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-term Investments	Equity Investments
June 30, 2021								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	**$ 4,316**	**$ 0**	**$ 0**	**$ 4,316**	**$ 1,331**	**$ 2,985**	**$ 0**
Certificates of deposit	Level 2	**3,615**	**0**	**0**	**3,615**	**2,920**	**695**	**0**
U.S. government securities	Level 1	**90,664**	**3,832**	**(111)**	**94,385**	**1,500**	**92,885**	**0**
U.S. agency securities	Level 2	**807**	**2**	**0**	**809**	**0**	**809**	**0**
Foreign government bonds	Level 2	**6,213**	**9**	**(2)**	**6,220**	**225**	**5,995**	**0**
Mortgage- and asset-backed securities	Level 2	**3,442**	**22**	**(6)**	**3,458**	**0**	**3,458**	**0**
Corporate notes and bonds	Level 2	**8,443**	**249**	**(9)**	**8,683**	**0**	**8,683**	**0**
Corporate notes and bonds	Level 3	**63**	**0**	**0**	**63**	**0**	**63**	**0**
Municipal securities	Level 2	**308**	**63**	**0**	**371**	**0**	**371**	**0**
Municipal securities	Level 3	**95**	**0**	**(7)**	**88**	**0**	**88**	**0**
Total debt investments		**$ 117,966**	**$ 4,177**	**$ (135)**	**$ 122,008**	**$ 5,976**	**$ 116,032**	**$ 0**
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				**$ 1,582**	**$ 976**	**$ 0**	**$ 606**
Equity investments	Other				**5,378**	**0**	**0**	**5,378**
Total equity investments					**$ 6,960**	**$ 976**	**$ 0**	**$ 5,984**
Cash					**$ 7,272**	**$ 7,272**	**$ 0**	**$ 0**
Derivatives, net (a)					**78**	**0**	**78**	**0**
Total					**$ 136,318**	**$ 14,224**	**$ 116,110**	**$ 5,984**

(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:

	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, 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		12 Months or Greater			Total Unrealized Losses
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Total Fair Value	
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 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 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.