ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INCOME STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	2019	2018	2017
Revenue:			
Product	**$ 66,069**	$ 64,497	$ 63,811
Service and other	**59,774**	45,863	32,760
Total revenue	**125,843**	110,360	96,571
Cost of revenue:			
Product	**16,273**	15,420	15,175
Service and other	**26,637**	22,933	19,086
Total cost of revenue	**42,910**	38,353	34,261
Gross margin	**82,933**	72,007	62,310
Research and development	**16,876**	14,726	13,037
Sales and marketing	**18,213**	17,469	15,461
General and administrative	**4,885**	4,754	4,481
Restructuring	**0**	0	306
Operating income	**42,959**	35,058	29,025
Other income, net	**729**	1,416	876
Income before income taxes	**43,688**	36,474	29,901
Provision for income taxes	**4,448**	19,903	4,412
Net income	**$ 39,240**	$ 16,571	$ 25,489
Earnings per share:			
Basic	**$ 5.11**	$ 2.15	$ 3.29
Diluted	**$ 5.06**	$ 2.13	$ 3.25
Weighted average shares outstanding:			
Basic	**7,673**	7,700	7,746
Diluted	**7,753**	7,794	7,832

Refer to accompanying notes.

COMPREHENSIVE INCOME STATEMENTS

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Net income	**$ 39,240**	$ 16,571	$ 25,489
Other comprehensive income (loss), net of tax:			
Net change related to derivatives	**(173)**	39	(218)
Net change related to investments	**2,405**	(2,717)	(1,116)
Translation adjustments and other	**(318)**	(178)	167
Other comprehensive income (loss)	**1,914**	(2,856)	(1,167)
Comprehensive income	**$ 41,154**	$ 13,715	$ 24,322

Refer to accompanying notes. Refer to Note 18 – Accumulated Other Comprehensive Income (Loss) for further information.

BALANCE SHEETS

(In millions)

June 30,	2019	2018
Assets		
Current assets:		
Cash and cash equivalents	**$ 11,356**	$ 11,946
Short-term investments	**122,463**	121,822
Total cash, cash equivalents, and short-term investments	**133,819**	133,768
Accounts receivable, net of allowance for doubtful accounts of **$411** and $377	**29,524**	26,481
Inventories	**2,063**	2,662
Other	**10,146**	6,751
Total current assets	**175,552**	169,662
Property and equipment, net of accumulated depreciation of **$35,330** and $29,223	**36,477**	29,460
Operating lease right-of-use assets	**7,379**	6,686
Equity investments	**2,649**	1,862
Goodwill	**42,026**	35,683
Intangible assets, net	**7,750**	8,053
Other long-term assets	**14,723**	7,442
Total assets	**$286,556**	$258,848
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**$ 9,382**	$ 8,617
Current portion of long-term debt	**5,516**	3,998
Accrued compensation	**6,830**	6,103
Short-term income taxes	**5,665**	2,121
Short-term unearned revenue	**32,676**	28,905
Other	**9,351**	8,744
Total current liabilities	**69,420**	58,488
Long-term debt	**66,662**	72,242
Long-term income taxes	**29,612**	30,265
Long-term unearned revenue	**4,530**	3,815
Deferred income taxes	**233**	541
Operating lease liabilities	**6,188**	5,568
Other long-term liabilities	**7,581**	5,211
Total liabilities	**184,226**	176,130
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding **7,643** and 7,677	**78,520**	71,223
Retained earnings	**24,150**	13,682
Accumulated other comprehensive loss	**(340)**	(2,187)
Total stockholders' equity	**102,330**	82,718
Total liabilities and stockholders' equity	**$286,556**	$258,848

Refer to accompanying notes.

CASH FLOWS STATEMENTS

(In millions)

Year Ended June 30,	2019	2018	2017
Operations			
Net income	**$ 39,240**	$ 16,571	$ 25,489
Adjustments to reconcile net income to net cash from operations:			
Depreciation, amortization, and other	**11,682**	10,261	8,778
Stock-based compensation expense	**4,652**	3,940	3,266
Net recognized gains on investments and derivatives	**(792)**	(2,212)	(2,073)
Deferred income taxes	**(6,463)**	(5,143)	(829)
Changes in operating assets and liabilities:			
Accounts receivable	**(2,812)**	(3,862)	(1,216)
Inventories	**597**	(465)	50
Other current assets	**(1,718)**	(952)	1,028
Other long-term assets	**(1,834)**	(285)	(917)
Accounts payable	**232**	1,148	81
Unearned revenue	**4,462**	5,922	3,820
Income taxes	**2,929**	18,183	1,792
Other current liabilities	**1,419**	798	356
Other long-term liabilities	**591**	(20)	(118)
Net cash from operations	**52,185**	43,884	39,507
Financing			
Repayments of short-term debt, maturities of 90 days or less, net	**0**	(7,324)	(4,963)
Proceeds from issuance of debt	**0**	7,183	44,344
Repayments of debt	**(4,000)**	(10,060)	(7,922)
Common stock issued	**1,142**	1,002	772
Common stock repurchased	**(19,543)**	(10,721)	(11,788)
Common stock cash dividends paid	**(13,811)**	(12,699)	(11,845)
Other, net	**(675)**	(971)	(190)
Net cash from (used in) financing	**(36,887)**	(33,590)	8,408
Investing			
Additions to property and equipment	**(13,925)**	(11,632)	(8,129)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	**(2,388)**	(888)	(25,944)
Purchases of investments	**(57,697)**	(137,380)	(176,905)
Maturities of investments	**20,043**	26,360	28,044
Sales of investments	**38,194**	117,577	136,350
Securities lending payable	**0**	(98)	(197)
Net cash used in investing	**(15,773)**	(6,061)	(46,781)
Effect of foreign exchange rates on cash and cash equivalents	**(115)**	50	19
Net change in cash and cash equivalents	**(590)**	4,283	1,153
Cash and cash equivalents, beginning of period	**11,946**	7,663	6,510
Cash and cash equivalents, end of period	**$ 11,356**	$ 11,946	$ 7,663

Refer to accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Common stock and paid-in capital			
Balance, beginning of period	**$ 71,223**	$ 69,315	$ 68,178
Common stock issued	**6,829**	1,002	772
Common stock repurchased	**(4,195)**	(3,033)	(2,987)
Stock-based compensation expense	**4,652**	3,940	3,266
Other, net	**11**	(1)	86
Balance, end of period	**78,520**	71,223	69,315
Retained earnings			
Balance, beginning of period	**13,682**	17,769	13,118
Net income	**39,240**	16,571	25,489
Common stock cash dividends	**(14,103)**	(12,917)	(12,040)
Common stock repurchased	**(15,346)**	(7,699)	(8,798)
Cumulative effect of accounting changes	**677**	(42)	0
Balance, end of period	**24,150**	13,682	17,769
Accumulated other comprehensive income (loss)			
Balance, beginning of period	**(2,187)**	627	1,794
Other comprehensive income (loss)	**1,914**	(2,856)	(1,167)
Cumulative effect of accounting changes	**(67)**	42	0
Balance, end of period	**(340)**	(2,187)	627
Total stockholders' equity	**$ 102,330**	$ 82,718	$ 87,711
Cash dividends declared per common share	**$ 1.84**	$ 1.68	$ 1.56

Refer to accompanying notes.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

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

We have recast certain prior period amounts related to investments, derivatives, and fair value measurements to conform to the current period presentation based on our adoption of the new accounting standard for financial instruments. We have recast prior period commercial cloud revenue to include the commercial portion of LinkedIn to provide a comparable view of our commercial cloud business performance. The commercial portion of LinkedIn includes LinkedIn Recruiter, Sales Navigator, premium business subscriptions, and other services for organizations. We have also recast components of the prior period deferred income tax assets and liabilities to conform to the current period presentation. The recast of these prior period amounts had no impact on our consolidated balance sheets, consolidated income statements, or net cash from or used in operating, financing, or investing on our consolidated cash flows statements.

Principles of Consolidation

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

Estimates and Assumptions

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

Foreign Currencies

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

Revenue

Product Revenue and Service and Other Revenue

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

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

Revenue Recognition

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

Nature of Products and Services

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

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

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

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

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

Refer to Note 20 – Segment Information and Geographic Data for further information, including revenue by significant product and service offering.

Significant Judgments

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

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

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

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

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

Contract Balances

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

As of June 30, 2019 and 2018, long-term accounts receivable, net of allowance for doubtful accounts, was $2.2 billion and $1.8 billion, respectively, and is included in other long-term assets in our consolidated balance sheets.

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

Activity in the allowance for doubtful accounts was as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Balance, beginning of period	**$ 397**	$ 361	$ 409
Charged to costs and other	**153**	134	58
Write-offs	**(116)**	(98)	(106)
Balance, end of period	**$ 434**	$ 397	$ 361

Allowance for doubtful accounts included in our consolidated balance sheets:

(In millions)

June 30,	**2019**	**2018**	**2017**
Accounts receivable, net of allowance for doubtful accounts	**$ 411**	$ 377	$ 345
Other long-term assets	**23**	20	16
Total	**$ 434**	$ 397	$ 361

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

Refer to Note 14 – Unearned Revenue for further information, including unearned revenue by segment and changes in unearned revenue during the period.

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

Assets Recognized from Costs to Obtain a Contract with a Customer

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

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

Cost of Revenue

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

Product Warranty

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

Research and Development

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

Sales and Marketing

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs. Advertising costs are expensed as incurred. Advertising expense was $1.6 billion, $1.6 billion, and $1.5 billion in fiscal years 2019, 2018, and 2017, respectively.

Stock-Based Compensation

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

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

Income Taxes

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

Financial Instruments

Investments

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

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

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

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

Derivatives

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

For derivative instruments designated as fair value hedges, gains and losses are recognized in other income (expense), net with offsetting gains and losses on the hedged items.

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

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

Fair Value Measurements

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

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

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

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

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

Inventories

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

Property and Equipment

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

Leases

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

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

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

Goodwill

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

Intangible Assets

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

Recent Accounting Guidance

Recently Adopted Accounting Guidance

Income Taxes – Intra-Entity Asset Transfers

In October 2016, the Financial Accounting Standards Board (“FASB”) issued new guidance requiring an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs, rather than when the asset has been sold to an outside party. We adopted the guidance effective July 1, 2018. Adoption of the guidance was applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. We recorded a net cumulative-effect adjustment that resulted in an increase in retained earnings of $557 million, which reversed the previous deferral of income tax consequences and recorded new deferred tax assets from intra-entity transfers involving assets other than inventory, partially offset by a U.S. deferred tax liability related to global intangible low-taxed income (“GILTI”). Adoption of the standard resulted in an increase in long-term deferred tax assets of $2.8 billion, an increase in long-term deferred tax liabilities of $2.1 billion, and a reduction in other current assets of $152 million. Adoption of the standard had no impact on cash from or used in operating, financing, or investing on our consolidated cash flows statements.

Financial Instruments – Recognition, Measurement, Presentation, and Disclosure

In January 2016, the FASB issued a new standard related to certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most prominent among the changes in the standard is the requirement for changes in the fair value of our equity investments, with certain exceptions, to be recognized through net income rather than OCI.

We adopted the standard effective July 1, 2018. Adoption of the standard was applied using a modified retrospective approach through a cumulative-effect adjustment from accumulated other comprehensive income (“AOCI”) to retained earnings as of the effective date, and we elected to measure equity investments without readily determinable fair values at cost with adjustments for observable changes in price or impairments. The cumulative-effect adjustment included any previously held unrealized gains and losses held in AOCI related to our equity investments carried at fair value as well as the impact of recording the fair value of certain equity investments carried at cost. The impact on our consolidated balance sheets upon adoption was not material. Adoption of the standard had no impact on cash from or used in operating, financing, or investing on our consolidated cash flows statements.

Recent Accounting Guidance Not Yet Adopted

Financial Instruments – Targeted Improvements to Accounting for Hedging Activities

In August 2017, the FASB issued new guidance related to accounting for hedging activities. This guidance expands strategies that qualify for hedge accounting, changes how many hedging relationships are presented in the financial statements, and simplifies the application of hedge accounting in certain situations. The standard will be effective for us beginning July 1, 2019, with early adoption permitted for any interim or annual period before the effective date. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. We evaluated the impact of this standard on our consolidated financial statements, including accounting policies, processes, and systems, and do not expect the impact to be material upon adoption.

Financial Instruments – Credit Losses

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

NOTE 2 — EARNINGS PER SHARE

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

The components of basic and diluted EPS were as follows:

(In millions, except earnings per share)

Year Ended June 30,	**2019**	**2018**	**2017**
Net income available for common shareholders (A)	**$ 39,240**	$ 16,571	$ 25,489
Weighted average outstanding shares of common stock (B)	**7,673**	7,700	7,746
Dilutive effect of stock-based awards	**80**	94	86
Common stock and common stock equivalents (C)	**7,753**	7,794	7,832
Earnings Per Share			
Basic (A/B)	**$ 5.11**	$ 2.15	$ 3.29
Diluted (A/C)	**$ 5.06**	$ 2.13	$ 3.25

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

NOTE 3 — OTHER INCOME (EXPENSE), NET

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

(In millions)

Year Ended June 30,	2019	2018	2017
Interest and dividends income	**$ 2,762**	$ 2,214	$ 1,387
Interest expense	**(2,686)**	(2,733)	(2,222)
Net recognized gains on investments	**648**	2,399	2,583
Net gains (losses) on derivatives	**144**	(187)	(510)
Net losses on foreign currency remeasurements	**(82)**	(218)	(111)
Other, net	**(57)**	(59)	(251)
Total	**$ 729**	$ 1,416	$ 876

Net Recognized Gains (Losses) on Investments

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

(In millions)

Year Ended June 30,	2019	2018	2017
Realized gains from sales of available-for-sale securities	**$ 12**	$ 27	$ 108
Realized losses from sales of available-for-sale securities	**(93)**	(987)	(162)
Other-than-temporary impairments of investments	**(16)**	(6)	(14)
Total	**$ (97)**	$ (966)	$ (68)

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

(In millions)

Year Ended June 30,	2019	2018	2017
Net realized gains on investments sold	**$ 276**	$ 3,406	$ 2,692
Net unrealized gains on investments still held	**479**	0	0
Impairments of investments	**(10)**	(41)	(41)
Total	**$ 745**	$ 3,365	$ 2,651

NOTE 4 — INVESTMENTS

Investment Components

The components of investments were as follows:

(In millions)	Fair Value Level	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2019								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 2,211	$ 0	$ 0	$ 2,211	$ 1,773	$ 438	$ 0
Certificates of deposit	Level 2	2,018	0	0	2,018	1,430	588	0
U.S. government securities	Level 1	104,925	1,854	(104)	106,675	769	105,906	0
U.S. agency securities	Level 2	988	0	0	988	698	290	0
Foreign government bonds	Level 2	6,350	4	(8)	6,346	2,506	3,840	0
Mortgage- and asset-backed securities	Level 2	3,554	10	(3)	3,561	0	3,561	0
Corporate notes and bonds	Level 2	7,437	111	(7)	7,541	0	7,541	0
Corporate notes and bonds	Level 3	15	0	0	15	0	15	0
Municipal securities	Level 2	242	48	0	290	0	290	0
Municipal securities	Level 3	7	0	0	7	0	7	0
Total debt investments		$ 127,747	$ 2,027	$ (122)	$ 129,652	$ 7,176	$ 122,476	$ 0
Changes in Fair Value Recorded in Net Income								
Equity investments	Level 1				$ 973	$ 409	$ 0	$ 564
Equity investments	Other				2,085	0	0	2,085
Total equity investments					$ 3,058	$ 409	$ 0	$ 2,649
Cash					$ 3,771	$ 3,771	$ 0	$ 0
Derivatives, net (a)					(13)	0	(13)	0
Total					$ 136,468	$ 11,356	$ 122,463	$ 2,649

(In millions)	Fair Value Level	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity Investments
June 30, 2018								
Changes in Fair Value Recorded in Other Comprehensive Income								
Commercial paper	Level 2	$ 2,513	$ 0	$ 0	$ 2,513	$ 2,215	$ 298	$ 0
Certificates of deposit	Level 2	2,058	0	0	2,058	1,865	193	0
U.S. government securities	Level 1	108,120	62	(1,167)	107,015	2,280	104,735	0
U.S. agency securities	Level 2	1,742	0	0	1,742	1,398	344	0
Foreign government bonds	Level 1	22	0	0	22	0	22	0
Foreign government bonds	Level 2	5,063	1	(10)	5,054	0	5,054	0
Mortgage- and asset-backed securities	Level 2	3,864	4	(13)	3,855	0	3,855	0
Corporate notes and bonds	Level 2	6,929	21	(56)	6,894	0	6,894	0
Corporate notes and bonds	Level 3	15	0	0	15	0	15	0
Municipal securities	Level 2	271	37	(1)	307	0	307	0
Total debt investments		$ 130,597	$ 125	$ (1,247)	$ 129,475	$ 7,758	$ 121,717	$ 0
Equity investments	Level 1				$ 533	$ 246	$ 0	$ 287
Equity investments	Level 3				18	0	0	18
Equity investments	Other				1,558	0	1	1,557
Total equity investments					$ 2,109	$ 246	$ 1	$ 1,862
Cash					$ 3,942	$ 3,942	$ 0	$ 0
Derivatives, net (a)					104	0	104	0
Total					$ 135,630	$ 11,946	$ 121,822	$ 1,862

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

Equity investments presented as “Other” in the tables above include investments without readily determinable fair values measured using the equity method or measured at cost with adjustments for observable changes in price or impairments, and investments measured at fair value using net asset value as a practical expedient which are not categorized in the fair value hierarchy. As of June 30, 2019 and 2018, equity investments without readily determinable fair values measured at cost with adjustments for observable changes in price or impairments were $1.2 billion and $697 million, respectively.

As of June 30, 2019, we had no collateral received under agreements for loaned securities. As of June 30, 2018, collateral received under agreements for loaned securities was $1.8 billion and primarily comprised U.S. government and agency securities.

Unrealized Losses on Debt Investments

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

	Less than 12 Months		12 Months or Greater			
(In millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2019						
U.S. government and agency securities	**$ 1,491**	**$ (1)**	**$ 39,158**	**$ (103)**	**$ 40,649**	**$ (104)**
Foreign government bonds	**25**	**0**	**77**	**(8)**	**102**	**(8)**
Mortgage- and asset-backed securities	**664**	**(1)**	**378**	**(2)**	**1,042**	**(3)**
Corporate notes and bonds	**498**	**(3)**	**376**	**(4)**	**874**	**(7)**
Total	**$ 2,678**	**$ (5)**	**$ 39,989**	**$ (117)**	**$ 42,667**	**$ (122)**

(In millions)	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or Greater Fair Value	12 Months or Greater Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2018						
U.S. government and agency securities	$ 82,352	$ (1,064)	$ 4,459	$ (103)	$ 86,811	$ (1,167)
Foreign government bonds	3,457	(7)	13	(3)	3,470	(10)
Mortgage- and asset-backed securities	2,072	(9)	96	(4)	2,168	(13)
Corporate notes and bonds	3,111	(43)	301	(13)	3,412	(56)
Municipal securities	45	(1)	0	0	45	(1)
Total	$ 91,037	$ (1,124)	$ 4,869	$ (123)	$ 95,906	$ (1,247)

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

Debt Investment Maturities

(In millions)	Cost Basis	Estimated Fair Value
June 30, 2019		
Due in one year or less	**$ 53,200**	**$ 53,124**
Due after one year through five years	**47,016**	**47,783**
Due after five years through 10 years	**26,658**	**27,824**
Due after 10 years	**873**	**921**
Total	**$ 127,747**	**$ 129,652**

NOTE 5 — DERIVATIVES

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

Foreign Currency

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions. Option and forward contracts are used to hedge a portion of forecasted international revenue and are designated as cash flow hedging instruments. Principal currencies hedged include the euro, Japanese yen, British pound, Canadian dollar, and Australian dollar.

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

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

Equity

Securities held in our equity investments portfolio are subject to market price risk. Market price risk is managed relative to broad-based global and domestic equity indices using certain convertible preferred investments, options, futures, and swap contracts not designated as hedging instruments. In the past, to hedge our price risk, we also used and designated equity derivatives as hedging instruments, including puts, calls, swaps, and forwards.

Other

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using exchange-traded option and futures contracts, and over-the-counter swap and option contracts, none of which are designated as hedging instruments.

In addition, we use "To Be Announced" forward purchase commitments of mortgage-backed assets to gain exposure to agency mortgage-backed securities. These meet the definition of a derivative instrument in cases where physical delivery of the assets is not taken at the earliest available delivery date.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts, not designated as hedging instruments, to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. We use credit default swaps as they are a low-cost method of managing exposure to individual credit risks or groups of credit risks.

Credit-Risk-Related Contingent Features

Certain of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of June 30, 2019, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

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

(In millions)	June 30, 2019	June 30, 2018
Designated as Hedging Instruments		
Foreign exchange contracts sold	**$ 6,034**	$ 11,101
Not Designated as Hedging Instruments		
Foreign exchange contracts purchased	**14,889**	9,425
Foreign exchange contracts sold	**15,614**	13,374
Equity contracts purchased	**680**	49
Equity contracts sold	**5**	5
Other contracts purchased	**1,327**	878
Other contracts sold	**451**	472

Fair Values of Derivative Instruments

The following table presents our derivative instruments:

(In millions)	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
		June 30, 2019		June 30, 2018
Changes in Fair Value Recorded in Other Comprehensive Income				
Designated as Hedging Instruments				
Foreign exchange contracts	**$ 0**	**$ 0**	$ 174	$ 0
Changes in Fair Value Recorded in Net Income				
Designated as Hedging Instruments				
Foreign exchange contracts	**0**	**(93)**	95	0
Not Designated as Hedging Instruments				
Foreign exchange contracts	**204**	**(172)**	256	(197)
Equity contracts	**38**	**0**	2	(7)
Other contracts	**8**	**(7)**	11	(3)
Gross amounts of derivatives	**250**	**(272)**	538	(207)
Gross amounts of derivatives offset in the balance sheet	**(113)**	**114**	(152)	153
Cash collateral received	**0**	**(78)**	0	(235)
Net amounts of derivatives	**$ 137**	**$ (236)**	$ 386	$ (289)
Reported as				
Short-term investments	**$ (13)**	**$ 0**	$ 104	$ 0
Other current assets	**146**	**0**	260	0
Other long-term assets	**4**	**0**	22	0
Other current liabilities	**0**	**(221)**	0	(288)
Other long-term liabilities	**0**	**(15)**	0	(1)
Total	**$ 137**	**$ (236)**	$ 386	$ (289)

Gross derivative assets and liabilities subject to legally enforceable master netting agreements for which we have elected to offset were $247 million and $272 million, respectively, as of June 30, 2019, and $533 million and $207 million, respectively, as of June 30, 2018.

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

(In millions)	Level 1	Level 2	Level 3	Total
June 30, 2019				
Derivative assets	**$ 0**	**$ 247**	**$ 3**	**$ 250**
Derivative liabilities	**0**	**(272)**	**0**	**(272)**
June 30, 2018				
Derivative assets	1	535	2	538
Derivative liabilities	(1)	(206)	0	(207)

Fair Value Hedge Gains (Losses)

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

(In millions)

Year Ended June 30,	2019	2018	2017
Foreign Exchange Contracts			
Derivatives	**$ 38**	$ 25	$ 441
Hedged items	**130**	78	(386)
Total amount of ineffectiveness	**$ 168**	$ 103	$ 55
Equity Contracts			
Derivatives	**$ 0**	$ (324)	$ (74)
Hedged items	**0**	324	74
Total amount of ineffectiveness	**$ 0**	$ 0	$ 0
Amount of equity contracts excluded from effectiveness assessment	**$ 0**	$ 80	$ (80)

Cash Flow Hedge Gains (Losses)

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

(In millions)

Year Ended June 30,	2019	2018	2017
Effective Portion			
Gains recognized in other comprehensive income (loss), net of tax of **$1**, $11, and $4	**$ 159**	$ 219	$ 328
Gains reclassified from accumulated other comprehensive income (loss) into revenue	**341**	185	555
Amount Excluded from Effectiveness Assessment and Ineffective Portion			
Losses recognized in other income (expense), net	**(64)**	(255)	(389)

We do not have any net derivative gains included in AOCI as of June 30, 2019 that will be reclassified into earnings within the following 12 months. No significant amounts of gains (losses) were reclassified from AOCI into earnings as a result of forecasted transactions that failed to occur during fiscal year 2019.

Non-designated Derivative Gains (Losses)

We recognized in other income (expense), net the following gains (losses) on derivatives not designated as hedging instruments:

(In millions)

Year Ended June 30,	2019	2018	2017
Foreign exchange contracts	**$ (97)**	$ (33)	$ (117)
Equity contracts	**3**	(87)	(114)
Other contracts	**35**	(17)	(3)
Total	**$ (59)**	$ (137)	$ (234)

NOTE 6 — INVENTORIES

The components of inventories were as follows:

(In millions)

June 30,	2019	2018
Raw materials	$ 399	$ 655
Work in process	53	54
Finished goods	1,611	1,953
Total	$ 2,063	$ 2,662

NOTE 7 — PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

(In millions)

June 30,	2019	2018
Land	$ 1,540	$ 1,254
Buildings and improvements	26,288	20,604
Leasehold improvements	5,316	4,735
Computer equipment and software	33,823	27,633
Furniture and equipment	4,840	4,457
Total, at cost	71,807	58,683
Accumulated depreciation	(35,330)	(29,223)
Total, net	$ 36,477	$ 29,460

During fiscal years 2019, 2018, and 2017, depreciation expense was $9.7 billion, $7.7 billion, and $6.1 billion, respectively. We have committed $4.0 billion for the construction of new buildings, building improvements, and leasehold improvements as of June 30, 2019.

NOTE 8 — BUSINESS COMBINATIONS

GitHub, Inc.

On October 25, 2018, we acquired GitHub, Inc. (“GitHub”), a software development platform, in a $7.5 billion stock transaction (inclusive of total cash payments of $1.3 billion in respect of vested GitHub equity awards and an indemnity escrow). The acquisition is expected to empower developers to achieve more at every stage of the development lifecycle, accelerate enterprise use of GitHub, and bring Microsoft’s developer tools and services to new audiences. The financial results of GitHub have been included in our consolidated financial statements since the date of the acquisition. GitHub is reported as part of our Intelligent Cloud segment.

The allocation of the purchase price to goodwill was completed as of June 30, 2019. The major classes of assets and liabilities to which we allocated the purchase price were as follows:

(In millions)	
Cash, cash equivalents, and short-term investments	$ 234
Goodwill	5,497
Intangible assets	1,267
Other assets	143
Other liabilities	(217)
Total	$ 6,924

The goodwill recognized in connection with the acquisition is primarily attributable to anticipated synergies from future growth and is not expected to be deductible for tax purposes. We assigned the goodwill to our Intelligent Cloud segment.

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

(In millions)	Amount	Weighted Average Life
Customer-related	$ 648	8 years
Technology-based	447	5 years
Marketing-related	170	10 years
Contract-based	2	2 years
Total	$ 1,267	7 years

Transactions recognized separately from the purchase price allocation were approximately $600 million, primarily related to equity awards recognized as expense over the related service period.

LinkedIn Corporation

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

The allocation of the purchase price to goodwill was completed as of June 30, 2017. The major classes of assets and liabilities to which we allocated the purchase price were as follows:

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

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

(b) *Convertible senior notes issued by LinkedIn on November 12, 2014, substantially all of which were redeemed after our acquisition of LinkedIn. The remaining $18 million of notes are not redeemable and are included in long-term debt in our consolidated balance sheets. Refer to Note 11 – Debt for further information.*

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

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

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

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

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

(In millions, except per share amounts)		
Year Ended June 30,	2017	2016
Revenue	$ 98,291	$ 94,490
Net income	25,179	19,128
Diluted earnings per share	3.21	2.38

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

Other

During fiscal year 2019, we completed 19 additional acquisitions for $1.6 billion, substantially all of which were paid in cash. These entities have been included in our consolidated results of operations since their respective acquisition dates.

NOTE 9 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	June 30, 2017	Acquisitions	Other	June 30, 2018	Acquisitions	Other	June 30, 2019
Productivity and Business Processes	$ 23,739	$ 72	$ 12	**$ 23,823**	**$ 514**	**$ (60)**	**$ 24,277**
Intelligent Cloud	5,555	164	(16)	**5,703**	**5,605(a)**	**43(a)**	**11,351**
More Personal Computing	5,828	394	(65)	**6,157**	**289**	**(48)**	**6,398**
Total	$ 35,122	$ 630	$ (69)	**$ 35,683**	**$ 6,408**	**$ (65)**	**$ 42,026**

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

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

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

Goodwill Impairment

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

No instances of impairment were identified in our May 1, 2019, May 1, 2018, or May 1, 2017 tests. As of June 30, 2019 and 2018, accumulated goodwill impairment was $11.3 billion.

NOTE 10 — INTANGIBLE ASSETS

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

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
June 30,			2019			2018
Technology-based	**$ 7,691**	**$ (5,771)**	**$ 1,920**	$ 7,220	$ (5,018)	$ 2,202
Customer-related	**4,709**	**(1,785)**	**2,924**	4,031	(1,205)	2,826
Marketing-related	**4,165**	**(1,327)**	**2,838**	4,006	(1,071)	2,935
Contract-based	**574**	**(506)**	**68**	679	(589)	90
Total	**$ 17,139(a)**	**$ (9,389)**	**$ 7,750**	$ 15,936	$ (7,883)	$ 8,053

(a) *Includes intangible assets of $1.3 billion related to GitHub. See Note 8 – Business Combinations for further information.*

No material impairments of intangible assets were identified during fiscal years 2019, 2018, or 2017. We estimate that we have no significant residual value related to our intangible assets.

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

(In millions)	Amount	Weighted Average Life	Amount	Weighted Average Life
Year Ended June 30,	**2019**		**2018**	
Technology-based	**$ 814**	**5 years**	$ 178	4 years
Marketing-related	**177**	**10 years**	14	5 years
Contract-based	**7**	**3 years**	14	4 years
Customer-related	**710**	**8 years**	13	5 years
Total	**$ 1,708**	**7 years**	$ 219	5 years

Intangible assets amortization expense was $1.9 billion, $2.2 billion, and $1.7 billion for fiscal years 2019, 2018, and 2017, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of June 30, 2019:

(In millions)	
Year Ending June 30,	
2020	**$ 1,488**
2021	**1,282**
2022	**1,187**
2023	**1,053**
2024	**737**
Thereafter	**2,003**
Total	**$ 7,750**

NOTE 11 — DEBT

Short-term Debt

As of June 30, 2019 and 2018, we had no commercial paper issued or outstanding. Effective August 31, 2018, we terminated our credit facilities, which served as back-up for our commercial paper program.

Long-term Debt

As of June 30, 2019, the total carrying value and estimated fair value of our long-term debt, including the current portion, were $72.2 billion and $78.9 billion, respectively. As of June 30, 2018, the total carrying value and estimated fair value of our long-term debt, including the current portion, were $76.2 billion and $77.5 billion, respectively. These estimated fair values are based on Level 2 inputs.

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

(In millions, except interest rates)	Face Value June 30, 2019	Face Value June 30, 2018	Stated Interest Rate	Effective Interest Rate
Notes				
November 3, 2018	**$ 0**	$ 1,750	**1.300%**	**1.396%**
December 6, 2018	**0**	1,250	**1.625%**	**1.824%**
June 1, 2019	**0**	1,000	**4.200%**	**4.379%**
August 8, 2019	**2,500**	2,500	**1.100%**	**1.203%**
November 1, 2019	**18**	18	**0.500%**	**0.500%**
February 6, 2020	**1,500**	1,500	**1.850%**	**1.952%**
February 12, 2020	**1,500**	1,500	**1.850%**	**1.935%**
October 1, 2020	**1,000**	1,000	**3.000%**	**3.137%**
November 3, 2020	**2,250**	2,250	**2.000%**	**2.093%**
February 8, 2021	**500**	500	**4.000%**	**4.082%**
August 8, 2021	**2,750**	2,750	**1.550%**	**1.642%**
December 6, 2021 (a)	**1,994**	2,044	**2.125%**	**2.233%**
February 6, 2022	**1,750**	1,750	**2.400%**	**2.520%**
February 12, 2022	**1,500**	1,500	**2.375%**	**2.466%**
November 3, 2022	**1,000**	1,000	**2.650%**	**2.717%**
November 15, 2022	**750**	750	**2.125%**	**2.239%**
May 1, 2023	**1,000**	1,000	**2.375%**	**2.465%**
August 8, 2023	**1,500**	1,500	**2.000%**	**2.101%**
December 15, 2023	**1,500**	1,500	**3.625%**	**3.726%**
February 6, 2024	**2,250**	2,250	**2.875%**	**3.041%**
February 12, 2025	**2,250**	2,250	**2.700%**	**2.772%**
November 3, 2025	**3,000**	3,000	**3.125%**	**3.176%**
August 8, 2026	**4,000**	4,000	**2.400%**	**2.464%**
February 6, 2027	**4,000**	4,000	**3.300%**	**3.383%**
December 6, 2028 (a)	**1,993**	2,044	**3.125%**	**3.218%**
May 2, 2033 (a)	**626**	642	**2.625%**	**2.690%**
February 12, 2035	**1,500**	1,500	**3.500%**	**3.604%**
November 3, 2035	**1,000**	1,000	**4.200%**	**4.260%**
August 8, 2036	**2,250**	2,250	**3.450%**	**3.510%**
February 6, 2037	**2,500**	2,500	**4.100%**	**4.152%**
June 1, 2039	**750**	750	**5.200%**	**5.240%**
October 1, 2040	**1,000**	1,000	**4.500%**	**4.567%**
February 8, 2041	**1,000**	1,000	**5.300%**	**5.361%**
November 15, 2042	**900**	900	**3.500%**	**3.571%**
May 1, 2043	**500**	500	**3.750%**	**3.829%**
December 15, 2043	**500**	500	**4.875%**	**4.918%**
February 12, 2045	**1,750**	1,750	**3.750%**	**3.800%**
November 3, 2045	**3,000**	3,000	**4.450%**	**4.492%**
August 8, 2046	**4,500**	4,500	**3.700%**	**3.743%**
February 6, 2047	**3,000**	3,000	**4.250%**	**4.287%**
February 12, 2055	**2,250**	2,250	**4.000%**	**4.063%**
November 3, 2055	**1,000**	1,000	**4.750%**	**4.782%**
August 8, 2056	**2,250**	2,250	**3.950%**	**4.033%**
February 6, 2057	**2,000**	2,000	**4.500%**	**4.528%**
Total	**$ 72,781**	$ 76,898		

(a) *Euro-denominated debt securities.*

The notes in the table above are senior unsecured obligations and rank equally with our other senior unsecured debt outstanding. Interest on these notes is paid semi-annually, except for the euro-denominated debt securities on which interest is paid annually. Cash paid for interest on our debt for fiscal years 2019, 2018, and 2017 was $2.4 billion, $2.4 billion, and $1.6 billion, respectively. As of June 30, 2019 and 2018, the aggregate debt issuance costs and unamortized discount associated with our long-term debt, including the current portion, were $603 million and $658 million, respectively.

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

(In millions)	
Year Ending June 30,	
2020	**$ 5,518**
2021	**3,750**
2022	**7,994**
2023	**2,750**
2024	**5,250**
Thereafter	**47,519**
Total	**$ 72,781**

NOTE 12 — INCOME TAXES

Tax Cuts and Jobs Act

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted into law, which significantly changed existing U.S. tax law and included numerous provisions that affect our business, such as imposing a one-time transition tax on deemed repatriation of deferred foreign income, reducing the U.S. federal statutory tax rate, and adopting a territorial tax system. In fiscal year 2018, the TCJA required us to incur a transition tax on deferred foreign income not previously subject to U.S. income tax at a rate of 15.5% for foreign cash and certain other net current assets, and 8% on the remaining income. The TCJA reduced the U.S. federal statutory tax rate from 35% to 21% effective January 1, 2018. In addition, the TCJA subjected us to a tax on our GILTI effective July 1, 2018.

Under GAAP, we can make an accounting policy election to either treat taxes due on the GILTI inclusion as a current period expense or factor such amounts into our measurement of deferred taxes. We elected the deferred method, under which we recorded the corresponding deferred tax assets and liabilities on our consolidated balance sheets.

During fiscal year 2018, we recorded a net charge of $13.7 billion related to the enactment of the TCJA, due to the impact of the one-time transition tax on the deemed repatriation of deferred foreign income of $17.9 billion, offset in part by the impact of changes in the tax rate of $4.2 billion, primarily on deferred tax assets and liabilities. During the second quarter of fiscal year 2019, we recorded additional tax expense of $157 million, which related to completing our provisional accounting for GILTI deferred taxes pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 118.

In the fourth quarter of fiscal year 2019, in response to the TCJA and recently issued regulations, we transferred certain intangible properties held by our foreign subsidiaries to the U.S. and Ireland. The transfers of intangible properties resulted in a $2.6 billion net income tax benefit recorded in the fourth quarter of fiscal year 2019, as the value of future tax deductions exceeded the current tax liability from foreign jurisdictions and U.S. GILTI tax.

Provision for Income Taxes

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

(In millions)

Year Ended June 30,	2019	2018	2017
Current Taxes			
U.S. federal	**$ 4,718**	$ 19,764	$ 2,739
U.S. state and local	**662**	934	30
Foreign	**5,531**	4,348	2,472
Current taxes	**$ 10,911**	$ 25,046	$ 5,241
Deferred Taxes			
U.S. federal	**$ (5,647)**	$ (4,292)	$ (554)
U.S. state and local	**(1,010)**	(458)	269
Foreign	**194**	(393)	(544)
Deferred taxes	**$ (6,463)**	$ (5,143)	$ (829)
Provision for income taxes	**$ 4,448**	$ 19,903	$ 4,412

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

(In millions)

Year Ended June 30,	2019	2018	2017
U.S.	**$ 15,799**	$ 11,527	$ 6,843
Foreign	**27,889**	24,947	23,058
Income before income taxes	**$ 43,688**	$ 36,474	$ 29,901

Effective Tax Rate

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

Year Ended June 30,	2019	2018	2017
Federal statutory rate	**21.0%**	28.1%	35.0%
Effect of:			
Foreign earnings taxed at lower rates	**(4.1)%**	(7.8)%	(11.6)%
Impact of the enactment of the TCJA	**0.4%**	37.7%	0%
Phone business losses	**0%**	0%	(5.7)%
Impact of intangible property transfers	**(5.9)%**	0%	0%
Foreign-derived intangible income deduction	**(1.4)%**	0%	0%
Research and development credit	**(1.1)%**	(1.3)%	(0.9)%
Excess tax benefits relating to stock-based compensation	**(2.2)%**	(2.5)%	(2.1)%
Interest, net	**1.0%**	1.2%	1.4%
Other reconciling items, net	**2.5%**	(0.8)%	(1.3)%
Effective rate	**10.2%**	54.6%	14.8%

The decrease from the federal statutory rate in fiscal year 2019 is primarily due to a $2.6 billion net income tax benefit related to intangible property transfers, and earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland, Singapore, and Puerto Rico. The increase from the federal statutory rate in fiscal year 2018 is primarily due to the net charge related to the enactment of the TCJA in the second quarter of fiscal year 2018, offset in part by earnings taxed at lower rates in foreign jurisdictions. The decrease from the federal statutory rate in fiscal year 2017 is primarily due to earnings taxed at lower rates in foreign jurisdictions. Our foreign regional operating centers in Ireland, Singapore and Puerto Rico, which are taxed at rates lower than the U.S. rate, generated 82%, 87%, and 76% of our foreign income before tax in fiscal years 2019, 2018, and 2017, respectively. Other reconciling items, net consists primarily of tax credits, GILTI, and U.S. state income taxes. In fiscal years 2019, 2018, and 2017, there were no individually significant other reconciling items.

The decrease in our effective tax rate for fiscal year 2019 compared to fiscal year 2018 was primarily due to the net charge related to the enactment of the TCJA in the second quarter of fiscal year 2018, and a $2.6 billion net income tax benefit in the fourth quarter of fiscal year 2019 related to intangible property transfers. The increase in our effective tax rate for fiscal year 2018 compared to fiscal year 2017 was primarily due to the net charge related to the enactment of the TCJA and the realization of tax benefits attributable to previous Phone business losses in fiscal year 2017.

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

(In millions)

June 30,	**2019**	**2018**
Deferred Income Tax Assets		
Stock-based compensation expense	**$ 406**	$ 460
Accruals, reserves, and other expenses	**2,287**	1,832
Loss and credit carryforwards	**3,518**	3,369
Depreciation and amortization	**7,046**	351
Leasing liabilities	**1,594**	1,427
Unearned revenue	**475**	0
Other	**367**	56
Deferred income tax assets	**15,693**	7,495
Less valuation allowance	**(3,214)**	(3,186)
Deferred income tax assets, net of valuation allowance	**$ 12,479**	$ 4,309
Deferred Income Tax Liabilities		
Unrealized gain on investments and debt	**$ (738)**	$ 0
Unearned revenue	**(30)**	(639)
Depreciation and amortization	**0**	(1,164)
Leasing assets	**(1,510)**	(1,366)
Deferred GILTI tax liabilities	**(2,607)**	(61)
Other	**(291)**	(251)
Deferred income tax liabilities	**$ (5,176)**	$ (3,481)
Net deferred income tax assets (liabilities)	**$ 7,303**	$ 828
Reported As		
Other long-term assets	**$ 7,536**	$ 1,369
Long-term deferred income tax liabilities	**(233)**	(541)
Net deferred income tax assets (liabilities)	**$ 7,303**	$ 828

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

As of June 30, 2019, we had federal, state and foreign net operating loss carryforwards of $978 million, $770 million, and $11.6 billion, respectively. The federal and state net operating loss carryforwards will expire in various years from fiscal 2020 through 2039, if not utilized. The majority of our foreign net operating loss carryforwards do not expire. Certain acquired net operating loss carryforwards are subject to an annual limitation, but are expected to be realized with the exception of those which have a valuation allowance.

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

Income taxes paid, net of refunds, were $8.4 billion, $5.5 billion, and $2.4 billion in fiscal years 2019, 2018, and 2017, respectively.

Uncertain Tax Positions

Gross unrecognized tax benefits related to uncertain tax positions as of June 30, 2019, 2018, and 2017, were $13.1 billion, $12.0 billion, and $11.7 billion, respectively, which were primarily included in long-term income taxes in our consolidated balance sheets. If recognized, the resulting tax benefit would affect our effective tax rates for fiscal years 2019, 2018, and 2017 by $12.0 billion, $11.3 billion, and $10.2 billion, respectively.

As of June 30, 2019, 2018, and 2017, we had accrued interest expense related to uncertain tax positions of $3.4 billion, $3.0 billion, and $2.3 billion, respectively, net of income tax benefits. The provision for (benefit from) income taxes for fiscal years 2019, 2018, and 2017 included interest expense related to uncertain tax positions of $515 million, $688 million, and $399 million, respectively, net of income tax benefits.

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

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Beginning unrecognized tax benefits	**$ 11,961**	$ 11,737	$ 10,164
Decreases related to settlements	**(316)**	(193)	(4)
Increases for tax positions related to the current year	**2,106**	1,445	1,277
Increases for tax positions related to prior years	**508**	151	397
Decreases for tax positions related to prior years	**(1,113)**	(1,176)	(49)
Decreases due to lapsed statutes of limitations	**0**	(3)	(48)
Ending unrecognized tax benefits	**$ 13,146**	$ 11,961	$ 11,737

We settled a portion of the Internal Revenue Service (“IRS”) audit for tax years 2004 to 2006 in fiscal year 2011. In February 2012, the IRS withdrew its 2011 Revenue Agents Report related to unresolved issues for tax years 2004 to 2006 and reopened the audit phase of the examination. We also settled a portion of the IRS audit for tax years 2007 to 2009 in fiscal year 2016, and a portion of the IRS audit for tax years 2010 to 2013 in fiscal year 2018. We remain under audit for tax years 2004 to 2013. We expect the IRS to begin an examination of tax years 2014 to 2017 within the next 12 months.

As of June 30, 2019, the primary unresolved issues for the IRS audits relate to transfer pricing, which could have a material impact on our consolidated financial statements when the matters are resolved. We believe our allowances for income tax contingencies are adequate. We have not received a proposed assessment for the unresolved issues and do not expect a final resolution of these issues in the next 12 months. Based on the information currently available, we do not anticipate a significant increase or decrease to our tax contingencies for these issues within the next 12 months.

We are subject to income tax in many jurisdictions outside the U.S. Our operations in certain jurisdictions remain subject to examination for tax years 1996 to 2018, some of which are currently under audit by local tax authorities. The resolution of each of these audits is not expected to be material to our consolidated financial statements.

NOTE 13 — RESTRUCTURING CHARGES

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

NOTE 14 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

June 30,	2019	2018
Productivity and Business Processes	**$ 16,831**	$ 14,864
Intelligent Cloud	**16,988**	14,706
More Personal Computing	**3,387**	3,150
Total	**$ 37,206**	$ 32,720

Changes in unearned revenue were as follows:

(In millions)

Year Ended June 30, 2019	
Balance, beginning of period	**$ 32,720**
Deferral of revenue	**69,493**
Recognition of unearned revenue	**(65,007)**
Balance, end of period	**$ 37,206**

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized ("contracted not recognized revenue"), which includes unearned revenue and amounts that will be invoiced and recognized as revenue in future periods. Contracted not recognized revenue was $91 billion as of June 30, 2019, of which we expect to recognize approximately 50% of the revenue over the next 12 months and the remainder thereafter. Many customers are committing to our products and services for longer contract terms, which is increasing the percentage of contracted revenue that will be recognized beyond the next 12 months.

NOTE 15 — LEASES

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

The components of lease expense were as follows:

(In millions)

Year Ended June 30,	2019	2018	2017
Operating lease cost	**$ 1,707**	$ 1,585	$ 1,412
Finance lease cost:			
Amortization of right-of-use assets	**$ 370**	$ 243	$ 104
Interest on lease liabilities	**247**	175	68
Total finance lease cost	**$ 617**	$ 418	$ 172

Supplemental cash flow information related to leases was as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Cash paid for amounts included in the measurement of lease liabilities:			
Operating cash flows from operating leases	**$ 1,670**	$ 1,522	$ 1,157
Operating cash flows from finance leases	**247**	175	68
Financing cash flows from finance leases	**221**	144	46
Right-of-use assets obtained in exchange for lease obligations:			
Operating leases	**2,303**	1,571	1,270
Finance leases	**2,532**	1,933	1,773

Supplemental balance sheet information related to leases was as follows:

(In millions, except lease term and discount rate)

June 30,	**2019**	**2018**
Operating Leases		
Operating lease right-of-use assets	**$ 7,379**	$ 6,686
Other current liabilities	**$ 1,515**	$ 1,399
Operating lease liabilities	**6,188**	5,568
Total operating lease liabilities	**$ 7,703**	$ 6,967
Finance Leases		
Property and equipment, at cost	**$ 7,041**	$ 4,543
Accumulated depreciation	**(774)**	(404)
Property and equipment, net	**$ 6,267**	$ 4,139
Other current liabilities	**$ 317**	$ 176
Other long-term liabilities	**6,257**	4,125
Total finance lease liabilities	**$ 6,574**	$ 4,301
Weighted Average Remaining Lease Term		
Operating leases	**7 years**	7 years
Finance leases	**13 years**	13 years
Weighted Average Discount Rate		
Operating leases	**3.0%**	2.7%
Finance leases	**4.6%**	5.2%

Maturities of lease liabilities were as follows:

(In millions)

Year Ending June 30,	**Operating Leases**	**Finance Leases**
2020	**$ 1,678**	**$ 591**
2021	**1,438**	**616**
2022	**1,235**	**626**

2023	**1,036**	631
2024	**839**	641
Thereafter	**2,438**	5,671
Total lease payments	**8,664**	8,776
Less imputed interest	**(961)**	(2,202)
Total	**$ 7,703**	$ 6,574

As of June 30, 2019, we have additional operating and finance leases, primarily for datacenters, that have not yet commenced of $2.3 billion and $6.1 billion, respectively. These operating and finance leases will commence between fiscal year 2020 and fiscal year 2022 with lease terms of 1 year to 15 years.

NOTE 16 — CONTINGENCIES

Patent and Intellectual Property Claims

There were 44 patent infringement cases pending against Microsoft as of June 30, 2019, none of which are material individually or in aggregate.

Antitrust, Unfair Competition, and Overcharge Class Actions

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

The trial of the British Columbia action commenced in May 2016. Following a mediation, the parties agreed to a global settlement of all three Canadian actions, and submitted the proposed settlement agreement to the courts in all three jurisdictions for approval. The final settlement has been approved by the courts in British Columbia, Ontario, and Quebec, and the claims administration process will commence.

Other Antitrust Litigation and Claims

China State Administration for Industry and Commerce Investigation

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

Product-Related Litigation

U.S. Cell Phone Litigation

Microsoft Mobile Oy, a subsidiary of Microsoft, along with other handset manufacturers and network operators, is a defendant in 40 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims in our agreement to acquire Nokia’s Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines (“FCC Guidelines”) are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

In 2013, the defendants in the consolidated cases moved to exclude the plaintiffs’ expert evidence of general causation on the basis of flawed scientific methodologies. In 2014, the trial court granted in part and denied in part the defendants’ motion to exclude the plaintiffs’ general causation experts. The defendants filed an interlocutory appeal to the District of Columbia Court of Appeals challenging the standard for evaluating expert scientific evidence. In October 2016, the Court of Appeals issued its decision adopting the standard advocated by the defendants and remanding the cases to the trial court for further proceedings under that standard. The plaintiffs have filed supplemental expert evidence, portions of which the defendants have moved to strike. In August 2018, the trial court issued an order striking portions of the plaintiffs’ expert reports. A hearing is expected to be scheduled in the second half of calendar year 2019.

Employment-Related Litigation

Moussouris v. Microsoft

Current and former female Microsoft employees in certain engineering and information technology roles brought this class action in federal court in Seattle in 2015, alleging systemic gender discrimination in pay and promotions. The plaintiffs moved to certify the class in October 2017. Microsoft filed an opposition in January 2018, attaching an expert report showing no statistically significant disparity in pay and promotions between similarly situated men and women. In June 2018, the court denied the plaintiffs' motion for class certification. Plaintiffs sought an interlocutory appeal to the U.S. Court of Appeals for the Ninth Circuit, which was granted in September 2018. Oral argument is scheduled for October 2019.

Other Contingencies

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

As of June 30, 2019, we accrued aggregate legal liabilities of $386 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $1.0 billion in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact on our consolidated financial statements for the period in which the effects become reasonably estimable.

NOTE 17 — STOCKHOLDERS' EQUITY

Shares Outstanding

Shares of common stock outstanding were as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Balance, beginning of year	**7,677**	7,708	7,808
Issued	**116**	68	70
Repurchased	**(150)**	(99)	(170)
Balance, end of year	**7,643**	7,677	7,708

Share Repurchases

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

On September 20, 2016, our Board of Directors approved a share repurchase program authorizing up to an additional $40.0 billion in share repurchases ("2016 Share Repurchase Program"). This share repurchase program commenced on December 22, 2016 following completion of the 2013 Share Repurchase Program, has no expiration date, and may be suspended or discontinued at any time without notice. As of June 30, 2019, $11.4 billion remained of the 2016 Share Repurchase Program.

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

(In millions)	Shares	Amount	Shares	Amount	Shares	Amount
Year Ended June 30,		2019		2018		2017
First Quarter	**24**	**$ 2,600**	22	$ 1,600	63	$ 3,550
Second Quarter	**57**	**6,100**	22	1,800	59	3,533
Third Quarter	**36**	**3,899**	34	3,100	25	1,600
Fourth Quarter	**33**	**4,200**	21	2,100	23	1,600
Total	**150**	**$ 16,799**	99	$ 8,600	170	$ 10,283

Shares repurchased in the first and second quarter of fiscal year 2017 were under the 2013 Share Repurchase Program. All other shares repurchased were under the 2016 Share Repurchase Program. The above table excludes shares repurchased to settle employee tax withholding related to the vesting of stock awards of $2.7 billion, $2.1 billion, and $1.5 billion for fiscal years 2019, 2018, and 2017, respectively. All share repurchases were made using cash resources.

Dividends

Our Board of Directors declared the following dividends:

Declaration Date	Record Date	Payment Date	Dividend Per Share	Amount
Fiscal Year 2019				(In millions)
September 18, 2018	**November 15, 2018**	**December 13, 2018**	**$ 0.46**	**$ 3,544**
November 28, 2018	**February 21, 2019**	**March 14, 2019**	**0.46**	**3,526**
March 11, 2019	**May 16, 2019**	**June 13, 2019**	**0.46**	**3,521**
June 12, 2019	**August 15, 2019**	**September 12, 2019**	**0.46**	**3,516**
Total			**$ 1.84**	**$ 14,107**
Fiscal Year 2018				
September 19, 2017	November 16, 2017	December 14, 2017	$ 0.42	$ 3,238
November 29, 2017	February 15, 2018	March 8, 2018	0.42	3,232
March 12, 2018	May 17, 2018	June 14, 2018	0.42	3,226
June 13, 2018	August 16, 2018	September 13, 2018	0.42	3,220
Total			$ 1.68	$ 12,916

The dividend declared on June 12, 2019 was included in other current liabilities as of June 30, 2019.

NOTE 18 — ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Derivatives			
Balance, beginning of period	**$ 173**	$ 134	$ 352
Unrealized gains, net of tax of **$2**, $11, and $4	**160**	218	328
Reclassification adjustments for gains included in revenue	**(341)**	(185)	(555)
Tax expense included in provision for income taxes	**8**	6	9
Amounts reclassified from accumulated other comprehensive income (loss)	**(333)**	(179)	(546)
Net change related to derivatives, net of tax of **$(6),** $5, and $(5)	**(173)**	39	(218)
Balance, end of period	**$ 0**	$ 173	$ 134
Investments			
Balance, beginning of period	**$ (850)**	$ 1,825	$ 2,941
Unrealized gains (losses), net of tax of **$616**, $(427), and $267	**2,331**	(1,146)	517
Reclassification adjustments for (gains) losses included in other income (expense), net	**93**	(2,309)	(2,513)
Tax expense (benefit) included in provision for income taxes	**(19)**	738	880
Amounts reclassified from accumulated other comprehensive income (loss)	**74**	(1,571)	(1,633)
Net change related to investments, net of tax of **$635**, $(1,165), and $(613)	**2,405**	(2,717)	(1,116)
Cumulative effect of accounting changes	**(67)**	42	0
Balance, end of period	**$ 1,488**	$ (850)	$ 1,825
Translation Adjustments and Other			
Balance, beginning of period	**$ (1,510)**	$ (1,332)	$ (1,499)
Translation adjustments and other, net of tax effects of **$(1)**, $0, and $9	**(318)**	(178)	167
Balance, end of period	**$ (1,828)**	$ (1,510)	$ (1,332)
Accumulated other comprehensive income (loss), end of period	**$ (340)**	$ (2,187)	$ 627

NOTE 19 — EMPLOYEE STOCK AND SAVINGS PLANS

We grant stock-based compensation to employees and directors. As of June 30, 2019, an aggregate of 327 million shares were authorized for future grant under our stock plans. Awards that expire or are canceled without delivery of shares generally become available for issuance under the plans. We issue new shares of Microsoft common stock to satisfy vesting of awards granted under our stock plans. We also have an ESPP for all eligible employees.

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

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Stock-based compensation expense	**$ 4,652**	$ 3,940	$ 3,266
Income tax benefits related to stock-based compensation	**816**	823	1,066

Stock Plans

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

Executive Incentive Plan

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

Activity for All Stock Plans

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

Year Ended June 30,	2019	2018	2017
Dividends per share (quarterly amounts)	**$0.42 - $0.46**	$0.39 - $0.42	$0.36 - $0.39
Interest rates	**1.8% - 3.1%**	1.7% - 2.9%	1.2% - 2.2%

During fiscal year 2019, the following activity occurred under our stock plans:

	Shares	Weighted Average Grant-Date Fair Value
	(In millions)	
Stock Awards		
Nonvested balance, beginning of year	**174**	**$ 57.85**
Granted (a)	**63**	**107.02**
Vested	**(77)**	**57.08**
Forfeited	**(13)**	**69.35**
Nonvested balance, end of year	**147**	**$ 78.49**

(a) *Includes 2 million, 3 million, and 2 million of PSUs granted at target and performance adjustments above target levels for fiscal years 2019, 2018, and 2017, respectively.*

As of June 30, 2019, there was approximately $8.6 billion of total unrecognized compensation costs related to stock awards. These costs are expected to be recognized over a weighted average period of 3 years. The weighted average grant-date fair value of stock awards granted was $107.02, $75.88, and $55.64 for fiscal years 2019, 2018, and 2017, respectively. The fair value of stock awards vested was $8.7 billion, $6.6 billion, and $4.8 billion, for fiscal years 2019, 2018, and 2017, respectively.

Employee Stock Purchase Plan

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

(Shares in millions)

Year Ended June 30,	2019	2018	2017
Shares purchased	**11**	13	13
Average price per share	**$ 104.85**	$ 76.40	$ 56.36

As of June 30, 2019, 105 million shares of our common stock were reserved for future issuance through the ESPP.

Savings Plan

We have savings plans in the U.S. that qualify under Section 401(k) of the Internal Revenue Code, and a number of savings plans in international locations. Eligible U.S. employees may contribute a portion of their salary into the savings plans, subject to certain limitations. We contribute fifty cents for each dollar a participant contributes into the plans, with a maximum employer contribution of 50% of the IRS contribution limit for the calendar year. Employer-funded retirement benefits for all plans were $877 million, $807 million, and $734 million in fiscal years 2019, 2018, and 2017, respectively, and were expensed as contributed.

NOTE 20 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

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

Our reportable segments are described below.

Productivity and Business Processes

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

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

Intelligent Cloud

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

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

More Personal Computing

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

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

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

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

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

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
Revenue			
Productivity and Business Processes	**$ 41,160**	$ 35,865	$ 29,870
Intelligent Cloud	**38,985**	32,219	27,407
More Personal Computing	**45,698**	42,276	39,294
Total	**$ 125,843**	$ 110,360	$ 96,571
Operating Income (Loss)			
Productivity and Business Processes	**$ 16,219**	$ 12,924	$ 11,389
Intelligent Cloud	**13,920**	11,524	9,127
More Personal Computing	**12,820**	10,610	8,815
Corporate and Other	**0**	0	(306)
Total	**$ 42,959**	$ 35,058	$ 29,025

Corporate and Other operating loss comprised restructuring expenses.

No sales to an individual customer or country other than the United States accounted for more than 10% of revenue for fiscal years 2019, 2018, or 2017. Revenue, classified by the major geographic areas in which our customers were located, was as follows:

(In millions)

Year Ended June 30,	**2019**	**2018**	**2017**
United States (a)	**$ 64,199**	$ 55,926	$ 51,078
Other countries	**61,644**	54,434	45,493
Total	**$ 125,843**	$ 110,360	$ 96,571

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

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

(In millions)

Year Ended June 30,	2019	2018	2017
Server products and cloud services	**$ 32,622**	$ 26,129	$ 21,649
Office products and cloud services	**31,769**	28,316	25,573
Windows	**20,395**	19,518	18,593
Gaming	**11,386**	10,353	9,051
Search advertising	**7,628**	7,012	6,219
LinkedIn	**6,754**	5,259	2,271
Enterprise Services	**6,124**	5,846	5,542
Devices	**6,095**	5,134	5,062
Other	**3,070**	2,793	2,611
Total	**$ 125,843**	$ 110,360	$ 96,571

Our commercial cloud revenue, which includes Office 365 Commercial, Azure, the commercial portion of LinkedIn, Dynamics 365, and other commercial cloud properties, was $38.1 billion, $26.6 billion and $16.2 billion in fiscal years 2019, 2018, and 2017, respectively. These amounts are primarily included in Office products and cloud services, Server products and cloud services, and LinkedIn in the table above.

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

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

(In millions)

June 30,	2019	2018	2017
United States	**$ 55,252**	$ 44,501	$ 42,730
Ireland	**12,958**	12,843	12,889
Other countries	**25,422**	22,538	19,898
Total	**$ 93,632**	$ 79,882	$ 75,517

NOTE 21 — QUARTERLY INFORMATION (UNAUDITED)

(In millions, except per share amounts)

Quarter Ended	September 30	December 31	March 31	June 30	Total
Fiscal Year 2019					
Revenue	**$ 29,084**	**$ 32,471**	**$ 30,571**	**$ 33,717**	**$ 125,843**
Gross margin	**19,179**	**20,048**	**20,401**	**23,305**	**82,933**
Operating income	**9,955**	**10,258**	**10,341**	**12,405**	**42,959**
Net income (a)	**8,824**	**8,420**	**8,809**	**13,187**	**39,240**
Basic earnings per share	**1.15**	**1.09**	**1.15**	**1.72**	**5.11**
Diluted earnings per share (b)	**1.14**	**1.08**	**1.14**	**1.71**	**5.06**
Fiscal Year 2018					
Revenue	$ 24,538	$ 28,918	$ 26,819	$ 30,085	$ 110,360
Gross margin	16,260	17,854	17,550	20,343	72,007
Operating income	7,708	8,679	8,292	10,379	35,058
Net income (loss) (c)	6,576	(6,302)	7,424	8,873	16,571
Basic earnings (loss) per share	0.85	(0.82)	0.96	1.15	2.15
Diluted earnings (loss) per share (d)	0.84	(0.82)	0.95	1.14	2.13

(a) *Reflects the $157 million net charge related to the enactment of the TCJA for the second quarter and the $2.6 billion net income tax benefit related to the intangible property transfers for the fourth quarter, which together increased net income by $2.4 billion for fiscal year 2019. See Note 12 – Income Taxes for further information.*

(b) *Reflects the net charge related to the enactment of the TCJA and the net income tax benefit related to the intangible property transfers, which decreased (increased) diluted EPS $0.02 for the second quarter, $(0.34) for the fourth quarter, and $(0.31) for fiscal year 2019.*

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

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of Microsoft Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Microsoft Corporation and subsidiaries (the “Company”) as of June 30, 2019 and 2018, the related consolidated statements of income, comprehensive income, stockholders’ equity, and cash flows, for each of the three years in the period ended June 30, 2019, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2019, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company's internal control over financial reporting as of June 30, 2019, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 1, 2019, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

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

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

Critical Audit Matters

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

Revenue Recognition — Refer to Note 1 to the Financial Statements

Critical Audit Matter Description

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

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

- Determination of whether products and services are considered distinct performance obligations that should be accounted for separately versus together, such as software licenses and related services that are sold with cloud-based services.
- Determination of stand-alone selling prices for each distinct performance obligation and for products and services that are not sold separately.
- The pattern of delivery (i.e., timing of when revenue is recognized) for each distinct performance obligation.
- Estimation of variable consideration when determining the amount of revenue to recognize (e.g., customer credits, incentives, and in certain instances, estimation of customer usage of products and services).

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

How the Critical Audit Matter Was Addressed in the Audit

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

- We tested the effectiveness of internal controls related to the identification of distinct performance obligations, the determination of the timing of revenue recognition, and the estimation of variable consideration.
- We evaluated management's significant accounting policies related to these customer agreements for reasonableness.
- We selected a sample of customer agreements and performed the following procedures:
    - Obtained and read contract source documents for each selection, including master agreements, and other documents that were part of the agreement.
    - Tested management's identification of significant terms for completeness, including the identification of distinct performance obligations and variable consideration.
    - Assessed the terms in the customer agreement and evaluated the appropriateness of management's application of their accounting policies, along with their use of estimates, in the determination of revenue recognition conclusions.
- We evaluated the reasonableness of management's estimate of stand-alone selling prices for products and services that are not sold separately.
- We tested the mathematical accuracy of management's calculations of revenue and the associated timing of revenue recognized in the financial statements.

Income Taxes — Uncertain Tax Positions — Refer to Note 12 to the Financial Statements

Critical Audit Matter Description

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

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

How the Critical Audit Matter Was Addressed in the Audit

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

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

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
August 1, 2019

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