

# 10-K Filing Data

## Section: Item1

>ITEM 1. B

USINESS

GENERAL

Embracing Our Future

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. We are creating the platforms and tools

,  
powered by artificial intelligence ("

AI

"), that deliver better, faster, and more effective solutions to support small and large business competitiveness, improve educational and health outcomes, grow public-sector efficiency, and empower human ingenuity. From infrastructure and data, to business applications and collaboration, we provide unique, differentiated value to customers.

In a world of increasing economic complexity, AI has the power to revolutionize many types of work.

Microsoft is now innovating and expanding our portfolio with AI capabilities to help people and organizations overcome today's challenges and emerge stronger. Customers are looking to unlock value from their digital spend and innovate for this next generation of AI, while simplifying security and management. Those leveraging the Microsoft Cloud are best positioned to take advantage of technological advancements and drive innovation. Our investment in AI spans the entire company, from Microsoft Teams and Outlook, to Bing and Xbox, and we are infusing generative AI capability into our consumer and commercial offerings to deliver copilot capability for all services across the Microsoft Cloud.

We're committed to making the promise of AI real - and doing it responsibly. Our work is guided by a core set of principles: fairness, reliability and safety, privacy and security, inclusiveness, transparency, and accountability.

## What We Offer

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

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

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

## The Ambitions That Drive Us

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

-

Reinvent productivity and business processes.

-

Build the intelligent cloud and intelligent edge platform.

-

Create more personal computing.

Reinvent Productivity and Business Processes

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

4

## PART I

### Item 1

Our growth depends on securely delivering continuous innovation and advancing our leading productivity and collaboration tools and services, including Office 365, Dynamics 365, and LinkedIn. Microsoft 365 brings together Office 365, Windows, and Enterprise Mobility + Security to help organizations empower their employees with AI-backed tools that unlock creativity, increase collaboration, and fuel innovation, all the while enabling compliance coverage and data protection.

Microsoft Teams is a comprehensive platform for work, with meetings, calls, chat, collaboration, and business process automation. Microsoft Viva is an employee experience platform that brings together communications, knowledge, learning, resources, and insights. Microsoft 365 Copilot combines next-generation AI with business data in the Microsoft Graph and Microsoft 365 applications.

Together with the Microsoft Cloud, Dynamics 365, Microsoft Teams, and our AI offerings bring a new era of collaborative applications that optimize business functions, processes, and applications to better serve customers and employees while creating more business value. Microsoft Power Platform is helping domain experts drive productivity gains with low-code/no-code tools, robotic process automation, virtual agents, and business intelligence. In a dynamic labor market, LinkedIn is helping professionals use the platform to connect, learn, grow, and get hired.

Build the Intelligent Cloud and Intelligent Edge

Platform

As digital transformation and adoption of AI accelerates and revolutionizes more business workstreams, organizations in every sector across the globe can address challenges that will have a fundamental impact on their success. For enterprises, digital technology empowers employees, optimizes operations, engages customers, and in some cases, changes the very core of products and services. We continue to invest in high performance and sustainable computing to meet the growing demand for fast access to Microsoft services provided by our network of cloud computing

infrastructure and datacenters.

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

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

Our AI platform, Azure AI, is helping organizations transform, bringing intelligence and insights to the hands of their employees and customers to solve their most pressing challenges. Organizations large and small are deploying Azure AI solutions to achieve more at scale, more easily, with the proper enterprise-level and responsible AI protections.

We have a long-term partnership with OpenAI, a leading AI research and deployment company. We

deploy OpenAI's models across our consumer and enterprise products. As OpenAI's exclusive cloud provider, Azure powers all of OpenAI's workloads. We have also increased our investments in the development and deployment of specialized supercomputing systems to accelerate OpenAI's research.

Our hybrid infrastructure offers integrated, end-to-end security, compliance, identity, and management capabilities to support the real-world needs and evolving regulatory requirements of commercial customers and enterprises. Our industry clouds bring together capabilities across the entire Microsoft Cloud, along with industry-specific customizations. Azure Arc simplifies governance and management by delivering a consistent multi-cloud and on-premises management platform.

Nuance, a leader in conversational AI and ambient intelligence across industries including healthcare, financial services, retail, and telecommunications, joined Microsoft in 2022. Microsoft and Nuance enable organizations to accelerate their business goals with security-focused, cloud-based solutions infused with AI.

We are accelerating our development of mixed reality solutions with new Azure services and devices. Microsoft Mesh enables organizations to create custom, immersive experiences for the workplace to help bring remote and hybrid workers and teams together.

## PART I

### Item 1

The ability to convert data into AI drives our competitive advantage. The Microsoft Intelligent Data Platform is a leading cloud data platform that fully integrates databases, analytics, and governance. The platform empowers organizations to invest more time creating value rather than integrating and managing their data. Microsoft Fabric is an end-to-end, unified analytics platform that brings together all the data and analytics tools that organizations need.

GitHub Copilot is at the forefront of AI-powered software development, giving developers a new tool to write code easier and faster so they can focus on more creative problem-solving. From GitHub to Visual Studio, we provide a developer tool chain for everyone, no matter the technical experience, across all platforms, whether Azure, Windows, or any other cloud or client platform.

Windows also plays a critical role in fueling our cloud business with Windows 365, a desktop operating system that's also a cloud service. From another internet-connected device, including



Android or macOS devices, users can run Windows 365, just like a virtual machine.

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

## Create More Personal Computing

We strive to make computing more personal, enabling users to interact with technology in more intuitive, engaging, and dynamic ways.

Windows 11 offers innovations focused on enhancing productivity, including Windows Copilot with centralized AI assistance and Dev Home to help developers become more productive. Windows 11 security and privacy features include operating system security, application security, and user and identity security.

Through our Search, News, Mapping, and Browser services, Microsoft delivers unique trust, privacy, and safety features. In February 2023, we launched an all new, AI-powered Microsoft Edge browser and Bing search engine with Bing Chat to deliver better search, more complete answers, and the ability to generate content. Microsoft Edge is our fast and secure browser that helps protect users' data. Quick access to AI-powered tools, apps, and more within Microsoft Edge's sidebar enhance

browsing capabilities.

We are committed to designing and marketing first-party devices to help drive innovation, create new device categories, and stimulate demand in the Windows ecosystem. The Surface family includes Surface Pro, Surface Laptop, and other Surface products.

Microsoft continues to invest in gaming content, community, and cloud services. We have broadened our approach to how we think about gaming end-to-end, from the way games are created and distributed to how they are played, including subscription services like Xbox Game Pass and new devices from third-party manufacturers so players can engage across PC, console, and mobile. In January 2022, we announced plans to acquire Activision Blizzard, Inc., a leader in game development and an interactive entertainment content publisher.

## Our Future Opportunity

We are focused on helping customers use the breadth and depth of the Microsoft Cloud to get the most value out of their digital spend while leading the new AI wave across our solution areas. We continue to develop complete, intelligent solutions for our customers that empower people to be productive and collaborate, while safeguarding businesses and simplifying IT management. Our goal is to lead the industry in several distinct areas of technology over the long term, which we expect will translate to sustained growth. We are investing significant resources in:

-

Transforming the workplace to deliver new modern, modular business applications, drive deeper insights, and improve how people communicate, collaborate, learn, work, and interact with one another.

-

Building and running cloud-based services in ways that utilize ubiquitous computing to unleash new experiences and opportunities for businesses and individuals.

-

Applying AI and ambient intelligence to drive insights, revolutionize many types of work, and provide substantive productivity gains using natural methods of communication.

-

Tackling security from all angles with our integrated, end-to-end solutions spanning security, compliance, identity, and management, across all clouds and platforms.

-

Inventing new gaming experiences that bring people together around their shared love for games on any devices and pushing the boundaries of innovation with console and PC gaming.

-

Using Windows to fuel our cloud business, grow our share of the PC market, and drive increased engagement with our services like Microsoft 365 Consumer, Microsoft Teams, Microsoft Edge, Bing, Xbox Game Pass, and more.

Our future growth depends on our ability to transcend current product category definitions, business models, and sales motions.

Corporate Social Responsibility

## Commitment to Sustainability

Microsoft's approach to addressing climate change starts with the sustainability of our own business. In 2020, we committed to being a carbon negative, water positive, and zero waste company by 2030.

In May 2023, we released our Environmental Sustainability Report which looked back at our progress during fiscal year 2022. We continued to make progress on our goals, with our overall emissions declining by 0.5 percent. While our Scope 1 and Scope 2 emissions continued to decline, Scope 3 emissions increased by 0.5 percent. Scope 3 represented 96 percent of our total emissions, resulting primarily from the operations of our suppliers and the use of our products across our customers.

A few examples of our continued progress include:

-

Signed new power purchase agreements, bringing our total portfolio of carbon-free energy to over 13.5 gigawatts.

-

Contracted for water replenishment projects that are estimated to provide more than 15.6 million cubic meters in volumetric water benefit over the lifetime of these projects.

-

Diverted 12,159 metric tons of solid waste from landfills and incinerators across our direct operational footprint.

-

Protected 12,270 acres of land in Belize - more than the 11,206 acres of land that we use around the world.

Microsoft has a role to play in developing and advancing new climate solutions, but we recognize that no solution can be offered by any single company, organization, or government. Our approach helps to support the sustainability needs of our customers and the global community. Our Microsoft Cloud for Sustainability, an environmental sustainability management platform that includes Microsoft Sustainability Manager, enables organizations to record, report, and reduce their Scope 1, 2, and 3 emissions. These digital tools can interoperate with business systems and unify data intelligence for organizations.

## Addressing Racial Injustice and Inequity

We are committed to addressing racial injustice and inequity in the United States for Black and

African American communities and helping improve lived experiences at Microsoft, in employees' communities, and beyond. Our Racial Equity Initiative focuses on three multi-year pillars, each containing actions and progress we expect to make or exceed by 2025.

-

Strengthening our communities: using data, technology, and partnerships to help improve the lives of Black and African American people in the United States, including our employees and their communities.

-

Engaging our ecosystem: using our balance sheet and relationships with suppliers and partners to foster societal change and create new opportunities.

-

Increasing representation and strengthening inclusion: building on our momentum by adding a \$150 million investment to strengthen inclusion and double the number of Black, African American, Hispanic, and Latinx leaders in the United States by 2025.

## PART I

### Item 1

In fiscal year 2023, we collaborated with partners and worked within neighborhoods and communities to launch and scale a number of projects and programs, including:

-

Working with 103 unique organizations in 165 cities and counties on our Justice Reform Initiative to empower communities and advance racial equity and fairness in the justice system.

-

Increasing access to affordable broadband, devices, and digital literacy training across 14 geographies, including 11 cities and three states in the Black Rural south.

-

Growing our Nonprofit Tech Acceleration for Black and African American Communities program, which uses data, technology, and partnerships to help more than 2,000 local organizations to



modernize and streamline operations.

-

Expanding our Technology Education and Learning Support ("TEALS") program to reach nearly 400 high schools in 21 communities to increase computer science opportunities for Black and African American students.

We exceeded our 2020 goal to double the percentage of our transaction volumes with Black- and African American-owned financial institutions by 2023. We are also increasing investment activity with Black- and African American-owned asset managers, which now represent 45 percent of our external manager group, enabling increased funds into local communities. We also met our goal of creating a \$100 million program focused on mission-driven banks. We enriched our supplier pipeline, achieving our goal to spend \$500 million with double the number of Black- and African American-owned suppliers. We also increased the number of identified partners in the Black Partner Growth Initiative by more than 250 percent, surpassing our initial goal.

We have made meaningful progress on representation and inclusion at Microsoft. As of June 2023, we are 93 percent of the way to our 2025 commitment to double the number of Black and African American people managers in the U.S. (below director level), and 107 percent of the way for Black and African American directors (people managers and individual contributors). We are 28 percent of the way for Hispanic and Latinx people managers (below director level) and 74 percent of the way for Hispanic and Latinx directors.

## Investing in Digital Skills

After helping over 80 million jobseekers around the world access digital skilling resources, we introduced a new Skills for Jobs initiative to support a more skills-based labor market, with greater flexibility and accessible learning paths to develop the right skills needed for the most in-demand jobs. Our Skills for Jobs initiative brings together learning resources, certification opportunities, and job-seeker tools from LinkedIn, GitHub, and Microsoft Learn, and is built on data insights drawn from LinkedIn's Economic Graph.

We also launched a national campaign to help skill and recruit 250,000 people into the cybersecurity workforce by 2025, representing half of the country's workforce shortage. To that end, we are making curriculum available free of charge to all of the nation's higher education institutions, providing training for new and existing faculty, and providing scholarships and supplemental resources to 25,000 students. We have expanded the cyber skills initiative to 27 additional countries that show elevated cyberthreat risks coupled with significant gaps in their cybersecurity workforces, partnering with nonprofits and other educational institutions to train the next generation of cybersecurity workers.

Generative AI is creating unparalleled opportunities to empower workers globally, but only if everyone has the skills to use it. To address this, in June 2023 we launched a new AI Skills Initiative to help everyone learn how to harness the power of AI. This includes a new LinkedIn learning pathway offering new coursework on learning the foundations of generative AI. We also launched a

new global grant challenge to uncover new ways of training workers on generative AI and are providing greater access to digital learning events and resources for everyone to improve their AI fluency.

## HUMAN CAPITAL RESOURCES

### Overview

Microsoft aims to recruit, develop, and retain world-changing talent from a diversity of backgrounds. To foster their and our success, we seek to create an environment where people can thrive and do their best work. We strive to maximize the potential of our human capital resources by creating a respectful, rewarding, and inclusive work environment that enables our global employees to create products and services that further our mission.

## PART I

As of June 30, 2023, we employed approximately 221,000 people on a full-time basis, 120,000 in the U.S. and 101,000 internationally. Of the total employed people, 89,000 were in operations, including manufacturing, distribution, product support, and consulting services; 72,000 were in product research and development; 45,000 were in sales and marketing; and 15,000 were in general and administration. Certain employees are subject to collective bargaining agreements.

## Our Culture

Microsoft's culture is grounded in growth mindset. This means everyone is on a continuous journey to learn and grow, operating as one company instead of multiple siloed businesses.

Our employee listening systems enable us to gather feedback directly from our workforce to inform our programs and employee needs globally. Employees participate in our Employee Signals surveys, which cover a variety of topics such as thriving, inclusion, team culture, wellbeing, and learning and development. We also collect Daily Signals employee survey responses, giving us real-time insights into ways we can support our employees. In addition to Employee Signals and Daily Signals surveys, we gain insights through onboarding, exit surveys, internal Viva Engage channels, employee Q&A sessions, and our internal AskHR Service support.

Diversity and inclusion are core to our business model, and we hold ourselves accountable for driving global systemic change in our workforce and creating an inclusive work environment. We support multiple highly active Employee Resource Groups for women, families, racial and ethnic minorities, military, people with disabilities, and employees who identify as LGBTQIA+, where employees can go for support, networking, and community-building. As described in our 2022 Proxy Statement, annual performance and compensation reviews of our senior leadership team include an evaluation of their contributions to employee culture and diversity. To ensure accountability over time, we publicly disclose our progress on a multitude of workforce metrics including:

-

Detailed breakdowns of gender, racial, and ethnic minority representation in our employee population, with data by job types, levels, and segments of our business.

-

Our EEO-1 report (equal employment opportunity).

-

Disability representation.

-

Pay equity (see details below).

## Total Rewards and Pay Equity

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

In order to manage our costs in a dynamic, competitive environment, in fiscal year 2023 we announced that base salaries of salaried employees would remain at fiscal year 2022 levels. Pay increases continue to be available for rewards-eligible hourly and equivalent employees. We will continue our practice of investing in stock for all rewards-eligible employees, salaried and hourly, and investing in bonuses for all eligible employees.

## Item 1

Since 2016, we have reported on pay equity as part of our annual Diversity and Inclusion report. In 2022, we reported that all racial and ethnic minority employees in the U.S. combined earn \$1.008 for every \$1.000 earned by their white counterparts, that women in the U.S. earn \$1.007 for every \$1.000 earned by their counterparts who are men, and that women outside the U.S. earn \$1.002 for every \$1.000 earned by their counterparts outside the U.S. who are men. In this year's report, we again expanded our pay equity data beyond the U.S. to report on 61 additional countries (up from 12 last year), representing 99.8% of our global Microsoft workforce.

In addition, we began reporting on unadjusted median pay in our annual report, comparing total pay amounts for all employees regardless of factors such as job title, level, or tenure. For employees who are eligible for rewards, the analysis showed that total pay for women is 89.6% of total pay for men in the U.S. and 86.2% outside of the U.S., and total pay for racial and ethnic minorities in the U.S. is 89.9% of total pay for white employees. As we continue to increase representation for women and racial and ethnic minorities at more senior levels, and continue to ensure pay equity for all, the gap between the medians will reduce.

Our intended result is a global performance and development approach that fosters our culture, and competitive compensation that ensures equitable pay by role while supporting pay for performance.

## Wellbeing and Hybrid Work

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

We introduced Hybrid Workplace Flexibility Guidance to better support leaders, managers, and employees in hybrid work scenarios. Our ongoing survey data shows that 93% of employees value the flexibility related to work location, work site, and work hours, and 78% are satisfied with the quality of connection with co-workers. There is no one-size-fits-all approach to flexible work at Microsoft. As a company, we will continue to leverage data and research to inform decision making, balancing the needs of business, team, and individual.

## Learning and Development



We offer a range of learning opportunities, including personalized opportunities on our internal and external learning portals, in-classroom learning, required learning on compliance and company culture, on-the-job advancement opportunities, and manager coaching. We also provide customized manager learning, new employee orientation, and tools for operating in a flexible hybrid work environment.

All Microsoft employees globally access our single Viva Learning tool for both required and personal choice learning. This includes courses focused on our core principles and compliance matters, such as Business Conduct, Privacy, Security Foundations, and Harassment Prevention. We also deliver skills training for employees based on their profession and role discipline.

We have over 27,000 people managers, all of whom must complete between 20-33 hours of compulsory training on leadership and management and are assigned additional targeted training on an ongoing basis related to people management, compliance, and culture.

## Item 1

### OPERATING SEGMENTS

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

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

Our reportable segments are described below.

Productivity and Business Processes

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

-

Office Commercial (Office 365 subscriptions, the Office 365 portion of Microsoft 365 Commercial subscriptions, and Office licensed on-premises), comprising Office, Exchange, SharePoint, Microsoft Teams, Office 365 Security and Compliance, Microsoft Viva, and Microsoft 365 Copilot.

-

Office Consumer, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services.

-

LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.

-

Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based applications across ERP, CRM (including Customer Insights), Power Apps, and Power Automate; and on-premises ERP and CRM applications.

## Office Commercial

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

## Office Consumer

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

## PART I

### Item 1

#### LinkedIn

LinkedIn connects the world's professionals to make them more productive and successful and transforms the way companies hire, market, sell, and learn. Our vision is to create economic opportunity for every member of the global workforce through the ongoing development of the world's first Economic Graph, a digital representation of the global economy. In addition to LinkedIn's free services, LinkedIn offers monetized solutions: Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions. Talent Solutions provide insights for workforce planning and tools to hire, nurture, and develop talent. Talent Solutions also includes Learning Solutions, which help businesses close critical skills gaps in times where companies are having to do more with existing talent. Marketing Solutions help companies reach, engage, and convert their audiences at scale. Premium Subscriptions enable professionals to manage their professional

identity, grow their network, find jobs, and connect with talent through additional services like premium search. Sales Solutions help companies strengthen customer relationships, empower teams with digital selling tools, and acquire new opportunities. LinkedIn has over 950 million members and has offices around the globe. Growth will depend on our ability to increase the number of LinkedIn members and our ability to continue offering services that provide value for our members and increase their engagement. LinkedIn revenue is mainly affected by demand from enterprises and professional organizations for subscriptions to Talent Solutions, Sales Solutions, and Premium Subscriptions offerings, as well as member engagement and the quality of the sponsored content delivered to those members to drive Marketing Solutions.

## Dynamics

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

## Competition

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

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

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

## PART I

### Item 1

#### Intelligent Cloud

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

-

Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses ("CALs"); and Nuance and GitHub.



-

Enterprise Services, including Enterprise Support Services, Industry Solutions (formerly Microsoft Consulting Services

),

and Nuance professional services.

## Server Products and Cloud Services

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

Azure AI offerings provide a competitive advantage as companies seek ways to optimize and scale their business with machine learning. Azure's purpose-built, AI-optimized infrastructure allows advanced models, including GPT-4 services designed for developers and data scientists, to do more with less. Customers can integrate large language models and develop the next generation of AI apps and services.

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

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

## Enterprise Services

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

various Microsoft products.

## Competition

Azure faces diverse competition from companies such as Amazon, Google, IBM, Oracle, VMware, and open source offerings. Azure's competitive advantage includes enabling a hybrid cloud, allowing deployment of existing datacenters with our public cloud into a single, cohesive infrastructure, and the ability to run at a scale that meets the needs of businesses of all sizes and complexities. Our AI offerings compete with AI products from hyperscalers such as Amazon Bedrock, Amazon CodeWhisperer, and Google AI, as well as products from other emerging competitors, many of which are also current or potential partners, including Meta's LLaMA2 and other open source solutions. Our Enterprise Mobility + Security offerings also compete with products from a range of competitors including identity vendors, security solution vendors, and numerous other security point solution vendors. We believe our cloud's global scale, coupled with our broad portfolio of identity and security solutions, allows us to effectively solve complex cybersecurity challenges for our customers and differentiates us from the competition.

## Item 1

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

,  
and many contribute to Linux operating system development. The competitive position of Linux has also benefited from the large number of compatible applications now produced by many commercial and non-commercial software developers. A number of companies, such as Red Hat, supply versions of Linux.

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

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

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

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

More Personal Computing

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

-

Windows, including Windows OEM licensing ("Windows OEM") and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; and Windows IoT.

-

Devices, including Surface, HoloLens, and PC accessories.

-

Gaming, including Xbox hardware and Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, advertising, third-party disc royalties, and other cloud services.

-

Search and news advertising, comprising Bing (including Bing Chat), Microsoft News, Microsoft Edge, and third-party affiliates.

## Windows

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

-

The mix of computing devices based on form factor and screen size.

-

Differences in device market demand between developed markets and growth markets.

-

Attachment of Windows to devices shipped.

## PART I

### Item 1

-

Customer mix between consumer, small and medium businesses, and large enterprises.

-

Changes in inventory levels in the OEM channel.

-

Pricing changes and promotions, pricing variation that occurs when the mix of devices manufactured shifts from local and regional system builders to large multinational OEMs, and different pricing of Windows versions licensed.

-

Constraints in the supply chain of device components.



-

Piracy.

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

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

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

Devices

We design and sell devices, including Surface, HoloLens, and PC accessories. Our devices are designed to enable people and organizations to connect to the people and content that matter most

using Windows and integrated Microsoft products and services. Surface is designed to help organizations, students, and consumers be more productive. Growth in Devices is dependent on total PC shipments, the ability to attract new customers, our product roadmap, and expanding into new categories.

## Gaming

Our gaming platform is designed to provide a variety of entertainment through a unique combination of content, community, and cloud services. Our exclusive game content is created through Xbox Game Studios, a collection of first-party studios creating iconic and differentiated gaming experiences. We continue to invest in new gaming studios and content to expand our intellectual property roadmap and leverage new content creators. These unique gaming experiences are the cornerstone of Xbox Game Pass, a subscription service and gaming community with access to a curated library of over 400 first- and third-party console and PC titles.

The gamer remains at the heart of the Xbox ecosystem. We are identifying new opportunities to attract gamers across a variety of different end points through our first- and third-party content and business diversification across subscriptions, ads, and digital stores. We've seen new devices from third-party manufacturers along with key PC and mobile end points that help us empower gamers to play in a way that is most convenient to them. We are focused on growing the platform and expanding to new ecosystems to engage as many gamers as possible.

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

15

## PART I

Item 1

Search and News Advertising

Our Search and news advertising business is designed to deliver relevant search, native, and display advertising to a global audience. Our Microsoft Edge browser and Bing Chat capabilities are key tools to enable user acquisition and engagement, while our technology platform enables accelerated delivery of digital advertising solutions. In addition to first-party tools, we have several partnerships with companies, such as Yahoo, through which we provide and monetize search offerings. Growth depends on our ability to attract new users, understand intent, and match intent with relevant content on advertising offerings.

## Competition

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

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

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

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

## OPERATIONS

We have regional operations service centers that support our operations, including customer contract and order processing, billing, credit and collections, information processing, and vendor management and logistics. The center in Ireland supports the African, Asia-Pacific, European, and Middle East regions; and the centers in Arlington, Virginia, Atlanta, Georgia, Charlotte, North Carolina, Fargo, North Dakota, Fort Lauderdale, Florida, Redmond, Washington, Reno, Nevada, and Puerto Rico support the American regions.

In addition to our operations centers, we also operate datacenters throughout each of these regions. We continue to identify and evaluate opportunities to expand our datacenter locations and increase our server capacity to meet the evolving needs of our customers, particularly given the growing demand for AI services. Our datacenters depend on the availability of permitted and buildable land, predictable energy, networking supplies, and servers, including graphics processing units ("GPUs") and other components.

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

## PART I

### Item 1

## RESEARCH AND DEVELOPMENT

### Product and Service Development, and Intellectual Property

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

-

#### Cloud and AI

- focuses on making IT professionals, developers, partners, independent software vendors, and their systems more productive and efficient through development of Azure AI platform and cloud infrastructure, server, database, CRM, ERP, software development tools and services (including GitHub), AI cognitive services, and other business process applications and services for enterprises.

-

#### Strategic Missions and Technologies

- focuses on incubating technical products and support solutions with transformative potential for

the future of cloud computing and continued company growth across quantum computing, Azure Space & Missions Engineering, telecommunications, and Microsoft Federal Sales and Delivery.

-

#### Experiences and Devices

- focuses on delivering high value end-user experiences across our products, services, and devices, including Microsoft 365, Windows, Microsoft Teams, Search (including Microsoft Edge and Bing Chat) and other advertising-based services, and the Surface line of devices.

-

#### Microsoft Security

- focuses on delivering a comprehensive portfolio of services that protect our customers' digital infrastructure through cloud platform and application security, data protection and governance, identity and network access, and device management.

-

#### Technology and Research

- focuses on fundamental research, product and business incubations, and forward-looking AI innovations that span infrastructure, services, and applications.

-

#### LinkedIn



- focuses on our services that transform the way professionals grow their network and find jobs and the way businesses hire, market, sell, and learn.

- 

## Gaming

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

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

We protect our intellectual property investments in a variety of ways. We work actively in the U.S. and internationally to ensure the enforcement of copyright, trademark, trade secret, and other protections that apply to our software and hardware products, services, business plans, and branding. We are a leader among technology companies in pursuing patents and currently have a portfolio of over 70,000 U.S. and international patents issued and over 19,000 pending worldwide. While we employ much of our internally-developed intellectual property in our products and services,

we also engage in outbound licensing of specific patented technologies that are incorporated into licensees' products. From time to time, we enter into broader cross-license agreements with other technology companies covering entire groups of patents. We may also purchase or license technology that we incorporate into our products and services. At times, we make select intellectual property broadly available at no or low cost to achieve a strategic objective, such as promoting industry standards, advancing interoperability, supporting societal and/or environmental efforts, or attracting and enabling our external development community. Our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations.

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

## Item 1

### Investing in the Future

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

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

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

In addition to our main research and development operations, we also operate Microsoft Research. Microsoft Research is one of the world's largest corporate research organizations, often working in close collaboration with top universities around the world, and is focused on advancing the state-of-the-art in computer science and a broad range of other disciplines. Our investment in fundamental research provides us a unique perspective on future trends and contributes to our innovation.

## DISTRIBUTION, SALES, AND MARKETING

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

## OEMs

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

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

## Direct

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

We also sell commercial and consumer products and services directly to customers, such as cloud services, search, and gaming, through our digital marketplaces and online stores. Additionally, our Microsoft Experience Centers are designed to facilitate deeper engagement with our partners and customers across industries.

## Distributors and Resellers

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

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

Our Dynamics business solutions are also licensed to enterprises through a global network of

channel partners providing vertical solutions and specialized services.

## LICENSING OPTIONS

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

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

### Volume Licensing Programs

#### Enterprise Agreement



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

#### Microsoft Customer Agreement

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

#### Microsoft Online Subscription Agreement

A Microsoft Online Subscription Agreement is

designed for small and medium organizations that want to subscribe to, activate, provision, and maintain cloud services seamlessly and directly via the web. The agreement allows customers to

acquire monthly or annual subscriptions for cloud-based services.

## Microsoft Products and Services Agreement

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

## Open Value

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

## Select Plus

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

## Partner Programs

The Microsoft Cloud Solution Provider Program offers customers an easy way to license the cloud services they need in combination with the value-added services offered by their systems integrator,

managed services provider, or cloud reseller partner. Partners in this program can easily package their own products and services to directly provision, manage, and support their customer subscriptions.

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

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

## CUSTOMERS

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

## INFORMATION ABOUT OUR EXECUTIV

## E OFFICERS

Our executive officers as of July 27, 2023 were as follows:

Name

Age

Position with the Company

Satya Nadella

Chairman and Chief Executive Officer

Judson B. Althoff



Executive Vice President and Chief Commercial Officer

Christopher C. Capossela

Executive Vice President and Chief Marketing Officer

Kathleen T. Hogan

Executive Vice President and Chief Human Resources Officer

Amy E. Hood

Executive Vice President and Chief Financial Officer

Bradford L. Smith

Vice Chair and President

Christopher D. Young

51

Executive Vice President, Business Development, Strategy, and Ventures

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

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

## PART I

### Item 1

Mr. Capossela was appointed Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer in July 2016. He had served as Executive Vice President, Chief Marketing Officer since March 2014. Since joining Microsoft in 1991, Mr. Capossela has held a variety of marketing leadership roles in the Consumer Channels Group, and in the Microsoft Office Division where he was responsible for marketing productivity solutions including Microsoft Office, Office 365, SharePoint, Exchange, Skype for Business, Project, and Visio.

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

Ms. Hood was appointed Executive Vice President and Chief Financial Officer in July 2013,

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

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

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



## PART I

### Item 1

#### AVAILABLE INFORMATION

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

-

Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file that material with or furnish it to the Securities and Exchange Commission ("SEC") at [www.sec.gov](http://www.sec.gov).

-

Information on our business strategies, financial results, and metrics for investors.

-

Announcements of investor conferences, speeches, and events at which our executives talk about our product, service, and competitive strategies. Archives of these events are also available.

-

Press releases on quarterly earnings, product and service announcements, legal developments, and international news.

-

Corporate governance information including our articles of incorporation, bylaws, governance guidelines, committee charters, codes of conduct and ethics, global corporate social responsibility initiatives, and other governance-related policies.

-

Other news and announcements that we may post from time to time that investors might find useful or interesting.

-

Opportunities to sign up for email alerts to have information pushed in real time.

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

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

## PART I

### Item 1A

## ITEM 1A. RIS

### K FACTORS

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

### STRATEGIC AND COMPETITIVE RISKS

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

#### Competition in the technology sector

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

devices, and services that appeal to businesses and consumers.

## Competition among platform-based ecosystems

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

-

A competing vertically-integrated model, in which a single firm controls the software and hardware elements of a product and related services, has succeeded with some consumer products such as personal computers, tablets, phones, gaming consoles, wearables, and other endpoint devices. Competitors pursuing this model also earn revenue from services integrated with the hardware and software platform, including applications and content sold through their integrated marketplaces. They may also be able to claim security and performance benefits from their vertically integrated offer. We also offer some vertically-integrated hardware and software products and services. To the extent we shift a portion of our business to a vertically integrated model we increase our cost of revenue and reduce our operating margins.

-

We derive substantial revenue from licenses of Windows operating systems on PCs. We face

significant competition from competing platforms developed for new devices and form factors such as smartphones and tablet computers. These devices compete on multiple bases including price and the perceived utility of the device and its platform. Users are increasingly turning to these devices to perform functions that in the past were performed by personal computers. Even if many users view these devices as complementary to a personal computer, the prevalence of these devices may make it more difficult to attract application developers to our PC operating system platforms. Competing with operating systems licensed at low or no cost may decrease our PC operating system margins. Popular products or services offered on competing platforms could increase their competitive strength. In addition, some of our devices compete with products made by our original equipment manufacturer ("OEM") partners, which may affect their commitment to our platform.

-

Competing platforms have content and application marketplaces with scale and significant installed bases. The variety and utility of content and applications available on a platform are important to device purchasing decisions. Users may incur costs to move data and buy new content and applications when switching platforms. To compete, we must successfully enlist developers to write applications for our platform and ensure that these applications have high quality, security, customer appeal, and value. Efforts to compete with competitors' content and application marketplaces may increase our cost of revenue and lower our operating margins. Competitors' rules governing their content and applications marketplaces may restrict our ability to distribute products and services through them in accordance with our technical and business model objectives.

## PART I

### Item 1A

#### Business model competition

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

-

Even as we transition more of our business to infrastructure-, platform-, and software-as-a-service business model, the license-based proprietary software model generates a substantial portion of our software revenue. We bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from licensing our products. Many of our competitors also develop and sell software to businesses and consumers under this model.

-

We are investing in artificial intelligence ("AI") across the entire company and infusing generative AI capabilities into our consumer and commercial offerings. We expect AI technology and services to be a highly competitive and rapidly evolving market. We will bear significant development and operational costs to build and support the AI capabilities, products, and services necessary to meet the needs of our customers. To compete effectively we must also be responsive to technological change, potential regulatory developments, and public scrutiny.

-

Other competitors develop and offer free applications, online services, and content, and make money by selling third-party advertising. Advertising revenue funds development of products and services these competitors provide to users at no or little cost, competing directly with our revenue-generating products.

-

Some companies compete with us by modifying and then distributing open source software at little or no cost to end users, using open source AI models,

and earning revenue on advertising or integrated products and services. These firms do not bear the full costs of research and development for the open source products. Some open source products mimic the features and functionality of our products.

The competitive pressures described above may cause decreased sales volumes, price reductions, and/or increased operating costs, such as for research and development, marketing, and sales



incentives. This may lead to lower revenue, gross margins, and operating income.

Our increasing focus on cloud-based services presents execution and competitive risks.

A growing part of our business involves cloud-based services available across the spectrum of computing devices. Our strategic vision is to compete and grow by building best-in-class platforms and productivity services that utilize ubiquitous computing and ambient intelligence to drive insights and productivity gains. At the same time, our competitors are rapidly developing and deploying cloud-based services for consumers and business customers. Pricing and delivery models are evolving. Devices and form factors influence how users access services in the cloud and sometimes the user's choice of which cloud-based services to use. Certain industries and customers have specific requirements for cloud services and may present enhanced risks.

We are devoting significant resources to develop and deploy our cloud-based strategies. The Windows ecosystem must continue to evolve with this changing environment. We embrace cultural and organizational changes to drive accountability and eliminate obstacles to innovation. Our intelligent cloud and intelligent edge offerings are connected to the growth of the Internet of Things ("IoT"), a network of distributed and interconnected devices employing sensors, data, and computing capabilities, including AI. Our success in driving ubiquitous computing and ambient intelligence will depend on the level of adoption of our offerings such as Azure, Azure AI, and Azure IoT Edge. We may not establish market share sufficient to achieve scale necessary to meet our business objectives.

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

several areas, including:

-

Continuing to bring to market compelling cloud-based experiences that generate increasing traffic and market share.

-

Maintaining the utility, compatibility, and performance of our cloud-based services on the growing array of computing devices, including PCs, smartphones, tablets, gaming consoles, and other devices, as well as sensors and other IoT endpoints.

-

Continuing to enhance the attractiveness of our cloud platforms to third-party developers.

-

Ensuring our cloud-based services meet the reliability expectations of our customers and maintain the security of their data as well as help them meet their own compliance needs.

-

Making our suite of cloud-based services platform-agnostic, available on a wide range of devices and ecosystems, including those of our competitors.

## PART I

### Item 1A

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

Some users may engage in fraudulent or abusive activities through our cloud-based services. These include unauthorized use of accounts through stolen credentials, use of stolen credit cards or other payment vehicles, failure to pay for services accessed, or other activities that violate our terms of service such as cryptocurrency mining or launching cyberattacks. If our efforts to detect such violations or our actions to control these types of fraud and abuse are not effective, we may

experience adverse impacts to our revenue or incur reputational damage.

## RISKS RELATING TO THE EVOLUTION OF OUR BUSINESS

We make significant investments in products and services that may not achieve expected returns.

We will continue to make significant investments in research, development, and marketing for existing products, services, and technologies, including the Windows operating system, Microsoft 365, Bing, SQL Server, Windows Server, Azure, Office 365, Xbox, LinkedIn, and other products and services. In addition, we are focused on developing new AI platform services and incorporating AI into existing products and services.

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

design, and product quality.

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

Acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business.

We expect to continue making acquisitions and entering into joint ventures and strategic alliances as part of our long-term business strategy. For example, in March 2021 we completed our acquisition of ZeniMax Media Inc. for \$8.1 billion, and in

March 2022 we completed our acquisition of Nuance Communications, Inc. for \$18.8 billion. In January 2022

we announced a definitive agreement to acquire

Activision Blizzard

, Inc. for \$68.7 billion. In January 2023 we announced the third phase of our OpenAI strategic partnership. Acquisitions and other transactions and arrangements involve significant challenges and risks, including that they do not advance our business strategy, that we get an unsatisfactory return on our investment, that they raise new compliance-related obligations and challenges, that we have difficulty integrating and retaining new employees, business systems, and technology, that they distract management from our other businesses, or that announced transactions may not be completed. If an arrangement fails to adequately anticipate changing circumstances and interests of a party, it may result in early termination or renegotiation of the arrangement. The success of these transactions and arrangements will depend in part on our ability to leverage them to enhance our existing products and services or develop compelling new ones, as well as acquired companies' ability to meet our policies and processes in areas such as data governance, privacy, and

cybersecurity. It may take longer than expected to realize the full benefits from these transactions and arrangements such as increased revenue or enhanced efficiencies, or the benefits may ultimately be smaller than we expected. These events could adversely affect our consolidated financial statements.

25

## PART I

### Item 1A

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings.

We acquire other companies and intangible assets and may not realize all the economic benefit from those acquisitions, which could cause an impairment of goodwill or intangibles. We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment at least annually. Factors that may be a change in circumstances, indicating that the carrying value of our goodwill or

amortizable intangible assets may not be recoverable, include a decline in our stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in industry segments in which we participate. We have in the past recorded, and may in the future be required to record, a significant charge in our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively affecting our results of operations.

## CYBERSECURITY, DATA PRIVACY, AND PLATFORM ABUSE RISKS

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

### Security of our information technology

Threats to IT security can take a variety of forms. Individual and groups of hackers and sophisticated organizations, including state-sponsored organizations or nation-states, continuously undertake attacks that pose threats to our customers and our IT. These actors may use a wide variety of methods, which may include developing and deploying malicious software or exploiting vulnerabilities or intentionally designed processes in hardware, software, or other infrastructure in order to attack our products and services or gain access to our networks and datacenters, using social engineering techniques to induce our employees, users, partners, or customers to disclose passwords or other sensitive information or take other actions to gain access to our data or our users' or customers' data, or acting in a coordinated manner to launch distributed denial of service

or other coordinated attacks. Nation-state and state-sponsored actors can deploy significant resources to plan and carry out attacks. Nation-state attacks against us, our customers, or our partners may intensify during periods of intense diplomatic or armed conflict, such as the ongoing conflict in Ukraine. Inadequate account security or organizational security practices may also result in unauthorized access to confidential data. For example, system administrators may fail to timely remove employee account access when no longer appropriate. Employees or third parties may intentionally compromise our or our users' security or systems or reveal confidential information. Malicious actors may employ the IT supply chain to introduce malware through software updates or compromised supplier accounts or hardware.

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

We are also subject to supply chain cyberattacks where malware can be introduced to a software provider's customers, including us, through software updates.



In addition, our internal IT environment continues to evolve. Often, we are early adopters of new devices and technologies. We embrace new ways of sharing data and communicating internally and with partners and customers using methods such as social networking and other consumer-oriented technologies. Increasing use of generative AI models in our internal systems may create new attack methods for adversaries.

Our business policies and internal security controls may not keep pace with these changes as new threats emerge, or emerging cybersecurity regulations in jurisdictions worldwide.

26

## PART I

### Item 1A

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

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

Additionally, we are actively adding new generative AI features to our services. Because generative AI is a new field, understanding of security risks and protection methods continues to develop; features that rely on generative AI may be susceptible to unanticipated security threats from sophisticated adversaries.

Our customers operate complex IT systems with third-party hardware and software from multiple vendors that may include systems acquired over many years. They expect our products and services to support all these systems and products, including those that no longer incorporate the strongest current security advances or standards. As a result, we may not be able to discontinue support in our services for a product, service, standard, or feature solely because a more secure alternative is available. Failure to utilize the most current security advances and standards can increase our customers' vulnerability to attack. Further, customers of widely varied size and technical sophistication use our technology, and consequently may still

have limited capabilities and resources to help them adopt and implement state of the art cybersecurity practices and technologies. In addition, we must account for this wide variation of technical sophistication when defining default settings for our products and services, including security default settings, as these settings may limit or otherwise impact other aspects of IT operations and some customers may have limited capability to review and reset these defaults.

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

## Development and deployment of defensive measures

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

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

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

Disclosure and misuse of personal data could result in liability and harm our reputation.

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

We may not be able to protect information in our products and services from use by others

. LinkedIn and other Microsoft products and services contain valuable information and content protected by contractual restrictions or technical measures. In certain cases, we have made

commitments to our members and users to limit access to or use of this information. Changes in the law or interpretations of the law may weaken our ability to prevent third parties from scraping or gathering information or content through use of bots or other measures and using it for their own benefit, thus diminishing the value of our products and services.

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

Advertising, professional, marketplace, and gaming platform abuses

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

## PART I

### Item 1A

#### Other digital safety abuses

Our hosted consumer services as well as our enterprise services may be used to generate or

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

The development of the IoT presents security, privacy, and execution risks.



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

Issues in the development and use of AI may result in reputational or competitive harm or liability . We are building AI into many of our offerings, including our productivity services, and we are also making AI available for our customers to use in solutions that they build. This AI may be developed by Microsoft or others, including our strategic partner, OpenAI. We expect these elements of our business to grow. We envision a future in which AI operating in our devices, applications, and the cloud helps our customers be more productive in their work and personal lives. As with many innovations, AI presents risks and challenges that could affect its adoption, and therefore our business. AI algorithms or training methodologies may be flawed. Datasets may be overbroad, insufficient, or contain biased information. Content generated by AI systems may be offensive, illegal, or otherwise harmful. Ineffective or inadequate AI development or deployment practices by Microsoft or others could result in incidents that impair the acceptance of AI solutions or cause harm to individuals, customers, or society, or result in our products and services not working as intended. Human review of certain outputs may be required. As a result of these and other challenges

associated with innovative technologies, our implementation of AI systems could subject us to competitive harm, regulatory action, legal liability, including under new proposed legislation regulating AI in jurisdictions such as the European Union ("EU"), new applications of existing data protection, privacy, intellectual property, and other laws, and brand or reputational harm. Some AI scenarios present ethical issues or may have broad impacts on society. If we enable or offer AI solutions that have unintended consequences, unintended usage or customization by our customers and partners, or are controversial because of their impact on human rights, privacy, employment, or other social, economic, or political issues, we may experience brand or reputational harm, adversely affecting our business and consolidated financial statements.

29

## PART I

### Item 1A

#### OPERATIONAL RISKS

We may have excessive outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure.

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

We may experience quality or supply problems.

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

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

There are limited suppliers for certain device and datacenter components. Our competitors use some of the same suppliers and their demand for hardware components can affect the capacity available to us. If components are delayed or become unavailable, whether because of supplier capacity constraint, industry shortages, legal or regulatory changes that restrict supply sources, or other reasons, we may not obtain timely replacement supplies, resulting in reduced sales or inadequate datacenter capacity to support the delivery and continued development of our products and services. Component shortages, excess or obsolete inventory, or price reductions resulting in

inventory adjustments may increase our cost of revenue. Xbox consoles, Surface devices, datacenter servers, and other hardware are assembled in Asia and other geographies that may be subject to disruptions in the supply chain, resulting in shortages that would affect our revenue and operating margins.

## LEGAL, REGULATORY, AND LITIGATION RISKS

Government litigation and regulatory activity relating to competition rules may limit how we design and market our products.

Government agencies closely scrutinize us under U.S. and foreign competition laws. Governments are actively enforcing competition laws and regulations, and this includes scrutiny in potentially large markets such as the EU, the U.S., and China. Some jurisdictions also allow competitors or consumers to assert claims of anti-competitive conduct. U.S. federal and state antitrust authorities have previously brought enforcement actions and continue to scrutinize our business.

For example, the European Commission ("the Commission") closely scrutinizes the design of high-volume Microsoft products and the terms on which we make certain technologies used in these products, such as file formats, programming interfaces, and protocols, available to other companies. Flagship product releases such as Windows can receive significant scrutiny under EU or other competition laws.

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

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

causing us to withdraw products from or modify products for certain markets, decreasing the value of our assets, adversely affecting our ability to monetize our products, or inhibiting our ability to consummate acquisition or impose conditions on acquisitions that may reduce their value.

Laws and regulations relating to anti-corruption and trade could result in increased costs, fines, criminal penalties, or reputational damage.

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

Increasing trade laws, policies, sanctions, and other regulatory requirements also affect our

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

## PART I

### Item 1A



Laws and regulations relating to the handling of personal data may impede the adoption of our services or result in increased costs, legal claims, fines against us, or reputational damage.

The growth of our Internet- and cloud-based services internationally relies increasingly on the movement of data across national boundaries. Legal requirements relating to the collection, storage, handling, and transfer of personal data continue to evolve. For example, while the EU-U.S. Data Privacy Framework ("DPF") has been recognized as adequate under EU law to allow transfers of personal data from the EU to certified companies in the U.S., the DPF is subject to further legal challenge which could cause the legal requirements for data transfers from the EU to be uncertain. EU data protection authorities have and may again block the use of certain U.S.-based services that involve the transfer of data to the U.S. In the EU and other markets, potential new rules and restrictions on the flow of data across borders could increase the cost and complexity of delivering our products and services.

In addition, the EU General Data Protection Regulation ("GDPR"), which applies to all of our activities conducted from an establishment in the EU or related to products and services offered in the EU, imposes a range of compliance obligations regarding the handling of personal data. More recently, the EU has been developing new requirements related to the use of data, including in the Digital Markets Act, the Digital Services Act, and the Data Act, that add additional rules and restriction on the use of data in our products and services. Engineering efforts to build and maintain capabilities to facilitate compliance with these laws involve substantial expense and the diversion of engineering resources from other projects. We might experience reduced demand for our offerings if we are unable to engineer products that meet our legal duties or help our customers meet their obligations under these and other data regulations, or if our implementation to comply makes our

offerings less attractive. Compliance with these obligations depends in part on how particular regulators interpret and apply them. If we fail to comply, or if regulators assert we have failed to comply (including in response to complaints made by customers), it may lead to regulatory enforcement actions, which can result in significant monetary penalties, private lawsuits, reputational damage, blockage of international data transfers, and loss of customers. The highest fines assessed under GDPR have recently been increasing, especially against large technology companies. Jurisdictions around the world, such as China, India, and states in the U.S. have adopted, or are considering adopting or expanding, laws and regulations imposing obligations regarding the collection, handling, and transfer of personal data.

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

Existing and increasing legal and regulatory requirements could adversely affect our results of operations.

We are subject to a wide range of laws, regulations, and legal requirements in the U.S. and globally, including those that may apply to our products and online services offerings, and those that impose requirements related to user privacy, telecommunications, data storage and protection, advertising, and online content. Laws in several jurisdictions, including EU Member State laws under the European Electronic Communications Code, increasingly define certain of our services as regulated telecommunications services. This trend may continue and will result in these offerings being subjected to additional data protection, security, law enforcement surveillance, and other obligations. Regulators and private litigants may assert that our collection, use, and management of customer data and other information is inconsistent with their laws and regulations, including laws that apply to the tracking of users via technology such as cookies. New environmental, social, and governance laws and regulations are expanding mandatory disclosure, reporting, and diligence requirements. Legislative or regulatory action relating to cybersecurity requirements may increase the costs to develop, implement, or secure our products and services. Compliance with evolving digital accessibility laws and standards will require engineering and is important to our efforts to empower all people and organizations to achieve more. Legislative and regulatory action is emerging in the areas of AI and content moderation, which could increase costs or restrict opportunity. For example, in the EU, an AI Act is being considered, and may entail increased costs or decreased opportunities for the operation of our AI services in the European market.

## PART I

### Item 1A

How these laws and regulations apply to our business is often unclear, subject to change over time, and sometimes may be inconsistent from jurisdiction to jurisdiction. In addition, governments' approach to enforcement, and our products and services, are continuing to evolve. Compliance with existing, expanding, or new laws and regulations may involve significant costs or require changes in products or business practices that could adversely affect our results of operations. Noncompliance could result in the imposition of penalties or orders we cease the alleged noncompliant activity. In addition, there is increasing pressure from advocacy groups, regulators, competitors, customers, and other stakeholders across many of these areas. If our products do not meet customer expectations or legal requirements, we could lose sales opportunities or face regulatory or legal actions.

We have claims and lawsuits against us that may result in adverse outcomes.

We are subject to a variety of claims and lawsuits. These claims may arise from a wide variety of business practices and initiatives, including major new product releases such as Windows, AI

services, significant business transactions, warranty or product claims, employment practices, and regulation. Adverse outcomes in some or all of these claims may result in significant monetary damages or injunctive relief that could adversely affect our ability to conduct our business. The litigation and other claims are subject to inherent uncertainties and management's view of these matters may change in the future. A material adverse impact in our consolidated financial statements could occur for the period in which the effect of an unfavorable outcome becomes probable and reasonably estimable.

Our business with government customers may present additional uncertainties.

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

We may have additional tax liabilities.

We are subject to income taxes in the U.S. and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. For example, compliance with the 2017 United States Tax Cuts and Jobs Act ("TCJA") and possible future legislative changes may require the collection of information not regularly produced within the

company, the use of estimates in our consolidated financial statements, and the exercise of significant judgment in accounting for its provisions. As regulations and guidance evolve with respect to the TCJA or possible future legislative changes, and as we gather more information and perform more analysis, our results may differ from previous estimates and may materially affect our consolidated financial statements.

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

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

## PART I

### Item 1A

#### INTELLECTUAL PROPERTY RISKS

We face risks related to the protection and utilization of our intellectual property that may result in our business and operating results may be harmed.

Protecting our intellectual property rights and combating unlicensed copying and use of our software and other intellectual property on a global basis is difficult. Similarly, the absence of harmonized patent laws makes it more difficult to ensure consistent respect for patent rights.

Changes in the law may continue to weaken our ability to prevent the use of patented technology or collect revenue for licensing our patents. Additionally, licensees of our patents may fail to satisfy

their obligations to pay us royalties or may contest the scope and extent of their obligations. Finally, our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations. If we are unable to protect our intellectual property, our revenue may be adversely affected.

Source code, the detailed program commands for our operating systems and other software programs, is critical to our business. If our source code leaks, we might lose future trade secret protection for that code. It may then become easier for third parties to compete with our products by copying functionality, which could adversely affect our revenue and operating results. Unauthorized disclosure of source code also could increase the security risks described elsewhere in these risk factors.

Third parties may claim that we infringe their intellectual property.

From time to time, others claim we infringe their intellectual property rights. To resolve these claims, we may enter into royalty and licensing agreements on terms that are less favorable than currently available, stop selling or redesign affected products or services, or pay damages to satisfy indemnification commitments with our customers. Adverse outcomes could also include monetary damages or injunctive relief that may limit or prevent importing, marketing, and selling our products or services that have infringing technologies. We have paid significant amounts to settle claims related to the use of technology and intellectual property rights and to procure intellectual property rights as part of our strategy to manage this risk, and may continue to do so.

## GENERAL RISKS



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

-

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

-

Public scrutiny of our decisions regarding user privacy, data practices, or content.

-

Data security breaches, compliance failures, or actions of partners or individual employees.

The proliferation of social media may increase the likelihood, speed, and magnitude of negative

brand events. If our brands or reputation are damaged, it could negatively impact our revenues or margins, or ability to attract the most highly qualified employees.

Adverse economic or market conditions may harm our business.

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

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

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

## PART I

### Item 1A

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

Catastrophic events or geopolitical conditions may disrupt our business.

A disruption or failure of our systems or operations because of a major earthquake, weather event, cyberattack, terrorist attack, pandemic, or other catastrophic event could cause delays in completing sales, providing services, or performing other critical functions. Our corporate headquarters, a significant portion of our research and development activities, and certain other essential business

operations are in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are seismically active regions. A catastrophic event that results in the destruction or disruption of any of our critical business or IT systems, or the infrastructure or systems they rely on, such as power grids, could harm our ability to conduct normal business operations. Providing our customers with more services and solutions in the cloud puts a premium on the resilience of our systems and strength of our business continuity management plans and magnifies the potential impact of prolonged service outages in our consolidated financial statements.

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

The occurrence of regional epidemics or a global pandemic, such as COVID-19, may adversely affect our operations, financial condition, and results of operations. The extent to which global pandemics impact our business going forward will depend on factors such as the duration and scope of the pandemic; governmental, business, and individuals' actions in response to the

pandemic; and the impact on economic activity, including the possibility of recession or financial market instability. Measures to contain a global pandemic may intensify other risks described in these Risk Factors.

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

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

## >Item 1A

Our global business exposes us to operational and economic risks.

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

Our business depends on our ability to attract and retain talented employees.

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

## PART I

Item 1B, 2, 3, 4

### **Section: Item7**

>Item 7

## STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

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



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

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

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

Satya Nadella

Chief Executive Officer

Amy E. Hood

Executive Vice President and Chief Financial Officer

Alice L. Jolla

Corporate Vice President and Chief Accounting Officer

PART II

Item 7A

## **Section: Item7a**

### **>ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **RISKS**

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

#### **Foreign Currencies**

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

## Interest Rate

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

## Credit

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

## Equity

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

SENSITIVITY ANALYSIS

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

(In millions)









Hypothetical Change

June 30,  
2023

Impact



Foreign currency - Revenue

10% decrease in foreign exchange rates

\$

(8,122

)

Earnings

Foreign currency - Investments

10% decrease in foreign exchange rates

(29

)

Fair Value



Interest rate

100 basis point increase in U.S. treasury interest rates

(1,832

)

Fair Value

Credit

100 basis point increase in credit spreads

(354

)

Fair Value

Equity

10% decrease in equity market prices

(705

)

Earnings



PART II

Item 8

ITEM 8. FINANCIAL STATE  
MENTS AND SUPPLEMENTARY DATA

INC  
OME STATEMENTS





(In millions, except per share amounts)



Year Ended June 30,

2023

2022

2021

Revenue:

Product

\$

64,699

\$

72,732

\$

71,074

Service and other

147,216



125,538

97,014





Total revenue

211,915

198,270

168,088





Cost of revenue:





Product

17,804

19,064

18,219

Service and other

48,059

43,586

34,013



Total cost of revenue

65,863

62,650



52,232





Gross margin

146,052

135,620

115,856

Research and development

27,195

24,512

20,716

Sales and marketing

22,759

21,825

20,117

General and administrative



7,575

5,900

5,107



Operating income

88,523

83,383

69,916

Other income, net

788

333

1,186







Income before income taxes

89,311

83,716

71,102

Provision for income taxes

16,950

10,978

9,831





Net income

\$

72,361



\$

72,738

\$

61,271





Earnings per share:

Basic

\$

9.72

\$

9.70

\$

8.12

Diluted

\$

9.68

\$

9.65

\$

8.05



Weighted average shares outstanding:



Basic

7,446

7,496

7,547

Diluted

7,472

7,540

7,608

Refer to accompanying notes.

PART II

Item 8

COMPREHENSIVE IN  
COME STATEMENTS





(In millions)



Year Ended June 30,

2023

2022

2021

Net income

\$

72,361

\$

72,738

\$

61,271







Other comprehensive income (loss), net of tax:



Net change related to derivatives

(

)

6

19

Net change related to investments

(  
1,444

)

(

5,360

)

(

2,266

)

Translation adjustments and other

(

207

)

(

1,146

)









Other comprehensive loss

(  
1,665

)

(  
6,500

)

(  
1,374

)







\$

70,696

\$

66,238



\$

59,897



Refer to accompanying notes.

PART II

Item 8

BALANCE  
SHEETS



(In millions)



June 30,

2023

2022

Assets



Current assets:

Cash and cash equivalents

\$

34,704

\$

13,931

Short-term investments

76,558

90,826





Total cash, cash equivalents, and short-term investments

111,262

104,757

Accounts receivable, net of allowance for doubtful accounts of

\$

650

and \$

633

48,688



44,261

Inventories

2,500

3,742

Other current assets

21,807

16,924



Total current assets

184,257

169,684

Property and equipment, net of accumulated depreciation of

\$

68,251

and \$

59,660

95,641

74,398

Operating lease right-of-use assets

14,346

13,148



Equity investments

9,879

6,891

Goodwill

67,886

67,524

Intangible assets, net

9,366

11,298

Other long-term assets

30,601

21,897



Total assets

\$

411,976

\$

364,840





Liabilities and stockholders' equity

Current liabilities:



Accounts payable

\$

18,095

\$

19,000

Current portion of long-term debt

5,247

2,749

Accrued compensation

11,009

10,661

Short-term income taxes

4,152



4,067

Short-term unearned revenue

50,901

45,538

Other current liabilities

14,745

13,067



Total current liabilities

104,149

95,082

Long-term debt

41,990

47,032

Long-term income taxes

25,560

26,069

Long-term unearned revenue



2,912

2,870

Deferred income taxes

433

230

Operating lease liabilities

12,728

11,489

Other long-term liabilities

17,981

15,526



Total liabilities

205,753

198,298









Stockholders' equity:

Common stock and paid-in capital - shares authorized

24,000

; outstanding

7,432

and

7,464

93,718

86,939

Retained earnings

118,848

84,281

Accumulated other comprehensive loss

(  
6,343

)

(  
4,678

)





Total stockholders' equity

206,223

166,542



Total liabilities and stockholders' equity

\$

411,976

\$

364,840

Refer to accompanying notes.

PART II

Item 8

CASH FLOWS S  
TATEMENTS





(In millions)



Year Ended June 30,

2023

2022

2021

Operations

Net income

\$

72,361

\$

72,738

\$

61,271

Adjustments to reconcile net income to net cash from operations:



Depreciation, amortization, and other

13,861

14,460

11,686

Stock-based compensation expense

9,611

7,502

6,118

Net recognized losses (gains) on investments and derivatives

196

(  
409

)

(  
1,249

)

Deferred income taxes

(  
6,059

)

(  
5,702

)

(

150

)

Changes in operating assets and liabilities:





Accounts receivable

(  
4,087

)

(  
6,834

)

(  
6,481

)

Inventories

1,242

(  
1,123

)

(

737

)

Other current assets

(

1,991

)

(

709

)

(

932

)

Other long-term assets

(  
2,833

)

(  
2,805

)

(

3,459

)

Accounts payable



(  
2,721

)

2,943

2,798

Unearned revenue

5,535

5,109

4,633

Income taxes

(  
358

)

696

(  
2,309

)

Other current liabilities

2,272

2,344

4,149

Other long-term liabilities

825

1,402







Net cash from operations

87,582

89,035

76,740







Financing



Cash premium on debt exchange

0

0

(

1,754

)

Repayments of debt

(

2,750

)

(  
9,023

)

(  
3,750

)

Common stock issued

1,866

1,841

1,693

Common stock repurchased

(  
22,245

)

(  
32,696

)

(

27,385

)

Common stock cash dividends paid

(

19,800

)



(  
18,135

)

(  
16,521

)

Other, net

(  
1,006

)

(  
863

)

(

769

)





Net cash used in financing

(

43,935

)

(

58,876

)

(

48,486

)







Investing

Additions to property and equipment

(  
28,107

)

(  
23,886

)

(  
20,622

)

Acquisition of companies, net of cash acquired, and purchases of intangible and other assets

(  
1,670

)

(  
22,038

)

(  
8,909

)

Purchases of investments

(  
37,651

)



(  
26,456

)

(  
62,924

)

Maturities of investments

33,510

16,451

51,792

Sales of investments

14,354

28,443

14,008

Other, net

(  
3,116

)

(  
2,825

)

(

922

)







Net cash used in investing

(

22,680

)

(

30,311

)

(

27,577

)





Effect of foreign exchange rates on cash and cash equivalents

(  
194

)

(

141

)

(

29

)







Net change in cash and cash equivalents

20,773

(  
293

)

Cash and cash equivalents, beginning of period

13,931

14,224

13,576





Cash and cash equivalents, end of period



\$

34,704

\$

13,931

\$

14,224



Refer to accompanying notes.

61

PART II

Item 8

STOCKHOLDERS' EQ  
UITY STATEMENTS



(In millions, except per share amounts)



Year Ended June 30,

2023

2022



2021

Common stock and paid-in capital

Balance, beginning of period

\$

86,939

\$

83,111

\$

80,552

Common stock issued

1,866

1,841

1,963

Common stock repurchased

(  
4,696

)

(  
5,688

)

(  
5,539

)

Stock-based compensation expense

9,611



7,502

6,118

Other, net

(

2

)







Balance, end of period

93,718

86,939

83,111







Retained earnings



Balance, beginning of period

84,281

57,055

34,566

Net income

72,361

72,738

61,271

Common stock cash dividends

(  
20,226

)

(  
18,552

)

(  
16,871

)

Common stock repurchased



(  
17,568

)

(  
26,960

)

(  
21,879

)

Cumulative effect of accounting changes

0

0

(

32

)



Balance, end of period

118,848

84,281







Accumulated other comprehensive income (loss)



Balance, beginning of period

(  
4,678

)

1,822

3,186

Other comprehensive loss

(  
1,665

)

(  
6,500

)

(

1,374

)

Cumulative effect of accounting changes

0

0







Balance, end of period

(  
6,343

)

(  
4,678

)

1,822





Total stockholders' equity

\$

206,223

\$

166,542



\$

141,988





Cash dividends declared per common share

\$

2.72

\$

2.48

\$

2.24



Refer to accompanying notes.

62

PART II

Item 8

NOTES TO FINANCIAL STATEMENTS



## NOTE 1 -- ACCOUNTING POLICIES

### Accounting Principles

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

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

### Principles of Consolidation

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

### Estimates and Assumptions

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

consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management's estimates and assumptions due to risks and uncertainties.

In July 2022, we completed an assessment of the useful lives of our server and network equipment. Due to investments in software that increased efficiencies in how we operate our server and network equipment, as well

as advances in technology, we determined we should increase the estimated useful lives of both server and network equipment from

four years

to

six years

. This change in accounting estimate was effective beginning fiscal year 2023. Based on the carrying amount of server and network equipment included in property and equipment, net as of June 30, 2022, the effect of this change in estimate for fiscal year 2023 was an increase in operating income of \$

3.7

billion and net income of \$

3.0

billion, or \$

0.40

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 and collaboration 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.

63

## PART II

### Item 8

#### Revenue Recognition

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

## Nature of Products and Services

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

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

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

Revenue from search advertising is recognized when the advertisement appears in the search

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

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

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

#### Significant Judgments

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

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

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

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

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

Contract Balances and Other Receivables

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

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

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

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days.

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

As of June 30, 2023 and 2022, long-term accounts receivable, net of allowance for doubtful

accounts, was \$

4.5

billion and \$

3.8

billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

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

65

## PART II

### Item 8

Activity in the allowance for doubtful accounts was as follows:





(In millions)







Year Ended June 30,

2023

2022





Balance, beginning of period

\$

\$

798

\$

816

Charged to costs and other



(

252

)

(

245

)

(

252

)







Balance, end of period

\$

716

\$

710

\$

798



Allowance for doubtful accounts included in our consolidated balance sheets:

(In millions)











June 30,

2023

2022

2021



Accounts receivable, net of allowance for doubtful accounts

\$

650

\$

633

\$

751

Other long-term assets









Total

\$

716

\$

710

\$

798



As of June 30, 2023 and 2022, other receivables related to activities to facilitate the purchase of server

components were \$

9.2

billion and \$

6.1

billion, respectively, and are included in other current assets in our consolidated balance sheets.

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, 2023 and 2022, our financing receivables, net were \$

5.3

billion and \$

4.1

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 organization 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 cloud-based and other

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.

66

## PART II

### Item 8

#### 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 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 \$

904

million

, \$

1.5

billion, and \$

1.5

billion in fiscal years 2023, 2022, and 2021, 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.

#### Employee Severance

On January 18, 2023, we announced a decision to reduce our overall workforce by approximately 10,000

jobs through the third quarter of fiscal year 2023. During the three months ended December 31, 2022, we recorded \$

800

million of employee severance expenses related to these job eliminations as part of an ongoing employee benefit plan. These employee severance expenses were incurred as part of a corporate program, and were included in general and administrative expenses in our consolidated income statements and allocated to our segments based on relative gross margin. Refer to Note 19 - Segment Information and Geographic Data for further information.

#### 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.

## PART II

### Item 8

#### Financial Instruments

##### Investments

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

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

basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

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

## Derivatives

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

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

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

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

## PART II

### Item 8

#### Fair Value Measurements

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

-

#### Level 1

- inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 investments include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.

-

#### Level 2

- inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 investments include commercial paper, certificates of deposit, U.S. agency securities, foreign government bonds, mortgage- and asset-backed securities, corporate notes and bonds, and municipal securities. Our

Level 2 derivative assets and liabilities include certain cleared swap contracts and over-the-counter forward, option, and swap contracts.

-

### Level 3

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

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

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

### Inventories

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

## Property and Equipment

Property and equipment is stated at cost less accumulated depreciation, and depreciated using the straight-line method over the shorter of the estimated useful life of the asset or the lease term. The estimated useful lives of our property and equipment are generally as follows: computer software developed or acquired for internal use,

three years

; computer equipment,

two

to

six

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.

69

## PART II

### Item 8

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) 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.

## 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,

2023

2022

2021





Net income available for common shareholders (A)

\$

72,361

\$

72,738

\$

61,271





Weighted average outstanding shares of common stock (B)

7,446

7,496

7,547

Dilutive effect of stock-based awards



44

61







Common stock and common stock equivalents (C)

7,472

7,540

7,608









Earnings Per Share





Basic (A/B)

\$

9.72

\$

9.70

\$

8.12

Diluted (A/C)

\$

9.68

\$

9.65

\$





Anti-dilutive stock-based awards excluded from the calculations of diluted EPS were immaterial

during the periods presented.

70

## PART II

### Item 8

#### NOTE 3 -- OTHER INCOME (EXPENSE), NET

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



(In millions)



Year Ended June 30,

2023

2022



Interest and dividends income

\$

2,994

\$

2,094



\$

2,131

Interest expense

(

1,968

)

(

2,063

)

(

2,346

)

Net recognized gains on investments

461

1,232

Net gains (losses) on derivatives

(

456

)

(

52

)

Net gains (losses) on foreign currency remeasurements

(  
75

)

54

Other, net

(  
223

)



(

32

)

98





Total

\$

788

\$

333

\$

1,186



## Net Recognized Gains (Losses) on Investments

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





(In millions)



Year Ended June 30,

2023

2022

2021

Realized gains from sales of available-for-sale securities

\$

36

\$

162

\$

105

Realized losses from sales of available-for-sale securities

(

124

)

(

138

)

(  
40

)

Impairments and allowance for credit losses

(  
10



)

(

81

)

(

2

)



Total

\$

(

98

)

\$

(

57

)

\$

63



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



(In millions)



Year Ended June 30,

2023

2022

2021

Net realized gains on investments sold

\$

\$

29

\$

123

Net unrealized gains on investments still held

509

1,057

Impairments of investments



(  
20

)

(  
20

)

(

11

)





Total

\$

358

\$

518

\$

1,169



PART II

Item 8

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, 2023

















Changes in Fair Value Recorded in Other Comprehensive Income

















Level 2

\$

16,589

\$

0

\$

0

\$

16,589

\$

12,231

\$

4,358



\$

0

Certificates of deposit

Level 2

2,701

0

0

2,701

2,657

0

U.S. government securities

Level 1

65,237

(  
3,870

)

61,369

2,991

58,378



0

U.S. agency securities

Level 2

2,703

0

0

2,703

894

1,809

0

Foreign government bonds

Level 2



)

475

0

475

0



Mortgage- and asset-backed securities

Level 2

1

(

39

)

786

0

786

0

Level 2

10,809

8

(

583

)

10,234

0

10,234

0

Corporate notes and bonds



Level 3

0

0

120

0

120

0

Municipal securities

Level 2



(

18

)

268



0

Municipal securities

Level 3





(

16

)

87

0

87

0

















Total debt investments

\$

99,869

\$

13

\$

(

4,550

)

\$

95,332

\$

18,780

\$

76,552

\$

0

















Changes in Fair Value Recorded in Net Income

















Equity investments

Level 1





\$

10,138

\$

7,446

\$

0

\$

2,692

Equity investments

Other



7,187

0

0

7,187

















Total equity investments



\$

17,325

\$

7,446



\$

0

\$

9,879

















Cash



\$

8,478

\$

8,478

\$

0

\$

0

Derivatives, net

(a)





0

6





















Total



\$

121,141

\$

34,704

\$

76,558

\$

9,879















(In millions)

Fair Value  
Level

Adjusted

Cost Basis

Unrealized

Gains

Unrealized  
Losses

Recorded  
Basis

Cash  
and Cash  
Equivalents

Short-term

Investments

Equity

Investments

















June 30, 2022

















Changes in Fair Value Recorded in Other Comprehensive Income















Commercial paper

Level 2

\$

2,500

\$

0

\$

0

\$

2,500

\$

2,498

\$

2



\$

0

Certificates of deposit

Level 2

2,071

0

0

2,071

2,032

39

0

U.S. government securities

Level 1

79,696

(  
2,178

)

77,547

77,538

0



U.S. agency securities

Level 2

0

(

9

)

410

0

410

0

Foreign government bonds

Level 2

0

(

24

)

482

0





Level 2

1

(  
30

)



0

Corporate notes and bonds

Level 2

11,661

4

(

554

)

11,111

0

11,111

0

Corporate notes and bonds

Level 3



67

0

0

67

0

67

0

Municipal securities

Level 2



(

13

)

374

0

374

0

Municipal securities

Level 3





6

)

97

0



















Total debt investments

\$

98,118

\$

\$

(  
2,814

)

\$

95,357

\$

4,539

\$

90,818

\$

0

















Changes in Fair Value Recorded in Net Income















Equity investments

Level 1





1,590

\$

1,134

\$

0

\$

456

Equity investments

Other



0

0

6,435

















Total equity investments



\$

8,025

\$

1,134



\$

0

\$

6,891

















Cash



\$

8,258

\$

8,258

\$

0

\$

0

Derivatives, net

(a)





0

8

0

















Total







111,648

\$

13,931

\$

90,826

\$

6,891







(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, 2023 and 2022, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were \$

4.2

billion and \$

3.8

billion, respectively.



## PART II

## Item 8

## 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

Total

Unrealized

Losses







(In millions)



Fair Value

Unrealized  
Losses

Fair Value

Unrealized  
Losses

Total  
Fair Value



June 30, 2023







U.S. government and agency securities

\$

7,950



\$

(

336

)

\$

45,273

\$

(  
3,534

)

\$

53,223

\$

(  
3,870

)

Foreign government bonds

(  
5

)

(

19

)

468

(

24

)

Mortgage- and asset-backed securities

257

(

5

)

(

34

)

669



(

39

)

Corporate notes and bonds

2,326

(

49

)

7,336

(

534

)

9,662

(

583

)

Municipal securities

111

(  
3

)

(

31

)

297

(

34

)













Total

\$

10,721

\$

(

398

)

\$

53,598

\$

(

4,152

)

\$

64,319

\$

(  
4,550

)











Less than 12 Months

12 Months or Greater

Total

Unrealized

Losses







(In millions)

Fair Value

Unrealized

Losses

Fair Value

Unrealized

Losses

Total

Fair Value













June 30, 2022













U.S. government and agency securities

\$

59,092

\$

(

1,835

)

\$

2,210

\$

(

352

)

\$

61,302

\$

(

2,187

)

Foreign government bonds

(

18

)

27

(

6

)

(

24

)

Mortgage- and asset-backed securities

(  
26

)



(

4

)

(  
30

)

Corporate notes and bonds

9,443

(  
477

)

786

(  
77

)

10,229

(

554

)

Municipal securities

(

12

)

(

7

)

(

19

)













Total

\$

69,641

\$

(

2,368

)

\$

3,138

\$

(

446

)

\$

72,779



\$

(

2,814

)





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, 2023





Due in one year or less

\$

38,182

\$

38,048

Due after one year through five years

47,127

44,490

Due after five years through 10 years

13,262

11,628

Due after 10 years

1,298

1,166





Total

\$

99,869

\$

95,332





PART II

Item 8

NOTE 5 -- DERIVATIVES

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

## Foreign Currencies

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

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

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

## Interest Rate

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

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

returns that correlate to certain broad-based fixed-income indices using option, futures, and swap 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.

## 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, 2023, 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.

## PART II

## Item 8

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

(In millions)

June 30,  
2023

June 30,  
2022





Designated as Hedging Instruments

Foreign exchange contracts purchased

\$

1,492

\$

635

Interest rate contracts purchased

1,078

1,139

Not Designated as Hedging Instruments



Foreign exchange contracts purchased

7,874

10,322

Foreign exchange contracts sold

25,159



21,606

Equity contracts purchased

3,867

1,131

Equity contracts sold

2,154

0

Other contracts purchased

1,224

1,642

Other contracts sold

581

544



Fair Values of Derivative Instruments

The following table presents our derivative instruments:





(In millions)

Derivative

Assets

Derivative

Liabilities

Derivative

Assets

Derivative

Liabilities





June 30,  
2023

June 30,  
2022



Designated as Hedging Instruments









Foreign exchange contracts

\$

\$

(

67

)

\$

0

\$

(

77

)

Interest rate contracts

16

0

3







Not Designated as Hedging Instruments







Foreign exchange contracts

249

(

332

)

333

(  
362

)



Equity contracts

165

(

400

)

5

(

95

)

Other contracts

5

(

6

)

15

(

17

)











Gross amounts of derivatives

(

805

)

356

(

551

)

Gross amounts of derivatives offset in the balance sheet

(

202

)

206

(

130

)

Cash collateral received

(  
125

)

0

(

75

)









Net amounts of derivatives

\$

\$

(  
724

)

\$

\$

(

493

)









Reported as









\$

6

\$

0

\$

8

\$

0

Other current assets

245

0



218

0

Other long-term assets

16

0

0

0

Other current liabilities

0

(

341

)

0

(

298

)

Other long-term liabilities

0

(

)

0

(

)









Total

\$

267

\$

(

724

)

\$

226

\$

(

493

)



Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were \$

442

million and \$

804

million, respectively, as of June 30, 2023, and \$

343

million and \$

550

million, respectively, as of June 30, 2022.

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, 2023









Derivative assets

\$

0

\$

462

\$

7

\$

469

Derivative liabilities

0

(

805

)

0

(

805

)





June 30, 2022







Derivative assets



Derivative liabilities



(

551

)

0

(

551

)



## PART II

### Item 8

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



(In millions)







Year Ended June 30,

2023

2022

2021

Designated as Fair Value Hedging Instruments



Foreign exchange contracts

Derivatives

\$

0

\$

49

\$

193

Hedged items

(  
50

)

(  
188

)

Excluded from effectiveness assessment

0

4



Interest rate contracts

Derivatives

(

65

)

(

)

(

37

)

Hedged items

38

108





Designated as Cash Flow Hedging Instruments

Foreign exchange contracts

Amount reclassified from accumulated other comprehensive income



61

(

79

)





Not Designated as Hedging Instruments



Foreign exchange contracts

(  
73

)



(  
420

)



(

6

)

Other contracts

(

41

)

(

85

)

15



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



(In millions)



Year Ended June 30,

2023



2022

2021

Designated as Cash Flow Hedging Instruments



Foreign exchange contracts



Included in effectiveness assessment

\$

34

\$

(

57

)

\$

34





## NOTE 6

--

### INVENTORIES

The components of inventories were as follows:

(In millions)

June 30,

2023

2022

Raw materials

\$

709

\$

1,144

Work in process

Finished goods

1,768

2,516





Total

\$

2,500

\$

3,742





## NOTE 7 -- PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

(In millions)

June 30,

2023

2022



Land

\$

5,683

\$

4,734

Buildings and improvements

68,465

55,014

Leasehold improvements

8,537

7,819

Computer equipment and software

74,961

60,631

Furniture and equipment

6,246

5,860



Total, at cost

163,892



134,058

Accumulated depreciation

(

68,251

)

(

59,660

)



Total, net

\$

95,641

\$

74,398

During fiscal years 2023, 2022, and 2021, depreciation expense was \$

11.0

billion, \$

12.6

billion, and \$

9.3

billion, respectively.

Depreciation expense declined in fiscal year 2023 due to the change in estimated useful lives of our

server and network equipment.

As of June 30, 2023, we have committed \$

13.5

billion for the construction of new buildings, building improvements, and leasehold improvements, primarily related to datacenters.

## NOTE 8 -- BUSINESS COMBINATIONS

Nuance Communications, Inc.

On

March 4, 2022

, we completed our acquisition of Nuance Communications, Inc. ("Nuance") for a total purchase price of \$

18.8

billion, consisting primarily of cash. Nuance is a cloud and artificial intelligence ("AI") software provider with healthcare and enterprise AI experience, and the acquisition will build on our industry-specific cloud offerings. The financial results of Nuance have been included in our consolidated financial statements since the date of the acquisition. Nuance is reported as part of our Intelligent Cloud segment.

The allocation of the purchase price to goodwill was completed as of December 31, 2022.

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





(In millions)



Goodwill

(a)

\$

16,326

Intangible assets

4,365

Other assets

42

Other liabilities

(b)

(  
1,972

)



Total

\$

18,761





(a)

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

(b)

Includes \$

986

million of convertible senior notes issued by Nuance in 2015 and 2017, substantially all of which have been redeemed.

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

(In millions, except average life)

Amount

Weighted

Average Life



Customer-related

\$

2,610

9

years

Technology-based

1,540

5

years



Marketing-related

215

4  
years



Total

\$

4,365

7

years



## PART II

### Item 8

ZeniMax Media Inc.

On

March 9, 2021

, we completed our acquisition of ZeniMax Media Inc. ("ZeniMax"), the parent company of Bethesda Softworks LLC ("Bethesda"), for a total purchase price of \$

8.1

billion, consisting primarily of cash. The purchase price included \$

766

million of cash and cash equivalents acquired. Bethesda is one of the largest, privately held game developers and publishers in the world, and brings a broad portfolio of games, technology, and talent to Xbox. The financial results of ZeniMax have been included in our consolidated financial statements since the date of the acquisition. ZeniMax is reported as part of our More Personal Computing segment.

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

(In millions)







Cash and cash equivalents

\$

766

Goodwill

5,510

Intangible assets

1,968

Other assets

Other liabilities

)



Total

\$

8,121



Goodwill was assigned to our More Personal Computing segment. The goodwill was primarily

attributed to increased synergies that are expected to be achieved from the integration of ZeniMax.

None of the goodwill is expected to be deductible for income tax purposes.

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

(In millions, except average life)

Amount

Weighted

Average Life





Technology-based

\$

1,341

years

Marketing-related







Total

\$

1,968

6

years



Activision Blizzard, Inc.

On

January 18, 2022

, we entered into a definitive agreement to acquire Activision Blizzard, Inc. ("Activision Blizzard") for \$

95.00

per share in an all-cash transaction valued at \$

68.7

billion, inclusive of Activision Blizzard's net cash. Activision Blizzard is a leader in game development and an interactive entertainment content publisher. The acquisition will accelerate the growth in our gaming business across mobile,

PC, console, and cloud gaming. The acquisition has been approved by Activision Blizzard's shareholders. We continue to work toward closing the transaction subject to obtaining required regulatory approvals and satisfaction of

other customary closing conditions. Microsoft and Activision Blizzard have jointly agreed to extend the merger agreement through October 18, 2023 to allow for additional time to resolve remaining regulatory concerns.

NOTE 9 -- GOODWILL

Changes in the carrying amount of goodwill were as follows:



(In millions)

June 30,

2021

Acquisitions

Other



June 30,  
2022

Acquisitions

Other

June 30,  
2023

















\$

24,317

\$

599

\$

(

105

)

\$

24,811

\$

\$

(  
47

)

\$

24,775

Intelligent Cloud

13,256

16,879

47

30,182



30,469

More Personal Computing



12,138

648

(

255

)

12,531

0

111

12,642















Total

\$

49,711

\$

18,126

\$

(

313

)

\$

67,524

\$

234

\$

128

\$

67,886









## PART II

### Item 8

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, 2023, May 1, 2022, or May 1, 2021 tests. As of June 30, 2023 and 2022, 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,





Technology-based

\$

11,245

\$

(  
7,589

)

\$

3,656

\$

11,277

\$

(

6,958

)

\$

4,319

Customer-related

7,281

(  
4,047

)

3,234



7,342

(  
3,171

)

4,171

Marketing-related

4,935

(  
2,473

)

2,462

4,942

(  
2,143

)

2,799

Contract-based

(

15

)

14

(

7

)













Total

\$

23,490

\$

(

14,124

)

\$

9,366

\$

23,577

\$

(

12,279

)

\$

11,298







No material impairments of intangible assets were identified during fiscal years 2023, 2022, or 2021.

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,

2023



2022

Technology-based

\$

7  
years

\$

2,611

4  
years

Customer-related

0

0

years

2,837

9

years

Marketing-related

7

5

years

233

4

years



Contract-based

12

3

years

0

0

years







Total

\$

541

6

years

\$

5,681

7

years







Intangible assets amortization expense was \$

2.5

billion, \$

2.0

billion, and \$

1.6

billion for fiscal years 2023, 2022, and 2021, respectively.

80

PART II

Item 8

The following table outlines the estimated future amortization expense related to intangible assets held as of June 30, 2023:

(In millions)

Year Ending June 30,



\$

2,363

2025

1,881

2026

1,381



2027

929

2028

652

Thereafter

2,160



Total

\$

9,366

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,  
2023

June 30,  
2022







2009

issuance of \$

3.8

billion

2039

5.20

%

5.24  
%

\$

520

\$

520

2010

issuance of \$

4.8

billion



2040

4.50

%

4.57

%

2011  
issuance of \$  
2.3  
billion



5.30

%

5.36

%

718

718

2012

issuance of \$

2.3

billion

2042

3.50

%

3.57

%



454

1,204

2013

issuance of \$

5.2

billion

2023

-

2043

3.63

%

-

4.88

%

3.73

%

-

4.92

%

1,814

2,814

2013

issuance of EUR

4.1

billion

2028

-

2033

2.63

%

-

3.13

%

2.69

%

-

3.22

%

2,509

2,404

2015  
issuance of \$  
23.8  
billion



2025

-

2055

2.70

%

-

4.75

%

2.77

%

-

4.78

%

9,805

10,805

2016  
issuance of \$  
19.8  
billion

2023

-

2056

2.00

%

-

3.95

%

2.10

%

-

4.03

%

9,430

9,430

2017

issuance of \$

17.0

billion

2024

-

2057

2.88

%

-

4.50

%

3.04

%

-

4.53

%



8,945

8,945

2020

issuance of \$

10.0

billion

2050

-

2060

2.53

%

-

2.68

%

2.53

%

-

2.68

%

10,000

10,000

2021

issuance of \$

8.2

billion

2052

-

2062

2.92

%

-

3.04

%

2.92

%

-

3.04

%

8,185

8,185









Total face value



55,511

Unamortized discount and issuance costs



(

438

)

(

471

)

Hedge fair value adjustments



(a)

(

106

)

(

68

)

Premium on debt exchange

(  
5,085

)

(  
5,191

)









Total debt



49,781

Current portion of long-term debt



(  
5,247

)

(  
2,749

)









Long-term debt



\$

41,990

\$

47,032





(a)

Refer to Note 5 - Derivatives for further information on the interest rate swaps related to fixed-rate debt.

As of June 30, 2023 and 2022, the estimated fair value of long-term debt, including the current portion, was \$

46.2

billion and \$

50.9

billion, respectively. The estimated fair values are based on Level 2 inputs.

Debt in the table above is comprised of senior unsecured obligations and ranks equally with our other outstanding obligations. Interest is paid semi-annually, except for the Euro-denominated debt, which is paid annually. Cash paid for interest on our debt for fiscal years 2023, 2022, and 2021 was \$

1.7

billion, \$

1.9

billion, and \$

2.0

billion, respectively.

## PART II

## Item 8

The following table outlines maturities of our long-term debt, including the current portion, as of June 30, 2023:

(In millions)





Year Ending June 30,

2024

\$

5,250

2025

2,250

2026

3,000

2027

8,000

2028

0

Thereafter

34,366





Total

\$

52,866

## NOTE 12 -- INCOME TAXES

### Provision for Income Taxes

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



(In millions)





Year Ended June 30,

2023

2022





Current Taxes





U.S. federal

\$

14,009

\$

8,329

\$

3,285

U.S. state and local

2,322

1,679

1,229

Foreign

6,678

6,672

5,467









Current taxes

\$

23,009

\$

16,680

\$

9,981



Deferred Taxes







U.S. federal

\$

(

6,146

)

\$

(

4,815

)

\$

25

U.S. state and local

(  
477

)

(  
1,062

)

(  
204

)

Foreign

564

175









Deferred taxes

\$

(

6,059

)

\$

(

5,702

)

\$

(

)





Provision for income taxes

\$

16,950

\$

10,978

\$

9,831





## PART II

### Item 8

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



(In millions)





Year Ended June 30,

2023

2022

2021



U.S.

\$

52,917

\$

47,837

\$

34,972

Foreign

36,394

35,879

36,130







Income before income taxes

\$

89,311

\$

83,716

\$

71,102





#### 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,

2023

2022

2021

Federal statutory rate

21.0

%



21.0  
%

21.0  
%

Effect of:

Foreign earnings taxed at lower rates

(  
1.8  
)%

(  
1.3  
)%

(  
2.7  
)%

Impact of intangible property transfers

0

%

(

3.9

)%

0

%

Foreign-derived intangible income deduction

(

1.3

)%

(

1.1

)%

(

1.3

)%



State income taxes, net of federal benefit

1.6

%

1.4

%

1.4

%

Research and development credit

(  
1.1  
)%

(  
0.9  
)%

(  
0.9  
)%

Excess tax benefits relating to stock-based compensation

(  
0.7  
)%

(  
1.9  
)%

(

2.4

)%

Interest, net

0.8

%

0.5  
%

0.5  
%

Other reconciling items, net

0.5

%



(  
0.7  
)%

(  
1.8  
)%







Effective rate

19.0

%

13.1

%

13.8

%



In the first quarter of fiscal year 2022, we transferred certain intangible properties from our Puerto Rico subsidiary to the U.S. The transfer of intangible properties resulted in a \$

3.3

billion net income tax benefit in the first quarter of fiscal year 2022, as the value of future U.S. tax deductions exceeded the current tax liability from the U.S. global intangible low-taxed income ("GILTI") tax.

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



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 2023 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 center in Ireland. The decrease from the federal statutory rate in fiscal year 2022 is primarily due to the net income tax benefit related to the transfer of intangible properties, earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations center in Ireland, and tax benefits relating to stock-based compensation. The decrease from the federal statutory rate in fiscal year 2021 is primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland and Puerto Rico, tax benefits relating to stock-based compensation, and tax benefits from the India Supreme Court decision on withholding taxes.

In fiscal year 2023, our foreign regional operating center in Ireland, which is taxed at a rate lower than the U.S. rate, generated

81

% of our foreign income before tax. In fiscal years 2022 and 2021

, our foreign regional operating centers in Ireland and Puerto Rico, which are taxed at rates lower than the U.S. rate, generated

71

% and

% of our foreign income before tax. Other reconciling items, net consists primarily of tax credits and GILTI tax, and in fiscal year 2021, includes tax benefits from the India Supreme Court decision on withholding taxes. In fiscal years 2023, 2022, and 2021, there were no individually significant other reconciling items.

## PART II

### Item 8

The increase in our effective tax rate for fiscal year 2023 compared to fiscal year 2022 was primarily due to a \$

3.3

billion net income tax benefit in the first quarter of fiscal year 2022 related to the transfer of intangible properties and a decrease in tax benefits relating to stock-based compensation. The decrease in our effective tax rate for fiscal year 2022 compared to fiscal year 2021 was primarily due to a \$

3.3

billion net income tax benefit in the first quarter of fiscal year 2022 related to the transfer of intangible properties, offset in part by changes in the mix of our income before income taxes between the U.S. and foreign countries, as well as tax benefits in the prior year from the India Supreme Court decision on withholding taxes, an agreement between the U.S. and India tax authorities related to transfer pricing, and final Tax Cuts and Jobs Act ("TCJA") regulations.

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



(In millions)



June 30,

2023

2022

Deferred Income Tax Assets



Stock-based compensation expense

\$

681

\$

601

Accruals, reserves, and other expenses

3,131

2,874

Loss and credit carryforwards

1,441

1,546

Amortization

(a)

9,440

10,183

Leasing liabilities

5,041

4,557

Unearned revenue

3,296

2,876

Book/tax basis differences in investments and debt



Capitalized research and development

(a)

6,958

473

Other

489

461





Deferred income tax assets

30,850

23,571

Less valuation allowance

(

939

)

(

1,012

)







Deferred income tax assets, net of valuation allowance

\$

29,911

\$

22,559





Deferred Income Tax Liabilities



Book/tax basis differences in investments and debt

\$

0

\$



(  
174

)

Leasing assets

(  
4,680

)

(  
4,291

)

Depreciation

(  
2,674

)

(  
1,602

)

Deferred tax on foreign earnings

(  
2,738

)

(  
3,104

)

Other

(  
89

)

(  
103

)



Deferred income tax liabilities

\$

(



10,181

)

\$

(

9,274

)





Net deferred income tax assets

\$

19,730

\$

13,285







Other long-term assets

\$

20,163



\$

13,515

Long-term deferred income tax liabilities

(

433

)

(

230

)





Net deferred income tax assets

\$

19,730

\$



(a)

Provisions enacted in the TCJA related to the capitalization for tax purposes of research and development expenditures became effective on July 1, 2022. These provisions require us to capitalize research and development expenditures and amortize them on our U.S. tax return over five or fifteen years, depending on where research is conducted.

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, 2023, we had federal, state, and foreign net operating loss carryforwards of \$

509

million, \$

1.2

billion, and \$

2.3

billion, respectively. The federal and state net operating loss carryforwards have varying expiration dates ranging

from fiscal year

2024

to

2043

or indefinite carryforward periods

, if not utilized. The majority of our foreign net operating loss carryforwards do not expire. Certain acquired net operating loss carryforwards are subject to an annual limitation but are expected to be realized with the exception of those which have a valuation allowance. As of June 30, 2023, we had

\$

456

million

federal capital loss carryforwards for U.S. tax purposes from our acquisition of Nuance. The federal capital loss carryforwards are subject to an annual limitation and will expire in fiscal year

2025

.

84

## PART II

### Item 8

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



realized.

Income taxes paid, net of refunds, were \$

23.1

billion, \$

16.0

billion, and \$

13.4

billion in fiscal years 2023, 2022, and 2021, respectively.

Uncertain Tax Positions

Gross unrecognized tax benefits related to uncertain tax positions as of June 30, 2023, 2022, and 2021, were \$

17.1

billion, \$

15.6

billion, and \$

14.6

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 2023, 2022, and 2021 by \$

14.4

billion, \$

13.3

billion, and \$

12.5

billion, respectively.

As of June 30, 2023, 2022, and 2021, we had accrued interest expense related to uncertain tax positions of \$

5.2

billion, \$

4.3

billion, and \$

4.3

billion, respectively, net of income tax benefits. The provision for income taxes for fiscal years 2023, 2022, and 2021 included interest expense related to uncertain tax positions of \$

918

million, \$

36

million, and \$

274

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,

2023

2022

2021



Beginning unrecognized tax benefits

\$

15,593

\$

14,550

\$

13,792

Decreases related to settlements

(  
329

)

(

317

)

(

195

)

Increases for tax positions related to the current year

1,051

1,145

790

Increases for tax positions related to prior years

870

461

461

Decreases for tax positions related to prior years

(  
60

)



(

246

)

(

297

)

Decreases due to lapsed statutes of limitations

(

5

)

0

(  
1

)





Ending unrecognized tax benefits

\$

17,120

\$

15,593

\$





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, 2023, 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. We 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

2022

, 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.

85

## PART II

### Item 8

## NOTE 13 -- UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)



June 30,

2023

2022

Productivity and Business Processes

\$

27,572



\$

24,558

Intelligent Cloud

21,563

19,371

More Personal Computing

4,678

4,479



Total

\$

53,813

\$

48,408

Changes in unearned revenue were as follows:

(In millions)





Year Ended June 30, 2023

Balance, beginning of period

\$

48,408

Deferral of revenue

123,935

Recognition of unearned revenue

(

118,530

)



Balance, end of period

\$

53,813



Revenue allocated to remaining performance obligations, which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods, was \$

229

billion as of June 30, 2023, of which \$

224

billion is related to the commercial portion of revenue. We expect to recognize approximately

45

% of this revenue over the next

12

months and the remainder thereafter.

## NOTE 14

--

### LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, Microsoft Experience Centers, and certain equipment. Our leases have remaining lease terms of less than

1

year to

18

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,

2023

2022

2021





Operating lease cost

\$

2,875

\$

2,461

\$

2,127





Finance lease cost:



Amortization of right-of-use assets

\$

1,352



\$

980

\$

921

Interest on lease liabilities

501

429







Total finance lease cost

\$

1,853

\$

1,409

\$

1,307





Supplemental cash flow information related to leases was as follows:



(In millions)





Year Ended June 30,

2023

2022

2021

Cash paid for amounts included in the measurement of lease liabilities:





Operating cash flows from operating leases

\$

2,706

\$

2,368

\$

2,052

Operating cash flows from finance leases

501

429

Financing cash flows from finance leases

1,056

896

648



Right-of-use assets obtained in exchange for lease obligations:





Operating leases

3,514

5,268

4,380

Finance leases

3,128

4,234





PART II

Item 8

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)





June 30,

2023

2022

Operating Leases



Operating lease right-of-use assets

\$

14,346

\$







Other current liabilities

\$

2,409

\$

2,228

Operating lease liabilities

12,728

11,489





Total operating lease liabilities

\$

15,137

\$

13,717





Finance Leases





Property and equipment, at cost

\$

20,538

\$

17,388

Accumulated depreciation

(  
4,647

)

(  
3,285

)



Property and equipment, net

\$



15,891

\$

14,103





Other current liabilities

\$

1,197

\$

1,060

Other long-term liabilities

15,870

13,842



Total finance lease liabilities



\$

17,067

\$

14,902





Weighted Average Remaining Lease Term



Operating leases

8

years

8

years

Finance leases

11

years

12

years





Weighted Average Discount Rate



Operating leases

2.9

%

2.1

%

Finance leases

3.4

%

3.1

%

The following table outlines maturities of our lease liabilities as of June 30, 2023:





(In millions)



Year Ending June 30,

Operating  
Leases

Finance  
Leases

2024

\$

2,784

\$

1,747

2025

2,508

2,087

2026

2,142

1,771

2027



1,757

1,780

2028

1,582

1,787

Thereafter

6,327

11,462





Total lease payments

17,100

20,634

Less imputed interest

(  
1,963

)

(  
3,567

)







Total

\$

15,137

\$

17,067





As of June 30, 2023, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of \$

7.7

billion and \$

34.4

billion, respectively. These operating and finance leases will commence between fiscal year 2024 and fiscal year 2030 with lease terms of

1

year to

18

years.

## PART II

### Item 8

#### NOTE 15 -- CONTINGENCIES

##### 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 were stricken by the court. A hearing on general causation took place in September of 2022. In April of 2023, the court granted defendants' motion to strike the testimony of plaintiffs' experts that cell phones cause brain cancer and entered an order excluding all of plaintiffs' experts from testifying.

#### Irish Data Protection Commission Matter

In 2018, the Irish Data Protection Commission ("IDPC") began investigating a complaint against LinkedIn as to whether LinkedIn's targeted advertising practices violated the recently implemented European Union General Data Protection Regulation ("GDPR"). Microsoft cooperated throughout the period of inquiry. In April 2023, the IDPC provided LinkedIn with a non-public preliminary draft decision alleging GDPR violations and proposing a fine. Microsoft intends to challenge the preliminary draft decision. There is no set timeline for the IDPC to issue a final decision.



## 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, 2023, we accrued aggregate legal liabilities of \$

617

million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately \$

600

million in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

Item 8

NOTE 16

--

STOCKHOLDERS' EQUITY

Shares Outstanding

Shares of common stock outstanding were as follows:

(In millions)





Year Ended June 30,

2023

2022

2021

Balance, beginning of year

7,464

7,519



7,571

Issued



Repurchased

(  
69

)

(

95

)

(

101

)





Balance, end of year

7,432

7,464

7,519





## Share Repurchases

On September 18, 2019, our Board of Directors approved a share repurchase program authorizing up to \$

40.0

billion in share repurchases. This share repurchase program commenced in February 2020 and was completed in November 2021.

On September 14, 2021, our Board of Directors approved a share repurchase program authorizing up to \$

60.0

billion in share repurchases. This share repurchase program commenced in November 2021,

following completion of the program approved on September 18, 2019, has no expiration date, and may be terminated at any time. As of June 30, 2023, \$

22.3

billion remained of this \$

60.0

billion share repurchase program.

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



(In millions)

Shares

Amount

Shares

Amount

Shares

Amount





Year Ended June 30,

2023

2022



First Quarter

\$

4,600

21

\$

6,200

25

\$

5,270

Second Quarter

4,600

20

6,233

27

5,750



Third Quarter

4,600

26

7,800

25

5,750

Fourth Quarter

14

4,600

28

7,800

24

6,200













Total

69

\$

18,400

95

\$

28,033

101

\$

22,970









## PART II

## Item 8

All repurchases were made using cash resources. Shares repurchased during fiscal year 2023 and the fourth and third quarters of fiscal year 2022 were under the share repurchase program approved on September 14, 2021. Shares repurchased during the second quarter of fiscal year 2022 were under the share repurchase programs approved on both September 14, 2021 and September 18, 2019. All other shares repurchased were under the share repurchase program approved on September 18, 2019. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of \$

3.8

billion, \$

4.7

billion, and \$

4.4

billion for fiscal years 2023, 2022, and 2021, respectively.

## Dividends

Our Board of Directors declared the following dividends:



Declaration Date

Record Date

Payment Date

Dividend  
Per Share

Amount



(In millions)







September 20, 2022

November 17, 2022

December 8, 2022

\$

0.68

\$

5,066

November 29, 2022

February 16, 2023

March 9, 2023

0.68

5,059

March 14, 2023

May 18, 2023

June 8, 2023

0.68

5,054

June 13, 2023

August 17, 2023



September 14, 2023

0.68

5,054







Total

\$

2.72

\$

20,233









Fiscal Year 2022







September 14, 2021



November 18, 2021

December 9, 2021

\$

0.62

\$

4,652

December 7, 2021

February 17, 2022

March 10, 2022

4,645

March 14, 2022

May 19, 2022

June 9, 2022

0.62

4,632

June 14, 2022

August 18, 2022

September 8, 2022

0.62

4,621









Total



\$

2.48

\$

18,550



The dividend declared on June 13, 2023 was included in other current liabilities as of June 30, 2023.



PART II

Item 8

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,

2023

2022

2021

Derivatives





Balance, beginning of period

\$

(

)

\$

(

)

\$

(

)

Unrealized gains (losses), net of tax of

\$

9

, \$(

15

), and \$

9

(  
57

)

34

Reclassification adjustments for (gains) losses included in other income (expense), net

(  
61

)

(

17

)

Tax expense (benefit) included in provision for income taxes

13

(

16

)









Amounts reclassified from accumulated other comprehensive income (loss)

(  
48

)

63

(

15

)





Net change related to derivatives, net of tax of

\$(

4

)

, \$

1

, and \$

7

(

14

)

6









Balance, end of period

\$

(

)

\$

(

13

)

\$

(

19

)



Investments





Balance, beginning of period

\$

(

2,138

)

\$

3,222

\$

5,478

Unrealized losses, net of tax of

\$(  
393  
)  
, \$(  
1,440  
) , and \$(  
589  
)

(  
1,523  
  
)

(  
5,405

)

(  
2,216

)

Reclassification adjustments for (gains) losses included in other income (expense), net

(  
63

)

Tax expense (benefit) included in provision for income taxes

(

20

)

(

12

)







Amounts reclassified from accumulated other comprehensive income (loss)

79

45

(

50

)





Net change related to investments, net of tax of

\$(  
373  
)  
, \$(  
1,428  
) , and \$(  
602  
)

(  
1,444  
  
)



(  
5,360

)

(  
2,266

)

Cumulative effect of accounting changes

0

0







Balance, end of period

\$

(  
3,582

)

\$

(  
2,138

)

\$

3,222





Translation Adjustments and Other



Balance, beginning of period

\$

(

2,527

)

\$

(

1,381

)

\$

(  
2,254

)

Translation adjustments and other, net of tax of

\$

0

, \$

0

, and \$(

9

)

(

207

)

(

1,146

)









Balance, end of period

\$

(

2,734

)

\$

(

2,527

)

\$

(

1,381

)





Accumulated other comprehensive income (loss), end of period

\$

(  
6,343

)

\$

(

4,678

)

\$

1,822





#### NOTE 18 -- EMPLOYEE STOCK AND SAVINGS PLANS

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

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



(In millions)



Year Ended June 30,

2023

2022

2021

Stock-based compensation expense

\$

9,611

\$

7,502

\$

6,118



Income tax benefits related to stock-based compensation

1,651

1,293

1,065

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

.

91

## PART II

### Item 8

#### 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,

2023

2022



2021

Dividends per share (quarterly amounts)

\$

0.62

-

0.68

\$

0.56

-

0.62

\$

0.51

-

0.56

Interest rates

2.0

% -

5.4

%

0.03

% -

3.6

%

0.01

% -

1.5

%

During fiscal year 2023, the following activity occurred under our stock plans:

Shares

Weighted Average

Grant-Date Fair

Value



(In millions)

Stock Awards

Nonvested balance, beginning of year

227.59

Granted

(a)

252.59

Vested

(

)

206.90

Forfeited

(

9

)

239.93







Nonvested balance, end of year

250.37

(a)

Includes

1

million,

1

million, and

2

million of PSUs granted at target and performance adjustments above target levels for fiscal years 2023, 2022, and 2021, respectively.

As of June 30, 2023, total unrecognized compensation costs related to stock awards were \$

18.6

billion. 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 \$

252.59

, \$

291.22

, and \$

221.13

for fiscal years 2023, 2022, and 2021, respectively. The fair value of stock awards vested was \$

11.9

billion, \$

14.1

billion, and \$

13.4

billion, for fiscal years 2023, 2022, and 2021, respectively. As of June 30, 2023, an aggregate of

164

million shares were authorized for future grant under our stock plans.

#### Employee Stock Purchase Plan

We have an ESPP for all eligible employees. Shares of our common stock may be purchased by employees at three-month intervals at

90

% of the fair market value on the last trading day of each three-month period. Employees may purchase shares having a value not exceeding

15

% of their gross compensation during an offering period.

Employees purchased the following shares during the periods presented:



(Shares in millions)





Year Ended June 30,

2023

2022

2021

Shares purchased



Average price per share

\$

245.59

\$

259.55

\$

207.88

As of June 30, 2023,

74

million shares of our common stock were reserved for future issuance through the ESPP.

92

## PART II

### Item 8

#### Savings Plans

We have savings plans in the U.S. that qualify under Section 401(k) of the Internal Revenue Code, and a number of savings plans in international locations. Eligible U.S. employees may contribute a portion of their salary into the savings plans, subject to certain limitations. We match a portion of each dollar a participant contributes into the plans. Employer-funded retirement benefits for all plans were \$

1.6

billion, \$

1.4

billion, and \$

1.2

billion in fiscal years 2023, 2022, and 2021, respectively, and were expensed as contributed.

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.

We have recast certain prior period amounts to conform to the way we internally manage and monitor our business.

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, Microsoft Viva, and Microsoft 365 Copilot.

-

Office Consumer, including Microsoft 365 Consumer subscriptions, Office licensed on-premises, and other Office services.

-

LinkedIn, including Talent Solutions, Marketing Solutions, Premium Subscriptions, and Sales Solutions.

-

Dynamics business solutions, including Dynamics 365, comprising a set of intelligent, cloud-based



applications across ERP, CRM (including Customer Insights), Power Apps, and Power Automate; and on-premises ERP and CRM applications.

## Intelligent Cloud

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

-

Server products and cloud services, including Azure and other cloud services; SQL Server, Windows Server, Visual Studio, System Center, and related Client Access Licenses ("CALs"); and Nuance and GitHub.

-

Enterprise Services, including Enterprise Support Services, Industry Solutions (formerly Microsoft Consulting Services), and Nuance professional services.

## More Personal Computing

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

-

Windows, including Windows OEM licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; and Windows Internet of Things.

-

Devices, including Surface, HoloLens, and PC accessories.

## PART II

### Item 8

-

Gaming, including Xbox hardware and Xbox content and services, comprising first- and third-party content (including games and in-game content), Xbox Game Pass and other subscriptions, Xbox Cloud Gaming, advertising, third-party disc royalties, and other cloud services.

-

Search and news advertising, comprising Bing (including Bing Chat), Microsoft News, Microsoft Edge, and third-party affiliates.

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 are incurred at a corporate level and allocated to our segments. These allocated costs

generally include legal, including settlements and fines, information technology, human resources, finance, excise taxes, field selling, shared facilities services, customer service and support

,

and severance incurred as part of a corporate program. Each allocation is measured differently based on the specific facts and circumstances of the costs being allocated and is generally based on relative gross margin or relative headcount.

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

(In millions)



Year Ended June 30,

2023

2022

2021





Revenue







Productivity and Business Processes

\$

69,274

\$

63,364

\$

53,915

Intelligent Cloud

87,907

74,965

59,728

More Personal Computing

54,734



59,941

54,445





Total

\$

211,915

\$

198,270

\$

168,088









Operating Income





Productivity and Business Processes

\$

34,189

\$

29,690

\$

24,351

Intelligent Cloud

37,884

33,203

26,471

More Personal Computing

16,450

20,490



19,094





Total

\$

88,523

\$

83,383

\$

69,916



No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for fiscal years 2023, 2022, or 2021.

Revenue, classified by the major geographic areas in which our customers were located, was as follows:





(In millions)

Year Ended June 30,

2023

2022

2021

United States

(a)

\$

106,744

\$

100,218

\$

83,953

Other countries

105,171

98,052

84,135







Total

\$

211,915

\$

198,270

\$

168,088



(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.

PART II

Item 8

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

(In millions)





Year Ended June 30,

2023

2022

2021

Server products and cloud services

\$

79,970

\$

67,350

\$

52,589

Office products and cloud services

48,728

44,862

39,872

Windows

21,507

24,732

22,488

Gaming

15,466

16,230



15,370

LinkedIn

15,145

13,816

10,289

Search and news advertising

12,208

11,591

9,267

Enterprise Services

7,722

7,407

6,943

Devices

5,521

7,306

7,143

Dynamics

5,437

4,687



3,754

Other

211

289

373





Total

\$

211,915

\$

198,270

\$

168,088





Our Microsoft Cloud revenue, which includes Azure and other cloud services, Office 365 Commercial, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was \$

111.6

billion, \$

91.4

billion, and \$

69.1

billion in fiscal years 2023, 2022, and 2021, respectively. These amounts are primarily included in Server products and cloud services, Office products and cloud services, LinkedIn, and Dynamics 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,

2023

2022

2021

United States

\$

114,380

\$

106,430

\$

76,153

Ireland

16,359



15,505

13,303

Other countries

56,500

44,433







Total

\$

187,239

\$

166,368

\$

128,314





PART II

Item 8

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, 2023 and 2022, 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, 2023, 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, 2023 and 2022, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2023, 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, 2023, 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 27, 2023, 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.

## PART II

### Item 8

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.

## PART II

### **Metadata**

CIK: 789019

CUSIP6: 594918

Source: <https://www.sec.gov/Archives/edgar/data/789019/000095017023035122/0000950170-23-035122.1>