541)**	(5,734)
Net deferred income tax assets (liabilities)	**$ 828**	$ (5,486)

We recorded a deferred tax liability of $7.4 billion related to the recognition of revenue as part of the adoption of the new revenue standard.

As of June 30, 2018, we had federal, state and foreign net operating loss carryforwards of $257 million, $1.4 billion and $11.4 billion, respectively. The federal and state net operating loss carryforwards will expire in various years from fiscal 2019 through 2038, if not utilized. The majority of our foreign net operating loss carryforwards do not expire. Certain acquired net operating loss carryforwards are subject to an annual limitation, but are expected to be realized with the exception of those which have a valuation allowance.

The valuation allowance disclosed in the table above relates to the foreign net operating loss carryforwards and other net deferred tax assets that may not be realized.

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases and are stated at enacted tax rates expected to be in effect when the taxes are paid or recovered.

Income taxes paid, net of refunds, were $5.5 billion, $2.4 billion, and $3.9 billion in fiscal years 2018, 2017, and 2016, respectively.

Uncertain Tax Positions

Unrecognized tax benefits as of June 30, 2018, 2017, and 2016, were $12.0 billion, $11.7 billion, and $10.2 billion, respectively, and were included in long-term income taxes in our consolidated balance sheets. If recognized, these tax benefits would affect our effective tax rates for fiscal years 2018, 2017, and 2016, by $11.3 billion, $10.2 billion, and $8.8 billion, respectively.

As of June 30, 2018, 2017, and 2016, we had accrued interest expense related to uncertain tax positions of $3.0 billion, $2.3 billion, and $1.9 billion, respectively, net of income tax benefits. Interest expense on unrecognized tax benefits, net of tax effects, was $688 million, $399 million, and $163 million in fiscal years 2018, 2017, and 2016, respectively, and was included in provision for income taxes.

The aggregate changes in the balance of unrecognized tax benefits were as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Balance, beginning of year	**$ 11,737**	$ 10,164	$ 9,599
Decreases related to settlements	**(193)**	(4)	(201)
Increases for tax positions related to the current year	**1,445**	1,277	1,086
Increases for tax positions related to prior years	**151**	397	115
Decreases for tax positions related to prior years	**(1,176)**	(49)	(317)
Decreases due to lapsed statutes of limitations	**(3)**	(48)	(118)
Balance, end of year	**$ 11,961**	$ 11,737	$ 10,164

While we settled a portion of the IRS audit for tax years 2004 to 2006 during the third quarter of fiscal year 2011, and a portion of the IRS audit for tax years 2007 to 2009 during the first quarter of fiscal year 2016, we remain under audit for those years. In the second quarter of fiscal year 2018, we settled a portion of the IRS audit for tax years 2010 to 2013. We continue to be subject to examination by the IRS for tax years 2010 to 2017. In February 2012, the IRS withdrew its 2011 Revenue Agents Report for tax years 2004 to 2006 and reopened the audit phase of the examination. As of June 30, 2018, the primary unresolved issue relates to transfer pricing, which could have a significant impact in our consolidated financial statements if not resolved favorably. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2017, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 14 — RESTRUCTURING CHARGES

2016 Restructuring

In the fourth quarter of fiscal year 2016, management approved restructuring plans that resulted in approximately 4,700 job eliminations in fiscal year 2017, primarily across our smartphone hardware business and global sales. In fiscal year 2016, we incurred restructuring charges of $501 million in connection with the 2016 restructuring plans, including severance expenses and other reorganization costs. The actions associated with these restructuring plans were completed as of June 30, 2017.

2017 Restructuring

In June 2017, management approved a sales and marketing restructuring plan. In fiscal year 2017, we recorded employee severance expenses of $306 million primarily related to this sales and marketing restructuring plan. The actions associated with this restructuring plan were completed as of June 30, 2018.

NOTE 15 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

June 30,	**2018**	**2017**
Productivity and Business Processes	**$ 14,864**	$ 12,692
Intelligent Cloud	**14,706**	11,152
More Personal Computing	**3,150**	2,812
Total	**$ 32,720**	$ 26,656

The opening balance of unearned revenue was $22.2 billion as of July 1, 2016.

Changes in unearned revenue were as follows:

(In millions)

Year Ended June 30, 2018	
Balance, beginning of period	**$ 26,656**
Deferral of revenue	**61,142**
Recognition of unearned revenue	**(55,078)**
Balance, end of period	**$ 32,720**

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized (“contracted not recognized revenue”), which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods. Contracted not recognized revenue was $73 billion as of June 30, 2018, of which we expect to recognize approximately 60% of the revenue over the next 12 months and the remainder thereafter.

NOTE 16 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, retail stores, and certain equipment. Our leases have remaining lease terms of 1 year to 20 years, some of which include options to extend the leases for up to 5 years, and some of which include options to terminate the leases within 1 year.

The components of lease expense were as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Operating lease cost	**$ 1,585**	$ 1,412	$ 936
Finance lease cost:			
Amortization of right-of-use assets	**$ 243**	$ 104	$ 28
Interest on lease liabilities	**175**	68	28
Total finance lease cost	**$ 418**	$ 172	$ 56

Supplemental cash flow information related to leases was as follows:

(In millions)

Year Ended June 30,	2018	2017	2016
Cash paid for amounts included in the measurement of lease liabilities:			
Operating cash flows from operating leases	**$ 1,522**	$ 1,157	$ 936
Operating cash flows from finance leases	**175**	68	28
Financing cash flows from finance leases	**144**	46	6
Right-of-use assets obtained in exchange for lease obligations:			
Operating leases	**1,571**	1,270	1,062
Finance leases	**1,933**	1,773	413

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

June 30,	2018	2017
Operating Leases		
Operating lease right-of-use assets	**$ 6,686**	$ 6,555
Other current liabilities	**$ 1,399**	$ 1,423
Operating lease liabilities	**5,568**	5,372
Total operating lease liabilities	**$ 6,967**	$ 6,795
Finance Leases		
Property and equipment, gross	**$ 4,543**	$ 2,658
Accumulated depreciation	**(404)**	(161)
Property and equipment, net	**$ 4,139**	$ 2,497
Other current liabilities	**$ 176**	$ 113
Other long-term liabilities	**4,125**	2,425
Total finance lease liabilities	**$ 4,301**	$ 2,538
Weighted Average Remaining Lease Term		
Operating leases	**7 years**	7 years
Finance leases	**13 years**	13 years
Weighted Average Discount Rate		
Operating leases	**2.7%**	2.5%
Finance leases	**5.2%**	4.7%

Maturities of lease liabilities were as follows:

(In millions)

Year Ending June 30,	Operating Leases	Finance Leases
2019	$ 1,492	$ 386
2020	1,347	393
2021	1,086	401
2022	902	408
2023	721	410

Thereafter	2,157	4,036
Total lease payments	7,705	6,034
Less imputed interest	(738)	(1,733)
Total	$ 6,967	$ 4,301

As of June 30, 2018, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $594 million and $2.4 billion, respectively. These operating and finance leases will commence between fiscal year 2019 and fiscal year 2020 with lease terms of 1 year to 20 years.

NOTE 17 — CONTINGENCIES

Patent and Intellectual Property Claims

There were 34 patent infringement cases pending against Microsoft as of June 30, 2018, none of which are material individually or in aggregate.

Antitrust, Unfair Competition, and Overcharge Class Actions

Antitrust and unfair competition class action lawsuits were filed against us in British Columbia, Ontario, and Quebec, Canada. All three have been certified on behalf of Canadian indirect purchasers who acquired licenses for Microsoft operating system software and/or productivity application software between 1998 and 2010.

The trial of the British Columbia action commenced in May 2016. Following a mediation, the parties agreed to a global settlement of all three Canadian actions, and have submitted the proposed settlement agreement to the courts in all three jurisdictions for approval. The courts will likely reach a decision on approval in September 2018.

Other Antitrust Litigation and Claims

China State Administration for Industry and Commerce Investigation

In 2014, Microsoft was informed that China's State Agency for Market Regulation ("SAMR") (formerly State Administration for Industry and Commerce) had begun a formal investigation relating to China's Anti-Monopoly Law, and the SAMR conducted onsite inspections of Microsoft offices in Beijing, Shanghai, Guangzhou, and Chengdu. SAMR has stated the investigation relates to compatibility, bundle sales, file verification issues related to Windows and Office software, and potentially other issues.

Product-Related Litigation

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 35 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs' expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants' motion to exclude the plaintiffs' general causation experts. The defendants filed an interlocutory appeal challenging the standard for evaluating expert scientific evidence, which the District of Columbia Court of Appeals heard *en banc*. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which the defendants have moved to strike.

Canadian Cell Phone Class Action

Microsoft Mobile Oy, along with other handset manufacturers and network operators, is a defendant in a 2013 class action lawsuit filed in the Supreme Court of British Columbia by a purported class of Canadians who have used cellular phones for at least 1,600 hours, including a subclass of users with brain tumors, alleging adverse health effects from cellular phone use. Microsoft was served with the complaint in June 2014 and has been substituted for the Nokia defendants. The litigation has been dormant for more than three years.

Employment-Related Litigation

Moussouris v. Microsoft

Current and former female Microsoft employees in certain engineering and information technology roles brought this class action in federal court in Seattle in 2015, alleging systemic gender discrimination in pay and promotions. The plaintiffs moved to certify the class in October 2017. Microsoft filed an opposition in January 2018, attaching an expert report showing no statistically significant disparity in pay and promotions between similarly situated men and women. In June 2018, the court denied the plaintiffs' motion for class certification. The plaintiffs have appealed to the U.S. Court of Appeals for the Ninth Circuit. In July, the court denied Microsoft's motion for summary judgment with respect to the named plaintiffs.

Other Contingencies

We also are subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in aggregate, will not have a material adverse impact in our consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future.

As of June 30, 2018, we accrued aggregate legal liabilities of $323 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $1.1 billion in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

Indemnifications

We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products and certain other matters. Additionally, we have agreed to cover damages resulting from breaches of certain security and privacy commitments in our cloud business. In evaluating estimated losses on these obligations, we consider factors such as the degree of probability of an unfavorable outcome and our ability to make a reasonable estimate of the amount of loss. These obligations did not have a material impact in our consolidated financial statements during the periods presented.

NOTE 18 — STOCKHOLDERS' EQUITY

Shares Outstanding

Shares of common stock outstanding were as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Balance, beginning of year	**7,708**	7,808	8,027
Issued	**68**	70	75
Repurchased	**(99)**	(170)	(294)
Balance, end of year	**7,677**	7,708	7,808

Share Repurchases

On September 16, 2013, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program became effective on October 1, 2013, and was completed on December 22, 2016.

On September 20, 2016, our Board of Directors approved a share repurchase program authorizing up to an additional $40.0 billion in share repurchases. This share repurchase program commenced on December 22, 2016 following completion of the prior program approved on September 16, 2013, has no expiration date, and may be suspended or discontinued at any time without notice. As of June 30, 2018, $28.2 billion remained of this $40.0 billion share repurchase program.

We repurchased the following shares of common stock under the share repurchase programs:

(In millions)	Shares	Amount	Shares	Amount	Shares	Amount
Year Ended June 30,		2018		2017		2016
First Quarter	**22**	**$ 1,600**	63	$ 3,550	89	$ 4,000
Second Quarter	**22**	**1,800**	59	3,533	66	3,600
Third Quarter	**34**	**3,100**	25	1,600	69	3,600
Fourth Quarter	**21**	**2,100**	23	1,600	70	3,600
Total	**99**	**$ 8,600**	170	$ 10,283	294	$ 14,800

Shares repurchased beginning in the third quarter of fiscal year 2017 were under the share repurchase program approved September 20, 2016. All other shares repurchased were under the share repurchase program approved September 16, 2013. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards. All repurchases were made using cash resources.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Dividend Per Share	Record Date	Amount	Payment Date
Fiscal Year 2018			(in millions)	
September 19, 2017	**$ 0.42**	**November 16, 2017**	**$ 3,238**	**December 14, 2017**
November 29, 2017	**0.42**	**February 15, 2018**	**3,232**	**March 8, 2018**
March 12, 2018	**0.42**	**May 17, 2018**	**3,226**	**June 14, 2018**
June 13, 2018	**0.42**	**August 16, 2018**	**3,224**	**September 13, 2018**
Fiscal Year 2017				
September 20, 2016	$ 0.39	November 17, 2016	$ 3,024	December 8, 2016
November 30, 2016	0.39	February 16, 2017	3,012	March 9, 2017
March 14, 2017	0.39	May 18, 2017	3,009	June 8, 2017
June 13, 2017	0.39	August 17, 2017	3,003	September 14, 2017

The dividend declared on June 13, 2018 was included in other current liabilities as of June 30, 2018.

NOTE 19 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following table summarizes the changes in accumulated other comprehensive income (loss) by component:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Derivatives			
Balance, beginning of period	**$ 134**	$ 352	$ 590
Unrealized gains, net of tax of **$11**, $4, and $24	**218**	328	351
Reclassification adjustments for gains included in revenue	**(185)**	(555)	(625)
Tax expense included in provision for income taxes	**6**	9	36
Amounts reclassified from accumulated other comprehensive income	**(179)**	(546)	(589)
Net change related to derivatives, net of tax of **$5,** $(5), and $(12)	**39**	(218)	(238)
Balance, end of period	**$ 173**	$ 134	$ 352
Investments			
Balance, beginning of period	**$ 1,825**	$ 2,941	$ 3,169
Unrealized gains (losses), net of tax of **$(427)**, $267, and $120	**(1,146)**	517	219
Reclassification adjustments for gains included in other income (expense), net	**(2,309)**	(2,513)	(688)
Tax expense included in provision for income taxes	**738**	880	241
Amounts reclassified from accumulated other comprehensive income	**(1,571)**	(1,633)	(447)
Net change related to investments, net of tax of **$(1,165)**, $(613), and $(121)	**(2,717)**	(1,116)	(228)
Balance, end of period	**$ (892)**	$ 1,825	$ 2,941
Translation Adjustments and Other			
Balance, beginning of period	**$ (1,332)**	$ (1,499)	$ (1,237)
Translation adjustments and other, net of tax effects of **$0**, $9, and $(33)	**(178)**	167	(262)
Balance, end of period	**$ (1,510)**	$ (1,332)	$ (1,499)
Cumulative effect of accounting change	**42**	0	0
Accumulated other comprehensive income (loss), end of period	**$ (2,187)**	$ 627	$ 1,794

NOTE 20 — EMPLOYEE STOCK AND SAVINGS PLANS

We grant stock-based compensation to employees and directors. As of June 30, 2018, an aggregate of 381 million shares were authorized for future grant under our stock plans. In fiscal year 2018, our Board of Directors approved the 2017 Stock Plan, which authorized an additional 308 million shares for future grant under our stock plans. Awards that expire or are canceled without delivery of shares generally become available for issuance under the plans. We issue new shares of Microsoft common stock to satisfy vesting of awards granted under our stock plans. We also have an ESPP for all eligible employees.

Stock-based compensation expense and related income tax benefits were as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Stock-based compensation expense	**$ 3,940**	$ 3,266	$ 2,668
Income tax benefits related to stock-based compensation	**823**	1,066	882

Stock Plans

Stock awards entitle the holder to receive shares of Microsoft common stock as the award vests. Stock awards generally vest over a four or five-year service period.

Executive Incentive Plan

Under the Executive Incentive Plan, the Compensation Committee approves stock awards to executive officers and certain senior executives. RSUs generally vest ratably over a four-year service period. PSUs generally vest over a three-year performance period. The number of shares the PSU holder receives is based on the extent to which the corresponding performance goals have been achieved.

Activity for All Stock Plans

The fair value of stock awards was estimated on the date of grant using the following assumptions:

Year Ended June 30,	2018	2017	2016
Dividends per share (quarterly amounts)	**\$0.39 - \$0.42**	\$0.36 - \$0.39	\$0.31 - \$0.36
Interest rates	**1.7% - 2.9%**	1.2% - 2.2%	1.1% - 1.8%

During fiscal year 2018, the following activity occurred under our stock plans:

	Shares	Weighted Average Grant-Date Fair Value
	(In millions)	
Stock Awards		
Nonvested balance, beginning of year	201	\$ 46.32
Granted (a)	70	75.88
Vested	(80)	45.74
Forfeited	(17)	53.41
Nonvested balance, end of year	174	57.85

(a) *Includes 3 million, 2 million, and 1 million of PSUs granted at target and performance adjustments above target levels for fiscal years 2018, 2017, and 2016, respectively.*

As of June 30, 2018, there was approximately \$7.0 billion of total unrecognized compensation costs related to stock awards. These costs are expected to be recognized over a weighted average period of 3 years. The weighted average grant-date fair value of stock awards granted was \$75.88, \$55.64, and \$41.51 for fiscal years 2018, 2017, and 2016, respectively. The fair value of stock awards vested was \$6.6 billion, \$4.8 billion, and \$3.9 billion, for fiscal years 2018, 2017, and 2016, respectively.

Employee Stock Purchase Plan

We have an ESPP for all eligible employees. Shares of our common stock may be purchased by employees at three-month intervals at 90% of the fair market value on the last trading day of each three-month period. Employees may purchase shares having a value not exceeding 15% of their gross compensation during an offering period. Employees purchased the following shares during the periods presented:

(Shares in millions)

Year Ended June 30,	2018	2017	2016
Shares purchased	**13**	13	15
Average price per share	**\$ 76.40**	\$ 56.36	\$ 44.83

As of June 30, 2018, 116 million shares of our common stock were reserved for future issuance through the ESPP.

Savings Plan

We have a savings plan in the U.S. that qualifies under Section 401(k) of the Internal Revenue Code, and a number of savings plans in international locations. Participating U.S. employees may contribute a portion of their salary, subject to certain limitations. We contribute fifty cents for each dollar a participant contributes in this plan, with a maximum employer contribution of 50% of the IRS contribution limit for the calendar year. Matching contributions for all plans were $807 million, $734 million, and $549 million in fiscal years 2018, 2017, and 2016, respectively, and were expensed as contributed.

NOTE 21 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

In its operation of the business, management, including our chief operating decision maker, who is also our Chief Executive Officer, reviews certain financial information, including segmented internal profit and loss statements prepared on a basis not consistent with GAAP. During the periods presented, we reported our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing.

Our reportable segments are described below.

Productivity and Business Processes

Our Productivity and Business Processes segment consists of products and services in our portfolio of productivity, communication, and information services, spanning a variety of devices and platforms. This segment primarily comprises:

- Office Commercial, including Office 365 subscriptions and Office licensed on-premises, comprising Office, Exchange, SharePoint, Skype for Business, and Microsoft Teams, and related Client Access Licenses (“CALs”).
- Office Consumer, including Office 365 subscriptions and Office licensed on-premises, and Office Consumer Services, including Skype, Outlook.com, and OneDrive.
- LinkedIn, including Talent Solutions, Marketing Solutions, and Premium Subscriptions.
- Dynamics business solutions, including Dynamics ERP on-premises, Dynamics CRM on-premises, and Dynamics 365, a set of cloud-based applications across ERP and CRM.

Intelligent Cloud

Our Intelligent Cloud segment consists of our public, private, and hybrid server products and cloud services that can power modern business. This segment primarily comprises:

- Server products and cloud services, including Microsoft SQL Server, Windows Server, Visual Studio, System Center, and related CALs, and Azure.
- Enterprise Services, including Premier Support Services and Microsoft Consulting Services.

More Personal Computing

Our More Personal Computing segment consists of products and services geared towards harmonizing the interests of end users, developers, and IT professionals across all devices. This segment primarily comprises:

- Windows, including Windows OEM licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; Windows Internet of Things (“IoT”); and MSN advertising.
- Devices, including Microsoft Surface, PC accessories, and other intelligent devices.
- Gaming, including Xbox hardware and Xbox software and services, comprising Xbox Live transactions, subscriptions, and advertising (“Xbox Live”), video games, and third-party video game royalties.
- Search.

Revenue and costs are generally directly attributed to our segments. However, due to the integrated structure of our business, certain revenue recognized and costs incurred by one segment may benefit other segments. Revenue from certain contracts is allocated among the segments based on the relative value of the underlying products and services, which can include allocation based on actual prices charged, prices when sold separately, or estimated costs plus a profit margin. Cost of revenue is allocated in certain cases based on a relative revenue methodology. Operating expenses that are allocated primarily include those relating to marketing of products and services from which multiple segments benefit and are generally allocated based on relative gross margin.

In addition, certain costs incurred at a corporate level that are identifiable and that benefit our segments are allocated to them. These allocated costs include costs of: legal, including settlements and fines; information technology; human resources; finance; excise taxes; field selling; shared facilities services; and customer service and support. Each allocation is measured differently based on the specific facts and circumstances of the costs being allocated. Certain corporate-level activity is not allocated to our segments, including impairment and restructuring expenses.

Segment revenue and operating income were as follows during the periods presented:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Revenue			
Productivity and Business Processes	**$ 35,865**	$ 29,870	$ 25,792
Intelligent Cloud	**32,219**	27,407	24,952
More Personal Computing	**42,276**	39,294	40,410
Total	**$ 110,360**	$ 96,571	$ 91,154
Operating Income (Loss)			
Productivity and Business Processes	**$ 12,924**	$ 11,389	$ 11,756
Intelligent Cloud	**11,524**	9,127	9,249
More Personal Computing	**10,610**	8,815	6,183
Corporate and Other	**0**	(306)	(1,110)
Total	**$ 35,058**	$ 29,025	$ 26,078

Corporate and Other operating loss comprised impairment and restructuring expenses.

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for the fiscal years 2018, 2017, or 2016. Revenue, classified by the major geographic areas in which our customers are located, was as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
United States (a)	**$ 55,926**	$ 51,078	$ 46,416
Other countries	**54,434**	45,493	44,738
Total	**$ 110,360**	$ 96,571	$ 91,154

(a) *Includes billings to OEMs and certain multinational organizations because of the nature of these businesses and the impracticability of determining the geographic source of the revenue.*

Revenue from external customers, classified by significant product and service offerings, was as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Office products and cloud services	**$ 28,316**	$ 25,573	$ 23,868
Server products and cloud services	**26,129**	21,649	19,062
Windows	**19,518**	18,593	17,548
Gaming	**10,353**	9,051	9,202
Search advertising	**7,012**	6,219	5,428
Enterprise Services	**5,846**	5,542	5,659
Devices	**5,134**	5,062	7,888
LinkedIn	**5,259**	2,271	0
Other	**2,793**	2,611	2,499
Total	**$ 110,360**	$ 96,571	$ 91,154

Our commercial cloud revenue, which primarily comprises Office 365 commercial, Azure, Dynamics 365, and other cloud properties, was $23.2 billion, $14.9 billion, and $9.5 billion in fiscal years 2018, 2017, and 2016, respectively. These amounts are primarily included in Office products and services and server products and cloud services in the table above.

Assets are not allocated to segments for internal reporting presentations. A portion of amortization and depreciation is included with various other costs in an overhead allocation to each segment; it is impracticable for us to separately identify the amount of amortization and depreciation by segment that is included in the measure of segment profit or loss.

Long-lived assets, excluding financial instruments and tax assets, classified by the location of the controlling statutory company and with countries over 10% of the total shown separately, were as follows:

(In millions)

June 30,	**2018**	**2017**	**2016**
United States	**$ 44,501**	$ 42,730	$ 25,145
Ireland	**12,843**	12,889	2,099
Luxembourg	**6,856**	6,854	6,868
Other countries	**15,682**	13,044	11,047
Total	**$ 79,882**	$ 75,517	$ 45,159

NOTE 22 — QUARTERLY INFORMATION (UNAUDITED)

(In millions, except per share amounts)

Quarter Ended	**September 30**	**December 31**	**March 31**	**June 30**	**Total**
Fiscal Year 2018					
Revenue	**$ 24,538**	**$ 28,918**	**$ 26,819**	**$ 30,085**	**$ 110,360**
Gross margin	**16,260**	**17,854**	**17,550**	**20,343**	**72,007**
Operating income	**7,708**	**8,679**	**8,292**	**10,379**	**35,058**
Net income (loss) (a)	**6,576**	**(6,302)**	**7,424**	**8,873**	**16,571**
Basic earnings (loss) per share	**0.85**	**(0.82)**	**0.96**	**1.15**	**2.15**
Diluted earnings (loss) per share (b)	**0.84**	**(0.82)**	**0.95**	**1.14**	**2.13**
Fiscal Year 2017 (c)					
Revenue	$ 21,928	$ 25,826	$ 23,212	$ 25,605	$ 96,571
Gross margin	14,084	15,925	15,152	17,149	62,310
Operating income	6,715	7,905	6,723	7,682 (d)	29,025 (d)
Net income	5,667	6,267	5,486	8,069 (d)	25,489 (d)
Basic earnings per share	0.73	0.81	0.71	1.05	3.29
Diluted earnings per share	0.72	0.80	0.70	1.03 (d)	3.25 (d)

(a) *Reflects the net charge (benefit) related to the TCJA of $13.8 billion for the second quarter, $(104) million for the fourth quarter, and $13.7 billion for fiscal year 2018.*

(b) *Reflects the net charge (benefit) related to the TCJA, which decreased (increased) diluted EPS $1.78 for the second quarter, $(0.01) for the fourth quarter, and $1.75 for fiscal year 2018.*

(c) *On December 8, 2016, we acquired LinkedIn Corporation. LinkedIn has been included in our consolidated results of operations starting on the acquisition date.*

(d) *Includes $306 million of employee severance expenses primarily related to our sales and marketing restructuring plan, which decreased operating income, net income, and diluted EPS by $306 million, $243 million, and $0.04, respectively.*

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2018 and 2017, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows, for each of the three years in the period ended June 30, 2018, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of June 30, 2018, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 3, 2018, expressed an unqualified opinion on the Company's internal control over financial reporting.

Change in Accounting Principles

As discussed in Note 1 to the financial statements, the Company has changed its method of accounting for revenue from contracts with customers and for accounting for leases in fiscal year 2018 due to the adoption of the new revenue standard and new lease standard, respectively. The Company adopted the new revenue standard using the full retrospective approach and adopted the new lease standard using a modified retrospective approach.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
August 3, 2018

We have served as the Company's auditor since 1983.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective.

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the company. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements; providing reasonable assurance that receipts and expenditures of company assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use, or disposition of company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the company’s internal control over financial reporting was effective as of June 30, 2018. Deloitte & Touche LLP has audited our internal control over financial reporting as of June 30, 2018; their report is included in Item 9A.

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We implemented internal controls to ensure we adequately evaluated our contracts and properly assessed the impact of the new accounting standards related to revenue recognition and leases on our financial statements to facilitate their adoption on July 1, 2017. There were no significant changes to our internal control over financial reporting due to the adoption of the new standards.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2018, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2018, based on the criteria established in *Internal Control — Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated financial statements and the related notes (collectively referred to as the "financial statements") as of and for the year ended June 30, 2018, of the Company and our report dated August 3, 2018, expressed an unqualified opinion on those financial statements and included an explanatory paragraph related to the Company's change in method of accounting for revenue from contracts with customers and for accounting for leases in fiscal year 2018 due to the adoption of the new revenue standard and new lease standard, respectively.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
August 3, 2018

ITEM 9B. OTHER INFORMATION

During the quarter ended December 31, 2017, Microsoft provided software services to a person or entity identified under section 560.304 of title 31, Code of Federal Regulations. The services constituted a cloud-based spam and malware filtering service and the cloud-based provision of Office 365 software services provided to two entities associated with the Iranian bank, Bank Sepah – Bank Sepah International PLC and Banque Sepah, respectively. For the former, an annual service fee equivalent to $600 was charged for a one-year period beginning in February 2017, and for the latter, use rights were charged at a price equivalent to approximately $55 per month from September 2016 through November 2017, totaling $770. It is not possible to determine the precise profits, if any, attributable to these activities, though they are less than the associated revenues. Microsoft has ceased providing these software services to these entities and has no intention of doing so in the future.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

A list of our executive officers and biographical information appears in Part I, Item 1 of this Form 10-K. Information about our directors may be found under the caption "Our director nominees" in our Proxy Statement for the Annual Meeting of Shareholders to be held November 28, 2018 (the "Proxy Statement"). Information about our Audit Committee may be found under the caption "Board committees" in the Proxy Statement. That information is incorporated herein by reference.

The information in the Proxy Statement set forth under the caption "Section 16(a) beneficial ownership reporting compliance" is incorporated herein by reference.

We have adopted the Microsoft Finance Code of Professional Conduct (the "finance code of ethics"), a code of ethics that applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer, and other finance organization employees. The finance code of ethics is publicly available on our website at https://aka.ms/FinanceCodeProfessionalConduct. If we make any substantive amendments to the finance code of ethics or grant any waiver, including any implicit waiver, from a provision of the code to our Chief Executive Officer, Chief Financial Officer, or Chief Accounting Officer, we will disclose the nature of the amendment or waiver on that website or in a report on Form 8-K.

ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions "Director compensation," "Named executive officer compensation," "Compensation Committee interlocks and insider participation," and "Compensation Committee report" is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information in the Proxy Statement set forth under the captions "Stock ownership information," "Principal shareholders" and "Equity compensation plan information" is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information set forth in the Proxy Statement under the captions "Director independence" and "Certain relationships and related transactions" is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information concerning principal accountant fees and services appears in the Proxy Statement under the headings "Fees billed by Deloitte & Touche" and "Policy on Audit Committee pre-approval of audit and permissible non-audit services of independent auditor" and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements and Schedules

The financial statements are set forth under Item 8 of this Form 10-K, as indexed below. Financial statement schedules have been omitted since they either are not required, not applicable, or the information is otherwise included.

(b) Exhibit Listing

			Incorporated by Reference			
Exhibit Number	Exhibit Description	Filed Herewith	Form	Period Ending	Exhibit	Filing Date
3.1	Amended and Restated Articles of Incorporation of Microsoft Corporation		8-K		3.1	12/1/16
3.2	Bylaws of Microsoft Corporation		8-K		3.2	6/14/17
4.1	Form of Indenture between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee ("Base Indenture")		S-3ASR		4.1	11/20/08
4.2	Form of First Supplemental Indenture for 2.95% Notes due 2014, 4.20% Notes due 2019, and 5.20% Notes due 2039, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Base Indenture		8-K		4.2	5/15/09
4.5	Form of Second Supplemental Indenture for 0.875% Notes due 2013, 1.625% Notes due 2015, 3.00% Notes due 2020, and 4.50% Notes due 2040, dated as of September 27, 2010, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	9/27/10

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.6	Third Supplemental Indenture for 2.500% Notes due 2016, 4.000% Notes due 2021, and 5.300% Notes due 2041, dated as of February 8, 2011, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	2/8/11
4.7	Fourth Supplemental Indenture for 0.875% Notes due 2017, 2.125% Notes due 2022, and 3.500% Notes due 2042, dated as of November 7, 2012, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	11/7/12
4.8	Fifth Supplemental Indenture for 2.625% Notes due 2033, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	5/1/13
4.9	Sixth Supplemental Indenture for 1.000% Notes due 2018, 2.375% Notes due 2023, and 3.750% Notes due 2043, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	5/1/13
4.10	Seventh Supplemental Indenture for 2.125% Notes due 2021 and 3.125% Notes due 2028, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	12/6/13

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.11	Eighth Supplemental Indenture for 1.625% Notes due 2018, 3.625% Notes due 2023, and 4.875% Notes due 2043, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	12/6/13
4.12	Ninth Supplemental Indenture for 1.850% Notes due 2020, 2.375% Notes due 2022, 2.700% Notes due 2025, 3.500% Notes due 2035, 3.750% Notes due 2045, and 4.000% Notes due 2055, dated as of February 12, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	2/12/15
4.13	Tenth Supplemental Indenture for 1.300% Notes due 2018, 2.000% Notes due 2020, 2.650% Notes due 2022, 3.125% Notes due 2025, 4.200% Notes due 2035, 4.450% Notes due 2045, and 4.750% Notes due 2055, dated as of November 3, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	11/3/15
4.14	Eleventh Supplemental Indenture for 1.100% Notes due 2019, 1.550% Notes due 2021, 2.000% Notes due 2023, 2.400% Notes due 2026, 3.450% Notes due 2036, 3.700% Notes due 2046, and 3.950% Notes due 2056, dated as of August 8, 2016, between Microsoft Corporation and U.S. Bank, National Association, as trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	8/5/16

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.15	Twelfth Supplemental Indenture for 1.850% Notes due 2020, 2.400% Notes due 2022, 2.875% Notes due 2024, 3.300% Notes due 2027, 4.100% Notes due 2037, 4.250% Notes due 2047, and 4.500% Notes due 2057, dated as of February 6, 2017, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	2/3/17
10.1*	Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.1	10/20/16
10.4*	Microsoft Corporation Employee Stock Purchase Plan		10-K	6/30/12	10.4	7/26/12
10.5*	Microsoft Corporation Deferred Compensation Plan	X				
10.6*	Microsoft Corporation 2017 Stock Plan		DEF14A		Annex C	10/16/17
10.7*	Form of Stock Award Agreement Under the Microsoft Corporation 2017 Stock Plan		10-Q	3/31/2018	10.26	4/26/18
10.8*	Form of Performance Stock Award Agreement Under the Microsoft Corporation 2017 Stock Plan		10-Q	3/31/2018	10.27	4/26/18
10.12	Amended and Restated Officers' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		10-Q	9/30/16	10.12	10/20/16
10.13	Amended and Restated Directors' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		10-Q	9/30/16	10.13	10/20/16
10.14*	Microsoft Corporation Deferred Compensation Plan for Non-Employee Directors		10-Q	12/31/17	10.14	1/31/18
10.17*	Executive Officer Incentive Plan		10-Q	9/30/15	10.17	10/22/15
10.18*	Form of Executive Officer Incentive Plan Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/15	10.18	10/22/15
10.19*			10-Q	9/30/16	10.17	10/20/16

	Microsoft Corporation Executive Incentive Plan				
10.20*	Form of Executive Incentive Plan (Executive Officer SAs) Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan	10-Q	9/30/16	10.18	10/20/16

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference			
			Form	Period Ending	Exhibit	Filing Date
10.21*	Form of Executive Incentive Plan Performance Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/16	10.25	10/20/16
10.22*	Senior Executive Severance Benefit Plan		10-Q	9/30/16	10.22	10/20/16
10.23*	Offer Letter, dated February 3, 2014, between Microsoft Corporation and Satya Nadella		8-K		10.1	2/4/14
10.24*	Long-Term Performance Stock Award Agreement between Microsoft Corporation and Satya Nadella		10-Q	12/31/14	10.24	1/26/15
10.25*	Form of Executive Officer Incentive Plan Performance Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/15	10.25	10/22/15
12	Computation of Ratios of Earnings to Fixed Charges	X				
21	Subsidiaries of Registrant	X				
23.1	Consent of Independent Registered Public Accounting Firm	X				
31.1	Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2	Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
32.1**	Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
32.2**	Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
101.INS	XBRL Instance Document	X				
101.SCH	XBRL Taxonomy Extension Schema	X				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase	X				
101.DEF	XBRL Taxonomy Extension Definition Linkbase	X				
101.LAB	XBRL Taxonomy Extension Label Linkbase	X				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	X				

* *Indicates a management contract or compensatory plan or arrangement*
** *Furnished, not filed*

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned; thereunto duly authorized, in the City of Redmond, State of Washington, on August 3, 2018.

MICROSOFT CORPORATION

/S/ FRANK H. BROD

Frank H. Brod
Corporate Vice President, Finance and Administration;
Chief Accounting Officer (Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on August 3, 2018.

Signature	Title
/s/ JOHN W. THOMPSON John W. Thompson	Chairman
/s/ SATYA NADELLA Satya Nadella	Director and Chief Executive Officer
/s/ WILLIAM H. GATES III William H. Gates III	Director
/s/ REID HOFFMAN Reid Hoffman	Director
/s/ HUGH F. JOHNSTON Hugh F. Johnston	Director
/s/ TERI L. LIST-STOLL Teri L. List-Stoll	Director
/s/ CHARLES H. NOSKI Charles H. Noski	Director
/s/ HELMUT PANKE Helmut Panke	Director
/s/ SANDRA E. PETERSON Sandra E. Peterson	Director
/s/ PENNY S. PRITZKER Penny S. Pritzker	Director
/s/ CHARLES W. SCHARF Charles W. Scharf	Director
/s/ ARNE M. SORENSON Arne M. Sorenson	Director
/s/ JOHN W. STANTON John W. Stanton	Director
/s/ PADMASREE WARRIOR Padmasree Warrior	Director
/s/ AMY E. HOOD Amy E. Hood	Executive Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ FRANK H. BROD Frank H. Brod	Corporate Vice President, Finance and Administration; Chief Accounting Officer (Principal Accounting Officer)