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

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For The Fiscal Year Ended June 30, 1997

[_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From _____ to ____

Commission File Number 0-14278

MICROSOFT CORPORATION

Washington	91-1144442
(State of incorporation)	(I.R.S. ID)

One Microsoft Way, Redmond, Washington 98052-6399

(425) 882-8080

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock

2 3/4% Convertible Exchangeable Principal-Protected Preferred Stock.

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [_]

The aggregate market value of common stock held by non-affiliates of the registrant as of September 12, 1997 was $106,179,466,860.

The number of shares outstanding of the registrant's common stock as of September 12, 1997 was 1,212,567,717.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 1997 Annual Report to Shareholders are incorporated by reference into Parts I, II and IV.

Portions of the definitive Proxy Statement dated September 26, 1997 to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held November 14, 1997 are incorporated by reference into Part III.

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MICROSOFT CORPORATION

FORM 10-K

For The Fiscal Year Ended June 30, 1997

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PART I

Item 1. Business

GENERAL

Microsoft Corporation (the "Company" or "Microsoft") was founded as a partnership in 1975 and incorporated in 1981. Microsoft develops, manufactures, licenses, sells, and supports a wide range of software products, including scalable operating systems for information appliances, personal computers (PCs) and servers; server applications for client/server environments; business and consumer productivity applications; software development tools; and Internet and intranet software and technologies. The Company has recently expanded its interactive content efforts, including entertainment and information software programs, MSN(TM), The Microsoft(R) Network online service, Internet-based services, and alliances with companies involved with other forms of digital interactivity. Microsoft also sells personal computer input devices and books, and researches and develops advanced technologies for future software products.

Microsoft's business strategy emphasizes the development of a broad line of software products for business and personal use, marketed through multiple channels of distribution. The Company is divided into three main groups: the Product Group, the Sales and Support Group, and the Operations Group.

The Platforms Product Group is comprised of five primary divisions, each responsible for a particular area of platform software development and marketing. The Personal Systems Division develops PC operating systems. The Business Systems Division develops server operating systems and server applications. The Internet Client and Collaboration Division develops Web browser technologies and e-mail, editing, and collaboration products. The Developer Tools Division creates software development tools. The Consumer Platforms Division develops system software for non-PC devices, multimedia devices, and digital authoring environments.

The Applications and Content Product Group creates and markets productivity programs, interactive entertainment and information products, desktop finance products, and PC input devices. The Desktop Applications Division creates business productivity applications and products designed for the home, school, and the small business market. Interactive Media offerings include children's titles, games, reference sources, online informational services, and MSN. The Desktop Finance Division develops personal finance products. The Input Device Division creates PC peripherals.

Microsoft has a research lab dedicated to creating new technology in support of the Company's vision for the evolution of personal computing.

The Sales and Support Group is responsible for building long-term business relationships with customers. This group is organized to serve various customer types, including original equipment manufacturers (OEMs), end-users, organizations, enterprises, application developers, and Internet content providers (ICPs) and infrastructure owners. Large enterprises are offered tailored license programs, enterprisewide support, consulting services, and other specialized services. The group manages the channels that serve customers by working with OEMs, distributors, and resellers. In addition to the OEM channel, Microsoft has three major geographic sales organizations: U.S. and Canada, Europe, and Other International. The group supports the Company's products with technical support for end-users, developers, and organizations.

The Operations Group is responsible for managing business operations and overall business planning. This includes the process of manufacturing and delivering finished goods and licenses; corporate functions such as finance, administration, human resources, and legal; and the publishing efforts of Microsoft Press.

PRODUCTS
PERSONAL SYSTEMS

The Personal Systems Division has overall responsibility for the Microsoft Windows(R) PC operating systems. Operating system software performs a variety of functions, such as allocating computer memory, scheduling applications software execution, managing information and communication flow among the various PC components, and enabling end-users to access files and information.

WINDOWS 95. Microsoft's primary personal operating system, the successor to MS-DOS(R) and Windows 3.1, was released commercially in August 1995; periodic service releases, system updates, and new device drivers have been made available to PC OEMs and to end-users via the Internet on the Company's web site, http://www.microsoft.com. Windows 95 is a fully integrated, multitasking 32-bit operating system, designed to be compatible with Intel microprocessor-based PCs, most hardware devices, and Windows 3.1 and MS-DOS applications.

WINDOWS NT WORKSTATION. Also a fully integrated, multitasking 32-bit operating system, Windows NT(R) Workstation provides greater security, robustness and portability. Windows NT Workstation is a multithreaded operating system for mission critical computing which provides the same features and applications programming interfaces (APIs) for Intel and Alpha AXP microprocessors.

MS-DOS. MS-DOS is a single-user, single-tasking operating system designed for Intel microprocessor-based PCs. MS-DOS was introduced in 1981 and was preinstalled by OEMs on most PCs shipped prior to the release of Windows 95.

WINDOWS 3.1. Microsoft Windows 3.1 provides a graphical user interface and other enhancements for MS-DOS-based PCs. Windows 3.1 supports 16-bit Windows-based applications, and offers ease of use, aesthetic appeal, and straightforward integration into corporate computing environments. Windows for Workgroups 3.11 integrates network and workgroup functionality directly into the Windows operating system.

BUSINESS SYSTEMS
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The Business Systems Division develops and markets Windows NT Server and related Microsoft BackOffice(R) and Internet server-based applications. Server operating systems are enterprise-wide platforms for building and deploying distributed applications for networked PCs.

WINDOWS NT SERVER. Windows NT Server is a powerful operating system foundation for both server applications and file and print sharing, with extensive network management features, administration tools, security, and high availability. Windows NT Server provides a platform for business critical applications and databases, connectivity, system management, and e-mail servers. The operating system integrates Web services such as Microsoft Internet Information Server, a server used to manage intranet and Internet functionality and Microsoft FrontPage(R) Web site creation and management tool.

MICROSOFT BACKOFFICE. Based on Windows NT Server, the Microsoft BackOffice family of server applications is an integrated series of software products that include services for file and print, applications, database, messaging, groupware, desktop management, Internet access, transaction processing, and host connectivity. BackOffice enables organizations to share information, collaborate, and manage and deploy business-critical applications. Microsoft Exchange Server provides e-mail, group scheduling, and integrated groupware capabilities; Microsoft SQL Server(TM) manages and stores data; Microsoft Proxy Server creates a single, secure gateway to the Internet; Microsoft SNA Server provides connectivity to host data and applications; and Microsoft Systems Management Server centrally manages this distributed environment.

INTERNET SERVER TOOLS. The Company also offers Internet servers based on Windows NT Server. In addition to the Web services technologies included in Windows NT Server, the Company also offers Microsoft Site Server, which allows a comprehensive management of sophisticated web sites and their content. Microsoft Transaction Server is a component-based transaction processing system for developing, deploying, and managing scalable enterprise, Internet, and intranet server applications.

INTERNET CLIENT AND COLLABORATION
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The Internet Client and Collaboration Division develops Internet browser technology and e-mail and group collaboration products.

INTERNET SOFTWARE. The division has overall development and marketing responsibility for Microsoft Internet Explorer, the Company's Internet browser. It also provides products for developing, running, and managing Internet and intranet applications and content, including ActiveX(TM) controls. Formerly known as object linking and embedding (OLE) controls, ActiveX controls are components (or objects) that can be inserted into a Web page or another application which allow packaged functionality programmed elsewhere to be reused and enables real-time, interactive content.

DEVELOPER TOOLS
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The Developer Tools Division provides software development tools and technical information to Windows and Internet applications developers. These products and services empower independent software developers, corporate developers, solutions developers, and Webmasters to create a broad spectrum of applications, primarily for Windows 95 and Windows NT, but also for the platform-independent Internet and intranets.

SOFTWARE DEVELOPMENT TOOLS AND COMPUTER LANGUAGES. Software development tools and computer languages allow software developers to write programs in a particular computer language and translate programs into a binary machine-readable set of commands that activate and instruct PC hardware. The Company develops and markets a number of software development environments, and language compilers. Microsoft Visual C++(R) is the Company's development system for Windows application development. The Microsoft Visual Basic(R) programming system provides easy access to a wide variety of data sources by integrating the Microsoft Access database engine and the ability to take advantage of investments in commercial applications through ActiveX controls. Microsoft Visual J++(TM), a development environment for Java applications and Internet applets, contains a high productivity Integrated Development Environment and a collection of integrated components to create, test, tune, and deploy Java code on multiple platforms using ActiveX controls.

DEVELOPER INFORMATION. The Company provides third party software developers with a wide range of technical and support information that assists them in developing software products intended to run on Windows operating systems, taking advantage of key technologies such as ActiveX controls and Windows 32-bit APIs. Developers can subscribe to the Microsoft Developer Network (MSDN) information service and receive periodic updates via CD-ROMs, magazines, and several on-line information services.

CONSUMER PLATFORMS
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The Consumer Platforms Division is developing software for non-PC devices, the Broadcast PC, multimedia devices, and network multimedia.

NON-PC DEVICES. The division develops Windows CE, a scaleable Windows platform for a broad range of communications, entertainment, and mobile computing devices. The Windows CE operating system enables information appliances to communicate with each other, share information with Windows PCs, and connect to the Internet. Handheld PCs based on Windows CE are manufactured and sold by various hardware OEMs and are designed to be companions to Windows-based PCs.

MULTIMEDIA DEVICES. In August 1997 Microsoft acquired WebTV Networks, Inc., an online service that enables consumers to experience the Internet through their televisions via set-top terminals based on WebTV technologies. Future versions of the set-top terminals will use the Windows CE operating system.

The Consumer Platforms Division is also responsible for Softimage, which develops, markets, and supports a family of interactive software products enabling digital media producers to create and edit two- and three-dimensional content for digital media productions. Softimage supplies 3D visualization software for broadcast, film production, and other high-end animation applications. In addition, Softimage has a product line of 2D visualization software for use on high-end applications, including postproduction editing and the integration of visual images, text, sound, and special effects technology. These products are designed for the Windows NT and IRIX operating systems.

SOFTIMAGE 3D. Softimage(R) 3D provides three-dimensional animation software for film and video professionals, animators, and artists who create and produce high-end three-dimensional imagery for traditional and new media.

SOFTIMAGE DS. Softimage DS is a digital authoring environment blending 2D and 3D graphics, digital video, and digital audio. The digital studio environment accommodates many types of projects for digital multimedia such as high-end advertising, entertainment, games, and integrated interactive multimedia.

DESKTOP APPLICATIONS
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The Desktop Applications Division develops applications software, which provides the PC with instructions for the performance of productivity tasks such as manipulating text, numbers, or graphics. The Company's desktop applications software is designed for use by a broad class of end-users, regardless of business, industry, or market segment. Primary examples of desktop applications software are word processing, spreadsheet, and presentation graphics programs. The Company's desktop applications programs are developed principally for Windows and Macintosh operating systems.

MICROSOFT OFFICE. Microsoft Office is a suite of software programs featuring seamless integration of the most commonly used desktop applications. Microsoft Office is based upon a document-centric concept, with common commands and extensive use of cross-application capabilities. Microsoft Office is available in several versions, with certain combinations of products available for the various operating system platforms. The most recent version for Windows, Microsoft Office 97, has enhanced Internet features such as integration with Microsoft Internet Explorer, a Web toolbar, the ability to save as an HTML format, connectivity to other Office documents or web sites via hyperlinks, and support for ActiveX controls. Products offered in the various versions include Microsoft Word, Microsoft Excel, the Microsoft PowerPoint(R) presentation graphics program, Microsoft Outlook(TM), the Microsoft Access database, Microsoft Bookshelf(R), and others. The Microsoft Home Essentials(TM) suite is marketed primarily toward users in the home.

MICROSOFT WORD. The Company's principal word processing program is Microsoft Word. Versions of Microsoft Word provide graphical word processing features, plus the ability to handle graphics, tables, spreadsheet data, charts, and images imported from other software programs.

MICROSOFT EXCEL. The Company's spreadsheet program is Microsoft Excel. It is an integrated spreadsheet with pivot table, database, and business graphics capabilities. Microsoft Excel allows full linking and embedding of objects that permits users to view and edit graphics or charts from other programs in the worksheet in which the object is stored. Microsoft Excel graphics capabilities can be linked to its spreadsheets to allow simultaneous changes to charts as changes are made to the spreadsheets.

MICROSOFT POWERPOINT. Microsoft PowerPoint is a presentation graphics program for producing transparencies, slides, overheads, and prints.

MICROSOFT ACCESS. Microsoft Access is a relational database management application that provides access to structured business data. Database products control the maintenance and utilization of structured data organized into a set of records or files.

MICROSOFT OUTLOOK. The division also develops the Microsoft Outlook desktop information management program, which manages e-mail, calendars, contacts, tasks, and files on the PC. Outlook helps users communicate through e-mail and share information by means of public folders, forms, and Internet connectivity.

MICROSOFT PROJECT. Microsoft Project is a critical path project scheduling and resource allocation program. The product can perform as a budgeting, monitoring, and cost estimating tool for large business projects and as a critical path and schedule planning tool.

OTHER PRODUCTIVITY PRODUCTS. The Company also offers other productivity products, including Microsoft Works, Microsoft Publisher, and Microsoft FrontPage. Microsoft Works is an integrated software program that contains basic word processing, spreadsheet, and database capabilities that allows the easy exchange of information from one tool to another. Microsoft Publisher is an easy-to-use, entry-level desktop publishing program. Microsoft FrontPage is a Web site creation and management tool for Web sites on the Internet or intranets.

INTERACTIVE MEDIA
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The Interactive Media Division develops and markets interactive entertainment and information products across a variety of media, including the Internet, The Microsoft Network, and CD-ROM.

LEARNING AND ENTERTAINMENT. Reference titles include Microsoft Encarta(R) and Microsoft Bookshelf. The Encarta multimedia encyclopedia database blends text in articles with a wealth of innovative, interactive information presented through animations, videos, maps, charts, sounds, and pictures. Bookshelf is a multimedia reference library that integrates seven well-respected and authoritative works, including a dictionary, world atlas, world almanac, thesaurus, concise encyclopedia, and two books of quotations.

Personal interest titles include Microsoft Cinemania(R), an interactive guide to the movies with entries for 19,000 films, Microsoft Dinosaurs, musical titles, and many others.

Titles for children include Microsoft Creative Writer, a full-featured creative writing and publishing program. The Company also has a series of products based on the popular children's book and television series, Scholastic's The Magic School Bus.

The Company offers a line of entertainment products. Microsoft Flight Simulator is a popular aircraft flight simulation product available for Windows, MS-DOS, and Macintosh operating systems. Games include Monster

Truck Madness(TM), Microsoft Golf, and other sports and action titles. Most games are available for the Windows 95 environment.

INTERACTIVE SERVICE MEDIA. The Company is developing an online decision support infrastructure for end-users in such fields as automobiles, retail, entertainment, and travel. Microsoft CarPoint(TM) provides current and objective information for new car purchases, including test drive reviews, dealer invoices, and surround videos. Additionally, CarPoint features a new car buying service. Comprised of a national network of dealers, this service refers customers to nearby dealers. Microsoft Sidewalk(TM) is a personalized city guide to local entertainment. The Sidewalk editorial team provides previews, reviews and even customized suggestions about entertainment events in Seattle, New York, Boston, and the Minneapolis, with city guides scheduled to launch in San Francisco, Houston, Washington, D.C., San Diego, Denver, and Sydney, Australia. Microsoft Expedia(TM) is a free travel service on the World Wide Web and MSN which enables users to find low fares, book flights, make hotel reservations, and rent cars. Expedia also offers a comprehensive source of information for more than 330 destinations including photos, historical information, and local details. Expedia Streets 98 and Expedia Trip Planner 98 are comprehensive route-planning programs with detailed maps and road information for routes in North America.

THE MICROSOFT NETWORK. MSN is Web-based interactive online service. MSN provides easy and inexpensive access for users to a wide range of graphically rich online content. The online service provides access to the Internet, electronic mail, bulletin boards, and a myriad of additional services offered by Microsoft and by independent content providers (ICPs).

JOINT VENTURES. The Company has entered into joint venture arrangements to take advantage of creative talent and content from other organizations. Microsoft owns 50 percent of DreamWorks Interactive L.L.C., a software company that develops interactive and multimedia products. DreamWorks SKG owns the remaining 50 percent. Microsoft owns 50 percent of MSNBC Cable L.L.C., a 24-hour cable news and information channel; and 50 percent of MSNBC Interactive News L.L.C., an interactive online news service. National Broadcasting Company (NBC) owns the remaining 50 percent of these two joint ventures.

DESKTOP FINANCE

Microsoft Money is a financial organization product that allows users to computerize their household finances. Microsoft Money is available for systems running Windows 95 and provides online home-banking services with numerous different banks in the U.S.

Microsoft Investor is an online investing site that provides a comprehensive offering of information and services designed to help personal investors make investment decisions, track their securities and understand the market. A blend of free and subscription-based services, Investor provides portfolio tracking and analysis, company and mutual fund research, an investment finder, daily editorial and market summaries, e-mail notifications and alerts, and access to online trading through leading financial services firms.

PC INPUT DEVICES

The Company's major input device is the Microsoft Mouse, a hand-held pointing device that facilitates use of a PC. It can be used with MS-DOS and Windows operating systems and works with most applications products from Microsoft and other companies. Microsoft also offers a mouse designed for the home and a mouse for young children. The Company also markets the Microsoft Natural(R) Keyboard, an ergonomically designed keyboard. Additionally, Microsoft sells joysticks and gamepads for use with PC games.

MICROSOFT PRESS

Microsoft Press publishes books about software products from Microsoft and other software developers and about current developments in the industry. Books published by Microsoft Press typically are written and copyrighted by independent authors who submit their manuscripts to the Company for publication and who receive royalties based on revenue generated by the book.

Microsoft Press contracts with an independent commercial printer for the manufacturing of its books. Publisher's Resources, Inc. acts as the Company's main fulfillment house in the United States, maintaining the majority of the inventory of Microsoft Press(R) books. Books are marketed by independent sales representatives and by Microsoft

Press sales personnel. Internationally, Microsoft Press has numerous international agreements with publishers for the worldwide distribution of its books. Microsoft Press has granted a publisher in England the right to distribute English language versions of its books in all countries except the United States, Canada, Central and South America, and certain Asian countries. In most cases, Microsoft Press provides each publisher with a book's manuscript, and the publisher arranges for its translation and the printing, marketing, and distribution of the translated version.

PRODUCT DEVELOPMENT

The PC software industry is characterized by extremely rapid technological change, which requires constant attention to software technology trends and shifting consumer demand, and rapid product innovation. The pace of change has recently become even greater due to the surge of interest in the Internet, other forms of online services, PC server-based networking, and new programming languages, such as Java.

Most of the Company's software products are developed internally. The Company also purchases technology, licenses intellectual property rights, and oversees third-party development and localization of certain products. Internal development enables Microsoft to maintain closer technical control over the products and gives the Company the freedom to designate which modifications and enhancements are most important and when they should be implemented. The Company has created a substantial body of proprietary development tools and has evolved development methodologies for creating and enhancing its products. These tools and methodologies are also designed to simplify a product's portability among different operating systems, microprocessors, or computers. Product documentation is generally created internally.

The Company believes that a crucial factor in the success of a new product is getting it to market quickly to respond to new user needs or advances in PCs, servers, peripherals, and the Internet, without compromising product quality. The Company strives to become informed at the earliest possible time about changing usage patterns and hardware advances that may affect software design.

During fiscal years 1995, 1996, and 1997, the Company spent $860 million, $1.43 billion, and $1.93 billion, respectively, on product research and development activities. Those amounts represented 14.5%, 16.5%, and 16.9%, respectively, of revenue in each of those years excluding funding of joint venture activity. The Company is committed to continue high expenditures for research and product development.

LOCALIZATION

In order to best serve the needs of users in foreign countries, Microsoft "localizes" many of its products to reflect local languages and conventions. In French versions, for example, all user messages and documentation are in French and all monetary references are in French francs. Various Microsoft products have been localized into more than 30 languages.

MANUFACTURING

Microsoft contracts most of its manufacturing activity to third parties. Outside manufacturers produce various retail software packaged products, documentation, and hardware such as mouse pointing devices, keyboards, and joysticks. There are other custom manufacturers in the event that outsourced manufacturing becomes unavailable from current sources.

In recent years the Company's sales mix has shifted to OEM and corporate and organizational licenses from packaged products. Online distribution of software may increase in the future. During July 1996, Microsoft sold its domestic manufacturing and distribution operation.

The Company's remaining manufacturing facilities are located in Puerto Rico and Ireland. The Irish manufacturing facility replicates disks, assembles other purchased parts, and packages final product. The Puerto Rico facility manufactures CD-ROMs, assembles other purchased parts, and packages final product. Quality control tests are performed on purchased parts, finished disks and CD-ROMs, and other products. The chief materials and components used in Microsoft products include disks or CD-ROMs, books, and multicolor printed materials. The Company is often able to acquire component parts and materials on a volume discount basis. The Company has multiple sources for raw materials, supplies, and components.

MARKETING AND DISTRIBUTION

Microsoft aligns its sales and marketing staff with several customer types, including OEMs, end-users, organizations, enterprises, applications developers, and Internet content providers (ICPs) and infrastructure owners. The Company's sales and marketing group seeks to build long-term relationships with customers of Microsoft products. In addition to the OEM channel, Microsoft has three major geographic sales and marketing organizations: the U.S. and Canada, Europe, and elsewhere in the world (Other International).

The OEM customer unit includes the sales force which works with original equipment manufacturers that preinstall Microsoft software on their PCs.

The end-user customer unit has responsibility for activities that target end-users that make individual buying decisions for the PCs they use at work or home. Most sales and marketing activities aimed at end-user customers are performed by this unit, including developing and administering reseller relationships; reseller sales terms and conditions; channel marketing and promotions; end-user marketing programs; support policies; and seminars, events, and sales training for resellers. The key products marketed by the end-user customer unit are the Company's desktop operating systems, desktop applications, and interactive media products.

The organization customer unit has responsibility for activities that target groups of users in small and medium organizations. The unit works with channel partners such as distributors, aggregators, value-added resellers, and Solution Providers to provide complete business solutions to this customer segment. The unit's sales and marketing activities include providing technical training to Solution Providers (described below) and channel resellers; developing support policies; and supporting and providing seminars, events, and sales training for channel partners.

The enterprise customer unit has responsibility for sales and marketing activities that target large organizations. The unit works directly with these organizations, and through large account resellers, to create and support enterprisewide, mission critical solutions for business computing needs.

The applications developer customer unit targets corporate developers and independent software vendors (ISVs) who build business applications with a development platform based on Microsoft Windows and BackOffice architecture. The unit's sales and marketing activities include providing industry specific technical training, seminars, and events for ISVs.

The Internet customer unit is responsible for introducing the Company's products and technologies to the public infrastructure owners and ICPs. Infrastructure owners include network operators (telephone companies, cable companies, Internet service providers, etc.) who build, own, and operate the public networks and ICPs who provide content for the Web.

FINISHED GOODS CHANNELS

DISTRIBUTORS AND RESELLERS. The Company markets its products in the finished goods channels primarily through independent non-exclusive distributors and resellers. Distributors include CHS Electronics, Computer 2000, Ingram Micro, Softbank, Tech Data, and Merisel. Resellers include Software Spectrum and Stream International. Microsoft has a network of field sales representatives and field support personnel who solicit orders from distributors and resellers and provide product training and sales support.

LARGE ACCOUNTS. The Microsoft Select program offers flexible software acquisition, licensing, and maintenance options specially customized to meet the needs of large multinational organizations. Targeted audiences include technology specialists and influential end-users in large enterprises. Marketing efforts and fulfillment are generally coordinated with the Microsoft network of large account resellers.

SOLUTION PROVIDERS. Microsoft's Solution Providers program is a comprehensive support relationship with independent organizations that provide network and system integration, custom development, training, and technical support for business computing solutions. The program supports value-added resellers (VARs), system integrators, consultants, custom application developers, solution developers, Internet service and hosting organizations, independent content providers, and sitebuilders (companies that build Web sites for other companies), as well as technical support and training organizations. Under this business partnership strategy, the Company provides sales and product information, development services, early access to Microsoft products, and customer support tools including priority telephone support, education, and business development support. To ensure high-quality technical services for the

Company's products, Microsoft Solution Providers are required to have Microsoft-certified professionals on staff.

CONSULTING SERVICES. The Company's Consulting Services Division assists customers in using the Company's computer operating systems, applications, and communications products. The group works with Solution Providers and helps create enterprisewide computing solutions for large corporate accounts.

INTERNATIONAL SALES SITES. The Company has established marketing and/or support subsidiaries in more than 60 countries. Product is generally delivered by the Company's owned or outsourced manufacturing operations.

The Company's international operations, both OEM and finished goods, are subject to certain risks common to foreign operations in general, such as governmental regulations, import restrictions, and foreign exchange rate fluctuations. Microsoft hedges a portion of its foreign exchange risk.

OEM CHANNEL

Microsoft operating systems are licensed primarily to OEMs under agreements that grant the OEMs the right to distribute copies of the Company's products with their computers. The Company also markets certain desktop applications and interactive media programs to OEMs under similar arrangements. In addition, the Company markets the Microsoft Mouse and Natural Keyboard to OEMs for distribution to buyers of their computers. In almost all cases, the products are distributed under Microsoft trademarks. The Company has OEM agreements covering one or more of its products with virtually all of the major PC OEMs, including AST Research, Acer, Compaq, Digital Equipment Corporation, Dell, Fujitsu, Gateway 2000, Hewlett-Packard, IBM, NEC, Packard Bell, Siemens, Toshiba, and Vobis.

ADVERTISING

The Company works closely with large advertising and direct marketing firms. Advertising, direct marketing, worldwide packaging, and marketing materials are targeted to various end-user segments. The Company utilizes broad consumer media (television, radio, and business publications) and trade publications. Microsoft has programs under which qualifying resellers and OEMs are reimbursed for certain advertising expenditures. The Company maintains a broad advertising campaign emphasizing the Microsoft brand identity.

CUSTOMERS

The Company's customers include end-users, organizations, enterprises, ISPs, application developers, and OEMs. Most end-users of Microsoft products are individuals in businesses, government agencies, educational institutions, and at home. These end-users obtain Microsoft products primarily through distributors, resellers, and OEMs, which include certain Microsoft products with their hardware. Notes to Financial Statements (see Item 8) describe customers that represent more than 10% of the Company's revenue. The Company's practice is to ship its products promptly upon receipt of purchase orders from its customers and, consequently, backlog is not significant.

PRODUCT SUPPORT

The Company provides product support coverage options to meet the needs of users of Microsoft products. Support personnel are located in various sites in the U.S. and around the world. Certain support is also supplied by qualified third-party support organizations. The Company hires individuals with product expertise and provides them with productivity tools, continuous product education and training, and consistent processes to deliver quality support for Microsoft products. Coverage options range from standard no-charge toll telephone support to fee-based offerings providing unlimited 800 number telephone and electronic technical support for all Microsoft products 24 hours per day, 7 days per week.

Users have access to troubleshooting "wizards" and Microsoft's KnowledgeBase, a library of thousands of technical articles that is updated regularly with useful information regarding Microsoft products. Microsoft provides access to KnowledgeBase via MSN, America Online, CompuServe, Prodigy, and the Internet. Additionally, several support offerings include Microsoft TechNet and Microsoft Developer Network information subscription services.

As a supplement or alternative to direct support, the Company enhances the third-party support channel by providing Microsoft Solution Providers with education, training, tools, and support. Microsoft Solution Providers include Authorized Training Centers, which offer advanced product education and certification on Microsoft products; and Authorized Support Centers, which provide a wide spectrum of multinational support, multivendor support, and integration services.

COMPETITION

The PC software business is intensely competitive and subject to extremely rapid technological change. Microsoft faces formidable competition in all areas of its business activity, including competition from many companies much larger than Microsoft. The rapid pace of technological change constantly creates new opportunities for existing competitors and start-ups and can quickly render existing technologies less valuable. The Company also faces constant competition from software pirates who unlawfully copy and distribute Microsoft's copyrighted software products.

OPERATING SYSTEMS. Microsoft's operating system products face substantial competition from a wide variety of companies. Major competitors such as IBM, Apple Computer, Digital Equipment Corporation, Hewlett-Packard, Sun Microsystems, and others are vertically integrated in both software development and hardware manufacturing and have developed operating systems that they preinstall on computers of their own manufacture. Many of these operating system software products are also licensed to third-party OEMs for preinstallation on their machines. Microsoft's operating system products compete with UNIX-based operating systems from a wide range of companies including IBM, AT&T, Hewlett-Packard, Sun, The Santa Cruz Operation, and others. Variants of UNIX run on a wide variety of computer platforms and have gained increasing acceptance as desktop operating systems. As PC technology increasingly moves toward connectivity and communications, Microsoft's operating system products will face increased competition from network server operating systems such as Novell's NetWare, Banyan's Vines, the many variants of UNIX, IBM's OS/2, "middleware" products such as IBM's Lotus Notes, and intranet servers from Netscape, IBM, Sun, and others.

BUSINESS SYSTEMS. The Company is a fairly recent entrant into the business of providing enterprisewide computing solutions. Several competitors enjoy a larger share of sales and larger installed bases. Many companies offer operating system software for mainframes and midrange computers, including IBM, Digital Equipment, Hewlett-Packard, and Sun. Since legacy business systems are typically support-intensive, these competitors also offer substantive support services. Software developers that provide competing server applications for PC-based distributed client/server environments include Oracle, IBM, Computer Associates, Sybase, and Informix. There are also several software vendors who offer connectivity servers. As mentioned above, there are numerous companies and organizations that offer Internet and intranet server software which compete against the Company's business systems. Additionally, IBM has a large installed base of Lotus Notes and cc:Mail, both of which compete with the Company's workgroup and mail products.

DESKTOP APPLICATIONS. The Company's competitors include many software application vendors, such as IBM (Lotus), Oracle, Apple (Claris), Corel, and local application developers in Europe and the Far East. IBM and Corel have large installed bases with their spreadsheet and word processor products, respectively, and both have aggressive pricing strategies. Also, IBM and Apple preinstall certain of their software products on various models of their PCs, competing directly with Microsoft desktop application software.

DEVELOPER TOOLS. The Company's developer products compete against offerings from Borland, Macromedia, Oracle, Sun, Sybase, Symantec, and other companies.

NEWS SERVICES. The Company's MSNBC joint ventures face formidable competition from other 24-hour cable and Internet news organizations such as CNN and Fox News Network. MSNBC also competes with traditional news media such as newspapers and broadcast TV and Internet news services.

CONSUMER PLATFORMS. A wide variety of companies develop operating systems for information appliances, including Apple, Motorola, 3Com, Psion Software, and others. The Company's nascent WebTV offerings and other multimedia consumer products face competitors such as Sun, Oracle, NetChannel, and others. An enormous range of companies, including media conglomerates, telephone companies, cable companies, retailers, hardware manufacturers, and software developers, are competing to make interactive services widely available to the home.

INTERNET PLATFORMS AND SERVICES. The advent of the Internet as a computing, communication, and collaboration platform as well as a low cost and efficient distribution vehicle increases competition and creates uncertainty as to future technology directions. The Company faces intense competition in the development and marketing of Internet (and intranet) software from a wide variety of companies and organizations including IBM, Netscape, Novell, Oracle, Sun, and many others. In addition, the very low barriers to entry on the Internet have allowed numerous Web-based service companies to build significant businesses in areas such as electronic mail, electronic commerce, Web search engines, and information of numerous types. Competitors include Netscape, Lycos, Yahoo, Excite, Infoseek, CitySearch, and many others.

ONLINE SERVICES. Microsoft's online services network, MSN, faces formidable competition from America Online and other online networks, such as CompuServe (the sale of which to America Online is pending), Prodigy, and impending entrants. Additionally, MSN faces competition from online services that are offered to users directly via the World Wide Web.

INTERACTIVE MEDIA. The Company's Interactive Media division faces many smaller but focused and branded competitors, particularly in the areas of entertainment and education. Consolidation in this area of software development has made certain competitors even stronger. Competitors include Intuit, Broderbund, Electronic Arts, The Learning Company (including Softkey, MECC, and Compton's), Voyager, CUC International (including Sierra On Line, Knowledge Adventures, and Davidson Associates), and Dorling Kindersley. Still other competitors own branded content, such as Disney and Lucas Arts.

Additionally, PC-based games are increasingly competing head-to-head against games created for proprietary systems such as Nintendo, Sony PlayStation, and Sega. Input devices face substantial competition from computer manufacturers, since computers are typically sold with a keyboard and mouse, and other manufacturers of these devices.

A number of Microsoft's most significant competitors, including IBM, Sun, Oracle, and Netscape, have jointly embarked upon various technology development and marketing initiatives that are intended to increase customer demand for products from these companies. These initiatives relate in part to efforts to move software from individual PCs to centrally-managed servers. While the likely technological and business success of such "thin client" strategies is currently unknown, widespread adoption of such computing systems would present significant challenges to the Company's historical business model.

The Company's competitive position may be adversely affected by one or more of these factors in the future, particularly in view of the fast pace of technological change in the software industry.

EMPLOYEES

As of June 30, 1997, the Company employed 22,232 people on a full-time basis, 15,835 in the U.S. and 6,397 internationally. Of the total, 8,059 were in product research and development, 11,074 in sales, marketing, and support, 1,115 in manufacturing and distribution, and 1,984 in finance and administration. Microsoft's success is highly dependent on its ability to attract and retain qualified employees. Competition for employees is intense in the software industry. To date, the Company believes it has been successful in its efforts to recruit qualified employees, but there is no assurance that it will continue to be as successful in the future. None of the Company's employees are subject to collective bargaining agreements. The Company believes relations with its employees are excellent.

Item 2. Properties

The Company's corporate offices consist of approximately 3.6 million square feet of office building space located in King County, Washington. There are two sites that total approximately 300 acres of land. The Company is constructing three office buildings comprising approximately 565,000 square feet of space. Occupancy on this site will be phased starting in the winter of 1997 and completed by spring of 1998. Additionally, construction is continuing on another set of office buildings with approximately 423,000 square feet of space. This site will be occupied in the winter of 1999. The Company owns all of its corporate campus.

The Company leases a 45,000 square foot disk duplication facility in Humacao, Puerto Rico. The Puerto Rico facility, which began operation in April 1990, is leased under a 10-year lease, with an option to renew for an additional 10 years. The Company's European manufacturing operation consists of a 161,000 square foot facility situated on 12 acres in Dublin, Ireland. The Ireland site also includes office buildings with 157,000 square feet for international localization. The Ireland facilities are fully owned by the Company. In Les Ulis, France, the Company owns a 199,000 square foot office building on four acres of land.

The Company is constructing an office building complex with 225,000 square feet on 33 acres of land near Redding, England. This is a phased construction project, occupancy is expected to begin in the fall of 1997 and be completed in winter of 1997.

In addition, the Company leases office space in numerous locations in the United States and many other countries.

Item 3. Legal Proceedings

The information set forth in Notes to Financial Statements-Commitments and Contingencies on page 40 of the 1997 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.4.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 1997.

PART II

Item 5. Market for Registrant's Common Stock and Related Stockholder Matters

The information set forth on page 42 of the 1997 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.1.

Item 6. Selected Financial Data

The information set forth on page 1 of the 1997 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.2.

Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition

The information set forth on pages 26-31 of the 1997 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.3.

Item 8. Financial Statements and Supplementary Data

The following financial statements for the Company and independent auditors' report set forth on pages 24-25, 32-41, 43 and 44 of the 1997 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.4.

- Income Statements for the three years ended June 30, 1997
- Cash Flows Statements for the three years ended June 30, 1997
- Balance Sheets as of June 30, 1996 and 1997
- Stockholders' Equity Statements for the three years ended June 30, 1997
- Notes to Financial Statements
- Independent Auditors' Report

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

Information with respect to Directors may be found under the caption "Election of Directors and Management Information" on pages 1 and 2 of the Company's Proxy Statement dated September 26, 1997, for the Annual Meeting of Shareholders to be held November 14, 1997 (the "Proxy Statement"). Such information is incorporated herein by reference.

The executive officers of Microsoft as of September 12, 1997 were as follows:

Name	Age	Position with the Company
William H. Gates	41	Chairman of the Board; Chief Executive Officer
Steven A. Ballmer	41	Executive Vice President, Sales and Support
Robert J. Herbold	55	Executive Vice President; Chief Operating Officer
Frank M. (Pete) Higgins	39	Group Vice President, Interactive Media
Paul A. Maritz	42	Group Vice President, Platforms and Applications
Nathan P. Myhrvold	38	Group Vice President, Chief Technology Officier
Jeffrey S. Raikes	39	Group Vice President, Sales and Marketing
James E. Allchin	45	Senior Vice President, Personal and Business Systems Division
Joachim Kempin	55	Senior Vice President, OEM Sales
Michel Lacombe	46	Senior Vice President, Microsoft; President, Microsoft Europe
Craig J. Mundie	48	Senior Vice President, Consumer Platforms Division
William H. Neukom	55	Senior Vice President, Law and Corporate Affairs; Secretary
Brad A. Silverberg	43	Senior Vice President, Applications and Internet Client
Gregory B. Maffei	37	Vice President, Finance; Chief Financial Officer

Mr. Gates co-founded Microsoft in 1975 and has been its Chairman of the Board and Chief Executive Officer since the original partnership was incorporated in 1981.

Mr. Ballmer was named Executive Vice President, Sales and Support in February 1992. He had been Senior Vice President, Systems Software since 1989. From 1984 until 1989, Mr. Ballmer served as Vice President, Systems Software. He joined Microsoft in 1980.

Mr. Herbold joined Microsoft as Executive Vice President and Chief Operating Officer in November 1994. Mr. Herbold had been with The Procter & Gamble Company since 1968, with experience in information services, advertising and market research. Most recently, he was P&G's Senior Vice President, Information Services and Advertising.

Mr. Higgins was named Group Vice President, Interactive Media Group in October 1996. He was named Group Vice President, Applications and Content in May 1995 and Senior Vice President, Desktop Applications Division in March 1993. He had been Vice President, Desktop Applications Division since 1992. Mr. Higgins joined Microsoft in 1983.

Mr. Maritz was named Group Vice President, Platforms and Applications in October 1996 and had been Group Vice President, Platforms since May 1995. He had been Senior Vice President, Product and Technology Strategy in November 1994 and had been Senior Vice President, Systems Division since February 1992. He had been Vice President, Advanced Operating Systems since 1989. Mr. Maritz joined Microsoft in 1986.

Mr. Myhrvold was named Group Vice President and Chief Technology Officer in October 1996. He was named Group Vice President, Applications and Content in May 1995 and had been Senior Vice President, Advanced Technology since July 1993. He had been Vice President, Advanced Technology and Business Development since 1989. Mr. Myhrvold joined Microsoft in 1986.

Mr. Raikes was named Group Vice President, Sales and Marketing in July 1996. He was named Senior Vice President, Microsoft North America in January 1992 and had been Vice President, Office Systems since 1990. Mr. Raikes joined Microsoft in 1981.

Mr. Allchin was named Senior Vice President, Personal and Business Systems Group in February 1996. He was named Senior Vice President, Business Systems Division in November 1994 and had been Vice President, Business Systems Division, since July 1991. Mr. Allchin joined Microsoft in 1991.

Mr. Kempin was named Senior Vice President, OEM Sales in August 1993. He had been Vice President, OEM Sales since 1987. Mr. Kempin joined Microsoft in 1983.

Mr. Lacombe was named President, Microsoft Europe in July 1997 and Senior Vice President, Microsoft in December 1996. He had been Vice President, Europe since September 1995 and Vice President, End User Customer Unit, Europe since April 1994. Mr. Lacombe had been Regional Director of Southern Europe from May 1991. Mr. Lacombe joined Microsoft in 1983.

Mr. Mundie was named Senior Vice President, Consumer Platforms in February 1996. He was named Senior Vice President, Consumer Systems Division in May 1995 and had been Vice President, Advanced Consumer Technology since July 1993. He joined Microsoft as General Manager, Advanced Consumer Technology Group in December 1992.

Mr. Neukom was named Senior Vice President, Law and Corporate Affairs in February 1994. He joined Microsoft in 1985 as Vice President, Law and Corporate Affairs.

Mr. Silverberg was named Senior Vice President, Applications and Internet Client Group in December 1996. He had been Senior Vice President, Internet Platform and Tools Division since February 1996. He was named Senior Vice President, Personal Systems Division in November 1994 after joining Microsoft in August 1990 as Vice President, Personal Operating Systems Division.

Mr. Maffei was named Vice President, Finance and Chief Financial Officer in July 1997. He was named Vice President, Corporate Development in July 1996 and Treasurer in April 1994. He joined Microsoft in April 1993 as Director, Business Development & Investments. Previously, Mr. Maffei was Executive Vice President and Chief Financial Officer of Pay 'N Pac Stores, Inc. from 1991 to 1992.

Item 11. Executive Compensation

The information in the Proxy Statement set forth under the captions "Information Regarding Executive Officer Compensation" on pages 4 through 7 and "Information Regarding the Board and its Committees" on page 2 is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information set forth under the caption "Information Regarding Beneficial Ownership of Principal Shareholders, Directors, and Management" on page 3 of the Proxy Statement is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

The information set forth in Notes to Financial Statements--Acquisitions on page 40 of the 1997 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.4.

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) Financial Statements and Schedules

The financial statements as set forth under Item 8 of this report on Form 10-K are incorporated herein by reference.

Financial statement schedules have been omitted since they are either not required, not applicable, or the information is otherwise included.

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the last quarter of fiscal 1997.

(c) Exhibit Listing

Exhibit Number	Description
3.1	Restated Articles of Incorporation (1)
3.2	Bylaws (1)
10.1	Microsoft Corporation 1991 Stock Option Plan
10.2	Microsoft Corporation 1981 Stock Option Plan (2)
10.3	Microsoft Corporation Stock Option Plan for Non-Employee Directors (1)
10.4	Microsoft Corporation Stock Option Plan for Consultants and Advisors (1)
10.5	Microsoft Corporation 1997 Employee Stock Purchase Plan
10.6	Microsoft Corporation Savings Plus Plan (1)
10.7	Trust Agreement dated June 1, 1993 between Microsoft Corporation and First Interstate Bank of Washington (3)
10.8	Form of Indemnification Agreement (3)
11.	Computation of Earnings Per Share
13.1	Quarterly and Market Information Incorporated by Reference to Page 42 of 1997 Annual Report to Shareholders ("1997 Annual Report")
13.2	Selected Financial Data Incorporated by Reference to Page 1 of 1997 Annual Report
13.3	Management's Discussion and Analysis of Results of Operations and Financial Condition Incorporated by Reference to Pages 26-31 of 1997 Annual Report
13.4	Financial Statements Incorporated by Reference to Pages 24-25, 32-41, 43, and 44 of 1997 Annual Report
21.	Subsidiaries of Registrant (4)
23.	Independent Auditors' Consent
27.	Financial Data Schedule

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(1) Incorporated by reference to Annual Report on Form 10-K For The Fiscal Year Ended June 30, 1994.
(2) Incorporated by reference to Registration Statement 33-37623 on Form S-8.
(3) Incorporated by reference to Annual Report on Form 10-K For The Fiscal Year Ended June 30, 1993.
(4) Incorporated by reference to Exhibit 13.4 filed herein.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Redmond, State of Washington, on September 26, 1997.

MICROSOFT CORPORATION

By /s/ Gregory B. Maffei

Gregory B. Maffei
Vice President, Finance; Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on September 26, 1997.

Signature	Title
/s/ William H. Gates William H. Gates	Chairman of the Board of Directors and Chief Executive Officer
/s/ Paul G. Allen Paul G. Allen	Director
Jill E. Barad	Director
/s/ Richard A. Hackborn Richard A. Hackborn	Director
/s/ David F. Marquardt David F. Marquardt	Director
/s/ Robert D. O'Brien Robert D. O'Brien	Director
/s/ Wm. G. Reed, Jr. Wm. G. Reed, Jr.	Director
/s/ Jon A. Shirley Jon A. Shirley	Director
/s/ Gregory B. Maffei Gregory B. Maffei	Vice President, Finance; Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBIT INDEX

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(4) Incorporated by reference to Exhibit 13.4 filed herein.

Exhibit 10.1.

Microsoft Corporation 1991 Stock Option Plan, As Amended

MICROSOFT CORPORATION

1991 STOCK OPTION PLAN, AS AMENDED

1. Purpose of the Plan. The purposes of this Stock Option Plan are to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to such individuals, and to promote the success of the Company's business by aligning employee financial interests with long-term shareholder value.

Options granted hereunder may be either Incentive Stock Options or Nonqualified Stock Options, at the discretion of the Board and as reflected in the terms of the written option agreement.

2. Definitions. As used herein, the following definitions shall apply:

(a) "Board" shall mean the Committee, if such Committee has been appointed, or the Board of Directors of the Company, if such Committee has not been appointed.

(b) "Code" shall mean the Internal Revenue Code of 1986, as amended.

(c) "Committee" shall mean the Committee appointed by the Board of Directors in accordance with paragraph (a) of Section 4 of the Plan, if one is appointed; provided, however, if the Board of Directors appoints more than one Committee pursuant to Section 4, then "Committee" shall refer to the appropriate Committee, as indicated by the context of the reference.

(d) "Common Shares" shall mean the common shares of Microsoft Corporation.

(e) "Company" shall mean Microsoft Corporation, a Washington corporation and any successor thereto.

(f) "Continuous Status as an Employee" shall mean the absence of any interruption or termination of service as an Employee. Continuous Status as an Employee shall not be considered interrupted in the case of sick leave, maternity leave, infant care leave, medical emergency leave, military leave, or any other leave of absence authorized in writing by a Vice President of the Company prior to its commencement.

(g) "Employee" shall mean any person, including officers, employed by the Company or any Parent or Subsidiary of the Company.

(h) "Incentive Stock Option" shall mean any Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.

(i) "Maximum Annual Employee Grant" shall have the meaning set forth in Section 5(e).

(j) "Non-Employee Director" shall have the same meaning as defined or interpreted for purposes of Rule 16b-3 (including amendments and successor provisions) as promulgated by the Securities and Exchange Commission pursuant to its authority under the Exchange Act ("Rule 16b-3").

(k) "Nonqualified Stock Option" shall mean an Option not intended to qualify as an Incentive Stock Option.

(l) "Option" shall mean a stock option granted pursuant to the Plan.

(m) "Optioned Shares" shall mean the Common Shares subject to an Option.

(n) "Optionee" shall mean an Employee who receives an Option.

(o) "Outside Director" shall have the same meaning as defined or interpreted for purposes of Section 162(m) of the Code.

(p) "Parent" shall mean a "parent corporation," whether now or hereafter existing, as defined in Section 424(e) of the Code.

(q) "Plan" shall mean this 1991 Stock Option Plan, including any amendments thereto.

(r) "Share" shall mean one Common Share, as adjusted in accordance with Section 11 of the Plan.

(s) "*Subsidiary*" shall mean (i) in the case of an Incentive Stock Option a "subsidiary corporation," whether now or hereafter existing, as defined in Section 424(f) of the Code, and (ii) in the case of a Nonqualified Stock Option, in addition to a subsidiary corporation as defined in (i), a limited liability company, partnership or other entity in which the Company controls 50 percent or more of the voting power or equity interests.

3. *Shares Subject to the Plan*. Subject to the provisions of Section 11 of the Plan, the maximum aggregate number of shares which may be optioned and sold under the Plan is 520,000,000 Common Shares. The Shares may be authorized, but unissued, or reacquired Common Shares.

If an Option should expire or become unexercisable for any reason without having been exercised in full, the unpurchased Shares which were subject thereto shall, unless the Plan shall have been terminated, become available for future grant under the Plan.

4. *Administration of the Plan*.

(a) *Procedure*. The Plan shall be administered by the Board of Directors of the Company.

(1) The Board of Directors may appoint one or more Committees each consisting of not less than two members of the Board of Directors to administer the Plan on behalf of the Board of Directors, subject to such terms and conditions as the Board of Directors may prescribe. Once appointed, such Committees shall continue to serve until otherwise directed by the Board of Directors.

(2) Any grants of Options to officers who are subject to Section 16 of the Securities Exchange Act of 1934 (the "Exchange Act") shall be made by (i) a Committee of two or more directors, each of whom is a Non-Employee Director and an Outside Director or (ii) as otherwise permitted by both Rule 16b-3, Section 162(m) of the Code and other applicable regulations.

(3) Subject to the foregoing subparagraphs (1) and (2), from time to time the Board of Directors may increase the size of the Committee(s) and appoint additional members thereof, remove members (with or without cause) and appoint new members in substitution therefor, or fill vacancies however caused.

(b) *Powers of the Board*. Subject to the provisions of the Plan, the Board shall have the authority, in its discretion: (i) to grant Incentive Stock Options or Nonqualified Stock Options; (ii) to determine, in accordance with Section 8(b) of the Plan, the fair market value of the Shares; (iii) to determine, in accordance with Section 8(a) of the Plan, the exercise price per share of Options to be granted; (iv) to determine the Employees to whom, and the time or times at which, Options shall be granted and the number of Shares to be represented by each Option; (v) to interpret the Plan; (vi) to prescribe, amend, and rescind rules and regulations relating to the Plan; (vii) to determine the terms and provisions of each Option granted (which need not be identical) and, with the consent of the holder thereof, modify or amend each Option; (viii) to reduce the exercise price per share of outstanding and unexercised Options; (ix) to accelerate or defer (with the consent of the Optionee) the exercise date of any Option; (x) to authorize any person to execute on behalf of the Company any instrument required to effectuate the grant of an Option previously granted by the Board; and (xi) to make all other determinations deemed necessary or advisable for the administration of the Plan.

(c) Effect of Board's Decision. All decisions, determinations, and interpretations of the Board shall be final and binding on all Optionees and any other holders of any Options granted under the Plan.

5. Eligibility.

(a) Options may be granted only to Employees. For avoidance of doubt, directors are not eligible to participate in the Plan unless they are full-time Employees.

(b) Each Option shall be designated in the written option agreement as either an Incentive Stock Option or a Nonqualified Stock Option. However, notwithstanding such designations, to the extent that the aggregate fair market value of the Shares with respect to which Options designated as Incentive Stock Options are exercisable for the first time by any Optionee during any calendar year (under all plans of the Company) exceeds $100,000, such Options shall be treated as Nonqualified Stock Options.

(c) For purposes of Section 5(b), Options shall be taken into account in the order in which they were granted, and the fair market value of the Shares shall be determined as of the time the Option with respect to such Shares is granted.

(d) Nothing in the Plan or any Option granted hereunder shall confer upon any Optionee any right with respect to continuation of employment with the Company, nor shall it interfere in any way with the Optionee's right or the Company's right to terminate the employment relationship at any time, with or without cause.

(e) The maximum number of Shares with respect to which an Option or Options may be granted to any Employee in any one taxable year of the Company shall not exceed 2,000,000 shares (the "Maximum Annual Employee Grant").

6. Term of Plan. The Plan shall become effective upon its adoption by the Board. It shall continue in effect until August 16, 2001, unless sooner terminated under Section 14 of the Plan.

7. Term of Option. The term of each Option shall be no more than ten (10) years from the date of grant. However, in the case of an Incentive Stock Option granted to an Optionee who, at the time the Option is granted, owns Shares representing more than ten percent (10%) of the voting power of all classes of shares of the Company or any Parent or Subsidiary, the term of the Option shall be no more than five (5) years from the date of grant.

8. Exercise Price and Consideration.

(a) The per Share exercise price under each Option shall be such price as is determined by the Board, subject to the following:

(1) In the case of an Incentive Stock Option

(i) granted to an Employee who, at the time of the grant of such Incentive Stock Option, owns shares representing more than ten percent (10%) of the voting power of all classes of shares of the Company or any Parent or Subsidiary, the per Share exercise price shall be no less than 110% of the fair market value per Share on the date of grant.

(ii) granted to any other Employee, the per Share exercise price shall be no less than 100% of the fair market value per Share on the date of grant.

(2) In the case of a Nonqualified Stock Option the per Share exercise price may be less than, equal to, or greater than the fair market value per Share on the date of grant.

(b) The fair market value per Share shall be the closing price per share of the Common Share on the Nasdaq Stock Market ("Nasdaq") on the date of grant. If the Shares cease to be listed on Nasdaq, the Board shall designate an alternative method of determining the fair market value of the Shares.

(c) The consideration to be paid for the Shares to be issued upon exercise of an Option, including the method of payment, shall be determined by the Board at the time of grant and may consist of cash and/or check. Payment may also be made by delivering a properly executed exercise notice together with irrevocable instructions to a broker to promptly deliver to the Company the amount of sale proceeds necessary to pay the exercise price. If the Optionee is an officer of the Company within the meaning of Section 16 of the Exchange Act, he may in addition be allowed to pay all or part of the purchase price with Shares. Shares used by officers to pay the exercise price shall be valued at their fair market value on the exercise date.

(d) Prior to issuance of the Shares upon exercise of an Option, the Optionee shall pay any federal, state, and local withholding obligations of the Company, if applicable. If an Optionee is an officer of the Company within the meaning of Section 16 of the Exchange Act, he may elect to pay such withholding tax obligations by having the Company withhold Shares having a value equal to the amount required to be withheld. The value of the Shares to be withheld shall equal the fair market value of the Shares on the day the Option is exercised. The right of an officer to dispose of Shares to the Company in satisfaction of withholding tax obligations shall be deemed to be approved as part of the initial grant of an option, unless thereafter rescinded, and shall otherwise be made in compliance with Rule 16b-3 and other applicable regulations.

9. Exercise of Option.

(a) Procedure for Exercise; Rights as a Shareholder. Any Option granted hereunder shall be exercisable at such times and under such conditions as determined by the Board at the time of grant, and as shall be permissible under the terms of the Plan.

An Option may not be exercised for a fraction of a Share.

An Option shall be deemed to be exercised when written notice of such exercise has been given to the Company in accordance with the terms of the Option by the person entitled to exercise the Option and full payment for the Shares with respect to which the Option is exercised has been received by the Company. Full payment may, as authorized by the Board, consist of any consideration and method of payment allowable under Section 8(c) of the Plan. Until the issuance (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the share certificate evidencing such Shares, no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. The Company shall issue (or cause to be issued) such share certificate promptly upon exercise of the Option. In the event that the exercise of an Option is treated in part as the exercise of an Incentive Stock Option and in part as the exercise of a Nonqualified Stock Option pursuant to Section 5(b), the Company shall issue a share certificate evidencing the Shares treated as acquired upon the exercise of an Incentive Stock Option and a separate share certificate evidencing the Shares treated as acquired upon the exercise of a Nonqualified Stock Option, and shall identify each such certificate accordingly in its share transfer records. No adjustment will be made for a dividend or other right for which the record date is prior to the date the share certificate is issued, except as provided in Section 11 of the Plan.

Exercise of an Option in any manner shall result in a decrease in the number of Shares which thereafter may be available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

(b) <u>Termination of Status as Employee.</u> In the event of termination of an Optionee's Continuous Status as an Employee, such Optionee may exercise stock options to the extent exercisable on the date of termination. Such exercise must occur within three (3) months (or such shorter time as may be specified in the grant), after the date of such termination (but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement). To the extent that the Optionee was not entitled to exercise the Option at the date of such termination, or does not exercise such Option within the time specified herein, the Option shall terminate.

(c) <u>Disability of Optionee.</u> Notwithstanding the provisions of Section 9(b) above, in the event of termination of an Optionee's Continuous Status as an Employee as a result of total and permanent disability (i.e., the inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of twelve (12) months), the Optionee may exercise the Option, but only to the extent of the right to exercise that would have accrued had the Optionee remained in Continuous Status as an Employee for a period of twelve (12) months after the date on which the Employee ceased working as a result of the total and permanent disability. Such exercise must occur within eighteen (18) months (or such shorter time as is specified in the grant) from the date on which the Employee ceased working as a result of the total and permanent disability (but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement). To the extent that the Optionee was not entitled to exercise such Option within the time specified herein, the Option shall terminate.

(d) <u>Death of Optionee.</u> Notwithstanding the provisions of Section 9(b) above, in the event of the death of an Optionee:

(i) who is at the time of death an Employee of the Company, the Option may be exercised, at any time within six (6) months following the date of death (but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement), by the Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent of the right to exercise that would have accrued had the Optionee continued living and remained in Continuous Status as an Employee twelve (12) months after the date of death; or

(ii) whose Option has not yet expired but whose Continuous Status as an Employee terminated prior to the date of death, the Option may be exercised, at any time within six (6) months following the date of death (but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement), by the Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent of the right to exercise that had accrued at the date of termination.

(e) Notwithstanding subsections (b), (c), and (d) above, the Board shall have the authority to extend the expiration date of any outstanding option in circumstances in which it deems such action to be appropriate (provided that no such extension shall extend the term of an option beyond the date on which the option would have expired if no termination of the Employee's Continuous Status as an Employee had occurred).

10. Non-Transferability of Options. The Option may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Optionee, only by the Optionee; provided that the Board may permit further transferability, on a general or specific basis, and may impose conditions and limitations on any permitted transferability.

11. Adjustments Upon Changes in Capitalization or Merger. Subject to any required action by the shareholders of the Company, the number of Shares covered by each outstanding Option, the Maximum Annual Employee Grant and the number of Shares which have been authorized for issuance under the Plan but as to which no Options have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Option, as well as the price per Share covered by each such outstanding Option, shall be proportionately adjusted for any increase or decrease in the number of issued Shares resulting from a stock split, reverse stock split, stock dividend, combination, or reclassification of the Shares, or any other increase or decrease in the number of issued Shares effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding, and conclusive. Except as expressly provided herein, no issuance by the Company of shares of any class, or securities convertible into shares of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Shares subject to an Option.

In the event of the proposed dissolution or liquidation of the Company, the Option will terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the Board. The Board may, in the exercise of its sole discretion in such instances, declare that any Option shall terminate as of a date fixed by the Board and give each Optionee the right to exercise an Option as to all or any part of the Optioned Shares, including Shares as to which the Option would not otherwise be exercisable. In the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, each Option shall be assumed or an equivalent option shall be substituted by such successor corporation or a parent or subsidiary of such successor corporation, unless such successor corporation does not agree to assume the Option or to substitute an equivalent option, in which case the Board shall, in lieu of such assumption or substitution, provide for the Optionee to have the right to exercise the Option as to all of the Optioned Shares, including Shares as to which the Option would not otherwise be exercisable. If the Board makes an Option fully exercisable in lieu of assumption or substitution in the event of a merger or sale of assets, the Board shall notify the Optionee that the Option shall be fully exercisable for a period of fifteen (15) days from the date of such notice, and the Option will terminate upon the expiration of such period.

12. Time of Granting Options. The date of grant of an Option shall, for all purposes, be the date on which the Company completes the corporate action relating to the grant of an option and all conditions to the grant have been satisfied, provided that conditions to the exercise of an option shall not defer the date of grant. Notice of a grant shall be given to each Employee to whom an Option is so granted within a reasonable time after the determination has been made.

13. Substitutions and Assumptions. The Board shall have the right to substitute or assume Options in connection with mergers, reorganizations, separations, or other transactions to which Section 424(a) of the Code applies, provided such substitutions and assumptions are permitted by Section 424 of the Code and the regulations promulgated thereunder. The number of Shares reserved pursuant to Section 3 may be increased by the corresponding number of Options assumed and, in the case of a substitution, by the net increase in the number of Shares subject to Options before and after the substitution.

14. Amendment and Termination of the Plan.

(a) Amendment and Termination. The Board may amend or terminate the Plan from time to time in such respects as the Board may deem advisable (including, but not limited to amendments which the Board deems appropriate to enhance the Company's ability to claim deductions related to stock option exercises); provided that any increase in the number of Shares subject to the Plan, other than in connection with an adjustment under Section 11 of the Plan, shall require approval of or ratification by the shareholders of the Company.

(b) Employees in Foreign Countries. The Board shall have the authority to adopt such modifications, procedures, and subplans as may be necessary or desirable to comply with provisions of the laws of foreign countries in which the Company or its Subsidiaries may operate to assure the viability of the benefits from Options granted to Employees employed in such countries and to meet the objectives of the Plan.

(c) Effect of Amendment or Termination. Any such amendment or termination of the Plan shall not affect Options already granted and such Options shall remain in full force and effect as if this Plan had not been amended or terminated, unless mutually agreed otherwise between the Optionee and the Board, which agreement must be in writing and signed by the Optionee and the Company.

15. Conditions Upon Issuance of Shares. Shares shall not be issued pursuant to the exercise of an Option unless the exercise of such Option and the issuance and delivery of such

Shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, and the requirements of any stock exchange upon which the Shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

16. Reservation of Shares. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

17. Shareholder Approval. The Plan, as amended, is subject to approval by the shareholders of the Company at the Annual Meeting of Shareholders to be held on November 12, 1996. If the Plan, as herein amended, is not so approved by the shareholders, the Plan, as previously approved, shall continue in effect.

[The number of shares in Sections 3 and 5(e) have been increased to reflect the 2-for-1 stock splits in May 1994 and November 1996.]

Exhibit 10.5.

Microsoft Corporation 1997 Employee Stock Purchase Plan

MICROSOFT CORPORATION

1997 EMPLOYEE STOCK PURCHASE PLAN

Microsoft Corporation (the "Company") does hereby establish its 1997 Employee Stock Purchase Plan as follows:

1. <u>Purpose of the Plan.</u> The purpose of this Plan is to provide eligible employees who wish to become shareholders in the Company a convenient method of doing so. It is believed that employee participation in the ownership of the business will be to the mutual benefit of both the employees and the Company.

2. <u>Definitions.</u>

2.1 "Base pay" means regular straight time earnings, plus review cycle bonuses and overtime payments, payments for incentive compensation, and other special payments except to the extent that any such item is specifically excluded by the Board of Directors of the Company (the "Board").

2.2 "Account" shall mean the funds accumulated with respect to an individual employee as a result of deductions from his paycheck for the purpose of purchasing stock under this Plan. The funds allocated to an employee's account shall remain the property of the respective employee at all times but may be commingled with the general funds of the Company.

3. <u>Employees Eligible to Participate.</u> Any employee of the Company or any of its subsidiaries who is in the employ of the Company or subsidiary on an offering commencement date is eligible to participate in that offering, except (a) employees whose customary employment is less than 20 hours per week, and (b) employees whose customary employment is for not more than five months in any calendar year.

4. <u>Offerings.</u> There will be twelve separate consecutive six-month offerings pursuant to the Plan. The first offering shall commence on January 1, 1997. Thereafter, offerings shall commence on each subsequent July 1 and January 1, and the final offering under this Plan shall commence on July 1, 2002 and terminate on December 31, 2002. In order to become eligible to purchase shares, an employee must sign an Enrollment Agreement, and any other necessary papers on or before the commencement date (January 1 or July 1) of the particular offering in which he wishes to participate. Participation in one offering under the Plan shall neither limit, nor require, participation in any other offering.

5. <u>Price.</u> The purchase price per share shall be the lesser of (1) 85% of the fair market value of the stock on the offering date; or (2) 85% of the fair market value of the stock on the last business day of the offering. Fair market value shall mean the closing bid price as reported on the National Association of Securities Dealers Automated Quotation System or, if the stock is traded on a stock exchange, the closing price for the stock on the principal such exchange.

6. <u>Offering Date.</u> The "offering date" as used in this Plan shall be the commencement date of the offering, if such date is a regular business day, or the first regular business day following such commencement date. A different date may be set by resolution of the Board.

7. Number of Shares to be Offered. The maximum number of shares that will be offered under the Plan is 20,000,000 shares. The shares to be sold to participants under the Plan will be common stock of the Company. If the total number of shares for which options are to be granted on any date in accordance with Section 10 exceeds the number of shares then available under the Plan (after deduction of all shares for which options have been exercised or are then outstanding), the Company shall make a pro rata allocation of the shares remaining available in as nearly a uniform manner as shall be practicable and as it shall determine to be equitable. In such event, the payroll deductions to be made pursuant to the authorizations therefor shall be reduced accordingly and the Company shall give written notice of such reduction to each employee affected thereby.

8. Participation.

8.1 An eligible employee may become a participant by completing an Enrollment Agreement provided by the Company and filing it with Shareholder Services prior to the Commencement of the offering to which it relates.

8.2 Payroll deductions for a participant shall commence on the offering date, and shall end on the termination date of such offering unless earlier terminated by the employee as provided in Paragraph 14.

9. Payroll Deductions.

9.1 At the time a participant files his authorization for a payroll deduction, he shall elect to have deductions made from his pay on each payday during the time he is a participant in an offering at the rate of 2%, 4%, 6%, 8%, or 10% of his base pay.

9.2 All payroll deductions made for a participant shall be credited to his account under the Plan. A participant may not make any separate cash payment into such account nor may payment for shares be made other than by payroll deduction.

9.3 A participant may discontinue his participation in the Plan as provided in Section 14, but no other change can be made during an offering and, specifically, a participant may not alter the rate of his payroll deductions for that offering.

10. Granting of Option. On the offering date, this Plan shall be deemed to have granted to the participant an option for as many full shares as he will be able to purchase with the payroll deductions credited to his account during his participation in that offering. Notwithstanding the foregoing, no participant may purchase more than 2,000 shares of stock during any single offering.

11. Exercise of Option. Each employee who continues to be a participant in an offering on the last business day of that offering shall be deemed to have exercised his option on such date and shall be deemed to have purchased from the Company such number of full shares of common stock reserved for the purpose of the Plan as his accumulated payroll deductions on such date will pay for at the option price.

12. Employee's Rights as a Shareholder. No participating employee shall have any right as a shareholder with respect to any shares until the shares have been purchased in accordance with Section 11 above and the stock has been issued by the Company.

13. Evidence of Stock Ownership.

13.1 Promptly following the end of each offering, the number of shares of common stock purchased by each participant shall be deposited into an account established in the participant's name at a stock brokerage or other financial services firm designated by the Company (the "ESPP Broker").

13.2 The participant may direct, by written notice to the Company at the time of his enrollment in the Plan, that his ESPP Broker account be established in the names of the participant and one other person designated by the participant, as joint tenants with right of survivorship, tenants in common, or community property, to the extent and in the manner permitted by applicable law.

13.3 A participant shall be free to undertake a disposition (as that term is defined in Section 424(c) of the Code) of the shares in his account at any time, whether by sale, exchange, gift, or other transfer of legal title, but in the absence of such a disposition of the shares, the shares must remain in the participant's account at the ESPP Broker until the holding period set forth in Section 423(a) of the Code has been satisfied. With respect to shares for which the Section 423(a) holding period has been satisfied, the participant may move those shares to another brokerage account of participant's choosing or request that a stock certificate be issued and delivered to him.

13.4 A participant who is not subject to payment of U.S. income taxes may move his shares to another brokerage account of his choosing or request that a stock certificate be issued and delivered to him at any time, without regard to the satisfaction of the Section 423(a) holding period.

14. Withdrawal.

14.1 An employee may withdraw from an offering, in whole but not in part, at any time prior to the last business day of such offering by delivering a Withdrawal Notice to the Company, in which event the Company will refund the entire balance of his deductions as soon as practicable thereafter.

14.2 To re-enter the Plan, an employee who has previously withdrawn must file a new Enrollment Agreement in accordance with Section 8.1. The employee's re-entry into the Plan will not become effective before the beginning of the next offering following his withdrawal, and if the withdrawing employee is an officer of the Company within the meaning of Section 16 of the Securities Exchange Act of 1934 he may not re-enter the Plan before the beginning of the second offering following his withdrawal.

15. Carryover of Account. At the termination of each offering the Company shall automatically re-enroll the employee in the next offering, and the balance in the employee's account shall be used for option exercises in the new offering, unless the employee has advised the Company otherwise. Upon termination of the Plan, the balance of each employee's account shall be refunded to him.

16. Interest. No interest will be paid or allowed on any money in the accounts of participating employees.

17. Rights Not Transferable. No employee shall be permitted to sell, assign, transfer, pledge, or otherwise dispose of or encumber either the payroll deductions credited to his account or any rights with regard to the exercise of an option or to receive shares under the Plan other than by will or the laws of descent and distribution, and such right and interest shall not be liable for, or subject to, the debts, contracts, or liabilities of the employee. If any such action is taken by the employee, or any claim is asserted by any other party in respect of such right and interest whether by garnishment, levy, attachment or otherwise, such action or claim will be treated as an election to withdraw funds in accordance with Section 14.

18. Termination of Employment. Upon termination of employment for any reason whatsoever, including but not limited to death or retirement, the balance in the account of a participating employee shall be paid to the employee or his estate.

19. Amendment or Discontinuance of the Plan. The Board shall have the right to amend, modify, or terminate the Plan at any time without notice, provided that no employee's existing rights under any offering already made under Section 4 hereof may be adversely affected thereby, and provided further that no such amendment of the Plan shall, except as provided in Section 20, increase above 20,000,000 shares the total number of shares to be offered unless shareholder approval is obtained therefor.

20. Changes in Capitalization. In the event of reorganization, recapitalization, stock split, stock dividend, combination of shares, merger, consolidation, offerings of rights, or any other change in the structure of the common shares of the Company, the Board may make such adjustment, if any, as it may deem appropriate in the number, kind, and the price of shares available for purchase under the Plan, and in the number of shares which an employee is entitled to purchase.

21. Share Ownership. Notwithstanding anything herein to the contrary, no employee shall be permitted to subscribe for any shares under the Plan if such employee, immediately after such subscription, owns shares (including all shares which may be purchased under outstanding subscriptions under the Plan) possessing 5% or more of the total combined voting power or value of all classes of shares of the Company or of its parent or subsidiary corporations. For the foregoing purposes the rules of Section 425(d) of the Internal Revenue Code of 1986 shall apply in determining share ownership. In addition, no employee shall be allowed to subscribe for any shares under the Plan which permits his rights to purchase shares under all "employee stock purchase plans" of the Company and its subsidiary corporations to accrue at a rate which exceeds $25,000 of the fair market value of such shares (determined at the time such right to subscribe is granted) for each calendar year in which such right to subscribe is outstanding at any time.

22. Administration. The Plan shall be administered by the Board. The Board may delegate any or all of its authority hereunder to such committee of the Board or officer of the Company as it may designate. The administrator shall be vested with full authority to make, administer, and interpret such rules and regulations as it deems necessary to administer the Plan, and any determination, decision, or action of the administrator in connection with the construction, interpretation, administration, or application of the Plan shall be final, conclusive, and binding upon all participants and any and all persons claiming under or through any participant.

23. Notices. All notices or other communications by a participant to the Company under or in connection with the Plan shall be deemed to have been duly given when received by Shareholder Services of the Company or when received in the form specified by the Company at the location, or by the person, designated by the Company for the receipt thereof.

24. <u>Termination of the Plan.</u> This Plan shall terminate at the earliest of the following:

24.1 December 31, 2002;

24.2 The date of the filing of a Statement of Intent to Dissolve by the Company or the effective date of a merger or consolidation wherein the Company is not to be the surviving corporation, which merger or consolidation is not between or among corporations related to the Company. Prior to the occurrence of either of such events, on such date as the Company may determine, the Company may permit a participating employee to exercise the option to purchase shares for as many full shares as the balance of his account will allow at the price set forth in accordance with Section 5. If the employee elects to purchase shares, the remaining balance of his account will be refunded to him after such purchase.

24.3 The date the Board acts to terminate the Plan in accordance with Section 19 above.

24.3 The date when all shares reserved under the Plan have been purchased.

25. <u>Limitations on Sale of Stock Purchased Under the Plan.</u> The Plan is intended to provide common stock for investment and not for resale. The Company does not, however, intend to restrict or influence any employee in the conduct of his own affairs. An employee, therefore, may sell stock purchased under the Plan at any time he chooses, subject to compliance with any applicable Federal or state securities laws. THE EMPLOYEE ASSUMES THE RISK OF ANY MARKET FLUCTUATIONS IN THE PRICE OF THE STOCK.

26. <u>Governmental Regulation.</u> The Company's obligation to sell and deliver shares of the Company's common stock under this Plan is subject to the approval of any governmental authority required in connection with the authorization, issuance, or sale of such shares.

[The number of shares in Sections 7, 10, and 19 have been increased to reflect the 2-for-1 stock split in November 1996.]

Exhibit 11.

Computation of Earnings Per Share
(In millions, except earnings per share)

	Year Ended June 30		
	1995	1996	1997
Weighted average common shares outstanding	1,176	1,194	1,204
Common equivalent shares from stock options	78	87	108
Average common and equivalent shares outstanding /(1)/	1,254	1,281	1,312
Net income	$1,453	$2,195	$3,454
Earnings per share /(1)/	$ 1.16	$ 1.71	$ 2.63

/(1)/ Fully diluted earnings per share have not been presented because the effects are not material.

Exhibit 13.1

Quarterly Information
(In millions, except per share data) (Unaudited)

	Quarter Ended				
	Sept. 30	Dec. 31	Mar. 31	June 30	Year
1995					
Revenue	$1,247	$1,482	$ 1,587	$ 1,621	$5,937
Operating income	437	520	549	532	2,038
Net income	316	373	396	368	1,453
Earnings per share	0.25	0.30	0.32	0.29	1.16
Common stock price per share:					
High	29.63	32.56	37.06	46.19	46.19
Low	23.44	26.94	29.13	34.38	23.44
1996					
Revenue	$2,016	$2,195	$ 2,205	$ 2,255	$8,671
Operating income	708	786	774	810	3,078
Net income	499	575	562	559	2,195
Earnings per share	0.39	0.45	0.44	0.43	1.71
Common stock price per share:					
High	54.63	51.69	53.53	62.94	62.94
Low	42.50	40.19	39.94	49.81	39.94
1997					
Revenue	$2,295	$2,680	$ 3,208	$ 3,175	$11,358
Operating income	902	1,081	1,568	1,579	5,130
Net income	614	741	1,042	1,057	3,454
Earnings per share	0.47	0.57	0.79	0.80	2.63
Common stock price per share:					
High	69.31	86.13	103.50	134.94	134.94
Low	53.75	65.44	80.75	89.75	53.75

The Company's common stock is traded on The Nasdaq Stock Market under the symbol MSFT. On July 31, 1997, there were 53,390 holders of record of the Company's common stock. The Company has not paid cash dividends on its common stock.

Exhibit 13.2

Financial Highlights
(In millions, except earnings per share)

Year Ended June 30	1993	1994	1995	1996	1997
Revenue	$3,753	$4,649	$5,937	$ 8,671	$11,358
Net income	953	1,146	1,453	2,195	3,454
Earnings per share /(1)/	0.79	0.94	1.16	1.71	2.63
Return on revenue	25.4%	24.7%	24.5%	25.3%	30.4%
Cash and short-term investments	$2,290	$3,614	$4,750	$ 6,940	$ 8,966
Total assets	3,805	5,363	7,210	10,093	14,387
Stockholders' equity	3,242	4,450	5,333	6,908	10,777

/(1)/ Earnings per share have been restated to reflect a two-for-one stock split in December 1996

Exhibit 13.3

Management's Discussion and Analysis

Results of Operations for 1995, 1996, and 1997

Microsoft develops, manufactures, licenses, sells, and supports a wide range of software products, including scalable operating systems for information appliances, personal computers (PCs), and servers; server applications for client/server environments; business and consumer productivity applications; software development tools; and Internet and intranet software and technologies. The Company has recently expanded its interactive content efforts, including entertainment and information software programs, MSN, The Microsoft Network online service, Internet-based services, and alliances with companies involved with other forms of digital interactivity. Microsoft also sells personal computer input devices and books, and researches and develops advanced technologies for future software products.

Revenue

The Company's revenue grew 46% in the fiscal year ended June 30, 1996 and 31% in fiscal 1997. Revenue growth was particularly strong in 1996 due to the retail introduction of the Microsoft Windows 95 operating system. Software license volume increases have been the principal factor in Microsoft's revenue growth. The average selling price per license has decreased, primarily because of general shifts in the sales mix from retail packaged products to licensing programs, from new products to product upgrades, and from stand-alone desktop applications to integrated product suites. Average revenue per license from original equipment manufacturer (OEM) licenses and corporate and organization license programs, such as Microsoft Select, is lower than average revenue per license from retail versions. Likewise, product upgrades have lower prices than new products. Also, prices of integrated suites, such as Microsoft Office, are less than the sum of the prices for the individual programs included in these suites when such programs are licensed separately. During 1996 and 1997, an increased percentage of products and programs became subject to ratable revenue recognition, such as Windows operating systems, Office 97, maintenance, and other subscription models. (See accompanying notes.)

Product groups. Microsoft has a Platforms Product Group and an Applications & Content Product Group.

Platforms Product Group revenue was $2.36 billion, $4.11 billion, and $5.97 billion in 1995, 1996, and 1997. Platform revenue is primarily from licenses of PC operating systems, business systems with client/server architectures, and software development tools.

The Company's principal desktop platform products in 1996 and 1997 were its 32-bit operating systems, Microsoft Windows 95 and Microsoft Windows NT Workstation. Released in August 1995, Windows 95 was a successor to MS-DOS and Microsoft Windows 3.x operating systems. Windows NT Workstation version 4.0 was released in fiscal 1997. Desktop operating systems increasingly contributed to revenue as shipments of new PCs preinstalled with such systems increased rapidly during the three-year period. Additionally, increased penetration of higher value 32-bit operating systems led to growth in 1996 and 1997. In 1996, retail license sales of Windows 95 were a major factor in the Platforms revenue increase, reflecting the typical sales pattern for major operating system upgrades. Also in 1996, a portion of Windows operating system revenue became subject to ratable recognition.

Business systems products offer an enterprise-wide distributed client/server environment based on the Microsoft Windows NT Server operating system and the server applications in the Microsoft BackOffice family of products. Revenue from these products increased strongly in 1995, 1996, and 1997 due to greater corporate demand, particularly for intranet solutions.

Revenue from developer products increased steadily in all three years, as more independent software vendors, corporate developers, and solutions developers licensed tools such as the Microsoft Visual Basic programming system to develop software for Windows 95 and Windows NT operating systems and the Internet.

Applications & Content Product Group revenue was $3.58 billion, $4.56 billion, and $5.39 billion in 1995, 1996, and 1997. Applications and Content revenue includes primarily licenses of desktop and consumer productivity applications, interactive media programs, and PC input devices. Microsoft Office for Windows 95 was released in fiscal 1996 and Microsoft Office 97 was released in fiscal 1997. Applications and Content revenue grew 27% in 1996 and 18% in 1997. The lower growth rate in 1997 was due to the expected impact of saturation of desktop applications, the continued shift in mix toward corporate licenses from packaged products, and the ratable revenue recognition model for Office 97.

Absolute increases in desktop applications revenue during the three-year period were led by Microsoft Office. The primary programs in Microsoft Office are Microsoft Word word processor, Microsoft Excel spreadsheet, and Microsoft PowerPoint presentation graphics program. Various versions of Office, which are available for the 32-bit version of Windows, the 16-bit version of Windows, and Macintosh operating systems, also include Microsoft Access database management program, Microsoft Outlook desktop information manager, or other programs. Revenue from stand-alone versions of Microsoft Excel, Microsoft Word, and Microsoft PowerPoint continued to decrease as the sales mix shifted to integrated product suites. Microsoft Project scheduling and project management program revenue increased during the three-year period.

Microsoft offers a broad range of interactive media products, which also showed moderate growth. Products include CD-ROM multimedia reference titles and programs for home and small office productivity, children's creativity, and entertainment. In addition to The Microsoft Network, recently introduced online Internet services include travel information and reservations, local event information, and new-car buying.

The Company also markets input devices. Mouse and gaming device sales increased while keyboard revenue was steady during the three-year period.

Sales channels. The Company distributes its products primarily through OEM licenses, corporate and organizational licenses, and retail packaged products. OEM channel revenue represents license fees from original equipment manufacturers. Microsoft has three major geographic sales and marketing organizations: the United States and Canada, Europe, and elsewhere in the world (Other International). Sales of corporate and organization licenses and packaged products in these channels are primarily to distributors and resellers.

OEM channel revenue was $1.65 billion in 1995, $2.50 billion in 1996, and $3.48 billion in 1997. The primary source of OEM revenue is the licensing of desktop operating systems, and OEM revenue is highly dependent on PC shipment volume.

Licensing programs continued to grow in popularity across all geographic areas during the three-year period. Packaged product volume increased in 1996 due to the release of retail upgrade versions of Windows 95. U.S. and Canadian channel revenue was $1.88 billion, $2.68 billion, and $3.41 billion in 1995, 1996, and 1997. Revenue in Europe was $1.49 billion, $2.02 billion, and $2.54 billion in 1995, 1996, and 1997. Growth rates have been lower in Europe than in other geographic areas due to general economic slowness, higher existing market shares, and a more dramatic shift to licensing programs. Other International channel revenue was $924 million in 1995, $1.47 billion in 1996, and $1.93 billion in 1997. Growth rates were higher in the Other International channel due to customers accepting newly localized products, particularly in Japan, and penetration in emerging markets.

The Company's operating results are affected by foreign exchange rates. Approximately 37%, 34%, and 32% of the Company's revenue was collected in foreign currencies during 1995, 1996, and 1997. Since a portion of local currency revenue is hedged and much of the Company's international manufacturing costs and operating expenses are also incurred in local currencies, the impact of exchange rates is partially mitigated.

Operating Expenses

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Cost of revenue. As a percentage of revenue, cost of revenue was 14.8% in 1995, 13.7% in 1996, and 9.6% in 1997. The decrease was due to the shifts in mix to CD-ROMs (which carry lower cost of goods than disks), licenses to OEMs and corporations, and higher-margin Windows NT Server and other BackOffice server products.

Research and development. Microsoft invested heavily in the future by funding research and development (R&D). Expense increases of 67% in 1996 and 34% in 1997 resulted primarily from development staff headcount growth and higher levels of third-party development costs in many areas, including continued development efforts for Windows desktop operating systems, Office, BackOffice, and Internet and intranet technologies. R&D costs also increased for development tools, consumer systems, and interactive media initiatives such as MSN and other online services.

Sales and marketing. The increase in the absolute dollar amount of sales and marketing expenses in the three-year period was due primarily to expanded product-specific marketing programs, particularly for Windows 95 during 1996. Sales and marketing costs as a percentage of revenue decreased, particularly in 1997, reflecting moderate headcount growth. Also in 1997, Microsoft brand advertising and product support expenses declined.

General and administrative. Increases in general and administrative expenses were primarily attributable to growth in the number of people and computer systems necessary to support overall increases in the scope of the Company's operations.

Nonoperating Items and Income Taxes

Interest income increased primarily as a result of a larger investment portfolio generated by cash from operations. Other expenses increased due to recognition of Microsoft's share of joint venture activities, including DreamWorks Interactive and the MSNBC entities. During 1995, Microsoft paid a $46 million breakup fee to Intuit Inc. in connection with the termination of a planned merger. The effective income tax rate was 33% in 1995 and 35% in 1996 and 1997.

Net Income

Net income as a percent of revenue increased in 1996 and 1997 due to the lower relative cost of revenue, sales and marketing expenses, and general and administrative expenses, partially offset by investments in research and development and joint ventures.

Financial Condition

Microsoft's cash and short-term investment portfolio totaled $8.97 billion at June 30, 1997. The portfolio is diversified among security types, industries, and individual issuers. Microsoft's investments are generally liquid and investment grade. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions in anticipation of continued international expansion. The portfolio is primarily invested in short-term securities to minimize interest rate risk and facilitate rapid deployment in the event of immediate cash needs.

During 1996, Microsoft and National Broadcasting Company (NBC) established two joint ventures: a 24-hour cable news and information channel and an interactive online news service. Microsoft agreed to pay $220 million over a five-year period for its interest in the cable venture and to pay one-half of operational funding of both joint ventures for a multiyear period.

During 1997, Microsoft invested $1.0 billion in Comcast Corporation, a cable television and diversified telecommunications company. Comcast Special Class A common stock of $500 million and convertible preferred stock of $500 million are included in equity investments on the balance sheet.

Microsoft has no material long-term debt and has $70 million of standby multicurrency lines of credit to support foreign currency hedging and cash management. Stockholders' equity at June 30, 1997 was $10.78 billion.

Microsoft will continue to invest in sales, marketing, and product support infrastructure. Additionally, research and development activities will include investments in existing and advanced areas of technology, including using cash to acquire technology and to fund ventures and other strategic opportunities. Additions to property and equipment will continue, including new facilities and computer systems for research and development, sales and marketing, support, and administrative staff. Commitments for constructing new buildings were $300 million on June 30, 1997.

Cash will also be used to repurchase common stock to provide shares for employee stock option and purchase plans. Despite recent increases in stock repurchases, the buyback program has not kept pace with employee stock option grants or exercises. Beginning in fiscal 1990, Microsoft has repurchased 154 million common shares for $6.2 billion while 363 million shares were issued under the Company's employee stock option and purchase plans. The market value of all outstanding stock options was $30.2 billion as of June 30, 1997. Microsoft enhances its repurchase program by selling put warrants. During December 1996, Microsoft issued 12.5 million shares of 2.75% convertible preferred stock. Net proceeds of $980 million were used to repurchase common shares.

Management believes existing cash and short-term investments together with funds generated from operations will be sufficient to meet operating requirements for the next 12 months. Microsoft's cash and short-term investments are available for strategic investments, mergers and acquisitions, other potential large-scale cash needs that may arise, and to fund an increased stock buyback program over historical levels to reduce the dilutive impact of the Company's employee stock option and purchase programs.

Microsoft has not paid cash dividends on its common stock. The preferred stock pays $2.196 per annum per share.

Outlook: Issues and Uncertainties

Microsoft does not provide forecasts of future financial performance. While Microsoft management is optimistic about the Company's long-term prospects, the following issues and uncertainties, among others, should be considered in evaluating its growth outlook.

Rapid technological change and competition. Rapid change, uncertainty due to new and emerging technologies, and fierce competition characterize the PC software industry. The pace of change has recently accelerated due to the Internet and new programming languages, such as Java.

Future initiatives. The Company is expanding its efforts to provide and support mission-critical systems to large enterprises. Scalability of BackOffice server and application products, manageability of Windows- and Office-based systems, and Internet and intranet integration are also major focus areas. Additionally, Microsoft is committed to providing technologies, operating systems, and interactive content for the future convergence of PCs, televisions, and the Internet. Future revenue from these initiatives may not duplicate historical revenue growth rates.

PC growth rates. The underlying PC unit growth rate, which may decrease in the future, directly impacts software revenue growth.

Product ship schedules. Shipments of new versions of major products such as Windows 95 have generally had positive impacts on revenue growth rates. The Company does not currently expect that individual products to be released in 1998 will repeat the financial performance of Windows 95. Also, delays in new-product releases can cause operational inefficiencies that impact manufacturing and distribution logistics, independent software vendor (ISV) and OEM relationships, and telephone support staffing.

Customer acceptance. While the Company performs extensive usability and beta testing of new products, user acceptance and corporate penetration rates ultimately dictate the success of development and marketing efforts.

Prices. Future product prices may decrease from historical levels, depending on competitive market and cost factors. European and Far Eastern software prices vary by country and are generally higher than in the United States to cover localization costs and higher costs of distribution. Increased global license agreements, European monetary unification, or other factors could erode such price uplifts in the future.

Earnings process. An increasingly higher percentage of the Company's revenue is subject to ratable recognition. Subsequent product support and delivery of unspecified enhancements require the applicable portion of revenue for certain products to be recognized over the product's life cycle. This policy may be required for future products, depending on specific license terms and conditions. Also, maintenance and other subscription programs may continue to increase in popularity, particularly with corporations and other large organizations.

Saturation. Product upgrades, which enable users to upgrade from earlier versions of the Company's products or from competitors' products, have lower prices and margins than new products. As the desktop applications market has become saturated, the sales mix has shifted from standard products to upgrade products. This trend is likely to continue.

Corporate licenses. Average revenue per unit from corporate and organization license programs is lower than average revenue per unit from retail versions shipped through the finished goods channels. Unit sales under licensing programs may continue to increase.

Channel mix. Average revenue per license is lower from OEM licenses than from retail versions, reflecting the relatively lower direct costs of operations in the OEM channel. An increasingly higher percentage of revenue was achieved through the OEM channel during 1996 and 1997.

Integrated suites. The price of integrated suites, such as Microsoft Office, is less than the sum of the prices for the individual programs included in these suites when such programs are licensed separately. Revenue from integrated suites may continue to increase as a percentage of total revenue.

Cost of revenue. Although cost of revenue as a percentage of revenue decreased in 1996 and 1997, it varies with channel mix and product mix within channels. The trend of declining cost of revenue as a percentage of revenue is unlikely to continue in 1998.

Pay and participation model. Microsoft employees currently receive salaries, incentive bonuses, other fringe benefits, and stock options. New government regulations, poor stock price performance, or other factors could diminish the value of the option program and force the Company into more of a cash compensation model. Had the Company paid employees in cash the grant date Black-Scholes value of options vested in 1995, 1996, and 1997, the pretax expense would have been approximately $310 million, $450 million, and $620 million.

Long-term research and development investment cycle. Developing and localizing software is expensive and the investment in product development often involves a long payback cycle. The Company plans to continue significant investments in software research and development and related product opportunities from which significant revenue is not anticipated for a number of years. Management expects total spending for research and development in 1998 to increase over spending in 1997.

Sales and marketing and support investments. The Company's plans for 1998 include accelerated investments in its sales and marketing and support groups.

Foreign exchange. A large percentage of the Company's sales, costs of manufacturing, and marketing is transacted in local currencies. As a result, the Company's international results of operations are subject to foreign exchange rate fluctuations.

Interest rate sensitivity. The Company's cash and short-term investment portfolio is subject to interest rate risk. An abrupt increase in interest rates would decrease the market value of the Company's fixed income securities. For example, a 200 basis point increase in short-term treasury security yields would reduce the carrying value of the portfolio at June 30, 1997 by $200 million.

Intellectual property rights. Microsoft diligently defends its intellectual property rights, but unlicensed copying of software represents a loss of revenue to the Company. While this adversely affects U.S. revenue, revenue loss is even more significant outside of the United States, particularly in countries where laws are less protective of intellectual property rights. Throughout the world, Microsoft actively educates consumers on the benefits of licensing genuine products and educates lawmakers on the advantages of a business climate where intellectual property rights are protected. However, continued efforts may not affect revenue positively.

Future growth rate. The revenue growth rate in 1998 may not approach the level attained in 1997, particularly when compared to the second half of 1997. As discussed above, operating expenses are expected to increase in 1998. Because of the fixed nature of a significant portion of such expenses, coupled with the possibility of slower revenue growth, operating margins in 1998 may decrease from those in 1997.

Litigation. Litigation regarding intellectual property rights, patents, and copyrights occurs in the PC software industry. In addition, there are government regulation and investigation risks along with other general corporate legal risks.

Exhibit 13.4

Microsoft Corporation

Financial Statements

Income Statements
(In millions, except earnings per share)

Year Ended June 30	1995	1996	1997
Revenue	$5,937	$8,671	$11,358
Operating expenses:			
Cost of revenue	877	1,188	1,085
Research and development	860	1,432	1,925
Sales and marketing	1,895	2,657	2,856
General and administrative	267	316	362
Total operating expenses	3,899	5,593	6,228
Operating income	2,038	3,078	5,130
Interest income	191	320	443
Other expenses	(62)	(19)	(259)
Income before income taxes	2,167	3,379	5,314
Provision for income taxes	714	1,184	1,860
Net income	1,453	2,195	3,454
Preferred stock dividends	--	--	15
Net income available for common shareholders	$1,453	$2,195	$ 3,439
Earnings per share(1)	$ 1.16	$ 1.71	$ 2.63
Weighted average shares outstanding(1)	1,254	1,281	1,312

See accompanying notes.

(1) Share and per share amounts have been restated to reflect a two-for-one stock split in December 1996.

Cash Flows Statements
(In millions)

Year Ended June 30	1995	1996	1997
Cash flows from operations			
Net income	$ 1,453	$ 2,195	$ 3,454
Depreciation and amortization	269	480	557
Unearned revenue	69	983	1,601
Recognition of unearned revenue from prior periods	(54)	(477)	(743)
Other current liabilities	404	584	321
Accounts receivable	(91)	(71)	(336)
Other current assets	(60)	25	(165)
Net cash from operations	1,990	3,719	4,689
Cash flows used for financing			
Common stock issued	332	504	744
Common stock repurchased	(698)	(1,385)	(3,101)
Put warrant proceeds	49	124	95
Preferred stock issued	--	--	980
Preferred stock dividends	--	--	(15)
Stock option income tax benefits	179	352	796
Net cash used for financing	(138)	(405)	(501)
Cash flows used for investments			
Additions to property, plant, and equipment	(495)	(494)	(499)
Equity investments and other	(230)	(625)	(1,669)
Short-term investments	(651)	(1,551)	(921)
Net cash used for investments	(1,376)	(2,670)	(3,089)
Net change in cash and equivalents	476	644	1,099
Effect of exchange rates on cash and equivalents	9	(5)	6
Cash and equivalents, beginning of year	1,477	1,962	2,601
Cash and equivalents, end of year	1,962	2,601	3,706
Short-term investments	2,788	4,339	5,260
Cash and short-term investments	$ 4,750	$ 6,940	$ 8,966

See accompanying notes.

Balance Sheets
(In millions)

June 30	1996	1997
Assets		
Current assets:		
Cash and short-term investments	$ 6,940	$ 8,966
Accounts receivable	639	980
Other	260	427
Total current assets	7,839	10,373
Property, plant, and equipment	1,326	1,465
Equity investments	675	2,346
Other assets	253	203
Total assets	$10,093	$14,387
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 808	$ 721
Accrued compensation	202	336
Income taxes payable	484	466
Unearned revenue	560	1,418
Other	371	669
Total current liabilities	2,425	3,610
Minority interest	125	--
Put warrants	635	--
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock--shares authorized 0 and 100; shares issued and outstanding 0 and 13	--	980
Common stock and paid-in capital--shares authorized 4,000; shares issued and outstanding 1,194 and 1,204	2,924	4,509
Retained earnings	3,984	5,288
Total stockholders' equity	6,908	10,777
Total liabilities and stockholders' equity	$10,093	$14,387

See accompanying notes.

Stockholders' Equity Statements
(In millions)

Year Ended June 30	1995	1996	1997
Convertible preferred stock			
Convertible preferred stock issued	--	--	$ 980
Balance, end of year	--	--	980
Common stock and paid-in capital			
Balance, beginning of year	$1,500	$ 2,005	2,924
Common stock issued	332	504	744
Common stock repurchased	(30)	(41)	(91)
Proceeds from sale of put warrants	49	124	95
Reclassification of put warrant obligation	(25)	(20)	45
Stock option income tax benefits	179	352	792
Balance, end of year	2,005	2,924	4,509
Retained earnings			
Balance, beginning of year	2,950	3,328	3,984
Net income	1,453	2,195	3,454
Preferred stock dividends	--	--	(15)
Common stock repurchased	(668)	(1,344)	(3,010)
Reclassification of put warrant obligation	(380)	(210)	590
Net unrealized investment gains and other	(27)	15	285
Balance, end of year	3,328	3,984	5,288
Total stockholders' equity	$5,333	$ 6,908	$10,777

See accompanying notes.

Notes to Financial Statements
(In millions, except per share amounts)

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Significant Accounting Policies

Accounting principles. The financial statements are prepared on a basis consistent with U.S. generally accepted accounting principles and International Accounting Standards formulated by the International Accounting Standards Committee (IASC).

Principles of consolidation. The financial statements include the accounts of Microsoft and its subsidiaries. Significant intercompany transactions and balances have been eliminated. Investments in 50% owned joint ventures are accounted for using the equity method; the Company's share of joint ventures' activities is reflected in other expenses.

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 include provisions for returns and bad debts and the length of product life cycles and buildings' lives. Actual results may differ from these estimates.

Foreign currencies. Assets and liabilities recorded in foreign currencies are translated at the exchange rate on the balance sheet date. Translation adjustments resulting from this process are charged or credited to equity. Revenue, costs, and expenses are translated at average rates of exchange prevailing during the year. Gains and losses on foreign currency transactions are included in other expenses.

Revenue recognition. Revenue is recognized when earned. Revenue from products licensed to original equipment manufacturers is recorded when OEMs ship licensed products while revenue from corporate and organization license programs is recorded when the user installs the product. Revenue from packaged product sales to distributors and resellers is recorded when related products are shipped. Maintenance and subscription revenue is recognized ratably over the contract period. Revenue attributable to significant support (technical support and unspecified enhancements such as service packs and Internet browser updates) is based on the price charged or derived value of the undelivered elements and is recognized ratably on a straight-line basis over the product's life cycle. Costs related to insignificant obligations, which include telephone support for certain products, are accrued. Provisions are recorded for returns and bad debts.

Research and development. Research and development costs are expensed as incurred. The current U.S. accounting rule, Statement of Financial Accounting Standards (SFAS) 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed, does not materially affect the Company.

Telephone support. Telephone support costs are included in sales and marketing.

Income taxes. Income tax expense includes U.S. and international income taxes, plus an accrual for U.S. taxes on undistributed earnings of international subsidiaries. Certain items of income and expense are not reported in tax returns and financial statements in the same year. The tax effect of this difference is reported as deferred income taxes. Tax credits are accounted for as a reduction of tax expense in the year in which the credits reduce taxes payable.

Earnings per share. Earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options using the "treasury stock" method and preferred shares using the "if-converted" method. Beginning in the second quarter of 1998, Microsoft will be required to report earnings per outstanding common share in addition to diluted earnings per share. Earnings per common share computed under the new pronouncement would have been $1.25, $1.85, and $2.87 while reported diluted earnings per share were $1.16, $1.71, and $2.63 in 1995, 1996, and 1997.

Stock split. In December 1996, outstanding shares of common stock were split two-for-one. All share and per share amounts have been restated.

Financial instruments. The Company considers all liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. Short-term investments generally mature between three months and five years from the purchase date. All cash and short-term investments are classified as available for sale and are recorded at market. Cost approximates market for all classifications of cash and short-term investments; realized and unrealized gains and losses were not material.

Publicly tradeable equity securities are recorded at market; unrealized gains and losses are reflected in stockholders' equity.

Property, plant, and equipment. Property, plant, and equipment is stated at cost and depreciated using the straight-line method over the shorter of the estimated life of the asset or the lease term, ranging from one to 30 years.

Reclassifications. Certain reclassifications have been made for consistent presentation.

Unearned Revenue

In fiscal 1996, Microsoft committed to integrating its Internet technologies, such as the Company's Internet browser, Microsoft Internet Explorer, into existing products at no additional cost to its customers. Given this strategy and other support commitments such as telephone support, Internet-based technical support, and unspecified product enhancements, Microsoft recognizes approximately 20% of Windows operating systems revenue over the product life cycles, currently estimated at two years. The unearned portion of revenue from Windows operating systems was $425 million and $860 million at June 30, 1996 and 1997.

Since Office 97 is also tightly integrated with the rapidly evolving Internet, and subsequent delivery of new Internet technologies, enhancements, and other support is likely to be more than minimal, a ratable revenue recognition policy became effective for Office 97 licenses beginning in 1997. Approximately 20% of Office 97 revenue is recognized ratably over the estimated 18-month product life cycle. Unearned revenue associated with Office 97 totaled $300 million at June 30, 1997.

Unearned revenue also includes maintenance and other subscription contracts, including custom corporate license agreements.

Financial Risks

The Company's investment portfolio is diversified and consists primarily of short-term investment grade securities. At June 30, 1996 and 1997, approximately 38% and 31% of accounts receivable represented amounts due from 10 channel purchasers. One customer accounted for approximately 12%, 13%, and 12% of revenue while another customer accounted for approximately 12%, 8%, and 5% of revenue in 1995, 1996, and 1997.

Finished goods sales to international customers in Europe, Japan, and Australia are primarily billed in local currencies. Payment cycles are relatively short, generally less than 90 days. European manufacturing costs and international selling, distribution, and support costs are generally disbursed in local currencies. Local currency cash balances in excess of short-term operating needs are generally converted into U.S. dollar cash and short-term investments on receipt. Therefore, foreign exchange rate fluctuations generally do not create a risk of material balance sheet gains or losses. As a result, Microsoft's hedging activities for balance sheet exposures have been minimal.

At June 30, 1997, the Company had contracts to deliver $500 million in a foreign currency, expiring July 1998, which hedge foreign exchange rate risk related to a foreign currency denominated investment.

Foreign exchange rates affect the translated results of operations of the Company's foreign subsidiaries. The Company hedges a percentage of planned international revenue with purchased options. The notional amount of the options outstanding at June 30, 1997 was $2.1 billion. At June 30, 1997, the fair value and premiums paid for the options were not material.

Cash and Short-Term Investments

June 30	1996	1997
Cash and equivalents:		
Cash	$ 64	$ 246
Commercial paper	1,664	1,660
Money market preferreds	105	946
Certificates of deposit	768	854
Cash and equivalents	2,601	3,706
Short-term investments:		
Municipal securities	1,357	571
Corporate notes and bonds	1,125	1,907
U.S. Treasury securities	1,591	1,513
Certificates of deposit	266	1,269
Short-term investments	4,339	5,260

Cash and short-term investments	$6,940	$8,966

Property, Plant, and Equipment

June 30	1996	1997
Land	$ 183	$ 183
Buildings	787	1,027
Computer equipment	885	1,064
Other	491	503
Property, plant, and equipment--at cost	2,346	2,777
Accumulated depreciation	(1,020)	(1,312)
Property, plant, and equipment--net	$ 1,326	$ 1,465

During 1996 and 1997, depreciation expense, of which the majority related to computer equipment, was $363 million and $353 million; disposals were immaterial.

Income Taxes

The provision for income taxes consisted of:

Year Ended June 30	1995	1996	1997
Current taxes:			
U.S. and state	$ 518	$1,139	$1,710
International	151	285	412
Current taxes	669	1,424	2,122
Deferred taxes	45	(240)	(262)
Provision for income taxes	$ 714	$1,184	$1,860

U.S. and international components of income before income taxes were:

Year Ended June 30	1995	1996	1997
U.S.	$1,549	$2,356	$3,775
International	618	1,023	1,539
Income before income taxes	$2,167	$3,379	$5,314

Income taxes payable were:

June 30	1996	1997
Deferred income tax assets:		
Revenue items	$ 193	$ 474
Expense items	322	505
Deferred income tax assets	515	979
Deferred income tax liabilities:		
International earnings	(261)	(465)
Other	(6)	(4)
Deferred income tax liabilities	(267)	(469)

Current income tax liabilities	(732)	(976)
Income taxes payable	$(484)	$(466)

Income taxes have been settled with the Internal Revenue Service for all years through 1989. The IRS has assessed taxes for 1990 and 1991 that the Company is contesting in Tax Court. The IRS is examining the Company's U.S. income tax returns for 1992 through 1994. Management believes any related adjustments that might be required will not be material to the financial statements. Income taxes paid were $430 million, $758 million, and $1.1 billion in 1995, 1996, and 1997.

Convertible Preferred Stock

During December 1996, Microsoft issued 12.5 million shares of 2.75% convertible exchangeable principal-protected preferred stock. Dividends are payable quarterly in arrears. Preferred shareholders have preference over common stockholders in dividends and liquidation rights. In December 1999, each preferred share is convertible into common shares or an equivalent amount of cash determined by a formula that provides a floor price of $79.875 and a cap of $102.24 per preferred share. Net proceeds of $980 million were used to repurchase common shares.

Common Stock

Shares of common stock outstanding were as follows:

Year Ended June 30	1995	1996	1997
Balance, beginning of year	1,162	1,176	1,194
Issued	38	44	47
Repurchased	(24)	(26)	(37)
Balance, end of year	1,176	1,194	1,204

The Company repurchases its common stock in the open market to provide shares for issuing to employees under stock option and stock purchase plans. The Company's Board of Directors authorized continuation of this program in 1998.

Put Warrants

To enhance its stock repurchase program, the Company sells put warrants to independent third parties. These put warrants entitle the holders to sell shares of Microsoft common stock to the Company on certain dates at specified prices. On June 30, 1996 and 1997, 13.0 million and 3.0 million warrants were outstanding. Outstanding put warrants at June 30, 1997 expire in September 1997 and have strike prices of $105 per share. At June 30, 1996, the outstanding put warrants were settleable in cash at Microsoft's option thus resulting in a reclassification of the maximum potential repurchase obligation of $635 million from stockholders' equity to put warrants. The outstanding put warrants at June 30, 1997 permitted a net-share settlement at the Company's option and did not result in a put warrant liability on the balance sheet.

Employee Stock and Savings Plans

Employee stock purchase plan. The Company has an employee stock purchase plan for all eligible employees. Under the plan, shares of the Company's common stock may be purchased at six-month intervals at 85% of the lower of the fair market value on the first or the last day of each six-month period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period. During 1995, 1996, and 1997, employees purchased 2.1 million, 1.8 million, and 1.4 million shares at average prices of $23.38, $37.72, and $59.64 per share. At June 30, 1997, 19.4 million shares were reserved for future issuance.

Savings plan. The Company has a savings plan, which qualifies under Section 401(k) of the Internal Revenue Code. Participating employees may defer up to 15% of pretax salary, but not more than statutory limits. The Company contributes fifty cents for each dollar a participant contributes, with a maximum contribution of 3% of a participant's earnings. Matching contributions were $12 million, $15 million, and $28 million in 1995, 1996, and 1997.

Stock option plans. The Company has stock option plans for directors, officers, and all employees, which provide for nonqualified and incentive stock options. The option exercise price is the fair market value at the date of grant. Options granted prior to 1995 generally vest over four and one-half years and expire 10 years from the date of grant. Options granted during and after 1995 generally vest over four and one-half years and expire seven years from the date of grant, while certain options vest over seven and one-half years and expire after 10 years. At June 30, 1997, options for 113 million shares were vested and 290 million shares were available for future grants under the plans.

Stock options outstanding were as follows:

	Shares	Price per Share Range	Price per Share Weighted Average
Balance, June 30, 1994	228	$ 0.16 - $ 25.07	$11.65
Granted	44	23.88 - 41.57	25.25
Exercised	(35)	0.16 - 23.88	7.91
Canceled	(9)	2.56 - 37.50	17.70
Balance, June 30, 1995	228	0.77 - 41.57	14.56
Granted	57	40.10 - 58.94	44.99
Exercised	(40)	0.77 - 45.25	10.75
Canceled	(7)	2.59 - 55.44	27.85
Balance, June 30, 1996	238	1.10 - 58.94	22.07
Granted	55	55.31 - 119.19	58.29
Exercised	(45)	1.10 - 58.94	13.27
Canceled	(9)	17.00 - 97.13	38.83
Balance, June 30, 1997	239	2.24 - 119.19	31.43

For various price ranges, weighted average characteristics of outstanding stock options at June 30, 1997 were as follows:

		Outstanding options		Exercisable options	
Range of exercise prices	Shares	Remaining life (years)	Weighted average price	Shares	Weighted average price
$2.24-$17.00	65	3.5	$ 9.64	64	$ 9.63
17.01-24.00	65	5.4	20.81	39	20.10
24.01-55.00	56	5.8	43.13	10	41.02
55.01-119.19	53	6.6	58.47	--	--

The Company follows APB Opinion 25, Accounting for Stock Issued to Employees, to account for stock option and employee stock purchase plans. No compensation cost is recognized because the option exercise price is equal to the market price of the underlying stock on the date of grant. Had compensation cost for these plans been determined based on the Black-Scholes value at the grant dates for awards as prescribed by SFAS Statement 123, Accounting for Stock-Based Compensation, pro forma net income and earnings per share would have been:

Year Ended June 30	1995	1996	1997
Pro forma net income	$1,243	$1,902	$3,053
Pro forma earnings per share	$ 0.99	$ 1.48	$ 2.32

The pro forma disclosures above include the amortization of the fair value of all options vested during 1995, 1996, and 1997. If only options granted during 1996 and 1997 were valued, as prescribed by SFAS 123, pro forma net income would have been $2,073 million and $3,179 million, and earnings per share would have been $1.62 and $2.42 for 1996 and 1997.

The weighted average Black-Scholes value of options granted under the stock option plans during 1995, 1996, and 1997 was $10.46, $17.72, and $23.43. Value was estimated using an expected life of five years, no dividends, volatility of .30, and risk-free interest rates of 7.0%, 6.0%, and 6.5% in 1995, 1996, and 1997.

MSN, The Microsoft Network

During October 1996, Microsoft and a subsidiary of Tele-Communications, Inc. (TCI) terminated a partnership under which TCI owned a 20% minority interest in The Microsoft Network, LLC, owner of the business assets of MSN, an online service. Due to the evolving nature of the online industry and the move by MSN to a Web-based offering, the original direction of the partnership changed and both Microsoft and TCI agreed to terminate this partnership focused exclusively on MSN. In return for approximately $125 million of TCI securities, Microsoft became the sole owner of MSN and the minority interest on the accompanying balance sheet was eliminated. There was no other material financial impact of the dissolution.

Acquisition

On August 1, 1997, the Company acquired WebTV Networks, Inc. (WebTV), an online service that enables consumers to experience the Internet through their televisions via set-top terminals based on proprietary technologies. A director of the

Company owned 10% of WebTV. Microsoft paid $425 million in stock and cash for WebTV. The Company expects to record an in-process R&D write-off of $300 million in the first quarter of 1998.

Commitments and Contingencies

The Company has operating leases for most U.S. and international sales and support offices and certain equipment. Rental expense for operating leases was $86 million, $92 million, and $92 million in 1995, 1996, and 1997. Future minimum rental commitments under noncancelable leases, in millions of dollars, are: 1998, $67; 1999, $54; 2000, $43; 2001, $30; 2002, $12; and thereafter, $16.

In connection with the Company's communications infrastructure and the operation of MSN, Microsoft has certain communication usage commitments. Future related minimum commitments, in millions of dollars, are: 1998, $133; 1999, $119; 2000, $92; and 2001, $20. Also, Microsoft has committed to certain volumes of outsourced telephone support and manufacturing of packaged product and has committed $300 million for constructing new buildings.

During 1996, Microsoft and National Broadcasting Company (NBC) established two MSNBC joint ventures: a 24-hour cable news and information channel and an interactive online news service. Microsoft agreed to pay $220 million over a five-year period for its interest in the cable venture, to pay one-half of operational funding of both joint ventures for a multiyear period, and to guarantee a portion of MSNBC debt.

In an ongoing investigation, the Antitrust Division of the U.S. Department of Justice requested information from Microsoft concerning various issues. Microsoft is also subject to various legal proceedings and claims that arise in the ordinary course of business. Management currently believes that resolving these matters will not have a material adverse impact on the Company's financial position or its results of operations.

Geographic Information

Year Ended June 30	1995	1996	1997
Revenue			
U.S. operations	$ 4,495	$ 6,739	$ 8,877
European operations	1,607	2,215	2,770
Other international operations	821	1,267	1,757
Eliminations	(986)	(1,550)	(2,046)
Total revenue	$ 5,937	$ 8,671	$11,358
Operating income			
U.S. operations	$ 1,414	$ 2,137	$ 3,733
European operations	444	649	1,013
Other international operations	163	297	469
Eliminations	17	(5)	(85)
Total operating income	$ 2,038	$ 3,078	$ 5,130
Identifiable assets			
U.S. operations	$ 5,862	$ 8,193	$11,630
European operations	1,806	2,280	3,395
Other international operations	689	1,042	705
Eliminations	(1,147)	(1,422)	(1,343)
Total identifiable assets	$ 7,210	$10,093	$14,387

Intercompany sales between geographic areas are accounted for at prices representative of unaffiliated party transactions. "U.S. operations" include shipments to customers in the United States, licensing to OEMs, and exports of finished goods directly to international customers, primarily in Asia, South America, and Canada. Exports and international OEM transactions are primarily in U.S. dollars and totaled $1.3 billion, $2.1 billion, and $2.5 billion in 1995, 1996, and 1997.

"Other international operations" primarily include subsidiaries in Japan, Canada, Australia, and Brazil. International revenue, which includes European operations, other international operations, exports, and OEM distribution, was 55%, 56%, and 56% of total revenue in 1995, 1996, and 1997. Most international identifiable assets are U.S. dollar denominated investment securities.

Subsidiaries

Microsoft Corporation
One Microsoft Way
Redmond, WA 98052-6399
Microsoft FSC Corp. (U.S. VIRGIN ISLANDS)
Microsoft Investments, Inc. (NEVADA)
Microsoft Licensing, Inc. (NEVADA)
Microsoft Manufacturing B.V. (THE NETHERLANDS)
Microsoft Puerto Rico, Inc. (Manufacturing) (DELAWARE)
Microsoft Research Limited (United Kingdom)
The Microsoft Network L.L.C. (DELAWARE)
GraceMac Corporation (NEVADA)
Vermeer Technologies, Inc. (DELAWARE)
Microsoft de Argentina S.A.
Microsoft Pty. Limited (AUSTRALIA)
Microsoft Gesellschaft m.b.H. (AUSTRIA)
Microsoft N.V. (BELGIUM)
Microsoft Informatica Limitada (BRAZIL)
Microsoft Canada Co.
SOFTIMAGE, Inc. (CANADA)
Microsoft Chile S.A.
Microsoft Colombia Inc. (DELAWARE)
Microsoft de Centroamerica S.A. (COSTA RICA)
Microsoft Hrvatska d.o.o. (CROATIA)
Microsoft s.r.o. (CZECH REPUBLIC)
Microsoft Danmark ApS (DENMARK)
Microsoft Del Ecuador S.A.
Microsoft Corporation (Representative Office) (EGYPT)
Microsoft Oy (FINLAND)
Microsoft France S.A.R.L.
Microsoft G.m.b.H. (GERMANY)
SOFTIMAGE G.m.b.H. (GERMANY)
Microsoft Hellas S.A. (GREECE)
Microsoft de Guatemala, S.A.
Microsoft Hong Kong Limited
Microsoft Hungary Kft.
Microsoft Corporation (India) Private Limited
PT. Microsoft Indonesia
Microsoft Israel Ltd.
Microsoft S.p.A. (ITALY)
Microsoft Cote d'Ivoire (IVORY COAST)
Microsoft Company, Limited (JAPAN)
East Africa Software Limited (KENYA)
Microsoft CH (KOREA)
Microsoft (Malaysia) Sdn. Bhd.
Microsoft Mexico, S.A. de C.V.
Microsoft Maroc S.A.R.L. (MOROCCO)

Microsoft B.V. (THE NETHERLANDS)
Microsoft International B.V. (THE NETHERLANDS)
Microsoft New Zealand Limited
Microsoft Norge AS (NORWAY)
Microsoft de Panama, S.A.
Microsoft (China) Company Limited (THE PEOPLE'S REPUBLIC OF CHINA)
Microsoft Peru, S.A.
Microsoft Philippines, Inc.
Microsoft sp. z.o.o. (POLAND)
MSFT-Software Para Microcomputadores, LDA (PORTUGAL)
Microsoft Caribbean, Inc. (PUERTO RICO) (DELAWARE)
Microsoft Romania SRL
Microsoft ZAO (RUSSIA)
Microsoft Singapore Pte Ltd
Microsoft Slovakia s.r.o.
Microsoft d.o.o., Ljubljana (SLOVENIA)
Microsoft (S.A.) (Proprietary) Limited (SOUTH AFRICA)
Microsoft Iberica S.R.L. (SPAIN)
Microsoft Aktiebolag (SWEDEN)
Microsoft AG (SWITZERLAND)
Microsoft Taiwan Corporation
Microsoft (Thailand) Limited
Microsoft Bilgisayar Yazilim Hizmetleri Limited Sirketi (TURKEY)
Microsoft Corporation (UNITED ARAB EMIRATES)
Microsoft Limited (UNITED KINGDOM)
SOFTIMAGE U.K. Limited
Microsoft Uruguay S.A.
Corporation MS 90 de Venezuela S.A.
The Resident Representative Office of MICROSOFT Corporation in Hanoi (VIETNAM)
DreamWorks Interactive L.L.C. (WASHINGTON, 50% owned)
MSBET L.L.C. (DELAWARE, 50% owned)
MSFDC, L.L.C. (DELAWARE, 50% owned)
MSNBC Cable, L.L.C. (DELAWARE, 50% owned)
MSNBC Interactive News, L.L.C. (DELAWARE, 50% owned)

Independent Auditors' Report

To the Board of Directors and Stockholders of Microsoft Corporation:

We have audited the accompanying balance sheets of Microsoft Corporation and subsidiaries as of June 30, 1996 and 1997, and the related statements of income, cash flows, and stockholders' equity for each of the three years ended June 30, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Microsoft Corporation and subsidiaries as of June 30, 1996 and 1997, and the results of their operations and their cash flows for each of the three years ended June 30, 1997 in conformity with accounting principles generally accepted in the United States and International Accounting Standards.

/s/ DELOITTE & TOUCHE LLP

Deloitte & Touche LLP

Seattle, Washington
July 17, 1997 (August 1, 1997 as to Acquisition Note)

Exhibit 23.

Independent Auditors' Consent

Microsoft Corporation:

We consent to the incorporation by reference in Registration Statement Numbers 33-06335, 33-18381, 33-25575, 33-33695, and 33-37623 (Microsoft Corporation 1981 Stock Option Plan), 33-44302 and 33-51583 (Microsoft Corporation 1991 Stock Option Plan), 33-37622 (Microsoft Corporation 1991 Employee Stock Purchase Plan), 33-10732 (Microsoft Corporation Savings Plus Plan), 33-36498 (Microsoft Corporation Stock Option Plan for Non-Employee Directors), 33-45617 (Microsoft Corporation Stock Option Plan for Consultants and Advisors), 333-16665 (Microsoft Corporation 1997 Employee Stock Purchase Plan) and 333-06298 of Microsoft Corporation on Forms S-8 and 33-29823, 33-34794, 33-36347, 33-46958, 33-49496, 33-56039, 33-57277, 33-57899, 33-58867, 33-62725, 33-63471, 33-64870, 333-857, 333-1177, 333-2759, 333-5961, 333-8081, 333-12441, 333-17143, 333-18055, 333-18195, 333-23621, and 333-31803 of Microsoft Corporation on Forms S-3 and 333-26411 of Microsoft Corporation on Form S-4 of our report dated July 17, 1997 (August 1, 1997 as to Acquisition Note) appearing in and incorporated by reference in this Annual Report on Form 10-K of Microsoft Corporation for the year ended June 30, 1997.

/s/ DELOITTE & TOUCHE LLP

Deloitte & Touche LLP

Seattle, Washington
September 26, 1997

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE ACCOMPANYING FINANCIAL STATEMENTS AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

YEAR
JUN-30-1997
JUN-30-1997
8,966
0
980
0
0
10,373
2,777
1,312
14,387
3,610
0
0
980
4,509
5,288
14,387
11,358
11,358
1,085
1,085
5,143
0
0
5,314
1,860
3,439
0
0
0
3,439
2.63
2.63