ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INCOME STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	2018	2017	2016
Revenue:			
Product	**$ 64,497**	$ 63,811	$ 67,336
Service and other	**45,863**	32,760	23,818
Total revenue	**110,360**	96,571	91,154
Cost of revenue:			
Product	**15,420**	15,175	17,880
Service and other	**22,933**	19,086	14,900
Total cost of revenue	**38,353**	34,261	32,780
Gross margin	**72,007**	62,310	58,374
Research and development	**14,726**	13,037	11,988
Sales and marketing	**17,469**	15,461	14,635
General and administrative	**4,754**	4,481	4,563
Impairment and restructuring	**0**	306	1,110
Operating income	**35,058**	29,025	26,078
Other income (expense), net	**1,416**	876	(439)
Income before income taxes	**36,474**	29,901	25,639
Provision for income taxes	**19,903**	4,412	5,100
Net income	**$ 16,571**	$ 25,489	$ 20,539
Earnings per share:			
Basic	**$ 2.15**	$ 3.29	$ 2.59
Diluted	**$ 2.13**	$ 3.25	$ 2.56
Weighted average shares outstanding:			
Basic	**7,700**	7,746	7,925
Diluted	**7,794**	7,832	8,013
Cash dividends declared per common share	**$ 1.68**	$ 1.56	$ 1.44

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Net income	**$ 16,571**	$ 25,489	$ 20,539
Other comprehensive income (loss), net of tax:			
Net change related to derivatives	**39**	(218)	(238)
Net change related to investments	**(2,717)**	(1,116)	(228)
Translation adjustments and other	**(178)**	167	(262)
Other comprehensive loss	**(2,856)**	(1,167)	(728)
Comprehensive income	**$ 13,715**	$ 24,322	$ 19,811

Refer to accompanying notes. Refer to Note 19 – Accumulated Other Comprehensive Income (Loss) for further information.

BALANCE SHEETS

(In millions)

June 30,	**2018**	**2017**
Assets		
Current assets:		
Cash and cash equivalents	**$ 11,946**	$ 7,663
Short-term investments	**121,822**	125,318
Total cash, cash equivalents, and short-term investments	**133,768**	132,981
Accounts receivable, net of allowance for doubtful accounts of **$377** and $345	**26,481**	22,431
Inventories	**2,662**	2,181
Other	**6,751**	5,103
Total current assets	**169,662**	162,696
Property and equipment, net of accumulated depreciation of **$29,223** and $24,179	**29,460**	23,734
Operating lease right-of-use assets	**6,686**	6,555
Equity and other investments	**1,862**	6,023
Goodwill	**35,683**	35,122
Intangible assets, net	**8,053**	10,106
Other long-term assets	**7,442**	6,076
Total assets	**$258,848**	$250,312
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**$ 8,617**	$ 7,390
Short-term debt	**0**	9,072
Current portion of long-term debt	**3,998**	1,049
Accrued compensation	**6,103**	5,819
Short-term income taxes	**2,121**	718
Short-term unearned revenue	**28,905**	24,013
Other	**8,744**	7,684
Total current liabilities	**58,488**	55,745
Long-term debt	**72,242**	76,073
Long-term income taxes	**30,265**	13,485
Long-term unearned revenue	**3,815**	2,643
Deferred income taxes	**541**	5,734
Operating lease liabilities	**5,568**	5,372
Other long-term liabilities	**5,211**	3,549
Total liabilities	**176,130**	162,601
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,677** and 7,708	**71,223**	69,315
Retained earnings	**13,682**	17,769
Accumulated other comprehensive income (loss)	**(2,187)**	627
Total stockholders' equity	**82,718**	87,711
Total liabilities and stockholders' equity	**$258,848**	$250,312

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Operations			
Net income	**$ 16,571**	$ 25,489	$ 20,539
Adjustments to reconcile net income to net cash from operations:			
Asset impairments	**0**	0	630
Depreciation, amortization, and other	**10,261**	8,778	6,622
Stock-based compensation expense	**3,940**	3,266	2,668
Net recognized gains on investments and derivatives	**(2,212)**	(2,073)	(223)
Deferred income taxes	**(5,143)**	(829)	2,479
Changes in operating assets and liabilities:			
Accounts receivable	**(3,862)**	(1,216)	562
Inventories	**(465)**	50	600
Other current assets	**(952)**	1,028	(1,212)
Other long-term assets	**(285)**	(917)	(1,110)
Accounts payable	**1,148**	81	88
Unearned revenue	**5,922**	3,820	2,565
Income taxes	**18,183**	1,792	(298)
Other current liabilities	**798**	356	(179)
Other long-term liabilities	**(20)**	(118)	(406)
Net cash from operations	**43,884**	39,507	33,325
Financing			
Proceeds from issuance (repayments) of short-term debt, maturities of 90 days or less, net	**(7,324)**	(4,963)	7,195
Proceeds from issuance of debt	**7,183**	44,344	13,884
Repayments of debt	**(10,060)**	(7,922)	(2,796)
Common stock issued	**1,002**	772	668
Common stock repurchased	**(10,721)**	(11,788)	(15,969)
Common stock cash dividends paid	**(12,699)**	(11,845)	(11,006)
Other, net	**(971)**	(190)	(369)
Net cash from (used in) financing	**(33,590)**	8,408	(8,393)
Investing			
Additions to property and equipment	**(11,632)**	(8,129)	(8,343)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(888)**	(25,944)	(1,393)
Purchases of investments	**(137,380)**	(176,905)	(129,758)
Maturities of investments	**26,360**	28,044	22,054
Sales of investments	**117,577**	136,350	93,287
Securities lending payable	**(98)**	(197)	203
Net cash used in investing	**(6,061)**	(46,781)	(23,950)
Effect of foreign exchange rates on cash and cash equivalents	**50**	19	(67)
Net change in cash and cash equivalents	**4,283**	1,153	915
Cash and cash equivalents, beginning of period	**7,663**	6,510	5,595
Cash and cash equivalents, end of period	**$ 11,946**	$ 7,663	$ 6,510

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Common stock and paid-in capital			
Balance, beginning of period	**$ 69,315**	$ 68,178	$ 68,465
Common stock issued	**1,002**	772	668
Common stock repurchased	**(3,033)**	(2,987)	(3,689)
Stock-based compensation expense	**3,940**	3,266	2,668
Other, net	**(1)**	86	66
Balance, end of period	**71,223**	69,315	68,178
Retained earnings			
Balance, beginning of period	**17,769**	13,118	16,191
Net income	**16,571**	25,489	20,539
Common stock cash dividends	**(12,917)**	(12,040)	(11,329)
Common stock repurchased	**(7,699)**	(8,798)	(12,283)
Cumulative effect of accounting change	**(42)**	0	0
Balance, end of period	**13,682**	17,769	13,118
Accumulated other comprehensive income (loss)			
Balance, beginning of period	**627**	1,794	2,522
Other comprehensive loss	**(2,856)**	(1,167)	(728)
Cumulative effect of accounting change	**42**	0	0
Balance, end of period	**(2,187)**	627	1,794
Total stockholders' equity	**$ 82,718**	$ 87,711	$ 83,090

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

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

We have recast certain prior period income tax liabilities as discussed in the Recent Tax Legislation section below. We have also recast prior period securities lending payables to other current liabilities in our consolidated balance sheets to conform to the current period presentation. These items had no impact in our consolidated income statements or net cash from or used in operating, financing, or investing in our consolidated cash flows statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Microsoft Corporation and its subsidiaries. Intercompany transactions and balances have been eliminated. Equity investments for which we are able to exercise significant influence over but do not control the investee and are not the primary beneficiary of the investee's activities are accounted for using the equity method. Investments for which we are not able to exercise significant influence over the investee and which do not have readily determinable fair values are accounted for under the cost method.

Estimates and Assumptions

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

Foreign Currencies

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

Revenue

Product Revenue and Service and Other Revenue

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

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

Revenue Recognition

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

Nature of Products and Services

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

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

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

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

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

Refer to Note 21 – Segment Information and Geographic Data for further information, including revenue by significant product and service offering.

Significant Judgments

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

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

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

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

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

Contract Balances

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

The opening balance of current and long-term accounts receivable, net of allowance for doubtful accounts, was $22.3 billion as of July 1, 2016.

As of June 30, 2018 and 2017, long-term accounts receivable, net of allowance for doubtful accounts, were $1.8 billion and $1.7 billion, respectively, and are included in other long-term assets in our consolidated balance sheets.

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

Activity in the allowance for doubtful accounts was as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Balance, beginning of period	**$ 361**	$ 409	$ 289
Charged to costs and other	**134**	58	175
Write-offs	**(98)**	(106)	(55)
Balance, end of period	**$ 397**	$ 361	$ 409

Allowance for doubtful accounts included in our consolidated balance sheets:

June 30,	**2018**	**2017**	**2016**
Accounts receivable, net of allowance for doubtful accounts	**$ 377**	$ 345	$ 392
Other long-term assets	**20**	16	17
Total	**$ 397**	$ 361	$ 409

Unearned revenue comprises mainly unearned revenue related to volume licensing programs, which may include SA and cloud services. Unearned revenue is generally invoiced annually at the beginning of each contract period for multi-year agreements and recognized ratably over the coverage period. Unearned revenue also includes payments for consulting services to be performed in the future; LinkedIn subscriptions; Office 365 subscriptions; Xbox Live subscriptions; Windows 10 post-delivery support; Dynamics business solutions; Skype prepaid credits and subscriptions; and other offerings for which we have been paid in advance and earn the revenue when we transfer control of the product or service.

Refer to Note 15 – Unearned Revenue for further information, including unearned revenue by segment and changes in unearned revenue during the period.

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

Assets Recognized from Costs to Obtain a Contract with a Customer

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

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

Cost of Revenue

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

Product Warranty

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

Research and Development

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

Sales and Marketing

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs. Advertising costs are expensed as incurred. Advertising expense was $1.6 billion, $1.5 billion, and $1.6 billion in fiscal years 2018, 2017, and 2016, respectively.

Stock-Based Compensation

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

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

Income Taxes

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

Fair Value Measurements

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

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments in active markets. Our Level 1 non-derivative investments primarily include U.S. government securities, common and preferred stock, and mutual funds. Our Level 1 derivative assets and liabilities include those actively traded on exchanges.
- *Level 2* – inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies. Our Level 2 non-derivative investments consist primarily of corporate notes and bonds, foreign government bonds, mortgage- and asset-backed securities, commercial paper, certificates of deposit, and U.S. agency securities. Our Level 2 derivative assets and liabilities primarily include certain over-the-counter option and swap contracts.
- *Level 3* – inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 non-derivative assets and liabilities primarily comprise investments in common and preferred stock, and goodwill and intangible assets, when they are recorded at fair value due to an impairment charge. Unobservable inputs used in the models are significant to the fair values of the assets and liabilities.

We measure certain assets, including our cost and equity method investments, at fair value on a nonrecurring basis when they are deemed to be other-than-temporarily impaired. The fair values of these investments are determined based on valuation techniques using the best information available, and may include quoted market prices, market comparables, and discounted cash flow projections. An impairment charge is recorded when the cost of the investment exceeds its fair value and this condition is determined to be other-than-temporary.

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

Financial Instruments

Investments

We consider all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. The fair values of these investments approximate their carrying values. In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. All cash equivalents and short-term investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in market value, excluding other-than-temporary impairments, are reflected in OCI.

Equity and other investments classified as long-term include both debt and equity instruments. Debt and publicly-traded equity securities are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in the market value of available-for-sale securities, excluding other-than-temporary impairments, are reflected in OCI. Common and preferred stock and other investments that are restricted for more than one year or are not publicly traded are recorded at cost or using the equity method.

We lend certain fixed-income and equity securities to increase investment returns. These transactions are accounted for as secured borrowings and the loaned securities continue to be carried as investments in our consolidated balance sheets. Cash and/or security interests are received as collateral for the loaned securities with the amount determined based upon the underlying security lent and the creditworthiness of the borrower. Cash received is recorded as an asset with a corresponding liability.

Investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. Fair value is calculated based on publicly available market information or other estimates determined by management. We employ a systematic methodology on a quarterly basis that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, the duration and extent to which the fair value is less than cost, and for equity securities, our intent and ability to hold, or plans to sell, the investment. For fixed-income securities, we also evaluate whether we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery. We also consider specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded to other income (expense), net and a new cost basis in the investment is established.

Derivatives

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

For derivative instruments designated as fair value hedges, the gains (losses) are recognized in earnings in the periods of change together with the offsetting losses (gains) on the hedged items attributed to the risk being hedged. For options designated as fair value hedges, changes in the time value are excluded from the assessment of hedge effectiveness and are recognized in earnings.

For derivative instruments designated as cash flow hedges, the effective portion of the gains (losses) on the derivatives is initially reported as a component of OCI and is subsequently recognized in earnings when the hedged exposure is recognized in earnings. For options designated as cash flow hedges, changes in the time value are excluded from the assessment of hedge effectiveness and are recognized in earnings. Gains (losses) on derivatives representing either hedge components excluded from the assessment of effectiveness or hedge ineffectiveness are recognized in earnings.

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

Inventories

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

Property and Equipment

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

Leases

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

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

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

Goodwill

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

Intangible Assets

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

Recent Tax Legislation

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted into law, which significantly changes existing U.S. tax law and includes numerous provisions that affect our business. Refer to Note 13 – Income Taxes for further discussion.

As a result of the TCJA, we have recast certain prior period income tax liabilities in our consolidated balance sheets to conform to the current period presentation. Previously reported balances were impacted as follows:

(In millions)	As Previously Reported	As Adjusted
Balance Sheets		**June 30, 2017**
Long-term income taxes	$ 0	$ 13,485
Other long-term liabilities	17,034	3,549

These adjustments had no impact in our consolidated income statements or net cash from or used in operating, financing, or investing in our consolidated cash flows statements.

Recent Accounting Guidance

Recently Adopted Accounting Guidance

Comprehensive Income – Reclassification of Certain Tax Effects

In February 2018, the Financial Accounting Standards Board ("FASB") issued new guidance to allow a reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for stranded tax effects resulting from the TCJA. In the second quarter of fiscal year 2018, we remeasured our deferred taxes related to unrealized gains on our investment balances using the reduced tax rate. As required by GAAP, we recognized the net tax benefit in the provision for income taxes in our consolidated income statements, even though the deferred taxes were initially recognized in AOCI, which resulted in stranded tax effects. We elected to early adopt the standard effective April 1, 2018 and reclassified a $42 million net tax benefit from AOCI to retained earnings in our consolidated balance sheets. Adoption of the standard had no impact to our consolidated income statements or cash flows statements.

Leases

In February 2016, the FASB issued a new standard related to leases to increase transparency and comparability among organizations by requiring the recognition of ROU assets and lease liabilities on the balance sheet. Most prominent among the changes in the standard is the recognition of ROU assets and lease liabilities by lessees for those leases classified as operating leases. Under the standard, disclosures are required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. We are also required to recognize and measure leases existing at, or entered into after, the beginning of the earliest comparative period presented using a modified retrospective approach, with certain practical expedients available.

We elected to early adopt the standard effective July 1, 2017 concurrent with our adoption of the new standard related to revenue recognition. We elected the available practical expedients and implemented internal controls and key system functionality to enable the preparation of financial information on adoption.

The standard had a material impact in our consolidated balance sheets, but did not have an impact in our consolidated income statements. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases, while our accounting for finance leases remained substantially unchanged. Adoption of the standard required us to restate certain previously reported results, including the recognition of additional ROU assets and lease liabilities for operating leases. Refer to Impacts to Previously Reported Results below for the impact of adoption of the standard in our consolidated financial statements.

Revenue from Contracts with Customers

In May 2014, the FASB issued a new standard related to revenue recognition. Under the standard, revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

We elected to early adopt the standard effective July 1, 2017, using the full retrospective method, which required us to restate each prior reporting period presented. We implemented internal controls and key system functionality to enable the preparation of financial information on adoption.

The most significant impact of the standard relates to our accounting for software license revenue. Specifically, for Windows 10, we recognize revenue predominantly at the time of billing and delivery rather than ratably over the life of the related device. For certain multi-year commercial software subscriptions that include both distinct software licenses and SA, we recognize license revenue at the time of contract execution rather than over the subscription period. Due to the complexity of certain of our commercial license subscription contracts, the actual revenue recognition treatment required under the standard depends on contract-specific terms and in some instances may vary from recognition at the time of billing. Revenue recognition related to our hardware, cloud offerings (such as Office 365), LinkedIn, and professional services remains substantially unchanged.

Adoption of the standard using the full retrospective method required us to restate certain previously reported results, including the recognition of additional revenue and an increase in the provision for income taxes, primarily due to the net change in Windows 10 revenue recognition. In addition, adoption of the standard resulted in an increase in accounts receivable and other current and long-term assets, driven by unbilled receivables from upfront recognition of revenue for certain multi-year commercial software subscriptions that include both distinct software licenses and SA; a reduction of unearned revenue, driven by the upfront recognition of license revenue from Windows 10 and certain multi-year commercial software subscriptions; and an increase in deferred income taxes, driven by the upfront recognition of revenue. Refer to Impacts to Previously Reported Results below for the impact of adoption of the standard in our consolidated financial statements.

Impacts to Previously Reported Results

Adoption of the standards related to revenue recognition and leases impacted our previously reported results as follows:

(In millions, except per share amounts)	As Previously Reported	New Revenue Standard Adjustment	As Restated
Income Statements			
Year Ended June 30, 2017			
Revenue	$ 89,950	$ 6,621	$ 96,571
Provision for income taxes	1,945	2,467	4,412
Net income	21,204	4,285	25,489
Diluted earnings per share	2.71	0.54	3.25
Year Ended June 30, 2016			
Revenue	$ 85,320	$ 5,834	$ 91,154
Provision for income taxes	2,953	2,147	5,100
Net income	16,798	3,741	20,539
Diluted earnings per share	2.10	0.46	2.56

(In millions)	As Previously Reported	New Revenue Standard Adjustment	New Lease Standard Adjustment	As Restated
Balance Sheets				
June 30, 2017				
Accounts receivable, net of allowance for doubtful accounts	$ 19,792	$ 2,639	$ 0	$ 22,431
Operating lease right-of-use assets	0	0	6,555	6,555
Other current and long-term assets	11,147	32	0	11,179
Unearned revenue	44,479	(17,823)	0	26,656
Deferred income taxes	531	5,203	0	5,734
Operating lease liabilities	0	0	5,372	5,372
Other current and long-term liabilities	23,464	(26)	1,183	24,621
Stockholders' equity	72,394	15,317	0	87,711

Adoption of the standards related to revenue recognition and leases had no impact to cash from or used in operating, financing, or investing in our consolidated cash flows statements.

Recent Accounting Guidance Not Yet Adopted

Financial Instruments – Targeted Improvements to Accounting for Hedging Activities

In August 2017, the FASB issued new guidance related to accounting for hedging activities. This guidance expands strategies that qualify for hedge accounting, changes how many hedging relationships are presented in the financial statements, and simplifies the application of hedge accounting in certain situations. The standard will be effective for us beginning July 1, 2019, with early adoption permitted for any interim or annual period before the effective date. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. We are currently evaluating the impact of this standard in our consolidated financial statements, including accounting policies, processes, and systems.

Income Taxes – Intra-Entity Asset Transfers

In October 2016, the FASB issued new guidance requiring an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs, rather than when the asset has been sold to an outside party. This guidance is effective for us beginning July 1, 2018, with early adoption permitted beginning July 1, 2017. We plan to adopt the guidance effective July 1, 2018. Adoption of the guidance will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. We currently expect a net cumulative-effect adjustment of approximately $550 million, which will reverse the deferral of income tax consequences from past intra-entity transfers involving assets other than inventory and new deferred tax assets for amounts not recognized under current GAAP, partially offset by a U.S. deferred tax liability related to global intangible low-taxed income (“GILTI”). Adoption of the standard is expected to result in an increase in long-term deferred tax assets of $2.8 billion, an increase in long-term deferred tax liabilities of $2.1 billion, and a reduction to other current assets of $150 million. As a result of the TCJA, we are continuing to evaluate the impact of this standard in our consolidated financial statements, including accounting policies, processes, and systems.

Financial Instruments – Credit Losses

In June 2016, the FASB issued a new standard to replace the incurred loss impairment methodology under current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. We will be required to use a forward-looking expected credit loss model for accounts receivables, loans, and other financial instruments. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The standard will be effective for us beginning July 1, 2020, with early adoption permitted beginning July 1, 2019. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date to align our credit loss methodology with the new standard. We are currently evaluating the impact of this standard in our consolidated financial statements, including accounting policies, processes, and systems.

Financial Instruments – Recognition, Measurement, Presentation, and Disclosure

In January 2016, the FASB issued a new standard related to certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most prominent among the changes in the standard is the requirement for changes in the fair value of our equity investments, with certain exceptions, to be recognized through net income rather than OCI. Under the standard, equity investments that do not have a readily determinable fair value are eligible for the measurement alternative. Using the measurement alternative, investments without readily determinable fair values will be valued at cost, with adjustments for changes in price or impairments reflected through net income.

The standard will be effective for us beginning July 1, 2018. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment from AOCI to retained earnings as of the effective date. A cumulative-effect adjustment will capture any previously held unrealized gains and losses held in AOCI related to our equity investments carried at fair value as well as the impact of recording the fair value of certain equity investments carried at cost. In preparation for adoption of this standard, we have implemented internal controls to align with the new standard and have concluded that we will elect the measurement alternative for equity investments that do not have readily determinable fair values.

The impact in our consolidated balance sheets upon adoption will not be material. Adoption of the standard will have no impact to cash from or used in operating, financing or investing in our consolidated cash flows statements.

NOTE 2 — EARNINGS PER SHARE

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

The components of basic and diluted EPS were as follows:

(In millions, except earnings per share)

Year Ended June 30,	**2018**	2017	2016
Net income available for common shareholders (A)	**$ 16,571**	$ 25,489	$ 20,539
Weighted average outstanding shares of common stock (B)	**7,700**	7,746	7,925
Dilutive effect of stock-based awards	**94**	86	88
Common stock and common stock equivalents (C)	**7,794**	7,832	8,013
Earnings Per Share			
Basic (A/B)	**$ 2.15**	$ 3.29	$ 2.59
Diluted (A/C)	**$ 2.13**	$ 3.25	$ 2.56

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

NOTE 3 — OTHER INCOME (EXPENSE), NET

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

(In millions)

Year Ended June 30,	**2018**	2017	2016
Dividends and interest income	**$ 2,214**	$ 1,387	$ 903
Interest expense	**(2,733)**	(2,222)	(1,243)
Net recognized gains on investments	**2,399**	2,583	668
Net losses on derivatives	**(187)**	(510)	(443)
Net losses on foreign currency remeasurements	**(218)**	(111)	(129)
Other, net	**(59)**	(251)	(195)
Total	**$ 1,416**	$ 876	$ (439)

Following are details of net recognized gains (losses) on investments during the periods reported:

(In millions) Year Ended June 30,	2018	2017	2016
Other-than-temporary impairments of investments	**$ (47)**	$ (55)	$ (322)
Realized gains from sales of available-for-sale securities	**3,478**	3,064	1,376
Realized losses from sales of available-for-sale securities	**(1,032)**	(426)	(386)
Total	**$ 2,399**	$ 2,583	$ 668

NOTE 4 — INVESTMENTS

Investment Components

The components of investments, including associated derivatives, were as follows:

(In millions)	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity and Other Investments
June 30, 2018							
Cash	**$ 3,942**	**$ 0**	**$ 0**	**$ 3,942**	**$ 3,942**	**$ 0**	**$ 0**
Mutual funds	**246**	**0**	**0**	**246**	**246**	**0**	**0**
Commercial paper	**2,513**	**0**	**0**	**2,513**	**2,215**	**298**	**0**
Certificates of deposit	**2,058**	**0**	**0**	**2,058**	**1,865**	**193**	**0**
U.S. government and agency securities	**109,862**	**62**	**(1,167)**	**108,757**	**3,678**	**105,079**	**0**
Foreign government bonds	**5,182**	**1**	**(10)**	**5,173**	**0**	**5,173**	**0**
Mortgage- and asset-backed securities	**3,868**	**4**	**(13)**	**3,859**	**0**	**3,859**	**0**
Corporate notes and bonds	**6,947**	**21**	**(56)**	**6,912**	**0**	**6,912**	**0**
Municipal securities	**271**	**37**	**(1)**	**307**	**0**	**307**	**0**
Common and preferred stock	**1,220**	**95**	**(10)**	**1,305**	**0**	**0**	**1,305**
Other investments	**558**	**0**	**0**	**558**	**0**	**1**	**557**
Total	**$136,667**	**$ 220**	**$ (1,257)**	**$135,630**	**$ 11,946**	**$ 121,822**	**$ 1,862**

(In millions)	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity and Other Investments
June 30, 2017							
Cash	$ 3,624	$ 0	$ 0	$ 3,624	$ 3,624	$ 0	$ 0
Mutual funds	1,478	0	0	1,478	1,478	0	0
Commercial paper	319	0	0	319	69	250	0
Certificates of deposit	1,358	0	0	1,358	972	386	0
U.S. government and agency securities	112,119	85	(360)	111,844	16	111,828	0
Foreign government bonds	5,276	2	(13)	5,265	1,504	3,761	0
Mortgage- and asset-backed securities	3,921	14	(4)	3,931	0	3,931	0
Corporate notes and bonds	4,786	61	(12)	4,835	0	4,835	0
Municipal securities	284	43	0	327	0	327	0
Common and preferred stock	2,472	3,062	(34)	5,500	0	0	5,500
Other investments	523	0	0	523	0	0	523
Total	$136,160	$ 3,267	$ (423)	$139,004	$ 7,663	$ 125,318	$ 6,023

As of June 30, 2018 and 2017, the recorded bases of common and preferred stock that are restricted for more than one year or are not publicly traded were $999 million and $1.1 billion, respectively. These investments are carried at cost and are reviewed quarterly for indicators of other-than-temporary impairment. It is not practicable for us to reliably estimate the fair value of these investments.

As of June 30, 2018 and 2017, collateral received under agreements for loaned securities was $1.8 billion and $3.7 billion, respectively, and primarily comprised U.S. government and agency securities.

Unrealized Losses on Investments

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

	Less than 12 Months		12 Months or Greater			
(In millions)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Total Fair Value**	**Total Unrealized Losses**
June 30, 2018						
U.S. government and agency securities	**$ 82,352**	**$ (1,064)**	**$ 4,459**	**$ (103)**	**$ 86,811**	**$ (1,167)**
Foreign government bonds	**3,457**	**(7)**	**13**	**(3)**	**3,470**	**(10)**
Mortgage- and asset-backed securities	**2,072**	**(9)**	**96**	**(4)**	**2,168**	**(13)**
Corporate notes and bonds	**3,111**	**(43)**	**301**	**(13)**	**3,412**	**(56)**
Municipal securities	**45**	**(1)**	**0**	**0**	**45**	**(1)**
Common and preferred stock	**75**	**(6)**	**8**	**(4)**	**83**	**(10)**
Total	**$ 91,112**	**$ (1,130)**	**$ 4,877**	**$ (127)**	**$ 95,989**	**$ (1,257)**

	Less than 12 Months		12 Months or Greater			
(In millions)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Total Fair Value**	**Total Unrealized Losses**
June 30, 2017						
U.S. government and agency securities	$ 87,558	$ (348)	$ 371	$ (12)	$ 87,929	$ (360)
Foreign government bonds	4,006	(2)	23	(11)	4,029	(13)
Mortgage- and asset-backed securities	1,068	(3)	198	(1)	1,266	(4)
Corporate notes and bonds	669	(8)	177	(4)	846	(12)
Common and preferred stock	69	(6)	148	(28)	217	(34)
Total	$ 93,370	$ (367)	$ 917	$ (56)	$ 94,287	$ (423)

Unrealized losses from fixed-income securities are primarily attributable to changes in interest rates. Unrealized losses from domestic and international equities are due to market price movements. Management does not believe any remaining unrealized losses represent other-than-temporary impairments based on our evaluation of available evidence.

Debt Investment Maturities

(In millions)	**Cost Basis**	**Estimated Fair Value**
June 30, 2018		
Due in one year or less	$ 31,590	$ 31,451
Due after one year through five years	76,422	75,810
Due after five years through 10 years	21,765	21,396
Due after 10 years	924	922
Total	$ 130,701	$ 129,579

NOTE 5 — DERIVATIVES

We use derivative instruments to manage risks related to foreign currencies, equity prices, interest rates, and credit; to enhance investment returns; and to facilitate portfolio diversification. Our objectives for holding derivatives include reducing, eliminating, and efficiently managing the economic impact of these exposures as effectively as possible.

Our derivative programs include strategies that both qualify and do not qualify for hedge accounting treatment. All notional amounts presented below are measured in U.S. dollar equivalents.

Foreign Currency

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions. Option and forward contracts are used to hedge a portion of forecasted international revenue for up to three years in the future and are designated as cash flow hedging instruments. Principal currencies hedged include the euro, Japanese yen, British pound, Canadian dollar, and Australian dollar. As of June 30, 2018 and 2017, the total notional amounts of these foreign exchange contracts sold were $6.1 billion and $8.9 billion, respectively.

Foreign currency risks related to certain non-U.S. dollar denominated securities are hedged using foreign exchange forward contracts that are designated as fair value hedging instruments. As of June 30, 2018 and 2017, the total notional amounts of these foreign exchange contracts sold were $5.0 billion and $5.1 billion, respectively.

Certain options and forwards not designated as hedging instruments are also used to manage the variability in foreign exchange rates on certain balance sheet amounts and to manage other foreign currency exposures. As of June 30, 2018, the total notional amounts of these foreign exchange contracts purchased and sold were $9.4 billion and $13.4 billion, respectively. As of June 30, 2017, the total notional amounts of these foreign exchange contracts purchased and sold were $8.8 billion and $10.6 billion, respectively.

Equity

Securities held in our equity and other investments portfolio are subject to market price risk. Market price risk is managed relative to broad-based global and domestic equity indices using certain convertible preferred investments, options, futures, and swap contracts not designated as hedging instruments. From time to time, to hedge our price risk, we may use and designate equity derivatives as hedging instruments, including puts, calls, swaps, and forwards. As of June 30, 2018, the total notional amounts of equity contracts purchased and sold for managing market price risk were $49 million and $5 million, respectively. As of June 30, 2017, the total notional amounts of equity contracts purchased and sold for managing market price risk were $1.9 billion and $2.4 billion, respectively, of which $1.6 billion and $1.8 billion, respectively, were designated as hedging instruments.

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using exchange-traded option and futures contracts, and over-the-counter swap and option contracts, none of which are designated as hedging instruments. As of June 30, 2018, the total notional amounts of fixed-interest rate contracts purchased and sold were $306 million and $390 million, respectively. As of June 30, 2017, the total notional amounts of fixed-interest rate contracts purchased and sold were $233 million and $352 million, respectively.

In addition, we use “To Be Announced” forward purchase commitments of mortgage-backed assets to gain exposure to agency mortgage-backed securities. These meet the definition of a derivative instrument in cases where physical delivery of the assets is not taken at the earliest available delivery date. As of June 30, 2018 and 2017, the total notional derivative amounts of mortgage contracts purchased were $568 million and $567 million, respectively.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts, not designated as hedging instruments, to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. We use credit default swaps as they are a low-cost method of managing exposure to individual credit risks or groups of credit risks. As of June 30, 2018, the total notional amounts of credit contracts purchased and sold were $4 million and $82 million, respectively. As of June 30, 2017, the total notional amounts of credit contracts purchased and sold were $267 million and $63 million, respectively.

Credit-Risk-Related Contingent Features

Certain of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of June 30, 2018, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

Fair Values of Derivative Instruments

The following table presents the fair values of derivative instruments designated as hedging instruments ("designated hedge derivatives") and not designated as hedging instruments ("non-designated hedge derivatives"). The fair values exclude the impact of netting derivative assets and liabilities when a legally enforceable master netting agreement exists and fair value adjustments related to our own credit risk and counterparty credit risk:

	Assets				Liabilities	
(In millions)	**Short-term Investments**	**Other Current Assets**	**Equity and Other Investments**	**Other Long-term Assets**	**Other Current Liabilities**	**Other Long-term Liabilities**
June 30, 2018						
Non-designated Hedge Derivatives						
Foreign exchange contracts	$ 10	$ 221	$ 0	$ 25	$ (193)	$ (4)
Equity contracts	2	0	0	0	(7)	0
Interest rate contracts	11	0	0	0	(2)	0
Credit contracts	0	0	0	0	(1)	0
Total	$ 23	$ 221	$ 0	$ 25	$ (203)	$ (4)
Designated Hedge Derivatives						
Foreign exchange contracts	$ 95	$ 174	$ 0	$ 0	$ 0	$ 0
Equity contracts	0	0	0	0	0	0
Total	$ 95	$ 174	$ 0	$ 0	$ 0	$ 0
Total gross amounts of derivatives	$ 118	$ 395	$ 0	$ 25	$ (203)	$ (4)
Gross derivatives either offset or subject to an enforceable master netting agreement	$ 113	$ 395	$ 0	$ 25	$ (203)	$ (4)
Gross amounts of derivatives offset on the balance sheet	(14)	(135)	0	(3)	150	3
Net amounts presented on the balance sheet	99	260	0	22	(53)	(1)
Gross amounts of derivatives not offset on the balance sheet	0	0	0	0	0	0
Cash collateral received	0	0	0	0	(235)	0
Net amount	$ 99	$ 260	$ 0	$ 22	$ (288)	$ (1)

(In millions)	Assets: Short-term Investments	Assets: Other Current Assets	Assets: Equity and Other Investments	Assets: Other Long-term Assets	Liabilities: Other Current Liabilities	Liabilities: Other Long-term Liabilities
June 30, 2017						
Non-designated Hedge Derivatives						
Foreign exchange contracts	$ 9	$ 203	$ 0	$ 6	$ (134)	$ (8)
Equity contracts	3	0	0	0	(6)	0
Interest rate contracts	3	0	0	0	(7)	0
Credit contracts	5	0	0	0	(1)	0
Total	$ 20	$ 203	$ 0	$ 6	$ (148)	$ (8)
Designated Hedge Derivatives						
Foreign exchange contracts	$ 80	$ 133	$ 0	$ 0	$ (3)	$ 0
Equity contracts	0	0	67	0	(186)	0
Total	$ 80	$ 133	$ 67	$ 0	$ (189)	$ 0
Total gross amounts of derivatives	$ 100	$ 336	$ 67	$ 6	$ (337)	$ (8)
Gross derivatives either offset or subject to an enforceable master netting agreement	$ 100	$ 336	$ 67	$ 6	$ (334)	$ (8)
Gross amounts of derivatives offset on the balance sheet	(20)	(132)	(67)	(8)	221	7
Net amounts presented on the balance sheet	80	204	0	(2)	(113)	(1)
Gross amounts of derivatives not offset on the balance sheet	0	0	0	0	0	0
Cash collateral received	0	0	0	0	(228)	0
Net amount	$ 80	$ 204	$ 0	$ (2)	$ (341)	$ (1)

Refer to Note 4 – Investments and Note 6 – Fair Value Measurements for further information.

Fair Value Hedge Gains (Losses)

We recognized in other income (expense), net the following gains (losses) on contracts designated as fair value hedges and their related hedged items:

(In millions)

Year Ended June 30,	2018	2017	2016
Foreign Exchange Contracts			
Derivatives	**$ 25**	$ 441	$ (797)
Hedged items	**78**	(386)	838
Total amount of ineffectiveness	**$ 103**	$ 55	$ 41
Equity Contracts			
Derivatives	**$ (324)**	$ (74)	$ (76)
Hedged items	**324**	74	76
Total amount of ineffectiveness	**$ 0**	$ 0	$ 0
Amount of equity contracts excluded from effectiveness assessment	**$ 80**	$ (80)	$ (10)

Cash Flow Hedge Gains (Losses)

We recognized the following gains (losses) on foreign exchange contracts designated as cash flow hedges:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Effective Portion			
Gains recognized in other comprehensive income (net of tax of **$11**, $4, and $24)	**$ 219**	$ 328	$ 351
Gains reclassified from accumulated other comprehensive income (loss) into revenue	**185**	555	625
Amount Excluded from Effectiveness Assessment and Ineffective Portion			
Losses recognized in other income (expense), net	**(255)**	(389)	(354)

We estimate that $179 million of net derivative gains included in AOCI as of June 30, 2018 will be reclassified into earnings within the following 12 months. No significant amounts of gains (losses) were reclassified from AOCI into earnings as a result of forecasted transactions that failed to occur during fiscal year 2018.

Non-designated Derivative Gains (Losses)

Gains (losses) from changes in fair values of derivatives that are not designated as hedges are primarily recognized in other income (expense), net. These amounts are shown in the table below, with the exception of gains (losses) on derivatives presented in income statement line items other than other income (expense), net, which were immaterial for the periods presented.

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Foreign exchange contracts	**$ (33)**	$ (117)	$ (55)
Equity contracts	**(87)**	(114)	(21)
Interest rate contracts	**(15)**	14	10
Credit contracts	**(2)**	5	(1)
Other contracts	**0**	(22)	(87)
Total	**$ (137)**	$ (234)	$ (154)

NOTE 6 — FAIR VALUE MEASUREMENTS

Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present the fair value of our financial instruments that are measured at fair value on a recurring basis:

(In millions)	Level 1	Level 2	Level 3	Gross Fair Value	Netting(a)	Net Fair Value
June 30, 2018						
Assets						
Mutual funds	**$ 246**	**$ 0**	**$ 0**	**$ 246**	**$ 0**	**$ 246**
Commercial paper	**0**	**2,513**	**0**	**2,513**	**0**	**2,513**
Certificates of deposit	**0**	**2,058**	**0**	**2,058**	**0**	**2,058**
U.S. government and agency securities	**107,015**	**1,742**	**0**	**108,757**	**0**	**108,757**
Foreign government bonds	**22**	**5,054**	**0**	**5,076**	**0**	**5,076**
Mortgage- and asset-backed securities	**0**	**3,855**	**0**	**3,855**	**0**	**3,855**
Corporate notes and bonds	**0**	**6,894**	**15**	**6,909**	**0**	**6,909**
Municipal securities	**0**	**307**	**0**	**307**	**0**	**307**
Common and preferred stock	**287**	**0**	**18**	**305**	**0**	**305**
Derivatives	**1**	**535**	**2**	**538**	**(152)**	**386**
Total	**$ 107,571**	**$ 22,958**	**$ 35**	**$ 130,564**	**$ (152)**	**$ 130,412**
Liabilities						
Derivatives and other	**$ 1**	**$ 206**	**$ 0**	**$ 207**	**$ (153)**	**$ 54**

(In millions)	Level 1	Level 2	Level 3	Gross Fair Value	Netting(a)	Net Fair Value
June 30, 2017						
Assets						
Mutual funds	$ 1,478	$ 0	$ 0	$ 1,478	$ 0	$ 1,478
Commercial paper	0	319	0	319	0	319
Certificates of deposit	0	1,358	0	1,358	0	1,358
U.S. government and agency securities	109,228	2,616	0	111,844	0	111,844
Foreign government bonds	0	5,187	0	5,187	0	5,187
Mortgage- and asset-backed securities	0	3,934	0	3,934	0	3,934
Corporate notes and bonds	0	4,829	1	4,830	0	4,830
Municipal securities	0	327	0	327	0	327
Common and preferred stock	2,414	1,994	18	4,426	0	4,426
Derivatives	1	508	0	509	(227)	282
Total	$ 113,121	$ 21,072	$ 19	$ 134,212	$ (227)	$ 133,985
Liabilities						
Derivatives and other	$ 0	$ 345	$ 39	$ 384	$ (228)	$ 156

(a) *These amounts represent the impact of netting derivative assets and derivative liabilities when a legally enforceable master netting agreement exists and fair value adjustments related to our own credit risk and counterparty credit risk.*

The changes in our Level 3 financial instruments that are measured at fair value on a recurring basis were immaterial during the periods presented.

The following table reconciles the total "Net Fair Value" of assets above to the balance sheet presentation of these same assets in Note 4 – Investments.

(In millions)

June 30,	2018	2017
Net fair value of assets measured at fair value on a recurring basis	**$ 130,412**	$ 133,985
Cash	**3,942**	3,624
Common and preferred stock measured at fair value on a nonrecurring basis	**999**	1,073
Other investments measured at fair value on a nonrecurring basis	**557**	523
Less derivative net assets classified as other current and long-term assets	**(282)**	(202)
Other	**2**	1
Recorded basis of investment components	**$ 135,630**	$ 139,004

Financial Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

During fiscal year 2018 and 2017, we did not record any material other-than-temporary impairments on financial assets required to be measured at fair value on a nonrecurring basis.

NOTE 7 — INVENTORIES

The components of inventories were as follows:

(In millions)

June 30,	2018	2017
Raw materials	**$ 655**	$ 797
Work in process	**54**	145
Finished goods	**1,953**	1,239
Total	**$ 2,662**	$ 2,181

NOTE 8 — PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

(In millions)

June 30,	2018	2017
Land	**$ 1,254**	$ 1,107
Buildings and improvements	**20,604**	16,284
Leasehold improvements	**4,735**	5,064
Computer equipment and software	**27,633**	21,414
Furniture and equipment	**4,457**	4,044
Total, at cost	**58,683**	47,913
Accumulated depreciation	**(29,223)**	(24,179)
Total, net	**$ 29,460**	$ 23,734

During fiscal years 2018, 2017, and 2016, depreciation expense was $7.7 billion, $6.1 billion, and $4.9 billion, respectively. We have committed $1.9 billion for the construction of new buildings, building improvements, and leasehold improvements as of June 30, 2018.

NOTE 9 — BUSINESS COMBINATIONS

LinkedIn Corporation

On December 8, 2016, we completed our acquisition of all issued and outstanding shares of LinkedIn Corporation, the world's largest professional network on the Internet, for a total purchase price of $27.0 billion. The purchase price consisted primarily of cash of $26.9 billion. The acquisition is expected to accelerate the growth of LinkedIn, Office 365, and Dynamics 365. The financial results of LinkedIn have been included in our consolidated financial statements since the date of the acquisition.

The allocation of the purchase price to goodwill was completed as of June 30, 2017.

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

(In millions)	
Cash and cash equivalents	$ 1,328
Short-term investments	2,110
Other current assets	697
Property and equipment	1,529
Intangible assets	7,887
Goodwill (a)	16,803
Short-term debt (b)	(1,323)
Other current liabilities	(1,117)
Deferred income taxes	(774)
Other	(131)
Total purchase price	$ 27,009

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

(b) *Convertible senior notes issued by LinkedIn on November 12, 2014, substantially all of which were redeemed after our acquisition of LinkedIn. The remaining $18 million of notes are not redeemable and are included in long-term debt in our consolidated balance sheets. Refer to Note 12 – Debt for further information.*

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

(In millions)	Amount	Weighted Average Life
Customer-related	$ 3,607	7 years
Marketing-related (trade names)	2,148	20 years
Technology-based	2,109	3 years
Contract-based	23	5 years
Fair value of intangible assets acquired	$ 7,887	9 years

Our consolidated income statements include the following revenue and operating loss attributable to LinkedIn since the date of acquisition:

(In millions)	
Year Ended June 30,	2017
Revenue	$ 2,271
Operating loss	(924)

Following are the supplemental consolidated financial results of Microsoft Corporation on an unaudited pro forma basis, as if the acquisition had been consummated on July 1, 2015:

(In millions, except earnings per share)

Year Ended June 30,	**2017**	**2016**
Revenue	$ 98,291	$ 94,490
Net income	25,179	19,128
Diluted earnings per share	3.21	2.38

These pro forma results were based on estimates and assumptions, which we believe are reasonable. They are not the results that would have been realized had we been a combined company during the periods presented and are not necessarily indicative of our consolidated results of operations in future periods. The pro forma results include adjustments related to purchase accounting, primarily amortization of intangible assets. Acquisition costs and other nonrecurring charges were immaterial and are included in the earliest period presented.

GitHub Inc.

On June 4, 2018, we entered into a definitive agreement to acquire GitHub Inc. (“GitHub”) for $7.5 billion in an all-stock transaction. We expect the acquisition will close by the end of the calendar year, subject to approval by GitHub’s shareholders, satisfaction of certain regulatory approvals, and other customary closing conditions. GitHub will be included in our consolidated results of operations as of the date of acquisition.

Other

During fiscal year 2018, we completed nine acquisitions for total consideration of $948 million, substantially all of which was paid in cash. These entities have been included in our consolidated results of operations since their respective acquisition dates. Pro forma results of operations for these acquisitions have not been presented because the effects of these business combinations, individually and in aggregate, were not material to our consolidated results of operations.

NOTE 10 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	**June 30, 2016**	**Acquisitions**	**Other**	**June 30, 2017**	**Acquisitions**	**Other**	**June 30, 2018**
Productivity and Business Processes	$ 6,678	$ 17,072(a)	$ (11)	$ 23,739	**$ 72**	**$ 12**	**$ 23,823**
Intelligent Cloud	5,467	49	39	5,555	**164**	**(16)**	**5,703**
More Personal Computing	5,727	115	(14)	5,828	**394**	**(65)**	**6,157**
Total	$ 17,872	$ 17,236	$ 14	$ 35,122	**$ 630**	**$ (69)**	**$ 35,683**

(a) *Includes goodwill related to LinkedIn and other acquisitions. Refer to Note 9 – Business Combinations for further information.*

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

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

As of June 30, 2018 and 2017, accumulated goodwill impairment was $11.3 billion.

Goodwill Impairment

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

No instances of impairment were identified in our May 1, 2018, May 1, 2017, or May 1, 2016 tests.

NOTE 11 — INTANGIBLE ASSETS

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

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
June 30,			**2018**			**2017**
Technology-based	**$ 7,220**	**$ (5,018)**	**$ 2,202**	$ 7,765	$ (4,318)	$ 3,447
Customer-related	**4,031**	**(1,205)**	**2,826**	4,045	(692)	3,353
Marketing-related	**4,006**	**(1,071)**	**2,935**	4,016	(829)	3,187
Contract-based	**679**	**(589)**	**90**	841	(722)	119
Total	**$ 15,936**	**$ (7,883)**	**$ 8,053**	$ 16,667	$ (6,561)	$ 10,106

No material impairments of intangible assets were identified during fiscal year 2018 or 2017.

During fiscal year 2016, we recorded impairment charges of $480 million related to intangible assets in the Devices reporting unit within our More Personal Computing segment. In the fourth quarter of fiscal year 2016, we tested these intangible assets for recoverability due to changes in facts and circumstances associated with the shift in strategic direction and reduced profitability expectations for our Phone business. Based on the results of our testing, we determined that the carrying value of the intangible assets was not recoverable, and an impairment charge was recorded to the extent that estimated fair value exceeded carrying value. We primarily used the income approach to determine the fair value of the intangible assets and determine the amount of impairment.

These intangible assets impairment charges were included in impairment and restructuring expenses in our consolidated income statement and reflected in Corporate and Other in our table of operating income (loss) by segment in Note 21 – Segment Information and Geographic Data.

We estimate that we have no significant residual value related to our intangible assets.

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

(In millions)	Amount	Weighted Average Life	Amount	Weighted Average Life
Year Ended June 30,	**2018**		**2017**	
Technology-based	**$ 178**	**4 years**	$ 2,265	2 years
Marketing-related	**14**	**5 years**	2,148	19 years
Contract-based	**14**	**4 years**	63	6 years
Customer-related	**13**	**5 years**	3,607	7 years
Total	**$ 219**	**5 years**	$ 8,083	9 years

Intangible assets amortization expense was $2.2 billion, $1.7 billion, and $978 million for fiscal years 2018, 2017, and 2016, respectively. Amortization of capitalized software was $54 million, $55 million, and $69 million for fiscal years 2018, 2017, and 2016, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of June 30, 2018:

(In millions)

Year Ending June 30,	
2019	$ 1,785
2020	1,260
2021	1,043
2022	949
2023	806
Thereafter	2,210
Total	$ 8,053

NOTE 12 — DEBT

Short-term Debt

As of June 30, 2018, we had no commercial paper issued and outstanding. As of June 30, 2017, we had $9.1 billion of commercial paper issued and outstanding, with a weighted average interest rate of 1.01% and maturities ranging from 25 days to 264 days. The estimated fair value of this commercial paper approximates its carrying value.

We have two $5.0 billion credit facilities that expire on October 30, 2018 and October 31, 2022, respectively. These credit facilities serve as a back-up for our commercial paper program. As of June 30, 2018, we were in compliance with the only financial covenant in both credit agreements, which requires us to maintain a coverage ratio of at least three times earnings before interest, taxes, depreciation, and amortization to interest expense, as defined in the credit agreements. No amounts were drawn against these credit facilities during any of the periods presented.

Long-term Debt

As of June 30, 2018, the total carrying value and estimated fair value of our long-term debt, including the current portion, were $76.2 billion and $77.5 billion, respectively. As of June 30, 2017, the total carrying value and estimated fair value of our long-term debt, including the current portion, were $77.1 billion and $80.3 billion, respectively. These estimated fair values are based on Level 2 inputs.

The components of our long-term debt, including the current portion, and the associated interest rates were as follows:

(In millions, except interest rates)	Face Value June 30, 2018	Face Value June 30, 2017	Stated Interest Rate	Effective Interest Rate
Notes				
November 15, 2017	**$ 0**	$ 600	**0.875%**	**1.084%**
May 1, 2018	**0**	450	**1.000%**	**1.106%**
November 3, 2018	**1,750**	1,750	**1.300%**	**1.396%**
December 6, 2018	**1,250**	1,250	**1.625%**	**1.824%**
June 1, 2019	**1,000**	1,000	**4.200%**	**4.379%**
August 8, 2019	**2,500**	2,500	**1.100%**	**1.203%**
November 1, 2019	**18**	18	**0.500%**	**0.500%**
February 6, 2020	**1,500**	1,500	**1.850%**	**1.952%**
February 12, 2020	**1,500**	1,500	**1.850%**	**1.935%**
October 1, 2020	**1,000**	1,000	**3.000%**	**3.137%**
November 3, 2020	**2,250**	2,250	**2.000%**	**2.093%**
February 8, 2021	**500**	500	**4.000%**	**4.082%**
August 8, 2021	**2,750**	2,750	**1.550%**	**1.642%**
December 6, 2021 (a)	**2,044**	1,996	**2.125%**	**2.233%**
February 6, 2022	**1,750**	1,750	**2.400%**	**2.520%**
February 12, 2022	**1,500**	1,500	**2.375%**	**2.466%**
November 3, 2022	**1,000**	1,000	**2.650%**	**2.717%**
November 15, 2022	**750**	750	**2.125%**	**2.239%**
May 1, 2023	**1,000**	1,000	**2.375%**	**2.465%**
August 8, 2023	**1,500**	1,500	**2.000%**	**2.101%**
December 15, 2023	**1,500**	1,500	**3.625%**	**3.726%**
February 6, 2024	**2,250**	2,250	**2.875%**	**3.041%**
February 12, 2025	**2,250**	2,250	**2.700%**	**2.772%**
November 3, 2025	**3,000**	3,000	**3.125%**	**3.176%**
August 8, 2026	**4,000**	4,000	**2.400%**	**2.464%**
February 6, 2027	**4,000**	4,000	**3.300%**	**3.383%**
December 6, 2028 (a)	**2,044**	1,996	**3.125%**	**3.218%**
May 2, 2033 (a)	**642**	627	**2.625%**	**2.690%**
February 12, 2035	**1,500**	1,500	**3.500%**	**3.604%**
November 3, 2035	**1,000**	1,000	**4.200%**	**4.260%**
August 8, 2036	**2,250**	2,250	**3.450%**	**3.510%**
February 6, 2037	**2,500**	2,500	**4.100%**	**4.152%**
June 1, 2039	**750**	750	**5.200%**	**5.240%**
October 1, 2040	**1,000**	1,000	**4.500%**	**4.567%**
February 8, 2041	**1,000**	1,000	**5.300%**	**5.361%**
November 15, 2042	**900**	900	**3.500%**	**3.571%**
May 1, 2043	**500**	500	**3.750%**	**3.829%**
December 15, 2043	**500**	500	**4.875%**	**4.918%**
February 12, 2045	**1,750**	1,750	**3.750%**	**3.800%**
November 3, 2045	**3,000**	3,000	**4.450%**	**4.492%**
August 8, 2046	**4,500**	4,500	**3.700%**	**3.743%**
February 6, 2047	**3,000**	3,000	**4.250%**	**4.287%**
February 12, 2055	**2,250**	2,250	**4.000%**	**4.063%**
November 3, 2055	**1,000**	1,000	**4.750%**	**4.782%**
August 8, 2056	**2,250**	2,250	**3.950%**	**4.033%**
February 6, 2057	**2,000**	2,000	**4.500%**	**4.528%**
Total	**$ 76,898**	$ 77,837		

(a) *Euro-denominated debt securities.*

The notes in the table above are senior unsecured obligations and rank equally with our other senior unsecured debt outstanding. Interest on these notes is paid semi-annually, except for the euro-denominated debt securities on which interest is paid annually. Cash paid for interest on our debt for fiscal years 2018, 2017, and 2016 was $2.4 billion, $1.6 billion, and $1.1 billion, respectively. As of June 30, 2018 and 2017, the aggregate debt issuance costs and unamortized discount associated with our long-term debt, including the current portion, were $658 million and $715 million, respectively.

Maturities of our long-term debt for each of the next five years and thereafter are as follows:

(In millions)	
Year Ending June 30,	
2019	$ 4,000
2020	5,518
2021	3,750
2022	8,044
2023	2,750
Thereafter	52,836
Total	$ 76,898

NOTE 13 — INCOME TAXES

Recent Tax Legislation

On December 22, 2017, the TCJA was enacted into law, which significantly changes existing U.S. tax law and includes numerous provisions that affect our business, such as imposing a one-time transition tax on deemed repatriation of deferred foreign income, reducing the U.S. federal statutory tax rate, and adopting a territorial tax system. The TCJA required us to incur a one-time transition tax on deferred foreign income not previously subject to U.S. income tax at a rate of 15.5% for foreign cash and certain other net current assets, and 8% on the remaining income. The TCJA also reduced the U.S. federal statutory tax rate from 35% to 21% effective January 1, 2018. For fiscal year 2018, our blended U.S. federal statutory tax rate is 28.1%. This is the result of using the tax rate of 35% for the first and second quarter of fiscal year 2018 and the reduced tax rate of 21% for the third and fourth quarter of fiscal year 2018. The TCJA includes a provision to tax global intangible low-taxed income (“GILTI”) of foreign subsidiaries and a base erosion anti-abuse tax (“BEAT”) measure that taxes certain payments between a U.S. corporation and its foreign subsidiaries. The GILTI and BEAT provisions of the TCJA will be effective for us beginning July 1, 2018.

The TCJA was effective in the second quarter of fiscal year 2018. As of June 30, 2018, we have not completed our accounting for the estimated tax effects of the TCJA. During fiscal year 2018, we recorded a provisional net charge of $13.7 billion related to the TCJA based on reasonable estimates for those tax effects. Due to the timing of the enactment and the complexity in applying the provisions of the TCJA, the provisional net charge is subject to revisions as we continue to complete our analysis of the TCJA, collect and prepare necessary data, and interpret any additional guidance issued by the U.S. Treasury Department, Internal Revenue Service (“IRS”), FASB, and other standard-setting and regulatory bodies. Adjustments may materially impact our provision for income taxes and effective tax rate in the period in which the adjustments are made. Our accounting for the estimated tax effects of the TCJA will be completed during the measurement period, which is not expected to extend beyond one year from the enactment date. The impacts of our estimates are described further below.

During fiscal year 2018, we recorded an estimated net charge of $13.7 billion related to the TCJA, due to the impact of the one-time transition tax on the deemed repatriation of deferred foreign income of $17.9 billion, offset in part by the impact of changes in the tax rate of $4.2 billion, primarily on deferred tax assets and liabilities.

We recorded an estimated $17.9 billion charge in fiscal year 2018 related to the transition tax, which was included in the provision for income taxes in our consolidated income statements and income taxes in our consolidated balance sheets. We have not yet completed our accounting for the transition tax as our analysis of deferred foreign income is not complete. To calculate the transition tax, we estimated our deferred foreign income for fiscal year 2018 because these tax returns are not complete or due. Fiscal year 2018 taxable income will be known once the respective tax returns are completed and filed. In addition, U.S. and foreign audit settlements may significantly impact the estimated transition tax. The impact of the U.S. and foreign audits on the transition tax will be known as the audits are concluded.

In addition, we recorded an estimated $4.2 billion benefit in fiscal year 2018 from the impact of changes in the tax rate, primarily on deferred tax assets and liabilities, which was included in provision for income taxes in our consolidated income statements and deferred income taxes and long-term income taxes in our consolidated balance sheets. We remeasured our deferred taxes to reflect the reduced rate that will apply when these deferred taxes are settled or realized in future periods.

The TCJA subjects a U.S. corporation to tax on its GILTI. Due to the complexity of the new GILTI tax rules, we are continuing to evaluate this provision of the TCJA and the application of GAAP. Under GAAP, we can make an accounting policy election to either treat taxes due on the GILTI inclusion as a current period expense or factor such amounts into our measurement of deferred taxes. We elected the deferred method, and the corresponding deferred tax assets and liabilities are included in the table of deferred income tax assets and liabilities below.

On August 1, 2018, the Internal Revenue Service published on its website proposed regulations relating to the transition tax imposed by the TCJA. Once published in the Federal Register, the proposed regulations are subject to a 60-day comment period. Final regulations are expected to be issued after consideration of comments. We are currently evaluating the impact of the proposed regulations.

Provision for Income Taxes

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

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Current Taxes			
U.S. federal	**$ 19,764**	$ 2,739	$ 545
U.S. state and local	**934**	30	136
Foreign	**4,348**	2,472	1,940
Current taxes	**$ 25,046**	$ 5,241	$ 2,621
Deferred Taxes			
U.S. federal	**$ (4,292)**	$ (554)	$ 1,919
U.S. state and local	**(458)**	269	111
Foreign	**(393)**	(544)	449
Deferred taxes	**$ (5,143)**	$ (829)	$ 2,479
Provision for income taxes	**$ 19,903**	$ 4,412	$ 5,100

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

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
U.S.	**$ 11,527**	$ 6,843	$ 5,125
Foreign	**24,947**	23,058	20,514
Income before income taxes	**$ 36,474**	$ 29,901	$ 25,639

Effective Tax Rate

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

Year Ended June 30,	2018	2017	2016
Federal statutory rate	**28.1%**	35.0%	35.0%
Effect of:			
Foreign earnings taxed at lower rates	**(7.8)%**	(11.6)%	(14.5)%
Impacts of TCJA	**37.7%**	0%	0%
Phone business losses	**0%**	(5.7)%	1.0%
Excess tax benefits relating to stock-based compensation	**(2.5)%**	(2.1)%	(1.6)%
Interest, net	**1.2%**	1.4%	0.9%
Other reconciling items, net	**(2.1)%**	(2.2)%	(0.9)%
Effective rate	**54.6%**	14.8%	19.9%

The increase from the federal statutory rate in fiscal year 2018 is primarily due to the net charge related to the enactment of the TCJA in the second quarter of fiscal year 2018, offset in part by earnings taxed at lower rates in foreign jurisdictions. The decrease from the federal statutory rate in fiscal year 2017 and 2016 is primarily due to earnings taxed at lower rates in foreign jurisdictions. Our foreign regional operating centers in Ireland, Singapore and Puerto Rico, which are taxed at rates lower than the U.S. rate, generated 87%, 76%, and 91% of our foreign income before tax in fiscal years 2018, 2017, and 2016, respectively. Other reconciling items, net consists primarily of tax credits, U.S. state income taxes, and domestic production activities deduction. In fiscal years 2018, 2017, and 2016, there were no individually significant other reconciling items.

The increase in our effective tax rate for fiscal year 2018 compared to fiscal year 2017 was primarily due to the net charge related to the enactment of the TCJA and the realization of tax benefits attributable to previous Phone business losses in fiscal year 2017. The decrease in our effective tax rate for fiscal year 2017 compared to fiscal year 2016 was primarily due to the realization of tax benefits attributable to previous Phone business losses, offset in part by changes in the mix of our income before income taxes between the U.S. and foreign countries.

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

(In millions)

June 30,	**2018**	**2017**
Deferred Income Tax Assets		
Stock-based compensation expense	**$ 460**	$ 777
Accruals, reserves, and other expenses	**1,832**	1,859
Loss and credit carryforwards	**3,369**	4,809
Depreciation and amortization	**351**	53
Other	**56**	255
Deferred income tax assets	**6,068**	7,753
Less valuation allowance	**(3,186)**	(3,310)
Deferred income tax assets, net of valuation allowance	**$ 2,882**	$ 4,443
Deferred Income Tax Liabilities		
Foreign earnings	**$ 0**	$ (1,134)
Unrealized gain on investments and debt	**0**	(1,384)
Unearned revenue	**(639)**	(5,760)
Depreciation and amortization	**(1,103)**	(1,630)
Other	**(312)**	(21)
Deferred income tax liabilities	**$ (2,054)**	$ (9,929)
Net deferred income tax assets (liabilities)	**$ 828**	$ (5,486)
Reported As		
Other long-term assets	**$ 1,369**	$ 248
Long-term deferred income tax liabilities	**(541)**	(5,734)
Net deferred income tax assets (liabilities)	**$ 828**	$ (5,486)

We recorded a deferred tax liability of $7.4 billion related to the recognition of revenue as part of the adoption of the new revenue standard.

As of June 30, 2018, we had federal, state and foreign net operating loss carryforwards of $257 million, $1.4 billion and $11.4 billion, respectively. The federal and state net operating loss carryforwards will expire in various years from fiscal 2019 through 2038, if not utilized. The majority of our foreign net operating loss carryforwards do not expire. Certain acquired net operating loss carryforwards are subject to an annual limitation, but are expected to be realized with the exception of those which have a valuation allowance.

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

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

Income taxes paid, net of refunds, were $5.5 billion, $2.4 billion, and $3.9 billion in fiscal years 2018, 2017, and 2016, respectively.

Uncertain Tax Positions

Unrecognized tax benefits as of June 30, 2018, 2017, and 2016, were $12.0 billion, $11.7 billion, and $10.2 billion, respectively, and were included in long-term income taxes in our consolidated balance sheets. If recognized, these tax benefits would affect our effective tax rates for fiscal years 2018, 2017, and 2016, by $11.3 billion, $10.2 billion, and $8.8 billion, respectively.

As of June 30, 2018, 2017, and 2016, we had accrued interest expense related to uncertain tax positions of $3.0 billion, $2.3 billion, and $1.9 billion, respectively, net of income tax benefits. Interest expense on unrecognized tax benefits, net of tax effects, was $688 million, $399 million, and $163 million in fiscal years 2018, 2017, and 2016, respectively, and was included in provision for income taxes.

The aggregate changes in the balance of unrecognized tax benefits were as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Balance, beginning of year	**$ 11,737**	$ 10,164	$ 9,599
Decreases related to settlements	**(193)**	(4)	(201)
Increases for tax positions related to the current year	**1,445**	1,277	1,086
Increases for tax positions related to prior years	**151**	397	115
Decreases for tax positions related to prior years	**(1,176)**	(49)	(317)
Decreases due to lapsed statutes of limitations	**(3)**	(48)	(118)
Balance, end of year	**$ 11,961**	$ 11,737	$ 10,164

While we settled a portion of the IRS audit for tax years 2004 to 2006 during the third quarter of fiscal year 2011, and a portion of the IRS audit for tax years 2007 to 2009 during the first quarter of fiscal year 2016, we remain under audit for those years. In the second quarter of fiscal year 2018, we settled a portion of the IRS audit for tax years 2010 to 2013. We continue to be subject to examination by the IRS for tax years 2010 to 2017. In February 2012, the IRS withdrew its 2011 Revenue Agents Report for tax years 2004 to 2006 and reopened the audit phase of the examination. As of June 30, 2018, the primary unresolved issue relates to transfer pricing, which could have a significant impact in our consolidated financial statements if not resolved favorably. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2017, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 14 — RESTRUCTURING CHARGES

2016 Restructuring

In the fourth quarter of fiscal year 2016, management approved restructuring plans that resulted in approximately 4,700 job eliminations in fiscal year 2017, primarily across our smartphone hardware business and global sales. In fiscal year 2016, we incurred restructuring charges of $501 million in connection with the 2016 restructuring plans, including severance expenses and other reorganization costs. The actions associated with these restructuring plans were completed as of June 30, 2017.

2017 Restructuring

In June 2017, management approved a sales and marketing restructuring plan. In fiscal year 2017, we recorded employee severance expenses of $306 million primarily related to this sales and marketing restructuring plan. The actions associated with this restructuring plan were completed as of June 30, 2018.

NOTE 15 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

June 30,	2018	2017
Productivity and Business Processes	**$ 14,864**	$ 12,692
Intelligent Cloud	**14,706**	11,152
More Personal Computing	**3,150**	2,812
Total	**$ 32,720**	$ 26,656

The opening balance of unearned revenue was $22.2 billion as of July 1, 2016.

Changes in unearned revenue were as follows:

(In millions)

Year Ended June 30, 2018	
Balance, beginning of period	**$ 26,656**
Deferral of revenue	**61,142**
Recognition of unearned revenue	**(55,078)**
Balance, end of period	**$ 32,720**

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized (“contracted not recognized revenue”), which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods. Contracted not recognized revenue was $73 billion as of June 30, 2018, of which we expect to recognize approximately 60% of the revenue over the next 12 months and the remainder thereafter.

NOTE 16 — LEASES

We have operating and finance leases for datacenters, corporate offices, research and development facilities, retail stores, and certain equipment. Our leases have remaining lease terms of 1 year to 20 years, some of which include options to extend the leases for up to 5 years, and some of which include options to terminate the leases within 1 year.

The components of lease expense were as follows:

(In millions)

Year Ended June 30,	2018	2017	2016
Operating lease cost	**$ 1,585**	$ 1,412	$ 936
Finance lease cost:			
Amortization of right-of-use assets	**$ 243**	$ 104	$ 28
Interest on lease liabilities	**175**	68	28
Total finance lease cost	**$ 418**	$ 172	$ 56

Supplemental cash flow information related to leases was as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Cash paid for amounts included in the measurement of lease liabilities:			
Operating cash flows from operating leases	**$ 1,522**	$ 1,157	$ 936
Operating cash flows from finance leases	**175**	68	28
Financing cash flows from finance leases	**144**	46	6
Right-of-use assets obtained in exchange for lease obligations:			
Operating leases	**1,571**	1,270	1,062
Finance leases	**1,933**	1,773	413

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

June 30,	**2018**	**2017**
Operating Leases		
Operating lease right-of-use assets	**$ 6,686**	$ 6,555
Other current liabilities	**$ 1,399**	$ 1,423
Operating lease liabilities	**5,568**	5,372
Total operating lease liabilities	**$ 6,967**	$ 6,795
Finance Leases		
Property and equipment, gross	**$ 4,543**	$ 2,658
Accumulated depreciation	**(404)**	(161)
Property and equipment, net	**$ 4,139**	$ 2,497
Other current liabilities	**$ 176**	$ 113
Other long-term liabilities	**4,125**	2,425
Total finance lease liabilities	**$ 4,301**	$ 2,538
Weighted Average Remaining Lease Term		
Operating leases	**7 years**	7 years
Finance leases	**13 years**	13 years
Weighted Average Discount Rate		
Operating leases	**2.7%**	2.5%
Finance leases	**5.2%**	4.7%

Maturities of lease liabilities were as follows:

(In millions)

Year Ending June 30,	**Operating Leases**	**Finance Leases**
2019	$ 1,492	$ 386
2020	1,347	393
2021	1,086	401

2022	902	408
2023	721	410
Thereafter	2,157	4,036
Total lease payments	7,705	6,034
Less imputed interest	(738)	(1,733)
Total	$ 6,967	$ 4,301

As of June 30, 2018, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $594 million and $2.4 billion, respectively. These operating and finance leases will commence between fiscal year 2019 and fiscal year 2020 with lease terms of 1 year to 20 years.

NOTE 17 — CONTINGENCIES

Patent and Intellectual Property Claims

There were 34 patent infringement cases pending against Microsoft as of June 30, 2018, none of which are material individually or in aggregate.

Antitrust, Unfair Competition, and Overcharge Class Actions

Antitrust and unfair competition class action lawsuits were filed against us in British Columbia, Ontario, and Quebec, Canada. All three have been certified on behalf of Canadian indirect purchasers who acquired licenses for Microsoft operating system software and/or productivity application software between 1998 and 2010.

The trial of the British Columbia action commenced in May 2016. Following a mediation, the parties agreed to a global settlement of all three Canadian actions, and have submitted the proposed settlement agreement to the courts in all three jurisdictions for approval. The courts will likely reach a decision on approval in September 2018.

Other Antitrust Litigation and Claims

*China State Administration for Industry and Commerce Investigatio*n

In 2014, Microsoft was informed that China's State Agency for Market Regulation ("SAMR") (formerly State Administration for Industry and Commerce) had begun a formal investigation relating to China's Anti-Monopoly Law, and the SAMR conducted onsite inspections of Microsoft offices in Beijing, Shanghai, Guangzhou, and Chengdu. SAMR has stated the investigation relates to compatibility, bundle sales, file verification issues related to Windows and Office software, and potentially other issues.

Product-Related Litigation

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 35 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

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

Canadian Cell Phone Class Action

Microsoft Mobile Oy, along with other handset manufacturers and network operators, is a defendant in a 2013 class action lawsuit filed in the Supreme Court of British Columbia by a purported class of Canadians who have used cellular phones for at least 1,600 hours, including a subclass of users with brain tumors, alleging adverse health effects from cellular phone use. Microsoft was served with the complaint in June 2014 and has been substituted for the Nokia defendants. The litigation has been dormant for more than three years.

Employment-Related Litigation

Moussouris v. Microsoft

Current and former female Microsoft employees in certain engineering and information technology roles brought this class action in federal court in Seattle in 2015, alleging systemic gender discrimination in pay and promotions. The plaintiffs moved to certify the class in October 2017. Microsoft filed an opposition in January 2018, attaching an expert report showing no statistically significant disparity in pay and promotions between similarly situated men and women. In June 2018, the court denied the plaintiffs' motion for class certification. The plaintiffs have appealed to the U.S. Court of Appeals for the Ninth Circuit. In July, the court denied Microsoft's motion for summary judgment with respect to the named plaintiffs.

Other Contingencies

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

As of June 30, 2018, we accrued aggregate legal liabilities of $323 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $1.1 billion in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable.

Indemnifications

We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products and certain other matters. Additionally, we have agreed to cover damages resulting from breaches of certain security and privacy commitments in our cloud business. In evaluating estimated losses on these obligations, we consider factors such as the degree of probability of an unfavorable outcome and our ability to make a reasonable estimate of the amount of loss. These obligations did not have a material impact in our consolidated financial statements during the periods presented.

NOTE 18 — STOCKHOLDERS' EQUITY

Shares Outstanding

Shares of common stock outstanding were as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Balance, beginning of year	**7,708**	7,808	8,027
Issued	**68**	70	75
Repurchased	**(99)**	(170)	(294)
Balance, end of year	**7,677**	7,708	7,808

Share Repurchases

On September 16, 2013, our Board of Directors approved a share repurchase program authorizing up to $40.0 billion in share repurchases. This share repurchase program became effective on October 1, 2013, and was completed on December 22, 2016.

On September 20, 2016, our Board of Directors approved a share repurchase program authorizing up to an additional $40.0 billion in share repurchases. This share repurchase program commenced on December 22, 2016 following completion of the prior program approved on September 16, 2013, has no expiration date, and may be suspended or discontinued at any time without notice. As of June 30, 2018, $28.2 billion remained of this $40.0 billion share repurchase program.

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

(In millions)	Shares	Amount	Shares	Amount	Shares	Amount
Year Ended June 30,		2018		2017		2016
First Quarter	**22**	**$ 1,600**	63	$ 3,550	89	$ 4,000
Second Quarter	**22**	**1,800**	59	3,533	66	3,600
Third Quarter	**34**	**3,100**	25	1,600	69	3,600
Fourth Quarter	**21**	**2,100**	23	1,600	70	3,600
Total	**99**	**$ 8,600**	170	$ 10,283	294	$ 14,800

Shares repurchased beginning in the third quarter of fiscal year 2017 were under the share repurchase program approved September 20, 2016. All other shares repurchased were under the share repurchase program approved September 16, 2013. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards. All repurchases were made using cash resources.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Dividend Per Share	Record Date	Amount	Payment Date
Fiscal Year 2018			(in millions)	
September 19, 2017	**$ 0.42**	**November 16, 2017**	**$ 3,238**	**December 14, 2017**
November 29, 2017	**0.42**	**February 15, 2018**	**3,232**	**March 8, 2018**
March 12, 2018	**0.42**	**May 17, 2018**	**3,226**	**June 14, 2018**
June 13, 2018	**0.42**	**August 16, 2018**	**3,224**	**September 13, 2018**
Fiscal Year 2017				
September 20, 2016	$ 0.39	November 17, 2016	$ 3,024	December 8, 2016
November 30, 2016	0.39	February 16, 2017	3,012	March 9, 2017
March 14, 2017	0.39	May 18, 2017	3,009	June 8, 2017
June 13, 2017	0.39	August 17, 2017	3,003	September 14, 2017

The dividend declared on June 13, 2018 was included in other current liabilities as of June 30, 2018.

NOTE 19 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Derivatives			
Balance, beginning of period	**$ 134**	$ 352	$ 590
Unrealized gains, net of tax of **$11**, $4, and $24	**218**	328	351
Reclassification adjustments for gains included in revenue	**(185)**	(555)	(625)
Tax expense included in provision for income taxes	**6**	9	36
Amounts reclassified from accumulated other comprehensive income	**(179)**	(546)	(589)
Net change related to derivatives, net of tax of **$5,** $(5), and $(12)	**39**	(218)	(238)
Balance, end of period	**$ 173**	$ 134	$ 352
Investments			
Balance, beginning of period	**$ 1,825**	$ 2,941	$ 3,169
Unrealized gains (losses), net of tax of **$(427)**, $267, and $120	**(1,146)**	517	219
Reclassification adjustments for gains included in other income (expense), net	**(2,309)**	(2,513)	(688)
Tax expense included in provision for income taxes	**738**	880	241
Amounts reclassified from accumulated other comprehensive income	**(1,571)**	(1,633)	(447)
Net change related to investments, net of tax of **$(1,165)**, $(613), and $(121)	**(2,717)**	(1,116)	(228)
Balance, end of period	**$ (892)**	$ 1,825	$ 2,941
Translation Adjustments and Other			
Balance, beginning of period	**$ (1,332)**	$ (1,499)	$ (1,237)
Translation adjustments and other, net of tax effects of **$0**, $9, and $(33)	**(178)**	167	(262)
Balance, end of period	**$ (1,510)**	$ (1,332)	$ (1,499)
Cumulative effect of accounting change	**42**	0	0
Accumulated other comprehensive income (loss), end of period	**$ (2,187)**	$ 627	$ 1,794

NOTE 20 — EMPLOYEE STOCK AND SAVINGS PLANS

We grant stock-based compensation to employees and directors. As of June 30, 2018, an aggregate of 381 million shares were authorized for future grant under our stock plans. In fiscal year 2018, our Board of Directors approved the 2017 Stock Plan, which authorized an additional 308 million shares for future grant under our stock plans. Awards that expire or are canceled without delivery of shares generally become available for issuance under the plans. We issue new shares of Microsoft common stock to satisfy vesting of awards granted under our stock plans. We also have an ESPP for all eligible employees.

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

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Stock-based compensation expense	**$ 3,940**	$ 3,266	$ 2,668
Income tax benefits related to stock-based compensation	**823**	1,066	882

Stock Plans

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

Executive Incentive Plan

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

Activity for All Stock Plans

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

Year Ended June 30,	2018	2017	2016
Dividends per share (quarterly amounts)	**$0.39 - $0.42**	$0.36 - $0.39	$0.31 - $0.36
Interest rates	**1.7% - 2.9%**	1.2% - 2.2%	1.1% - 1.8%

During fiscal year 2018, the following activity occurred under our stock plans:

	Shares	Weighted Average Grant-Date Fair Value
	(In millions)	
Stock Awards		
Nonvested balance, beginning of year	201	$ 46.32
Granted (a)	70	75.88
Vested	(80)	45.74
Forfeited	(17)	53.41
Nonvested balance, end of year	174	57.85

(a) *Includes 3 million, 2 million, and 1 million of PSUs granted at target and performance adjustments above target levels for fiscal years 2018, 2017, and 2016, respectively.*

As of June 30, 2018, there was approximately $7.0 billion of total unrecognized compensation costs related to stock awards. These costs are expected to be recognized over a weighted average period of 3 years. The weighted average grant-date fair value of stock awards granted was $75.88, $55.64, and $41.51 for fiscal years 2018, 2017, and 2016, respectively. The fair value of stock awards vested was $6.6 billion, $4.8 billion, and $3.9 billion, for fiscal years 2018, 2017, and 2016, respectively.

Employee Stock Purchase Plan

We have an ESPP for all eligible employees. Shares of our common stock may be purchased by employees at three-month intervals at 90% of the fair market value on the last trading day of each three-month period. Employees may purchase shares having a value not exceeding 15% of their gross compensation during an offering period. Employees purchased the following shares during the periods presented:

(Shares in millions)

Year Ended June 30,	2018	2017	2016
Shares purchased	**13**	13	15
Average price per share	**$ 76.40**	$ 56.36	$ 44.83

As of June 30, 2018, 116 million shares of our common stock were reserved for future issuance through the ESPP.

Savings Plan

We have a savings plan in the U.S. that qualifies under Section 401(k) of the Internal Revenue Code, and a number of savings plans in international locations. Participating U.S. employees may contribute a portion of their salary, subject to certain limitations. We contribute fifty cents for each dollar a participant contributes in this plan, with a maximum employer contribution of 50% of the IRS contribution limit for the calendar year. Matching contributions for all plans were $807 million, $734 million, and $549 million in fiscal years 2018, 2017, and 2016, respectively, and were expensed as contributed.

NOTE 21 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

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

Our reportable segments are described below.

Productivity and Business Processes

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

- Office Commercial, including Office 365 subscriptions and Office licensed on-premises, comprising Office, Exchange, SharePoint, Skype for Business, and Microsoft Teams, and related Client Access Licenses (“CALs”).
- Office Consumer, including Office 365 subscriptions and Office licensed on-premises, and Office Consumer Services, including Skype, Outlook.com, and OneDrive.
- LinkedIn, including Talent Solutions, Marketing Solutions, and Premium Subscriptions.
- Dynamics business solutions, including Dynamics ERP on-premises, Dynamics CRM on-premises, and Dynamics 365, a set of cloud-based applications across ERP and CRM.

Intelligent Cloud

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

- Server products and cloud services, including Microsoft SQL Server, Windows Server, Visual Studio, System Center, and related CALs, and Azure.
- Enterprise Services, including Premier Support Services and Microsoft Consulting Services.

More Personal Computing

Our More Personal Computing segment consists of products and services geared towards harmonizing the interests of end users, developers, and IT professionals across all devices. This segment primarily comprises:

- Windows, including Windows OEM licensing and other non-volume licensing of the Windows operating system; Windows Commercial, comprising volume licensing of the Windows operating system, Windows cloud services, and other Windows commercial offerings; patent licensing; Windows Internet of Things (“IoT”); and MSN advertising.
- Devices, including Microsoft Surface, PC accessories, and other intelligent devices.
- Gaming, including Xbox hardware and Xbox software and services, comprising Xbox Live transactions, subscriptions, and advertising (“Xbox Live”), video games, and third-party video game royalties.
- Search.

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

In addition, certain costs incurred at a corporate level that are identifiable and that benefit our segments are allocated to them. These allocated costs include costs of: legal, including settlements and fines; information technology; human resources; finance; excise taxes; field selling; shared facilities services; and customer service and support. Each allocation is measured differently based on the specific facts and circumstances of the costs being allocated. Certain corporate-level activity is not allocated to our segments, including impairment and restructuring expenses.

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

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
Revenue			
Productivity and Business Processes	**$ 35,865**	$ 29,870	$ 25,792
Intelligent Cloud	**32,219**	27,407	24,952
More Personal Computing	**42,276**	39,294	40,410
Total	**$ 110,360**	$ 96,571	$ 91,154
Operating Income (Loss)			
Productivity and Business Processes	**$ 12,924**	$ 11,389	$ 11,756
Intelligent Cloud	**11,524**	9,127	9,249
More Personal Computing	**10,610**	8,815	6,183
Corporate and Other	**0**	(306)	(1,110)
Total	**$ 35,058**	$ 29,025	$ 26,078

Corporate and Other operating loss comprised impairment and restructuring expenses.

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for the fiscal years 2018, 2017, or 2016. Revenue, classified by the major geographic areas in which our customers are located, was as follows:

(In millions)

Year Ended June 30,	**2018**	**2017**	**2016**
United States (a)	**$ 55,926**	$ 51,078	$ 46,416
Other countries	**54,434**	45,493	44,738
Total	**$ 110,360**	$ 96,571	$ 91,154

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

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

(In millions)

Year Ended June 30,	2018	2017	2016
Office products and cloud services	**$ 28,316**	$ 25,573	$ 23,868
Server products and cloud services	**26,129**	21,649	19,062
Windows	**19,518**	18,593	17,548
Gaming	**10,353**	9,051	9,202
Search advertising	**7,012**	6,219	5,428
Enterprise Services	**5,846**	5,542	5,659
Devices	**5,134**	5,062	7,888
LinkedIn	**5,259**	2,271	0
Other	**2,793**	2,611	2,499
Total	**$ 110,360**	$ 96,571	$ 91,154

Our commercial cloud revenue, which primarily comprises Office 365 commercial, Azure, Dynamics 365, and other cloud properties, was $23.2 billion, $14.9 billion, and $9.5 billion in fiscal years 2018, 2017, and 2016, respectively. These amounts are primarily included in Office products and services and server products and cloud services in the table above.

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

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

(In millions)

June 30,	2018	2017	2016
United States	**$ 44,501**	$ 42,730	$ 25,145
Ireland	**12,843**	12,889	2,099
Luxembourg	**6,856**	6,854	6,868
Other countries	**15,682**	13,044	11,047
Total	**$ 79,882**	$ 75,517	$ 45,159

NOTE 22 — QUARTERLY INFORMATION (UNAUDITED)

(In millions, except per share amounts)

Quarter Ended	September 30	December 31	March 31	June 30	Total
Fiscal Year 2018					
Revenue	**$ 24,538**	**$ 28,918**	**$ 26,819**	**$ 30,085**	**$ 110,360**
Gross margin	**16,260**	**17,854**	**17,550**	**20,343**	**72,007**
Operating income	**7,708**	**8,679**	**8,292**	**10,379**	**35,058**
Net income (loss) (a)	**6,576**	**(6,302)**	**7,424**	**8,873**	**16,571**
Basic earnings (loss) per share	**0.85**	**(0.82)**	**0.96**	**1.15**	**2.15**
Diluted earnings (loss) per share (b)	**0.84**	**(0.82)**	**0.95**	**1.14**	**2.13**
Fiscal Year 2017 (c)					
Revenue	$ 21,928	$ 25,826	$ 23,212	$ 25,605	$ 96,571
Gross margin	14,084	15,925	15,152	17,149	62,310
Operating income	6,715	7,905	6,723	7,682(d)	29,025(d)
Net income	5,667	6,267	5,486	8,069(d)	25,489(d)
Basic earnings per share	0.73	0.81	0.71	1.05	3.29
Diluted earnings per share	0.72	0.80	0.70	1.03(d)	3.25(d)

(a) *Reflects the net charge (benefit) related to the TCJA of $13.8 billion for the second quarter, $(104) million for the fourth quarter, and $13.7 billion for fiscal year 2018.*

(b) *Reflects the net charge (benefit) related to the TCJA, which decreased (increased) diluted EPS $1.78 for the second quarter, $(0.01) for the fourth quarter, and $1.75 for fiscal year 2018.*

(c) *On December 8, 2016, we acquired LinkedIn Corporation. LinkedIn has been included in our consolidated results of operations starting on the acquisition date.*

(d) *Includes $306 million of employee severance expenses primarily related to our sales and marketing restructuring plan, which decreased operating income, net income, and diluted EPS by $306 million, $243 million, and $0.04, respectively.*

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2018 and 2017, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows, for each of the three years in the period ended June 30, 2018, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of June 30, 2018, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 3, 2018, expressed an unqualified opinion on the Company's internal control over financial reporting.

Change in Accounting Principles

As discussed in Note 1 to the financial statements, the Company has changed its method of accounting for revenue from contracts with customers and for accounting for leases in fiscal year 2018 due to the adoption of the new revenue standard and new lease standard, respectively. The Company adopted the new revenue standard using the full retrospective approach and adopted the new lease standard using a modified retrospective approach.

Basis for Opinion

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

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

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
August 3, 2018

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