

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended December 31, 2009

OR

**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**

(Exact name of registrant as specified in its charter)

**Washington**  
(State or other jurisdiction of  
incorporation or organization)

**One Microsoft Way, Redmond, Washington**  
(Address of principal executive offices)

**91-1144442**  
(I.R.S. Employer  
Identification No.)

**98052-6399**  
(Zip Code)

**(425) 882-8080**

(Registrant's telephone number, including area code)

**None**

(Former name, former address and former fiscal year, if changed since last report)

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class

Outstanding at January 25, 2010

Common Stock, \$0.00000625 par value per share

8,770,460,922 shares

**MICROSOFT CORPORATION**  
**FORM 10-Q**  
**For the Quarter Ended December 31, 2009**  
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PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS  
INCOME STATEMENTS

| (In millions, except per share amounts) (Unaudited) | Three Months Ended<br>December 31, |           | Six Months Ended<br>December 31, |           |
|---|------------------------------------|-----------|----------------------------------|-----------|
|   | 2009                               | 2008      | 2009                             | 2008      |
| Revenue   | \$ 19,022                          | \$ 16,629 | \$ 31,942                        | \$ 31,690 |
| Operating expenses:                                 |                                    |           |                                  |           |
| Cost of revenue                                     | 3,628                              | 3,907     | 6,470                            | 6,755     |
| Research and development                            | 2,079                              | 2,290     | 4,144                            | 4,573     |
| Sales and marketing                                 | 3,619                              | 3,662     | 6,409                            | 6,706     |
| General and administrative                          | 1,124                              | 831       | 1,865                            | 1,718     |
| Employee severance                                  | 59                                 | —         | 59                               | —         |
| Total operating expenses                            | 10,509                             | 10,690    | 18,947                           | 19,752    |
| Operating income                                    | 8,513                              | 5,939     | 12,995                           | 11,938    |
| Other income (expense)                              | 370                                | (301)     | 653                              | (309)     |
| Income before income taxes                          | 8,883                              | 5,638     | 13,648                           | 11,629    |
| Provision for income taxes                          | 2,221                              | 1,464     | 3,412                            | 3,082     |
| Net income  | \$ 6,662                           | \$ 4,174  | \$ 10,236                        | \$ 8,547  |
| Earnings per share:                                 |                                    |           |                                  |           |
| Basic   | \$ 0.75                            | \$ 0.47   | \$ 1.15                          | \$ 0.95   |
| Diluted   | \$ 0.74                            | \$ 0.47   | \$ 1.14                          | \$ 0.94   |
| Weighted average shares outstanding:                |                                    |           |                                  |           |
| Basic   | 8,856                              | 8,903     | 8,885                            | 8,994     |
| Diluted   | 8,951                              | 8,914     | 8,975                            | 9,052     |
| Cash dividends declared per common share            | \$ 0.13                            | \$ 0.13   | \$ 0.26                          | \$ 0.26   |

See accompanying notes.

**BALANCE SHEETS**

| (In millions)   | December 31,        | June 30,            |
|---|---------------------|---------------------|
|   | 2009<br>(Unaudited) | 2009 <sup>(1)</sup> |
| <b>Assets</b>   |                     |                     |
| Current assets:   |                     |                     |
| Cash and cash equivalents   | \$ 9,422            | \$ 6,076            |
| Short-term investments (including securities loaned of \$2,654 and \$1,540)             | 26,677              | 25,371              |
| <hr/>   |                     |                     |
| Total cash, cash equivalents, and short-term investments                                | 36,099              | 31,447              |
| Accounts receivable, net of allowance for doubtful accounts of \$506 and \$451          | 11,196              | 11,192              |
| Inventories   | 589                 | 717                 |
| Deferred income taxes   | 2,056               | 2,213               |
| Other   | 2,547               | 3,711               |
| <hr/>   |                     |                     |
| Total current assets  | 52,487              | 49,280              |
| Property and equipment, net of accumulated depreciation of \$8,170 and \$7,547          | 7,402               | 7,535               |
| Equity and other investments  | 6,976               | 4,933               |
| Goodwill  | 12,368              | 12,503              |
| Intangible assets, net  | 1,346               | 1,759               |
| Deferred income taxes   | —                   | 279                 |
| Other long-term assets  | 1,517               | 1,599               |
| <hr/>   |                     |                     |
| Total assets  | \$ 82,096           | \$ 77,888           |
| <hr/>   |                     |                     |
| <b>Liabilities and stockholders' equity</b>   |                     |                     |
| Current liabilities:  |                     |                     |
| Accounts payable  | \$ 3,171            | \$ 3,324            |
| Short-term debt   | 2,249               | 2,000               |
| Accrued compensation  | 2,417               | 3,156               |
| Income taxes  | 721                 | 725                 |
| Short-term unearned revenue   | 11,361              | 13,003              |
| Securities lending payable  | 2,911               | 1,684               |
| Other   | 2,885               | 3,142               |
| <hr/>   |                     |                     |
| Total current liabilities   | 25,715              | 27,034              |
| Long-term debt  | 3,746               | 3,746               |
| Long-term unearned revenue  | 1,167               | 1,281               |
| Deferred income taxes   | 377                 | —                   |
| Other long-term liabilities   | 6,808               | 6,269               |
| Commitments and contingencies   |                     |                     |
| Stockholders' equity:   |                     |                     |
| Common stock and paid-in capital—shares authorized 24,000; outstanding 8,811 and 8,908  | 62,566              | 62,382              |
| Retained deficit, including accumulated other comprehensive income of \$1,322 and \$969 | (18,283)            | (22,824)            |
| <hr/>   |                     |                     |
| Total stockholders' equity  | 44,283              | 39,558              |
| <hr/>   |                     |                     |
| Total liabilities and stockholders' equity  | \$ 82,096           | \$ 77,888           |

(1) Derived from audited financial statements.

See accompanying notes.

**CASH FLOWS STATEMENTS**

| (In millions) (Unaudited)  | Three Months Ended<br>December 31, |                 | Six Months Ended<br>December 31, |                 |
|--|------------------------------------|-----------------|----------------------------------|-----------------|
|  | 2009                               | 2008            | 2009                             | 2008            |
| <b>Operations</b>  |                                    |                 |                                  |                 |
| Net income   | \$ 6,662                           | \$ 4,174        | \$ 10,236                        | \$ 8,547        |
| Adjustments to reconcile net income to net cash from operations:       |                                    |                 |                                  |                 |
| Depreciation, amortization, and other noncash items                    | 615                                | 632             | 1,261                            | 1,217           |
| Stock-based compensation   | 485                                | 417             | 928                              | 860             |
| Net recognized losses (gains) on investments and derivatives           | (188)                              | 139             | (254)                            | 175             |
| Excess tax benefits from stock-based compensation                      | (15)                               | (2)             | (24)                             | (46)            |
| Deferred income taxes  | 550                                | 454             | 504                              | 830             |
| Deferral of unearned revenue   | 6,926                              | 5,969           | 13,605                           | 10,155          |
| Recognition of unearned revenue  | (9,126)                            | (6,364)         | (15,363)                         | (12,408)        |
| Changes in operating assets and liabilities:                           |                                    |                 |                                  |                 |
| Accounts receivable  | (2,789)                            | (1,647)         | (41)                             | 2,338           |
| Other current assets   | 1,244                              | 797             | 590                              | 239             |
| Other long-term assets   | 16                                 | (69)            | (62)                             | (185)           |
| Other current liabilities  | 285                                | 614             | (954)                            | (3,938)         |
| Other long-term liabilities  | 304                                | 668             | 650                              | 1,368           |
| <b>Net cash from operations</b>  | <b>4,969</b>                       | <b>5,782</b>    | <b>11,076</b>                    | <b>9,152</b>    |
| <b>Financing</b>   |                                    |                 |                                  |                 |
| Short-term borrowings (repayments), maturities of 90 days or less, net | (475)                              | 21              | (97)                             | 1,996           |
| Proceeds from issuance of debt, maturities longer than 90 days         | 1,046                              | —               | 1,741                            | —               |
| Repayments of debt, maturities longer than 90 days                     | (573)                              | —               | (1,396)                          | —               |
| Common stock issued  | 729                                | 96              | 977                              | 324             |
| Common stock repurchased   | (3,867)                            | (2,820)         | (5,407)                          | (9,313)         |
| Common stock cash dividends  | (1,152)                            | (1,157)         | (2,309)                          | (2,155)         |
| Excess tax benefits from stock-based compensation                      | 15                                 | 2               | 24                               | 46              |
| <b>Net cash used in financing</b>                                      | <b>(4,277)</b>                     | <b>(3,858)</b>  | <b>(6,467)</b>                   | <b>(9,102)</b>  |
| <b>Investing</b>   |                                    |                 |                                  |                 |
| Additions to property and equipment                                    | (376)                              | (842)           | (811)                            | (1,620)         |
| Acquisition of companies, net of cash acquired                         | (63)                               | (450)           | (102)                            | (827)           |
| Purchases of investments   | (4,287)                            | (6,596)         | (14,777)                         | (10,842)        |
| Maturities of investments  | 1,896                              | 290             | 5,394                            | 754             |
| Sales of investments   | 3,361                              | 5,700           | 7,778                            | 12,775          |
| Securities lending payable   | (623)                              | (601)           | 1,227                            | (2,144)         |
| <b>Net cash used in investing</b>                                      | <b>(92)</b>                        | <b>(2,499)</b>  | <b>(1,291)</b>                   | <b>(1,904)</b>  |
| Effect of exchange rates on cash and cash equivalents                  | (1)                                | (83)            | 28                               | (139)           |
| <b>Net change in cash and cash equivalents</b>                         | <b>599</b>                         | <b>(658)</b>    | <b>3,346</b>                     | <b>(1,993)</b>  |
| Cash and cash equivalents, beginning of period                         | 8,823                              | 9,004           | 6,076                            | 10,339          |
| <b>Cash and cash equivalents, end of period</b>                        | <b>\$ 9,422</b>                    | <b>\$ 8,346</b> | <b>\$ 9,422</b>                  | <b>\$ 8,346</b> |

See accompanying notes.

## STOCKHOLDERS' EQUITY STATEMENTS

| (In millions) (Unaudited)                        | Three Months Ended<br>December 31, |           | Six Months Ended<br>December 31, |           |
|--|------------------------------------|-----------|----------------------------------|-----------|
|  | 2009                               | 2008      | 2009                             | 2008      |
| <b>Common stock and paid-in capital</b>          |                                    |           |                                  |           |
| Balance, beginning of period                     | \$ 62,293                          | \$ 61,655 | \$ 62,382                        | \$ 62,849 |
| Common stock issued                              | 779                                | 86        | 1,027                            | 312       |
| Common stock repurchased                         | (923)                              | (674)     | (1,656)                          | (2,571)   |
| Stock-based compensation                         | 485                                | 417       | 928                              | 860       |
| Stock-based compensation income tax deficiencies | (68)                               | (91)      | (114)                            | (58)      |
| Other, net                                       | —                                  | (1)       | (1)                              | —         |
| Balance, end of period                           | <b>62,566</b>                      | 61,392    | <b>62,566</b>                    | 61,392    |
| <b>Retained deficit</b>                          |                                    |           |                                  |           |
| Balance, beginning of period                     | (21,081)                           | (28,061)  | (22,824)                         | (26,563)  |
| Net income                                       | 6,662                              | 4,174     | 10,236                           | 8,547     |
| Other comprehensive income:                      |                                    |           |                                  |           |
| Net unrealized gains (losses) on derivatives     | (42)                               | 473       | (361)                            | 766       |
| Net unrealized gains (losses) on investments     | 65                                 | (514)     | 653                              | (912)     |
| Translation adjustments and other                | (35)                               | (251)     | 61                               | (409)     |
| Comprehensive income                             | 6,650                              | 3,882     | 10,589                           | 7,992     |
| Common stock cash dividends                      | (1,140)                            | (1,147)   | (2,297)                          | (2,304)   |
| Common stock repurchased                         | (2,712)                            | (1,588)   | (3,751)                          | (6,039)   |
| Balance, end of period                           | <b>(18,283)</b>                    | (26,914)  | <b>(18,283)</b>                  | (26,914)  |
| Total stockholders' equity                       | <b>\$ 44,283</b>                   | \$ 34,478 | <b>\$ 44,283</b>                 | \$ 34,478 |

See accompanying notes.

**NOTES TO FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1 ACCOUNTING POLICIES**

**Basis of Presentation**

In the opinion of management, the accompanying balance sheets and related interim statements of income, cash flows, and stockholders' equity include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples include: estimates of loss contingencies, product warranties, product life cycles, product returns, and stock-based compensation forfeiture rates; assumptions such as the elements comprising a software arrangement, including the distinction between upgrades/enhancements and new products; when technological feasibility is achieved for our products; the potential outcome of future tax consequences of events that have been recognized in our financial statements or tax returns; estimating the fair value and/or goodwill impairment for our reporting units; and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from management's estimates and assumptions.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with information included in the Microsoft Corporation 2009 Form 10-K filed on July 30, 2009 with the U.S. Securities and Exchange Commission.

**Principles of Consolidation**

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

**Subsequent Events**

We evaluated events occurring between the end of our fiscal quarter, December 31, 2009 and January 28, 2010 when the financial statements were issued.

**Recently Adopted Accounting Guidance**

On July 1, 2009, we adopted guidance issued by the Financial Accounting Standards Board ("FASB") on business combinations. The guidance retains the fundamental requirements that the acquisition method of accounting (previously referred to as the purchase method of accounting) be used for all business combinations, but requires a number of changes, including changes in the way assets and liabilities are recognized and measured as a result of business combinations. It also requires the capitalization of in-process research and development at fair value and requires the expensing of acquisition-related costs as incurred. We have applied this guidance to business combinations completed since July 1, 2009.

On July 1, 2009, we adopted the guidance issued by the FASB that changes the accounting and reporting for non-controlling interests. Non-controlling interests are to be reported as a component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control are to be accounted for as equity transactions. In addition, net income attributable to a non-controlling interest is to be included in net income and, upon a loss of control, the interest sold, as well as any interest retained, is to be recorded at fair value with any gain or loss recognized in net income. Adoption of the new guidance did not have a material impact on our financial statements.

On July 1, 2009, we adopted the guidance on fair value measurement for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Adoption of the new guidance did not have a material impact on our financial statements.

**Recent Accounting Guidance Not Yet Adopted**

In January 2010, the FASB issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance will become effective for us with the reporting period beginning January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for us with the reporting period beginning July 1, 2011. Other than requiring additional disclosures, adoption of this new guidance will not have a material impact on our financial statements.

In October 2009, the FASB issued guidance on revenue recognition that will become effective for us beginning July 1, 2010, with earlier adoption permitted. Under the new guidance on arrangements that include software elements, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. Additionally, the FASB issued guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. We believe adoption of this new guidance will not have a material impact on our financial statements.

In June 2009, the FASB issued guidance on the consolidation of variable interest entities, which is effective for us beginning July 1, 2010. The new guidance requires revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities, and additional disclosures for variable interests. We believe adoption of this new guidance will not have a material impact on our financial statements.

**NOTE 2 EARNINGS PER SHARE**

Basic earnings per share is computed on the basis of the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed on the basis of the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options, stock awards, and shared performance stock awards. The components of basic and diluted earnings per share are as follows:

| (In millions, except earnings per share)                | Three Months Ended<br>December 31, |              | Six Months Ended<br>December 31, |              |
|---|------------------------------------|--------------|----------------------------------|--------------|
|   | 2009                               | 2008         | 2009                             | 2008         |
| Net income available for common shareholders (A)        | \$ 6,662                           | \$ 4,174     | \$ 10,236                        | \$ 8,547     |
| Weighted average shares of common stock outstanding (B) | 8,856                              | 8,903        | 8,885                            | 8,994        |
| Dilutive effect of stock-based awards                   | 95                                 | 11           | 90                               | 58           |
| Common stock and common stock equivalents (C)           | <u>8,951</u>                       | <u>8,914</u> | <u>8,975</u>                     | <u>9,052</u> |
| Earnings per share:                                     |                                    |              |                                  |              |
| Basic (A/B)   | \$ 0.75                            | \$ 0.47      | \$ 1.15                          | \$ 0.95      |
| Diluted (A/C)   | \$ 0.74                            | \$ 0.47      | \$ 1.14                          | \$ 0.94      |

We excluded the following shares underlying stock-based awards from the calculations of diluted earnings per share because their inclusion would have been anti-dilutive:

| (In millions)                                    | Three Months Ended<br>December 31, |      | Six Months Ended<br>December 31, |      |
|--|------------------------------------|------|----------------------------------|------|
|  | 2009                               | 2008 | 2009                             | 2008 |
| Shares excluded from calculations of diluted EPS | 101                                | 517  | 155                              | 326  |



**NOTE 3 OTHER INCOME (EXPENSE)**

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

| (In millions)   | Three Months Ended<br>December 31, |                 | Six Months Ended<br>December 31, |                 |
|---|------------------------------------|-----------------|----------------------------------|-----------------|
|   | 2009                               | 2008            | 2009                             | 2008            |
| Dividends and interest                                | \$ 159                             | \$ 175          | \$ 324                           | \$ 382          |
| Net recognized gains on investments                   | 92                                 | 270             | 162                              | 399             |
| Net gains (losses) on derivatives                     | 96                                 | (409)           | 92                               | (574)           |
| Net gains (losses) on foreign currency remeasurements | (23)                               | (350)           | 32                               | (529)           |
| Other   | 46                                 | 13              | 43                               | 13              |
| <b>Total</b>  | <b>\$ 370</b>                      | <b>\$ (301)</b> | <b>\$ 653</b>                    | <b>\$ (309)</b> |

Other-than-temporary impairments included in net recognized gains on investments were \$6 million and \$24 million for the three months and six months ended December 31, 2009, respectively, as compared with \$262 million and \$334 million during the three months and six months ended December 31, 2008, respectively.

**NOTE 4 INVESTMENTS**

**Investment Components**

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

| (In millions)                         | Cost Basis       | Unrealized<br>Gains | Unrealized<br>Losses | Recorded<br>Basis | Cash<br>and Cash<br>Equivalents | Short-term<br>Investments | Equity<br>and Other<br>Investments |
|---------------------------------------|------------------|---------------------|----------------------|-------------------|---------------------------------|---------------------------|------------------------------------|
| <b>December 31, 2009</b>              |                  |                     |                      |                   |                                 |                           |                                    |
| Cash                                  | \$ 2,151         | \$ —                | \$ —                 | \$ 2,151          | \$ 2,151                        | \$ —                      | \$ —                               |
| Mutual funds                          | 1,713            | —                   | —                    | 1,713             | 1,662                           | 51                        | —                                  |
| Commercial paper                      | 2,440            | —                   | —                    | 2,440             | 1,816                           | 624                       | —                                  |
| Certificates of deposit               | 3,292            | —                   | —                    | 3,292             | 3,058                           | 234                       | —                                  |
| U.S. government and agency securities | 12,542           | 50                  | (9)                  | 12,583            | 415                             | 12,168                    | —                                  |
| Foreign government bonds              | 3,530            | 84                  | (3)                  | 3,611             | —                               | 3,611                     | —                                  |
| Mortgage-backed securities            | 3,981            | 91                  | (4)                  | 4,068             | —                               | 4,068                     | —                                  |
| Corporate notes and bonds             | 5,411            | 288                 | (14)                 | 5,685             | 200                             | 5,485                     | —                                  |
| Municipal securities                  | 539              | 1                   | (2)                  | 538               | 120                             | 418                       | —                                  |
| Common and preferred stock            | 5,171            | 1,432               | (116)                | 6,487             | —                               | —                         | 6,487                              |
| Other investments                     | 507              | —                   | —                    | 507               | —                               | 18                        | 489                                |
| <b>Total</b>                          | <b>\$ 41,277</b> | <b>\$ 1,946</b>     | <b>\$ (148)</b>      | <b>\$ 43,075</b>  | <b>\$ 9,422</b>                 | <b>\$ 26,677</b>          | <b>\$ 6,976</b>                    |

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| (In millions)                         | PART I<br>Item 1 |                  |                   |                  |                           |                        |                              |
|---------------------------------------|------------------|------------------|-------------------|------------------|---------------------------|------------------------|------------------------------|
|                                       | Cost Basis       | Unrealized Gains | Unrealized Losses | Recorded Basis   | Cash and Cash Equivalents | Short-term Investments | Equity and Other Investments |
| <b>June 30, 2009</b>                  |                  |                  |                   |                  |                           |                        |                              |
| Cash                                  | \$ 2,064         | \$ —             | \$ —              | \$ 2,064         | \$ 2,064                  | \$ —                   | \$ —                         |
| Mutual funds                          | 1,007            | —                | (25)              | 982              | 900                       | 82                     | —                            |
| Commercial paper                      | 2,601            | —                | —                 | 2,601            | 400                       | 2,201                  | —                            |
| Certificates of deposit               | 555              | —                | —                 | 555              | 275                       | 280                    | —                            |
| U.S. government and agency securities | 13,450           | 21               | (5)               | 13,466           | 2,369                     | 11,097                 | —                            |
| Foreign government bonds              | 3,450            | 71               | (4)               | 3,517            | —                         | 3,517                  | —                            |
| Mortgage-backed securities            | 3,353            | 81               | (16)              | 3,418            | —                         | 3,418                  | —                            |
| Corporate notes and bonds             | 4,361            | 287              | (52)              | 4,596            | —                         | 4,596                  | —                            |
| Municipal securities                  | 255              | 2                | (1)               | 256              | 68                        | 188                    | —                            |
| Common and preferred stock            | 4,015            | 627              | (182)             | 4,460            | —                         | —                      | 4,460                        |
| Other investments                     | 465              | —                | —                 | 465              | —                         | (8)                    | 473                          |
| <b>Total</b>                          | <b>\$ 35,576</b> | <b>\$ 1,089</b>  | <b>\$ (285)</b>   | <b>\$ 36,380</b> | <b>\$ 6,076</b>           | <b>\$ 25,371</b>       | <b>\$ 4,933</b>              |

**Unrealized Losses on Investments**

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

| (In millions)                         | Less than 12 Months |                   | 12 Months or Greater |                   | Total Fair Value | Total Unrealized Losses |
|---------------------------------------|---------------------|-------------------|----------------------|-------------------|------------------|-------------------------|
|                                       | Fair Value          | Unrealized Losses | Fair Value           | Unrealized Losses |                  |                         |
| <b>December 31, 2009</b>              |                     |                   |                      |                   |                  |                         |
| U.S. government and agency securities | \$ 568              | \$ (9)            | \$ —                 | \$ —              | \$ 568           | \$ (9)                  |
| Foreign government bonds              | 1,395               | (1)               | 491                  | (2)               | 1,886            | (3)                     |
| Mortgage-backed securities            | 391                 | (2)               | 20                   | (2)               | 411              | (4)                     |
| Corporate notes and bonds             | 397                 | (5)               | 183                  | (9)               | 580              | (14)                    |
| Municipal securities                  | 110                 | (2)               | —                    | —                 | 110              | (2)                     |
| Common and preferred stock            | 887                 | (58)              | 243                  | (58)              | 1,130            | (116)                   |
| <b>Total</b>                          | <b>\$ 3,748</b>     | <b>\$ (77)</b>    | <b>\$ 937</b>        | <b>\$ (71)</b>    | <b>\$ 4,685</b>  | <b>\$ (148)</b>         |

| (In millions)                         | Less than 12 Months |                   | 12 Months or Greater |                   | Total Fair Value | Total Unrealized Losses |
|---------------------------------------|---------------------|-------------------|----------------------|-------------------|------------------|-------------------------|
|                                       | Fair Value          | Unrealized Losses | Fair Value           | Unrealized Losses |                  |                         |
| <b>June 30, 2009</b>                  |                     |                   |                      |                   |                  |                         |
| Mutual funds                          | \$ 3                | \$ (1)            | \$ 77                | \$ (24)           | \$ 80            | \$ (25)                 |
| U.S. government and agency securities | 4,033               | (5)               | —                    | —                 | 4,033            | (5)                     |
| Foreign government bonds              | 1,444               | (3)               | 669                  | (1)               | 2,113            | (4)                     |
| Mortgage-backed securities            | 503                 | (16)              | —                    | —                 | 503              | (16)                    |
| Corporate notes and bonds             | 713                 | (10)              | 504                  | (42)              | 1,217            | (52)                    |
| Municipal securities                  | 16                  | (1)               | —                    | —                 | 16               | (1)                     |
| Common and preferred stock            | 1,154               | (135)             | 120                  | (47)              | 1,274            | (182)                   |
| <b>Total</b>                          | <b>\$ 7,866</b>     | <b>\$ (171)</b>   | <b>\$ 1,370</b>      | <b>\$ (114)</b>   | <b>\$ 9,236</b>  | <b>\$ (285)</b>         |

At December 31, 2009 and June 30, 2009, the recorded bases and estimated fair values of common and preferred stock and other investments that are restricted for more than one year or are not publicly traded were \$209 million and \$204 million, respectively. The estimated fair values are based on publicly available market information or other estimates determined by management. Unrealized losses on fixed-income securities are primarily attributable to

changes in interest rates. Unrealized losses on domestic and international equities are due to market price movements. Management does not believe any remaining unrealized losses represent other-than-temporary impairments based on our evaluation of available evidence as of December 31, 2009.

### Debt Investment Maturities

| (In millions)                         | Cost Basis | Estimated Fair Value |
|---------------------------------------|------------|----------------------|
| Due in one year or less               | \$ 9,837   | \$ 9,845             |
| Due after one year through five years | 14,945     | 15,240               |
| Due after five years through 10 years | 2,617      | 2,708                |
| Due after 10 years                    | 4,337      | 4,423                |
| Total                                 | \$ 31,736  | \$ 32,216            |

### NOTE 5 DERIVATIVES

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

#### Foreign Currency

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions. Options and forward contracts are used to hedge a portion of forecasted international revenue for up to three years in the future and are designated as cash-flow hedging instruments. Principal currencies hedged include the euro, Japanese yen, British pound, and Canadian dollar. As of December 31, 2009, the total notional amount of such foreign exchange contracts sold was \$9.1 billion. Foreign currency risks related to certain non-U.S. dollar denominated securities are hedged using foreign exchange forward contracts that are designated as fair-value hedging instruments. As of December 31, 2009, the total notional amount of these foreign exchange contracts sold was \$3.7 billion. Certain options and forwards not designated as hedging instruments are also used to manage the variability in exchange rates on accounts receivable, cash, and intercompany positions, and to manage other foreign currency exposures. As of December 31, 2009, the total notional amounts of these foreign exchange contracts purchased and sold were \$4.5 billion and \$4.6 billion, respectively.

#### Equity

Securities held in our equity and other investments portfolio are subject to market price risk. Market price risk is managed relative to broad-based global and domestic equity indices using certain convertible preferred investments, options, futures, and swap contracts not designated as hedging instruments. From time to time, to hedge our price risk, we may use and designate equity derivatives as hedging instruments, including puts, calls, swaps, and forwards. As of December 31, 2009, the total notional amounts of designated and non-designated equity contracts purchased and sold were immaterial.

#### Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using exchange-traded option and futures contracts and over-the-counter swap and option contracts, none of which are designated as hedging instruments. As of December 31, 2009, the total notional amount of fixed-interest rate contracts purchased and sold were \$1.7 billion and \$653 million, respectively. In addition, we use "To Be Announced" forward purchase commitments of mortgage-backed assets to gain exposure to agency mortgage-backed securities. These meet the definition of a derivative instrument in cases where physical delivery of the assets is not taken at the earliest available delivery date. As of December 31, 2009, the total notional derivative amount of mortgage contracts purchased was \$858 million.

**Credit**

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts, not designated as hedging instruments, to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. We use credit default swaps as they are a low cost method of managing exposure to individual credit risks or groups of credit risks. As of December 31, 2009, the total notional amounts of credit contracts purchased and sold were immaterial.

**Commodity**

We use broad-based commodity exposures to enhance portfolio returns and to facilitate portfolio diversification. We use swap and futures contracts, not designated as hedging instruments, to generate and manage exposures to broad-based commodity indices. We use derivatives on commodities as they are low-cost alternatives to the purchase and storage of a variety of commodities, including, but not limited to, precious metals, energy, and grain. As of December 31, 2009, the total notional amounts of commodity contracts purchased and sold were \$692 million and \$22 million, respectively.

**Credit-Risk-Related Contingent Features**

Certain of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain a minimum liquidity of \$1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of December 31, 2009, our long-term unsecured debt rating was AAA, and cash investments were in excess of \$1.0 billion. As a result, no collateral is required to be posted.

**Fair Values of Derivative Instruments**

Following are the gross fair values of derivative instruments held at December 31, 2009, excluding the impact of netting derivative assets and liabilities when a legally enforceable master netting agreement exists and fair value adjustments related to our own credit risk and counterparty credit risk:

| (In millions)                                      | Foreign<br>Exchange<br>Contracts | Equity<br>Contracts | Interest<br>Rate<br>Contracts | Credit<br>Contracts | Commodity<br>Contracts | Total<br>Derivatives |
|--|----------------------------------|---------------------|-------------------------------|---------------------|------------------------|----------------------|
| <b>Assets</b>                                      |                                  |                     |                               |                     |                        |                      |
| Derivatives not designated as hedging instruments: |                                  |                     |                               |                     |                        |                      |
| Short-term investments                             | \$ 13                            | \$ 112              | \$ 5                          | \$ 7                | \$ 26                  | \$ 163               |
| Other current assets                               | 80                               | —                   | —                             | —                   | —                      | 80                   |
| <b>Total</b>                                       | <b>\$ 93</b>                     | <b>\$ 112</b>       | <b>\$ 5</b>                   | <b>\$ 7</b>         | <b>\$ 26</b>           | <b>\$ 243</b>        |
| Derivatives designated as hedging instruments:     |                                  |                     |                               |                     |                        |                      |
| Short-term investments                             | \$ 87                            | \$ —                | \$ —                          | \$ —                | \$ —                   | \$ 87                |
| Other current assets                               | 284                              | —                   | —                             | —                   | —                      | 284                  |
| <b>Total</b>                                       | <b>\$ 371</b>                    | <b>\$ —</b>         | <b>\$ —</b>                   | <b>\$ —</b>         | <b>\$ —</b>            | <b>\$ 371</b>        |
| <b>Total assets</b>                                | <b>\$ 464</b>                    | <b>\$ 112</b>       | <b>\$ 5</b>                   | <b>\$ 7</b>         | <b>\$ 26</b>           | <b>\$ 614</b>        |

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| (In millions)                                      | PART I<br>Item 1           |                  |                         |                  |                     |                   |
|--|----------------------------|------------------|-------------------------|------------------|---------------------|-------------------|
|  | Foreign Exchange Contracts | Equity Contracts | Interest Rate Contracts | Credit Contracts | Commodity Contracts | Total Derivatives |
| <b>Liabilities</b>                                 |                            |                  |                         |                  |                     |                   |
| Derivatives not designated as hedging instruments: |                            |                  |                         |                  |                     |                   |
| Other current liabilities                          | \$ (39)                    | \$ (5)           | \$ (6)                  | \$ (42)          | \$ (9)              | \$ (101)          |
| Derivatives designated as hedging instruments:     |                            |                  |                         |                  |                     |                   |
| Other current liabilities                          | \$ (103)                   | \$ —             | \$ —                    | \$ —             | \$ —                | \$ (103)          |
| <b>Total liabilities</b>                           | <b>\$ (142)</b>            | <b>\$ (5)</b>    | <b>\$ (6)</b>           | <b>\$ (42)</b>   | <b>\$ (9)</b>       | <b>\$ (204)</b>   |

See also Note 4 – Investments and Note 6 – Fair Value Measurements.

**Fair-Value Hedges**

For a derivative instrument designated as a fair-value hedge, the gain (loss) is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributed to the risk being hedged. For options designated as fair-value hedges, changes in the time value are excluded from the assessment of hedge effectiveness and are recognized in earnings.

We recognized in other income (expense) the following gains (losses) on foreign exchange contracts designated as fair value hedges (our only fair value hedges during the period) and their related hedged items:

| (In millions) | Three Months Ended<br>December 31, | Six Months Ended<br>December 31, |
|---------------|------------------------------------|----------------------------------|
|               | 2009                               | 2009                             |
| Derivatives   | \$ 89                              | \$ (104)                         |
| Hedged items  | (85)                               | 103                              |
| <b>Total</b>  | <b>\$ 4</b>                        | <b>\$ (1)</b>                    |

**Cash-Flow Hedges**

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

We recognized the following gains (losses) related to foreign exchange contracts designated as cash flow hedges (our only cash flow hedges during the period):

| (In millions)  | Three Months Ended<br>December 31, | Six Months Ended<br>December 31, |
|--|------------------------------------|----------------------------------|
|  | 2009                               | 2009                             |
| <b>Effective portion</b>   |                                    |                                  |
| Gain (loss) recognized in OCI, net of tax effect of \$1 and \$(111)          | \$ 2                               | \$ (207)                         |
| Gain reclassified from accumulated OCI into revenue                          | \$ 68                              | \$ 237                           |
| <b>Amount excluded from effectiveness assessment and ineffective portion</b> |                                    |                                  |
| Gain (loss) recognized in other income (expense)                             | \$ 26                              | \$ (14)                          |

We estimate that \$92 million of net derivative gains included in OCI will be reclassified into earnings within the next 12 months. No significant amounts of gains (losses) were reclassified from OCI into earnings as a result of forecasted transactions that failed to occur during the three months and six months ended December 31, 2009.

### Non-Designated Derivatives

Gains (losses) from changes in fair values of derivatives that are not designated as hedges are primarily recognized in other income (expense). These amounts are shown in the table below, with the exception of gains (losses) on derivatives presented in income statement line items other than other income (expense), which were immaterial for the three months and six months ended December 31, 2009. Other than those derivatives entered into for investment purposes, such as commodity contracts, the gains (losses) below are generally economically offset by unrealized gains (losses) in the underlying available-for-sale securities, which are recorded as a component of OCI until the securities are sold or other-than-temporarily impaired, at which time the amounts are moved from OCI into other income (expense).

| (In millions)              | Three Months Ended | Six Months Ended |
|----------------------------|--------------------|------------------|
|                            | December 31,       | December 31,     |
|                            | 2009               | 2009             |
| Foreign exchange contracts | \$ 47              | \$ 90            |
| Equity contracts           | 7                  | 16               |
| Interest-rate contracts    | 9                  | 12               |
| Credit contracts           | 2                  | 11               |
| Commodity contracts        | 54                 | 69               |
| Total                      | \$ 119             | \$ 198           |

### NOTE 6 FAIR VALUE MEASUREMENTS

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

- Level 1—inputs are based upon unadjusted quoted prices for identical instruments traded in active markets. Our Level 1 non-derivative investments primarily include domestic and international equities, U.S. treasuries and agency securities, and exchange-traded mutual funds. Our Level 1 derivative assets and liabilities include those traded on exchanges.
- Level 2—inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (e.g. the Black-Scholes model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, foreign exchange rates, and forward and spot prices for currencies and commodities. Our Level 2 non-derivative investments consist primarily of corporate notes and bonds, mortgage-backed securities, certificates of deposit, certain agency securities, foreign government bonds, and commercial paper. Our Level 2 derivative assets and liabilities primarily include certain over-the-counter options, futures, and swap contracts.
- Level 3—inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models. Our Level 3 non-derivative assets primarily comprise investments in certain corporate bonds. We value these corporate bonds using internally developed valuation models, inputs to which include interest rate curves, credit spreads, stock prices, and volatilities. Unobservable inputs used in these models are significant to the fair values of the investments. Our Level 3 derivative assets and liabilities primarily comprise derivatives for foreign equities. In certain cases, market-based observable inputs are not available and we use management judgment to develop assumptions to determine fair value for these derivatives.

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

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

| (In millions)                         | Level 1          | Level 2          | Level 3       | Gross Fair Value | Netting <sup>(1)</sup> | Net Fair Value   |
|---------------------------------------|------------------|------------------|---------------|------------------|------------------------|------------------|
| <b>December 31, 2009</b>              |                  |                  |               |                  |                        |                  |
| <b>Assets</b>                         |                  |                  |               |                  |                        |                  |
| Mutual funds                          | \$ 1,713         | \$ —             | \$ —          | \$ 1,713         | \$ —                   | \$ 1,713         |
| Commercial paper                      | —                | 2,450            | —             | 2,450            | —                      | 2,450            |
| Certificates of deposit               | —                | 3,292            | —             | 3,292            | —                      | 3,292            |
| U.S. government and agency securities | 9,321            | 3,246            | —             | 12,567           | —                      | 12,567           |
| Foreign government bonds              | 472              | 3,050            | —             | 3,522            | —                      | 3,522            |
| Mortgage-backed securities            | —                | 4,083            | —             | 4,083            | —                      | 4,083            |
| Corporate notes and bonds             | —                | 5,381            | 192           | 5,573            | —                      | 5,573            |
| Municipal securities                  | —                | 538              | —             | 538              | —                      | 538              |
| Common and preferred stock            | 6,233            | 39               | 5             | 6,277            | —                      | 6,277            |
| Derivatives                           | 22               | 588              | 4             | 614              | (149)                  | 465              |
| <b>Total</b>                          | <b>\$ 17,761</b> | <b>\$ 22,667</b> | <b>\$ 201</b> | <b>\$ 40,629</b> | <b>\$ (149)</b>        | <b>\$ 40,480</b> |
| <b>Liabilities</b>                    |                  |                  |               |                  |                        |                  |
| Derivatives                           | \$ 7             | \$ 197           | \$ —          | \$ 204           | \$ (147)               | \$ 57            |

| (In millions)                         | Level 1          | Level 2          | Level 3       | Gross Fair Value | Netting <sup>(1)</sup> | Net Fair Value   |
|---------------------------------------|------------------|------------------|---------------|------------------|------------------------|------------------|
| <b>June 30, 2009</b>                  |                  |                  |               |                  |                        |                  |
| <b>Assets</b>                         |                  |                  |               |                  |                        |                  |
| Mutual funds                          | \$ 982           | \$ —             | \$ —          | \$ 982           | \$ —                   | \$ 982           |
| Commercial paper                      | —                | 2,601            | —             | 2,601            | —                      | 2,601            |
| Certificates of deposit               | —                | 555              | —             | 555              | —                      | 555              |
| U.S. government and agency securities | 7,134            | 6,105            | —             | 13,239           | —                      | 13,239           |
| Foreign government bonds              | 501              | 3,022            | —             | 3,523            | —                      | 3,523            |
| Mortgage-backed securities            | —                | 3,593            | —             | 3,593            | —                      | 3,593            |
| Corporate notes and bonds             | —                | 4,073            | 253           | 4,326            | —                      | 4,326            |
| Municipal securities                  | —                | 256              | —             | 256              | —                      | 256              |
| Common and preferred stock            | 4,218            | 28               | 5             | 4,251            | —                      | 4,251            |
| Derivatives                           | 5                | 623              | 5             | 633              | (235)                  | 398              |
| <b>Total</b>                          | <b>\$ 12,840</b> | <b>\$ 20,856</b> | <b>\$ 263</b> | <b>\$ 33,959</b> | <b>\$ (235)</b>        | <b>\$ 33,724</b> |
| <b>Liabilities</b>                    |                  |                  |               |                  |                        |                  |
| Derivatives                           | \$ 5             | \$ 344           | \$ —          | \$ 349           | \$ (231)               | \$ 118           |

(1) This table includes the impact of netting derivative assets and derivative liabilities when a legally enforceable master netting agreement exists. These amounts also include fair value adjustments related to our own credit risk and counterparty credit risk.

**Changes in Financial Instruments Measured at Level 3 Fair Value on a Recurring Basis**

The following tables present the changes during the three months and six months ended December 31, 2009 and 2008 in our Level 3 financial instruments that are measured at fair value on a recurring basis. The majority of these instruments consist of investment securities classified as available-for-sale with changes in fair value included in other comprehensive income.

| (In millions)  | Corporate<br>Notes and<br>Bonds | Common<br>and<br>Preferred<br>Stock | Derivative<br>Assets | Total  |
|--|---------------------------------|-------------------------------------|----------------------|--------|
| <b>Three Months and Six Months Ended December 31, 2009</b>   |                                 |                                     |                      |        |
| Balance as of June 30, 2009  | \$ 253                          | \$ 5                                | \$ 5                 | \$ 263 |
| Total realized and unrealized gains (losses):  |                                 |                                     |                      |        |
| Included in other income (expense)   | 1                               | —                                   | (2)                  | (1)    |
| Included in other comprehensive income   | (74)                            | —                                   | —                    | (74)   |
| Balance as of September 30, 2009   | \$ 180                          | \$ 5                                | \$ 3                 | \$ 188 |
| Total realized and unrealized gains:   |                                 |                                     |                      |        |
| Included in other income (expense)   | 1                               | —                                   | 1                    | 2      |
| Included in other comprehensive income   | 11                              | —                                   | —                    | 11     |
| Balance as of December 31, 2009  | \$ 192                          | \$ 5                                | \$ 4                 | \$ 201 |
| Change in unrealized gains (losses) included in other income (expense) for the three months ended December 31, 2009 related to assets held as of December 31, 2009 | \$ 1                            | \$ —                                | \$ 1                 | \$ 2   |
| Change in unrealized gains (losses) included in other income (expense) for the six months ended December 31, 2009 related to assets held as of December 31, 2009   | \$ 2                            | \$ —                                | \$ (1)               | \$ 1   |

| (In millions)  | Corporate<br>Notes and<br>Bonds | Common<br>and<br>Preferred<br>Stock | Derivative<br>Assets | Total   |
|--|---------------------------------|-------------------------------------|----------------------|---------|
| <b>Three Months and Six Months Ended December 31, 2008</b>   |                                 |                                     |                      |         |
| Balance as of June 30, 2008  | \$ 138                          | \$ 8                                | \$ 71                | \$ 217  |
| Total realized and unrealized gains (losses):  |                                 |                                     |                      |         |
| Included in other income (expense)   | (9)                             | (4)                                 | 48                   | 35      |
| Included in other comprehensive income   | (29)                            | —                                   | —                    | (29)    |
| Purchases, issuances, and settlements  | —                               | —                                   | (104)                | (104)   |
| Transfers in and out of Level 3  | 11                              | —                                   | —                    | 11      |
| Balance as of September 30, 2008   | \$ 111                          | \$ 4                                | \$ 15                | \$ 130  |
| Total realized and unrealized gains (losses):  |                                 |                                     |                      |         |
| Included in other income (expense)   | 1                               | (2)                                 | —                    | (1)     |
| Included in other comprehensive income   | 10                              | —                                   | —                    | 10      |
| Purchases, issuances, and settlements  | —                               | —                                   | (15)                 | (15)    |
| Transfers in and out of Level 3  | (1)                             | —                                   | —                    | (1)     |
| Balance as of December 31, 2008  | \$ 121                          | \$ 2                                | \$ —                 | \$ 123  |
| Change in unrealized gains (losses) included in other income (expense) for the three months ended December 31, 2008 related to assets held as of December 31, 2008 | \$ —                            | \$ (2)                              | \$ —                 | \$ (2)  |
| Change in unrealized gains (losses) included in other income (expense) for the six months ended December 31, 2008 related to assets held as of December 31, 2008   | \$ (9)                          | \$ (5)                              | \$ 1                 | \$ (13) |

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

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



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An impairment charge is recorded when the cost of the investment exceeds its fair value and this condition is determined to be other-than-temporary. During the three months and six months ended December 31, 2009, we did not record any other-than-temporary impairments on those assets required to be measured at fair value on a non-recurring basis. The following table presents prior period balances for those assets required to be measured at fair value on a nonrecurring basis and the associated losses recognized during the three months and six months ended December 31, 2008:

| (In millions)              | December 31,<br>2008 | Level 1     | Level 2     | Level 3       | Total<br>Losses |
|----------------------------|----------------------|-------------|-------------|---------------|-----------------|
| <b>Assets</b>              |                      |             |             |               |                 |
| Common and preferred stock | \$ 164               | \$ —        | \$ —        | \$ 164        | \$ (85)         |
| <b>Total</b>               | <b>\$ 164</b>        | <b>\$ —</b> | <b>\$ —</b> | <b>\$ 164</b> | <b>\$ (85)</b>  |

NOTE 7 INVENTORIES

The components of inventories were as follows:

| (In millions)   | December 31,<br>2009 | June 30,<br>2009 |
|-----------------|----------------------|------------------|
| Raw materials   | \$ 100               | \$ 170           |
| Work in process | 11                   | 45               |
| Finished goods  | 478                  | 502              |
| <b>Total</b>    | <b>\$ 589</b>        | <b>\$ 717</b>    |

NOTE 8 BUSINESS COMBINATIONS

During the six months ended December 31, 2009, we acquired four entities for total consideration of \$110 million, substantially all of which was paid in cash. During this period, we also sold three entities for total consideration of \$602 million, including Razorfish in the second quarter of fiscal year 2010. These entities have been included in or removed from our consolidated results of operations since their acquisition or sale dates, respectively. Pro forma results of operations have not been presented because the effects of these business combinations, individually and in the aggregate, were not material to our consolidated results of operations.

NOTE 9 GOODWILL

Following are details of the changes in our goodwill balances during the three months and six months ended December 31, 2009:

| (In millions)                      | Balance<br>September 30,<br>2009 | Acquisitions | Purchase<br>Accounting<br>Adjustments<br>and Other | Balance<br>December 31,<br>2009 |
|------------------------------------|----------------------------------|--------------|--|---------------------------------|
| Windows & Windows Live Division    | \$ 77                            | \$ —         | \$ —   | \$ 77                           |
| Server and Tools                   | 1,070                            | 49           | —  | 1,119                           |
| Online Services Division           | 6,633                            | —            | (261)  | 6,372                           |
| Microsoft Business Division        | 3,998                            | —            | (2)  | 3,996                           |
| Entertainment and Devices Division | 804                              | —            | —  | 804                             |
| <b>Total</b>                       | <b>\$ 12,582</b>                 | <b>\$ 49</b> | <b>\$ (263)</b>                                    | <b>\$ 12,368</b>                |

| (In millions)                      | Balance          | Acquisitions | Purchase Accounting Adjustments and Other | Balance           |
|------------------------------------|------------------|--------------|---|-------------------|
|                                    | June 30, 2009    |              |   | December 31, 2009 |
| Windows & Windows Live Division    | \$ 77            | \$ —         | \$ —                                      | \$ 77             |
| Server and Tools                   | 1,038            | 82           | (1)                                       | 1,119             |
| Online Services Division           | 6,657            | —            | (285)                                     | 6,372             |
| Microsoft Business Division        | 3,927            | 3            | 66  | 3,996             |
| Entertainment and Devices Division | 804              | —            | —   | 804               |
| <b>Total</b>                       | <b>\$ 12,503</b> | <b>\$ 85</b> | <b>\$ (220)</b>                           | <b>\$ 12,368</b>  |

None of the amounts recorded as goodwill are expected to be deductible for tax purposes. The measurement period for purchase price allocations ends as soon as information on the facts and circumstances becomes available, but will not exceed 12 months. Adjustments in the purchase price allocation may require a recasting of the amounts allocated to goodwill retroactive to the period in which the acquisition occurred. Any change in the goodwill amounts resulting from foreign currency translations are presented as "other" in the table above. Also included within "other" is \$263 million for the three months ended December 31, 2009 and \$286 million for the six months ended December 31, 2009 of goodwill associated with business dispositions. See also Note 8.

In connection with the disposal of Razorfish, we performed an interim impairment analysis of our Online Services Division goodwill balance during the first quarter of fiscal year 2010. No impairment of goodwill was identified.

**NOTE 10 INTANGIBLE ASSETS**

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

| (In millions)     | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
|-------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|                   |                       |                          | December 31, 2009   |                       |                          | June 30, 2009       |
| Contract-based    | \$ 1,087              | \$ (884)                 | \$ 203              | \$ 1,087              | \$ (855)                 | \$ 232              |
| Technology-based  | 2,158                 | (1,284)                  | 874                 | 2,033                 | (1,090)                  | 943                 |
| Marketing-related | 117                   | (78)                     | 39                  | 188                   | (97)                     | 91                  |
| Customer-related  | 445                   | (215)                    | 230                 | 732                   | (239)                    | 493                 |
| <b>Total</b>      | <b>\$ 3,807</b>       | <b>\$ (2,461)</b>        | <b>\$ 1,346</b>     | <b>\$ 4,040</b>       | <b>\$ (2,281)</b>        | <b>\$ 1,759</b>     |

We generally amortize acquired intangibles on a straight-line basis over their estimated weighted average lives. Intangible assets amortization expense was \$169 million for the three months and \$318 million for the six months ended December 31, 2009 as compared with \$145 million for the three months and \$285 million for the six months ended December 31, 2008. The following table outlines the estimated future amortization expense related to intangible assets held at December 31, 2009:

| (In millions)   |                 |
|---|-----------------|
| <b>Year Ending June 30,</b>                             |                 |
| 2010 (excluding the six months ended December 31, 2009) | \$ 264          |
| 2011  | 509             |
| 2012  | 346             |
| 2013  | 205             |
| 2014 and thereafter                                     | 22              |
| <b>Total</b>  | <b>\$ 1,346</b> |

NOTE 11 DEBT

In September 2008, our Board of Directors authorized debt financings of up to \$6.0 billion. Our initial commercial paper program provided for the issuance and sale of up to \$2.0 billion. Following the issuance of our long-term debt in May 2009, we increased the commercial paper program and issued an additional \$250 million of commercial paper during the six months ended December 31, 2009. As of December 31, 2009, we had \$2.25 billion of commercial paper and \$3.75 billion of long-term debt issued and outstanding.

**Short-term Debt**

As of December 31, 2009, our \$2.25 billion of commercial paper issued and outstanding had a weighted average interest rate, including issuance costs, of 0.14% and maturities of 16 to 210 days. The estimated fair value of this commercial paper approximates its carrying value.

In November 2009, we replaced our \$2.0 billion and \$1.0 billion credit facilities with a \$2.25 billion 364-day credit facility, which expires on November 5, 2010. This facility serves as a back-up for our commercial paper program. As of December 31, 2009, we were in compliance with the financial covenant in the credit facility, which requires a coverage ratio be maintained of at least three times earnings before interest, taxes, depreciation, and amortization to interest expense. No amounts were drawn against the credit facilities during the six months ended December 31, 2009.

**Long-term Debt**

As of December 31, 2009, we had issued and outstanding \$3.75 billion of debt securities as follows: \$2.0 billion aggregate principal amount of 2.95% notes due 2014, \$1.0 billion aggregate principal amount of 4.20% notes due 2019, and \$750 million aggregate principal amount of 5.20% notes due 2039 (collectively "the Notes"). Interest on the Notes is payable semi-annually on June 1 and December 1 of each year to holders of record on the preceding May 15 and November 15. The Notes are senior unsecured obligations and rank equally with our other unsecured and unsubordinated debt outstanding.

As of December 31, 2009, the total carrying value and estimated fair value of our long-term debt were \$3.75 billion and \$3.77 billion, respectively. The estimated fair value is based on quoted prices for our publicly-traded debt as of December 31, 2009.

NOTE 12 INCOME TAXES

Our effective tax rate was 25% for both the three months and six months ended December 31, 2009, as compared with 26% for the three months and 27% for the six months ended December 31, 2008. The fiscal year 2010 rate reflects a higher mix of foreign earnings taxed at lower rates.

Tax contingencies and other tax liabilities were \$6.1 billion as of December 31, 2009 and \$5.5 billion as of June 30, 2009, and were included in other long-term liabilities.

NOTE 13 UNEARNED REVENUE

The components of unearned revenue were as follows:

| (In millions)             | December 31, | June 30,  |
|---------------------------|--------------|-----------|
|                           | 2009         | 2009      |
| Volume licensing programs | \$ 10,058    | \$ 11,350 |
| Undelivered elements      | 600          | 1,083     |
| Other                     | 1,870        | 1,851     |
| Total                     | \$ 12,528    | \$ 14,284 |

Unearned revenue by segment was as follows:

| (In millions)                   | December 31,     | June 30,         |
|---------------------------------|------------------|------------------|
|                                 | 2009             | 2009             |
| Windows & Windows Live Division | \$ 1,736         | \$ 2,345         |
| Server and Tools                | 4,227            | 4,732            |
| Microsoft Business Division     | 5,680            | 6,508            |
| Other segments                  | 885              | 699              |
| <b>Total</b>                    | <b>\$ 12,528</b> | <b>\$ 14,284</b> |

#### NOTE 14 PRODUCT WARRANTIES

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

Our aggregate product warranty liabilities, which are included in other current liabilities and other long-term liabilities on our balance sheets, changed during the three months and six months ended December 31, 2009 as follows:

| (In millions)                          | Three Months Ended<br>December 31, | Six Months Ended<br>December 31, |
|--|------------------------------------|----------------------------------|
|  | 2009                               | 2009                             |
| Balance, beginning of period           | \$ 289                             | \$ 342                           |
| Accrual for warranties issued          | 61                                 | 94                               |
| Adjustments to pre-existing warranties | (2)                                | (2)                              |
| Settlements of warranty claims         | (40)                               | (126)                            |
| <b>Balance, end of period</b>          | <b>\$ 308</b>                      | <b>\$ 308</b>                    |

#### NOTE 15 CONTINGENCIES

##### **Government Competition Law Matters**

In March 2004, the European Commission issued a competition law decision that, among other things, ordered us to license certain Windows server protocol technology to our competitors. In March 2007, the European Commission issued a statement of objections claiming that the pricing terms we proposed for licensing the technology as required by the March 2004 decision were "not reasonable." Following additional steps we took to address these concerns, the Commission announced on October 22, 2007 that we were in compliance with the March 2004 decision and that no further penalty should accrue after that date. On February 27, 2008, the Commission issued a fine of \$1.4 billion (€899 million) relating to the period prior to October 22, 2007. In May 2008, we filed an application with the European Court of First Instance to annul the February 2008 fine. We paid the \$1.4 billion (€899 million) fine in June 2008, pending the outcome of the appeal.

On December 16, 2009, the European Commission announced that it had adopted a decision that renders legally binding commitments offered by Microsoft to address the Commission's concerns regarding competition in Web browsing software. This decision ends the Commission's investigation. It does not address whether a violation of European Commission competition law occurred. The commitments offered by Microsoft broadly ensure that computer manufacturers will remain free to install any browser on the PCs they ship, and they provide for a Web browser "choice screen" to be offered to end users throughout Europe. The Commission had opened its investigation in January 2008 following a complaint filed with the Commission by Opera Software ASA.

In January 2008, the Commission also opened a competition law investigation that relates primarily to interoperability with respect to our Microsoft Office family of products. This investigation resulted from complaints filed with the Commission by a trade association of Microsoft's competitors. Microsoft has made a number of proposals to address the Commission's competition law concerns in this area. The Commission announced on December 16, 2009 that it welcomed these proposals and that it will take them into account in assessing this matter.

We are also subject to a Consent Decree and Final Judgment ("Final Judgments") that resolved lawsuits brought by the U.S. Department of Justice, 18 states, and the District of Columbia in two separate actions. The Final Judgments imposed various constraints on our Windows operating system businesses. The Final Judgments are scheduled to expire in May 2011.

In other ongoing investigations, various foreign governments and several state attorneys general have requested information from us concerning competition, privacy, and security issues.

### **Antitrust, Unfair Competition, and Overcharge Class Actions**

A large number of antitrust and unfair competition class action lawsuits were filed against us in various state, federal, and Canadian courts on behalf of various classes of direct and indirect purchasers of our PC operating system and certain other software products. We obtained dismissals of damages claims of indirect purchasers under federal law and in 15 states. Courts refused to certify classes in two additional states. We have reached agreements to settle all claims that have been made to date in 19 states and the District of Columbia.

Under the settlements, generally class members can obtain vouchers that entitle them to be reimbursed for purchases of a wide variety of platform-neutral computer hardware and software. The total value of vouchers that we may issue varies by state. We will make available to certain schools a percentage of those vouchers that are not issued or claimed (one-half to two-thirds depending on the state). The total value of vouchers we ultimately issue will depend on the number of class members who make claims and are issued vouchers. The maximum value of vouchers to be issued is approximately \$2.7 billion. The actual costs of these settlements will be less than that maximum amount, depending on the number of class members and schools that are issued and redeem vouchers.

The settlements in all states have received final court approval. Cases in Canada have not been settled. We estimate the total cost to resolve all of the overcharge class action cases will range between \$1.8 billion and \$2.0 billion. The actual cost depends on factors such as the claim rate, the quantity and mix of products for which claims are made, the number of eligible class members who ultimately use the vouchers, the nature of hardware and software that is acquired using the vouchers, and the cost of administering the claims. At December 31, 2009, we have recorded a liability related to these claims of approximately \$700 million, which reflects our estimated exposure of \$1.8 billion less payments made to date of approximately \$1.1 billion mostly for vouchers, legal fees, and administrative expenses.

### **Other Antitrust Litigation and Claims**

In November 2004, Novell, Inc. filed a complaint in U.S. District Court for the District of Utah, asserting antitrust and unfair competition claims against us related to Novell's ownership of WordPerfect and other productivity applications during the period between June 1994 and March 1996. This case was transferred to the District of Maryland. In June 2005, the trial court granted our motion to dismiss four of six claims of the complaint. Both parties appealed, and in October 2007, the court of appeals affirmed the decision of the trial court, and remanded the case to that court for further proceedings. Summary judgment motions were filed in October 2009, and will be heard in March 2010. If any claims survive those motions, the case will be transferred back to Utah for trial.

### **Patent and Intellectual Property Claims**

In 2003, we filed an action in U.S. District Court in California seeking a declaratory judgment that we do not infringe certain Alcatel-Lucent patents (although this action began before the merger of Alcatel and Lucent in 2006, for simplicity we refer to the post-merger entity of Alcatel-Lucent). In April 2008, a jury returned a verdict in Alcatel-Lucent's favor in a trial on a consolidated group of one video and three user interface patents. The jury concluded that we had infringed two user interface patents and awarded \$367 million in damages. In June 2008, the trial judge increased the amount of damages to \$512 million to include \$145 million of interest. We appealed that award to the Federal Circuit. In December 2008, we entered into a settlement agreement resolving all other litigation pending between Microsoft and Alcatel-Lucent, leaving approximately \$500 million remaining in dispute. In April 2009, the

U.S. Patent and Trademark Office, after a reexamination of the remaining patent in dispute, determined that the patent was invalid and Alcatel-Lucent has appealed that ruling. On September 11, 2009, the United States Court of Appeals for the Federal Circuit affirmed the liability award but vacated the verdict and remanded the case to the trial court for a re-trial of the damages ruling, indicating the damages previously awarded were too high.

In October 2003, Uniloc USA Inc., a subsidiary of a Singapore-based security technology company, filed a patent infringement suit in U.S. District Court in Rhode Island, claiming that product activation technology in Windows XP and certain other Microsoft programs violated a Uniloc patent. After we obtained a favorable summary judgment that we did not infringe any of the claims of this patent, the court of appeals vacated the trial court decision and remanded the case for trial. In April 2009, the jury returned a \$388 million verdict against us, including a finding of willful infringement. On September 29, 2009, the district court judge overturned the jury verdict, ruling that the evidence did not support the jury's finding that Microsoft infringed the patent. Uniloc has appealed.

In March 2007, i4i Limited Partnership sued Microsoft in U.S. District Court in Texas claiming that certain custom XML technology in Word 2003 and 2007 infringed i4i's patent. In May 2009, a jury returned a verdict against us, finding damages of \$200 million and that we willfully infringed the patent. In August 2009, the court denied our post-trial motions and awarded enhanced damages of \$40 million and prejudgment interest of \$37 million. The court also issued a permanent injunction prohibiting additional distribution of the allegedly infringing technology. We appealed and the appellate court stayed the injunction pending our appeal. On December 22, 2009, the court of appeals rejected our appeal and affirmed the trial court's judgment and injunction, except that the court of appeals modified the effective date of the injunction to January 11, 2010. We are seeking a rehearing before the court of appeals.

There are over 50 other patent infringement cases pending against Microsoft, 10 of which are set for trial in fiscal year 2010. These cases include a lawsuit filed against Microsoft by VirnetX Inc. in U.S. District Court in Texas in which VirnetX asserts that various Microsoft products including Windows client and server operating systems software and communications software infringe patents relating to certain secure Internet communications. Trial is scheduled for March 2010.

#### **Other**

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

As of December 31, 2009, we had accrued aggregate liabilities of approximately \$900 million in other current liabilities and approximately \$400 million in other long-term liabilities for all of the contingent matters described in this note. While we intend to vigorously defend these matters, there exists the possibility of adverse outcomes that we estimate could be up to \$1.0 billion in aggregate beyond recorded amounts. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact on our financial statements for the period in which the effects become reasonably estimable.

#### **NOTE 16 EMPLOYEE SEVERANCE**

In January 2009, we announced and implemented a resource management program to reduce discretionary operating expenses, employee headcount, and capital expenditures. As part of this program, we announced the elimination of 5,000 positions in research and development, marketing, sales, finance, legal, human resources, and information technology by June 30, 2010. As of September 30, 2009, we had reduced our overall number of positions by approximately 5,000 and headcount by approximately 4,600.

In November 2009, we identified an additional 800 positions for elimination based on our efforts to manage our expenses. Severance expense of approximately \$52 million associated with these additional eliminations was reflected in our second quarter financial statements. To date, we have had a headcount reduction of approximately 5,300 under our resource management efforts.

PART I  
Item 1

The changes in our employee severance liabilities related to our resource management efforts during the three months and six months ended December 31, 2009 were as follows:

| (In millions)                | Three Months Ended<br>December 31, |      | Six Months Ended<br>December 31, |       |
|------------------------------|------------------------------------|------|----------------------------------|-------|
|                              | 2009                               |      | 2009                             |       |
| Balance, beginning of period | \$                                 | 42   | \$                               | 127   |
| Additional accruals          |                                    | 52   |                                  | 52    |
| Adjustments                  |                                    | 7    |                                  | 7     |
| Cash payments                |                                    | (70) |                                  | (155) |
| Balance, end of period       | \$                                 | 31   | \$                               | 31    |

NOTE 17 STOCKHOLDERS' EQUITY

**Share Repurchases**

We repurchased the following shares of common stock during the periods presented:

| (In millions)                      | Three Months Ended<br>December 31, |          | Six Months Ended<br>December 31, |          |
|------------------------------------|------------------------------------|----------|----------------------------------|----------|
|                                    | 2009                               | 2008     | 2009                             | 2008     |
| Shares of common stock repurchased | 125                                | 94       | 183                              | 318      |
| Value of common stock repurchased  | \$ 3,583                           | \$ 2,234 | \$ 5,028                         | \$ 8,200 |

We repurchased all shares with cash resources. As of December 31, 2009, approximately \$29.5 billion remained of our \$40.0 billion repurchase program that we announced on September 22, 2008. The repurchase program expires September 30, 2013 but may be suspended or discontinued at any time without notice.

**Dividends**

Our Board of Directors declared the following dividends during the periods presented:

| Declaration Date        | Per Share<br>Dividend | Record Date       | Total Amount | Payment Date      |
|-------------------------|-----------------------|-------------------|--------------|-------------------|
| (in millions)           |                       |                   |              |                   |
| <b>Fiscal year 2010</b> |                       |                   |              |                   |
| September 18, 2009      | \$ 0.13               | November 19, 2009 | \$ 1,152     | December 10, 2009 |
| December 9, 2009        | \$ 0.13               | February 18, 2010 | \$ 1,145     | March 11, 2010    |
| <b>Fiscal year 2009</b> |                       |                   |              |                   |
| September 19, 2008      | \$ 0.13               | November 20, 2008 | \$ 1,157     | December 11, 2008 |
| December 10, 2008       | \$ 0.13               | February 19, 2009 | \$ 1,155     | March 12, 2009    |

The estimate of the amount to be paid as a result of the December 9, 2009 declaration was included in other current liabilities as of December 31, 2009.

NOTE 18 SEGMENT INFORMATION

In its operation of the business, management reviews certain financial information, including segmented internal profit and loss statements prepared on a basis not consistent with U.S. GAAP. Our five segments are: Windows & Windows Live Division; Server and Tools; Online Services Division; Microsoft Business Division; and Entertainment and Devices Division. We have recast certain prior period amounts within this note to conform to the way we internally managed and monitored segment performance during the current fiscal year, including moving Windows Live from Online Services Division to Windows & Windows Live Division, Mobile Services from Online Services Division to Entertainment and Devices Division, and Razorfish from Online Services Division to Corporate. Razorfish was disposed of during the second quarter of fiscal year 2010.

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

| (In millions)                      | Three Months Ended<br>December 31, |                  | Six Months Ended<br>December 31, |                  |
|------------------------------------|------------------------------------|------------------|----------------------------------|------------------|
|                                    | 2009                               | 2008             | 2009                             | 2008             |
| <b>Revenue</b>                     |                                    |                  |                                  |                  |
| Windows & Windows Live Division    | \$ 5,073                           | \$ 3,930         | \$ 9,058                         | \$ 8,041         |
| Server and Tools                   | 3,848                              | 3,775            | 7,285                            | 7,214            |
| Online Services Division           | 581                                | 595              | 1,067                            | 1,108            |
| Microsoft Business Division        | 4,749                              | 4,893            | 9,155                            | 9,810            |
| Entertainment and Devices Division | 2,938                              | 3,256            | 4,829                            | 5,149            |
| Unallocated and other              | 1,833                              | 180              | 548                              | 368              |
| <b>Consolidated</b>                | <b>\$ 19,022</b>                   | <b>\$ 16,629</b> | <b>\$ 31,942</b>                 | <b>\$ 31,690</b> |
| <b>Operating income (loss)</b>     |                                    |                  |                                  |                  |
| Windows & Windows Live Division    | \$ 3,516                           | \$ 2,550         | \$ 6,324                         | \$ 5,409         |
| Server and Tools                   | 1,370                              | 1,336            | 2,606                            | 2,336            |
| Online Services Division           | (478)                              | (378)            | (972)                            | (704)            |
| Microsoft Business Division        | 2,914                              | 2,991            | 5,747                            | 6,096            |
| Entertainment and Devices Division | 361                                | 103              | 654                              | 237              |
| Reconciling amounts                | 830                                | (663)            | (1,364)                          | (1,436)          |
| <b>Consolidated</b>                | <b>\$ 8,513</b>                    | <b>\$ 5,939</b>  | <b>\$ 12,995</b>                 | <b>\$ 11,938</b> |

Because of our integrated business structure, operating costs included in one segment may benefit other segments, and therefore these segments are not designed to measure operating income or loss directly related to the products included in each segment. Inter-segment cost commissions are estimated by management and used to compensate or charge each segment for such shared costs and to incent shared efforts. Management will continually evaluate the alignment of product development organizations, sales organizations, and inter-segment commissions for segment reporting purposes, which may result in changes to segment allocations in future periods.

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

Reconciling amounts include adjustments to conform with U.S. GAAP and corporate-level activity not specifically attributed to a segment. Significant internal accounting policies that differ from U.S. GAAP relate to revenue recognition, income statement classification, and accelerated depreciation and amortization of stock-based awards. In addition, certain revenue and expenses are excluded from segments or included in corporate-level activity, including certain legal settlements, accruals for legal contingencies, and accruals for employee severance. For the three months ended December 31, 2009, reconciling amounts include the recognition of previously deferred revenue related to sales of Windows Vista with a guarantee to be upgraded to Windows 7 at minimal or no cost and sales of Windows 7 to original equipment manufacturers and retailers before general availability.



Significant reconciling items were as follows:

| (In millions)                           | Three Months Ended<br>December 31, |          | Six Months Ended<br>December 31, |            |
|---|------------------------------------|----------|----------------------------------|------------|
|   | 2009                               | 2008     | 2009                             | 2008       |
| Corporate-level activity <sup>(1)</sup> | \$ (1,291)                         | \$ (979) | \$ (2,229)                       | \$ (2,086) |
| Stock-based compensation                | 109                                | 191      | 229                              | 371        |
| Revenue reconciling amounts             | 1,787                              | 116      | 421                              | 303        |
| Other                                   | 225                                | 9        | 215                              | (24)       |
| Total                                   | \$ 830                             | \$ (663) | \$ (1,364)                       | \$ (1,436) |

(1) Corporate-level activity excludes stock-based compensation and revenue reconciling amounts presented separately in those line items.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of Microsoft Corporation  
Redmond, Washington

We have reviewed the accompanying consolidated balance sheet of Microsoft Corporation and subsidiaries (the "Corporation") as of December 31, 2009, and the related consolidated statements of income, stockholders' equity, and cash flows for the three-month and six-month periods ended December 31, 2009 and 2008. These interim financial statements are the responsibility of the Corporation's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Microsoft Corporation and subsidiaries as of June 30, 2009, and the related consolidated statements of income, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated July 29, 2009 we expressed an unqualified opinion on those consolidated financial statements (which report includes an explanatory paragraph regarding the adoption of new accounting standards). In our opinion, the information set forth in the accompanying consolidated balance sheet as of June 30, 2009 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington

January 28, 2010

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Note About Forward-Looking Statements**

Certain statements in Management's Discussion and Analysis ("MD&A"), other than purely historical information, including estimates, projections, statements relating to our business plans, objectives, and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "plan," "may," "should," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which may cause actual results to differ materially from the forward-looking statements. A detailed discussion of risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in the section titled "Risk Factors" (refer to Part II, Item 1A). We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events, or otherwise.

**OVERVIEW**

Management's discussion and analysis is intended to help the reader understand the results of operations and financial condition of Microsoft Corporation. The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended June 30, 2009 and the Consolidated Financial Statements and accompanying notes ("Notes") included in this Form 10-Q.

We generate revenue by developing, manufacturing, licensing, and supporting a wide range of software products and services for many different types of computing devices. Our software products and services include operating systems for personal computers, servers, and intelligent devices; server applications for distributed computing environments; information worker productivity applications; business solutions applications; high-performance computing applications; software development tools; and video games. We provide consulting and product and solution support services, and we train and certify computer system integrators and developers. We also design and sell hardware, including the Xbox 360 video game console, the Zune digital music and entertainment device, and peripherals. Online offerings and information are delivered through Bing, Windows Live, Office Live, Xbox LIVE, our MSN portals and channels, and the Microsoft Online Services platform, which includes offerings for businesses, such as Microsoft Dynamics CRM Online, Exchange Hosted Services, Exchange Online, and SharePoint Online. We enable the delivery of online advertising across our broad range of digital media properties and on Bing through our proprietary adCenter platform.

Our revenue historically has fluctuated quarterly and has generally been the highest in the second quarter of our fiscal year due to corporate calendar year-end spending trends in our major markets and holiday season spending by consumers. Our Entertainment and Devices Division is particularly seasonal as its products are aimed at the consumer market and are in highest demand during the holiday shopping season. Typically, the Entertainment and Devices Division has generated approximately 40% of its yearly segment revenues in our second fiscal quarter. In addition, quarterly revenues may be impacted by the deferral of revenue. See the discussion below regarding the deferral of revenue related to Windows 7, which negatively impacted revenue for the first quarter of fiscal year 2010 and positively impacted revenue for the second quarter of fiscal year 2010.

All growth and percentage comparisons refer to the three months and six months ended December 31, 2009, as compared with the three months and six months ended December 31, 2008, unless otherwise noted.

**Summary**

| (In millions, except per share amounts and percentages) | Three Months Ended<br>December 31, |           | Percentage<br>Change | Six Months Ended<br>December 31, |           | Percentage<br>Change |
|---|------------------------------------|-----------|----------------------|----------------------------------|-----------|----------------------|
|   | 2009                               | 2008      |                      | 2009                             | 2008      |                      |
| Revenue   | \$ 19,022                          | \$ 16,629 | 14%                  | \$ 31,942                        | \$ 31,690 | 1%                   |
| Operating income  | \$ 8,513                           | \$ 5,939  | 43%                  | \$ 12,995                        | \$ 11,938 | 9%                   |
| Diluted earnings per share                              | \$ 0.74                            | \$ 0.47   | 57%                  | \$ 1.14                          | \$ 0.94   | 21%                  |

*Three months ended December 31, 2009 compared with three months ended December 31, 2008*

Revenue increased mainly due to the launch of Windows 7 on October 22, 2009. Operating income increased reflecting increased revenue and decreased operating expenses in most categories.

- Cost of revenue decreased \$279 million or 7%, primarily reflecting decreased Xbox 360 console costs and cost controls, offset in part by increased online costs, mainly traffic acquisition costs.
- Research and development expenses decreased \$211 million or 9%, primarily reflecting a decrease in third-party development and programming costs, a decrease in headcount, and the capitalization of certain software development costs.
- General and administrative expenses increased \$293 million or 35%, primarily due to increased legal charges.

Diluted earnings per share increased primarily reflecting increased net income and share repurchases during the past 12 months. We repurchased 183 million shares during the 12 months ended December 31, 2009.

*Six months ended December 31, 2009 compared with six months ended December 31, 2008*

Revenue increased mainly due to the launch of Windows 7 on October 22, 2009. Operating income increased reflecting increased revenue and decreased operating expenses in most categories.

- Research and development expenses decreased \$429 million or 9%, primarily reflecting a decrease in third-party development and programming costs, a decrease in headcount, and the capitalization of certain software development costs.
- Sales and marketing expenses decreased \$297 million or 4%, due mainly to cost controls and decreased corporate marketing and advertising spending.
- Cost of revenue decreased \$285 million or 4%, primarily reflecting decreased Xbox 360 console costs and cost controls, offset in part by increased online costs, mainly traffic acquisition costs.
- General and administrative expenses increased \$147 million or 9%, primarily due to increased legal charges, offset in part by cost controls.

Diluted earnings per share increased primarily reflecting increased net income and share repurchases during the past 12 months.

Demand for our software, services, hardware, and online offerings has a strong correlation to global macroeconomic factors. While we see the potential for improvement in calendar year 2010, the timing is uncertain. In the meantime, we are positive about our relative market position and our product delivery plans. In addition, we remain focused on executing in the areas we can control by continuing to provide high value products at the lowest total cost of ownership while managing our expenses.

SEGMENT PRODUCT REVENUE/OPERATING INCOME (LOSS)

The revenue and operating income (loss) amounts in this section are presented on a basis consistent with accounting principles generally accepted in the United States of America ("U.S. GAAP") and include certain reconciling items attributable to each of the segments. Segment information appearing in Note 18 – Segment Information of the Notes to Financial Statements (Part I, Item I) is presented on a basis consistent with our current internal management reporting. Certain corporate-level activity has been excluded from segment operating results and is analyzed separately. We have recast certain prior period amounts within this section to conform to the way we internally managed and monitored segment performance during fiscal year 2010, including moving Windows Live from Online Services Division to Windows & Windows Live Division, Mobile Services from Online Services Division to Entertainment and Devices Division, and Razorfish from Online Services Division to Corporate. Razorfish was disposed of in the second quarter of fiscal year 2010.

**Windows & Windows Live Division**

| (In millions, except percentages) | Three Months Ended<br>December 31, |          | Percentage<br>Change | Six Months Ended<br>December 31, |          | Percentage<br>Change |
|-----------------------------------|------------------------------------|----------|----------------------|----------------------------------|----------|----------------------|
|                                   | 2009                               | 2008     |                      | 2009                             | 2008     |                      |
| Revenue                           | \$ 6,904                           | \$ 4,064 | 70%                  | \$ 9,528                         | \$ 8,337 | 14%                  |
| Operating income                  | \$ 5,394                           | \$ 2,712 | 99%                  | \$ 6,854                         | \$ 5,761 | 19%                  |

Windows & Windows Live (“Windows”) Division offerings consist of premium and standard edition Windows operating systems and online software and services through Windows Live. Premium Windows operating systems are those that include additional functionality and are sold at a price above our standard editions. Premium editions include Windows 7 Home Premium, Windows 7 Professional, Windows 7 Ultimate, Windows 7 Enterprise, Windows Vista Business, Windows Vista Home Premium, Windows Vista Ultimate, and Windows Vista Enterprise. Standard editions include Windows 7 Starter, Windows 7 Home Basic, Windows Vista Home Basic, and Windows XP Home. Windows Live primarily generates revenue from online advertising.

Windows Division revenue growth is directly impacted by growth of PC purchases from original equipment manufacturers (“OEMs”) that pre-install versions of Windows operating systems because the OEM channel accounts for approximately 80% of total Windows Division revenue. The remaining approximately 20% of Windows Division revenue (“other revenue”) is generated by commercial and retail sales of Windows and online advertising from Windows Live. In the first quarter of fiscal year 2010, we deferred revenue (the “Windows 7 Deferral”) associated with sales of Windows Vista with a guarantee to be upgraded to Windows 7 at minimal or no cost and with sales of Windows 7 to retailers before general availability. We recognized the majority of this deferred revenue in the second quarter after launching Windows 7 on October 22, 2009.

*Three months ended December 31, 2009 compared with three months ended December 31, 2008*

Windows Division revenue increased due to strong sales of Windows 7 and PC market improvement. We estimate total worldwide PC shipments from all sources grew approximately 15% to 17%. OEM revenue increased \$2.3 billion or 72%. Excluding \$1.7 billion of revenue recognized related to the Windows 7 Deferral, OEM revenue increased \$664 million or 21%, while OEM license units increased 22%. The OEM revenue increase was primarily driven by PC market growth, higher Windows attach rates across all regions, channels, and types of PCs and the restoration of normal OEM inventory levels, offset in part by PC market changes, including stronger growth of consumer PCs versus business PCs and of emerging markets versus developed markets. Other revenue increased \$511 million or 60% driven primarily by strong Windows 7 retail sales.

Windows Division operating income increased as a result of increased revenue, offset in part by increased operating expenses. Cost of revenue increased \$81 million or 25%, primarily driven by increased retail product costs, traffic acquisition costs and royalties. Sales and marketing expenses increased \$113 million or 18% reflecting increased advertising and marketing campaigns for the launch of Windows 7.

*Six months ended December 31, 2009 compared with six months ended December 31, 2008*

Windows Division revenue increased primarily as a result of strong sales of Windows 7 and PC market improvement. We estimate total worldwide PC shipments from all sources grew approximately 8% to 10%. OEM revenue increased \$708 million or 11%. Excluding the recognition of \$248 million of revenue associated with the Windows 7 Deferral, OEM revenue increased \$460 million or 7%, while OEM license units increased 14%. The OEM revenue increase was primarily driven by PC market growth, higher Windows attach rates across all regions, channels, and types of PCs and the restoration of normal OEM inventory levels, offset in part by PC market changes, including stronger growth of consumer PCs versus business PCs and of emerging markets versus developed markets. Other revenue increased \$483 million or 29% driven primarily by strong Windows 7 retail sales.

Windows Division operating income increased as a result of increased revenue, offset in part by increased operating expenses. Cost of revenue increased \$122 million or 19%, primarily driven by increased retail product costs, traffic acquisition costs, and royalties. Research and development expenses decreased \$76 million or 11%, primarily as a result of capitalization of certain software development costs and completion of Windows 7 product development. Sales and marketing expenses increased \$74 million or 6%.

### Server and Tools

| (In millions, except percentages) | Three Months Ended<br>December 31, |          | Percentage<br>Change | Six Months Ended<br>December 31, |          | Percentage<br>Change |
|-----------------------------------|------------------------------------|----------|----------------------|----------------------------------|----------|----------------------|
|                                   | 2009                               | 2008     |                      | 2009                             | 2008     |                      |
| Revenue                           | \$ 3,844                           | \$ 3,755 | 2%                   | \$ 7,278                         | \$ 7,172 | 1%                   |
| Operating income                  | \$ 1,491                           | \$ 1,375 | 8%                   | \$ 2,767                         | \$ 2,409 | 15%                  |

Server and Tools licenses products, applications, tools, content, and services that are designed to make information technology professionals and developers more productive and efficient. Server and Tools product offerings consist of server software licenses and client access licenses ("CAL") for Windows Server, Microsoft SQL Server, and other server products. We also offer developer tools, training and certification. Our services offerings include Premier product support services and Microsoft Consulting Services. Server products can be run on-site, in a partner-hosted environment, or in a Microsoft-hosted environment. We use multiple channels for licensing, including pre-installed OEM versions, licenses through partners, and licenses directly to end customers. Approximately 50% of Server and Tools revenue comes from annuity volume licensing agreements, approximately 30% is purchased through transactional volume licensing programs, fully packaged product and licenses sold to OEMs, and the remainder comes from services.

#### *Three months ended December 31, 2009 compared with three months ended December 31, 2008*

Server and Tools revenue increased reflecting growth in product revenue, offset in part by a decline in services revenue. Product revenue increased \$103 million or 3%, primarily driven by growth in Windows Server, Enterprise CAL Suites and System Center revenue. The growth in product revenue reflects continued adoption of Windows platform applications. Services revenue declined \$14 million or 2%, primarily due to decreased revenue from consulting services.

Server and Tools operating income increased primarily due to product revenue growth and a decrease in research and development expenses. Research and development expenses decreased \$41 million or 7%, primarily driven by decreased headcount-related expenses and third-party development and programming costs.

#### *Six months ended December 31, 2009 compared with six months ended December 31, 2008*

Server and Tools revenue increased reflecting growth in product revenue, offset in part by a decline in services revenue. Product revenue increased \$138 million or 2%, primarily driven by growth in Enterprise CAL Suites, System Center and SQL Server revenue. The growth in product revenue reflects increased revenue from annuity volume licensing agreements and continued adoption of Windows platform applications. Services revenue declined \$32 million or 2%, primarily due to decreased revenue from consulting services.

Server and Tools operating income increased primarily due to product revenue growth and decreases in all operating expense categories. Sales and marketing expenses decreased \$87 million or 4%, primarily due to a decrease in headcount-related expenses and corporate marketing expenses. Research and development expenses decreased \$70 million or 6%, primarily driven by reduced third-party development and programming costs and headcount-related expenses. Cost of revenue decreased \$66 million or 5%, reflecting the decline in demand for consulting services. General and administrative expenses decreased \$27 million or 14%, due to decreased headcount-related expenses.

**Online Services Division**

| (In millions, except percentages) | Three Months Ended<br>December 31, |          | Percentage<br>Change | Six Months Ended<br>December 31, |          | Percentage<br>Change |
|-----------------------------------|------------------------------------|----------|----------------------|----------------------------------|----------|----------------------|
|                                   | 2009                               | 2008     |                      | 2009                             | 2008     |                      |
| Revenue                           | \$ 581                             | \$ 609   | (5)%                 | \$ 1,067                         | \$ 1,132 | (6)%                 |
| Operating loss                    | \$ (466)                           | \$ (320) | (46)%                | \$ (950)                         | \$ (635) | (50)%                |

Online Services Division (“OSD”) consists of an online advertising platform with offerings for both publishers and advertisers, online information offerings, such as Bing, and the MSN portals and channels around the world. We earn revenue primarily from online advertising, including search, display, and advertiser and publisher tools. Revenue is also generated through subscriptions and transactions generated from online paid services and from MSN narrowband Internet access subscribers (“Access”).

*Three months ended December 31, 2009 compared with three months ended December 31, 2008*

OSD revenue decreased as a result of lower Access and online advertising revenue. Access revenue decreased \$14 million or 29%, reflecting continued migration of subscribers to broadband or other competitively-priced service providers. Online advertising revenue decreased \$11 million or 2%, to \$516 million, reflecting a decrease in display advertising and advertiser and publisher tools revenue, offset in part by an increase in search revenue. Foreign currency exchange rates accounted for a \$13 million or two percentage point increase in revenue.

OSD operating loss increased mainly due to increased cost of revenue and decreased revenue, offset in part by decreased research and development expenses. Cost of revenue increased \$171 million or 50%, primarily driven by higher online traffic acquisition costs. Research and development expenses decreased \$49 million or 17%, primarily due to decreased third-party development and programming costs and headcount-related expenses.

*Six months ended December 31, 2009 compared with six months ended December 31, 2008*

OSD revenue decreased primarily as a result of lower online advertising and Access revenue. Online advertising revenue decreased \$32 million or 3%, to \$934 million, primarily reflecting a decrease in display advertising and advertiser and publisher tools revenue. Access revenue decreased \$28 million or 29%, reflecting continued migration of subscribers to broadband or other competitively-priced service providers.

OSD operating loss increased mainly due to increased cost of revenue and decreased revenue, offset in part by decreased research and development expenses. Cost of revenue increased \$347 million or 54%, primarily driven by higher online traffic acquisition costs. Research and development expenses decreased \$88 million or 16%, primarily due to decreased third-party development and programming costs.

*Yahoo! Commercial Agreement*

On December 4, 2009, we entered into a definitive 10-year agreement with Yahoo! Inc. (“Yahoo”) whereby Microsoft will provide the exclusive algorithmic and paid search platform for Yahoo websites. We believe this agreement will allow us over time to improve the effectiveness and increase the value of our search offering through greater scale in search queries and an expanded and more competitive search and advertising marketplace. The transaction is subject to regulatory review; we expect to close the transaction in fiscal year 2010.

**Microsoft Business Division**

| (In millions, except percentages) | Three Months Ended<br>December 31, |          | Percentage<br>Change | Six Months Ended<br>December 31, |          | Percentage<br>Change |
|-----------------------------------|------------------------------------|----------|----------------------|----------------------------------|----------|----------------------|
|                                   | 2009                               | 2008     |                      | 2009                             | 2008     |                      |
| Revenue                           | \$ 4,745                           | \$ 4,881 | (3)%                 | \$ 9,149                         | \$ 9,835 | (7)%                 |
| Operating income                  | \$ 3,010                           | \$ 3,021 | —%                   | \$ 5,867                         | \$ 6,199 | (5)%                 |

Microsoft Business Division (“MBD”) offerings consist of the Microsoft Office system and Microsoft Dynamics business solutions. Microsoft Office system products are designed to increase personal, team, and organization productivity through a range of programs, services, and software solutions. Microsoft Office system offerings generate over 90% of MBD revenue. Microsoft Dynamics products provide business solutions for financial management, customer relationship management, supply chain management, and analytics applications for small and mid-size businesses, large organizations, and divisions of global enterprises. We evaluate our results based upon the nature of the end user in two primary parts: business revenue, which includes Microsoft Office system revenue generated through volume licensing agreements and Microsoft Dynamics revenue; and consumer revenue, which includes revenue from retail packaged product sales and OEM revenue.

*Three months ended December 31, 2009 compared with three months ended December 31, 2008*

MBD revenue decreased reflecting decreased business revenue partially offset by increased consumer revenue. Business revenue decreased \$231 million or 6%, primarily reflecting a decline in licensing the 2007 Microsoft Office system to transactional business customers, offset in part by a 1% increase in Microsoft Dynamics revenue. Consumer revenue increased \$95 million or 12%, primarily as a result of growth in the PC market.

MBD operating income was flat reflecting decreased revenue, offset by decreased sales and marketing and research and development expenses. Sales and marketing expenses decreased \$81 million or 7%, primarily driven by a decrease in corporate marketing activities and headcount-related costs associated with our corporate sales force. Research and development expenses decreased \$64 million or 15%, primarily as a result of capitalization of certain Microsoft Office system software development costs.

*Six months ended December 31, 2009 compared with six months ended December 31, 2008*

MBD revenue decreased reflecting decreased business and consumer revenue. Business revenue decreased \$392 million or 5%, primarily reflecting a decline in licensing the 2007 Microsoft Office system to transactional business customers and a 2% decrease in Microsoft Dynamics revenue, offset in part by growth in multi-year volume licensing agreement revenue. The growth in multi-year volume licensing agreement revenue primarily reflects recognition of deferred revenue from previously signed agreements. Consumer revenue decreased \$295 million or 15%, primarily as a result of pricing promotions in the first half of fiscal year 2009 that drove increased licensing in that period, a shift to lower-priced products, and a decline in licensing the 2007 Microsoft Office system.

MBD operating income decreased due mainly to decreased revenue, offset in part by decreased sales and marketing and research and development expenses. Sales and marketing expenses decreased \$262 million or 12%, primarily driven by a decrease in corporate marketing activities and headcount-related costs associated with our corporate sales force. Research and development expenses decreased \$95 million or 11%, primarily as a result of capitalization of certain Microsoft Office system software development costs and lower headcount-related expenses.

**Entertainment and Devices Division**

| (In millions, except percentages) | Three Months Ended<br>December 31, |          | Percentage<br>Change | Six Months Ended<br>December 31, |          | Percentage<br>Change |
|-----------------------------------|------------------------------------|----------|----------------------|----------------------------------|----------|----------------------|
|                                   | 2009                               | 2008     |                      | 2009                             | 2008     |                      |
| Revenue                           | \$ 2,902                           | \$ 3,256 | (11)%                | \$ 4,793                         | \$ 5,149 | (7)%                 |
| Operating income                  | \$ 375                             | \$ 130   | 188 %                | \$ 686                           | \$ 290   | 137 %                |

Entertainment and Devices Division (“EDD”) offerings include the Xbox 360 platform (which includes the Microsoft Xbox 360 video game console system, Xbox 360 video games, Xbox LIVE, and Xbox 360 accessories), the Zune digital music and entertainment platform (including Zune HD, which was released in September 2009), PC software games, online games and services, Mediaroom (our Internet protocol television software), the Microsoft Surface computing platform, Windows Mobile and embedded device platforms, and other devices. EDD leads the development efforts for our line of consumer software and hardware products including application software for Apple’s Macintosh computers and Microsoft PC hardware products, and is responsible for all retail sales and marketing for Microsoft Office and Windows operating systems.



*Three months ended December 31, 2009 compared with three months ended December 31, 2008*

EDD revenue decreased reflecting a \$295 million or 12% decline in Xbox 360 platform and PC game revenue. This decrease was due mainly to decreased revenue from Xbox 360 video games, decreased Xbox 360 consoles sold, and decreased revenue per console, offset in part by increased Xbox LIVE revenue. The decreased revenue from Xbox 360 video games was due primarily to the release of two significant games in the second quarter of the prior year. We shipped 5.2 million Xbox 360 consoles during the second quarter of fiscal year 2010, compared with 6.0 million Xbox 360 consoles during the second quarter of fiscal year 2009. The decreased revenue per console resulted from price reductions during the past 12 months. Non-gaming revenue decreased \$59 million or 8%, primarily reflecting decreased sales of Zune digital music and entertainment devices and Windows Mobile device platforms. Foreign currency exchange rates accounted for a \$49 million or two percentage point increase in revenue.

EDD operating income increased due to reduced operating expenses. Cost of revenue decreased \$478 million or 23%, primarily due to lower Xbox 360 console costs, offset in part by increased royalties to partners related to increased Xbox LIVE transactions. Sales and marketing expenses decreased \$75 million or 15%, primarily due to decreased marketing for the Xbox 360 platform. Research and development expenses decreased \$50 million or 10%, primarily reflecting decreased headcount-related expenses and third-party development and programming costs.

*Six months ended December 31, 2009 compared with six months ended December 31, 2008*

EDD revenue decreased reflecting decreases in Xbox 360 platform and PC game revenue, as well as decreased revenue from the non-gaming portion of the business. Xbox 360 platform and PC game revenue decreased by \$199 million or 5% due mainly to decreased Xbox 360 consoles sold, decreased revenue per console, and decreased revenue from Xbox 360 games, offset in part by increased Xbox LIVE revenue. We shipped 7.3 million Xbox 360 consoles during the first half of fiscal year 2010, compared with 8.3 million Xbox 360 consoles during the first half of fiscal year 2009. The decreased revenue per console resulted from price reductions during the past 12 months. The decreased revenue from Xbox 360 video games was due primarily to the release of two significant games in the second quarter of the prior year. Non-gaming revenue decreased \$157 million or 11%, primarily reflecting decreased sales of Zune digital music and entertainment devices and Window Mobile device platforms.

EDD operating income increased due to reduced operating expenses. Cost of revenue decreased \$581 million or 19%, primarily due to lower Xbox 360 console costs, offset in part by increased royalties to partners related to increased Xbox LIVE transactions. Sales and marketing expenses decreased by \$59 million or 8%, primarily due to decreased marketing for the Xbox 360 platform. Research and development expenses decreased \$113 million or 12%, primarily reflecting decreased headcount-related expenses and third-party development and programming costs.

**Corporate-Level Activity**

| (In millions, except percentages) | Three Months Ended<br>December 31, |          | Percentage<br>Change | Six Months Ended<br>December 31, |            | Percentage<br>Change |
|-----------------------------------|------------------------------------|----------|----------------------|----------------------------------|------------|----------------------|
|                                   | 2009                               | 2008     |                      | 2009                             | 2008       |                      |
| Corporate-level activity          | \$ (1,291)                         | \$ (979) | (32)%                | \$ (2,229)                       | \$ (2,086) | (7)%                 |

Certain corporate-level activity is not allocated to our segments. Those results include expenses such as broad-based sales and marketing, product support services, human resources, legal, finance, information technology, corporate development and procurement activities, research and development and other costs, and legal settlements and contingencies. Corporate-level expenses increased, primarily reflecting an increase in legal charges, offset in part by cost controls and for the six months ended December 31, 2009, by decreased partner payments. Legal charges were approximately \$290 million during the three months ended December 31, 2009.

OPERATING EXPENSES**Cost of Revenue**

| (In millions, except percentages) | Three Months Ended<br>December 31, |          | Percentage<br>Change | Six Months Ended<br>December 31, |          | Percentage<br>Change |
|-----------------------------------|------------------------------------|----------|----------------------|----------------------------------|----------|----------------------|
|                                   | 2009                               | 2008     |                      | 2009                             | 2008     |                      |
| Cost of revenue                   | \$ 3,628                           | \$ 3,907 | (7)%                 | \$ 6,470                         | \$ 6,755 | (4)%                 |
| As a percent of revenue           | 19%                                | 23%      | (4)ppt               | 20%                              | 21%      | (1)ppt               |

Cost of revenue includes manufacturing and distribution costs for products sold and programs licensed, operating costs related to product support service centers and product distribution centers, costs incurred to drive traffic to our websites and/or acquire online advertising space ("traffic acquisition costs"), costs incurred to support and maintain Internet-based products and services, warranty costs, inventory valuation adjustments, costs associated with the delivery of consulting services, and the amortization of capitalized research and development costs associated with software products that have reached technological feasibility. Cost of revenue decreased reflecting decreased Xbox 360 platform costs and cost controls, offset in part by increased online costs, including traffic acquisition costs.

**Research and Development**

| (In millions, except percentages) | Three Months Ended<br>December 31, |          | Percentage<br>Change | Six Months Ended<br>December 31, |          | Percentage<br>Change |
|-----------------------------------|------------------------------------|----------|----------------------|----------------------------------|----------|----------------------|
|                                   | 2009                               | 2008     |                      | 2009                             | 2008     |                      |
| Research and development          | \$ 2,079                           | \$ 2,290 | (9)%                 | \$ 4,144                         | \$ 4,573 | (9)%                 |
| As a percent of revenue           | 11%                                | 14%      | (3)ppt               | 13%                              | 14%      | (1)ppt               |

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, the amortization of purchased software code and services content, and in-process research and development. The decrease in research and development expenses during the three months and six months ended December 31, 2009 was primarily driven by a decrease in third-party development and programming costs, a 3% reduction in headcount-related expenses, and the capitalization of certain software development costs.

**Sales and Marketing**

| (In millions, except percentages) | Three Months Ended<br>December 31, |          | Percentage<br>Change | Six Months Ended<br>December 31, |          | Percentage<br>Change |
|-----------------------------------|------------------------------------|----------|----------------------|----------------------------------|----------|----------------------|
|                                   | 2009                               | 2008     |                      | 2009                             | 2008     |                      |
| Sales and marketing               | \$ 3,619                           | \$ 3,662 | (1)%                 | \$ 6,409                         | \$ 6,706 | (4)%                 |
| As a percent of revenue           | 19%                                | 22%      | (3)ppt               | 20%                              | 21%      | (1)ppt               |

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel and advertising, promotions, trade shows, seminars, and other programs. Sales and marketing expenses decreased primarily as a result of decreased corporate marketing and advertising campaigns, and for the six months ended December 31, 2009, a 3% reduction in headcount-related expenses.

**General and Administrative**

| (In millions, except percentages) | Three Months Ended<br>December 31, |        | Percentage<br>Change | Six Months Ended<br>December 31, |          | Percentage<br>Change |
|-----------------------------------|------------------------------------|--------|----------------------|----------------------------------|----------|----------------------|
|                                   | 2009                               | 2008   |                      | 2009                             | 2008     |                      |
| General and administrative        | \$ 1,124                           | \$ 831 | 35%                  | \$ 1,865                         | \$ 1,718 | 9%                   |
| As a percent of revenue           | 6%                                 | 5%     | 1ppt                 | 6%                               | 5%       | 1ppt                 |

General and administrative expenses include payroll, employee benefits, stock-based compensation expense and other headcount-related expenses associated with finance, legal, facilities, certain human resources and other administrative headcount, and legal and other administrative fees. General and administrative expenses increased during the three months and six months ended December 31, 2009 primarily driven by increased legal charges, offset in part by an 8% decrease in headcount-related expenses for the six months ended December 31, 2009.

OTHER INCOME (EXPENSE) AND INCOME TAXES

**Other Income (Expense)**

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

| (In millions, except percentages)                        | Three Months Ended<br>December 31, |                 | Percentage<br>Change | Six Months Ended<br>December 31, |                 | Percentage<br>Change |
|--|------------------------------------|-----------------|----------------------|----------------------------------|-----------------|----------------------|
|  | 2009                               | 2008            |                      | 2009                             | 2008            |                      |
| Dividends and interest                                   | \$ 159                             | \$ 175          | (9)%                 | \$ 324                           | \$ 382          | (15)%                |
| Net recognized gains on investments                      | 92                                 | 270             | (66)%                | 162                              | 399             | (59)%                |
| Net gains (losses) on derivatives                        | 96                                 | (409)           | *                    | 92                               | (574)           | *                    |
| Net gains (losses) on foreign currency<br>remeasurements | (23)                               | (350)           | (93)%                | 32                               | (529)           | *                    |
| Other  | 46                                 | 13              | 254 %                | 43                               | 13              | 231 %                |
| <b>Total</b>   | <b>\$ 370</b>                      | <b>\$ (301)</b> | <b>*</b>             | <b>\$ 653</b>                    | <b>\$ (309)</b> | <b>*</b>             |

\* Not meaningful

*Three months ended December 31, 2009 compared with three months ended December 31, 2008*

Dividends and interest decreased primarily due to increased interest expense on our long-term debt and lower interest rates on our fixed-income investments, offset in part by higher average investment portfolio balances. Net recognized gains on investments decreased primarily due to sales of certain equity investments held in our strategic investments portfolio in the prior period, offset in part by lower other-than-temporary impairments. Other-than-temporary impairments were \$6 million during the three months ended December 31, 2009, as compared with \$262 million during the three months ended December 31, 2008 and decreased primarily due to improvements in market conditions. Net gains on derivatives increased across all asset classes in the current period as compared with losses in the prior period. Net losses from foreign currency remeasurements declined due to a weakening U.S. dollar. Other includes a gain on the divestiture of Razorfish.

*Six months ended December 31, 2009 compared with six months ended December 31, 2008*

Dividends and interest decreased primarily due to increased interest expense on our long-term debt and lower interest rates on our fixed-income investments, offset in part by higher average investment portfolio balances. Net recognized gains on investments decreased primarily due to sales of certain equity investments held in our strategic investments portfolio in the prior period, offset in part by lower other-than-temporary impairments. Other-than-temporary impairments were \$24 million during the six months ended December 31, 2009, as compared with \$334 million during the six months ended December 31, 2008 and decreased primarily due to improvements in market conditions. Net gains on derivatives increased across all asset classes as compared to the prior period. Net gains from foreign currency remeasurements compared to net losses in the prior period were due to a weakening U.S. dollar. Other includes a gain on the divestiture of Razorfish.

**Income Taxes**

Our effective tax rate was 25% for both the three months and six months ended December 31, 2009, as compared with 26% for the three months and 27% for the six months ended December 31, 2008. The fiscal year 2010 rate reflects a higher mix of foreign earnings taxed at lower rates.

**FINANCIAL CONDITION****Cash, Cash Equivalents, and Investments**

Cash, cash equivalents, and short-term investments totaled \$36.1 billion as of December 31, 2009, compared with \$31.4 billion as of June 30, 2009. Equity and other investments were \$7.0 billion as of December 31, 2009, compared with \$4.9 billion as of June 30, 2009. Our investments consist primarily of fixed-income securities, diversified among industries and individual issuers. Our investments are generally liquid and investment grade. The portfolio is invested predominantly in U.S. dollar-denominated securities, but also includes foreign currency-denominated securities in order to diversify risk. We invest primarily in short-term securities to facilitate liquidity and for capital preservation.

In general, and where applicable, we use quoted prices in active markets for identical assets or liabilities to determine fair value. This pricing methodology applies to our Level 1 investments, such as exchange-traded mutual funds, domestic and international equities, U.S. treasuries, and agency securities. If quoted prices in active markets for identical assets or liabilities are not available to determine fair value, then we use quoted prices for similar assets and liabilities or inputs other than the quoted prices that are observable either directly or indirectly. This pricing methodology applies to our Level 2 investments such as corporate notes and bonds, foreign government bonds, mortgage-backed securities, and certain agency securities. Level 3 investments are valued using internally developed models with unobservable inputs. Assets and liabilities measured using unobservable inputs are an immaterial portion of our portfolio.

A majority of our investments are priced by pricing vendors and are generally Level 1 or Level 2 investments as these vendors either provide a quoted market price in an active market or use observable inputs for their pricing without applying significant adjustments. Broker pricing is used mainly when a quoted price is not available, the investment is not priced by our pricing vendors, or when a broker price is more reflective of fair values in the market in which the investment trades. Our broker-priced investments are generally labeled as Level 2 investments because the broker prices these investments based on similar assets without applying significant adjustments. In addition, all of our broker-priced investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments. Our fair value processes include controls that are designed to ensure appropriate fair values are recorded. Such controls include model validation, review of key model inputs, analysis of period-over-period fluctuations, and independent recalculation of prices where appropriate.

While we own certain mortgage- and asset-backed fixed-income securities, our portfolio as of December 31, 2009 does not contain direct exposure to subprime mortgages or structured vehicles that derive their value from subprime collateral. The majority of the mortgage-backed securities are collateralized by prime residential mortgages and carry a 100% principal and interest guarantee, primarily from Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Government National Mortgage Association.

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

**Debt**

In September 2008, our Board of Directors authorized debt financings of up to \$6.0 billion. Our initial commercial paper program provided for the issuance and sale of up to \$2.0 billion. Following the issuance of our long-term debt in May 2009, we increased the commercial paper program and issued an additional \$250 million of commercial paper during the six months ended December 31, 2009. As of December 31, 2009, we had \$2.25 billion of commercial paper and \$3.75 billion of long-term debt issued and outstanding.

### Short-term Debt

As of December 31, 2009, our \$2.25 billion of commercial paper issued and outstanding had a weighted average interest rate, including issuance costs, of 0.14% and maturities of 16 to 210 days. In November 2009, we replaced our \$2.0 billion and \$1.0 billion credit facilities with a \$2.25 billion 364-day credit facility, which expires on November 5, 2010. This facility serves as a back-up for our commercial paper program. As of December 31, 2009, we were in compliance with the financial covenant in the credit facility, which requires a coverage ratio maintained of at least three times earnings before interest, taxes, depreciation, and amortization to interest expense. No amounts were drawn against the credit facilities during the six months ended December 31, 2009.

### Long-term Debt

As of December 31, 2009, we had issued and outstanding \$3.75 billion of debt securities as follows: \$2.0 billion aggregate principal amount of 2.95% notes due 2014, \$1.0 billion aggregate principal amount of 4.20% notes due 2019, and \$750 million aggregate principal amount of 5.20% notes due 2039 (collectively "the Notes"). Interest on the Notes is payable semi-annually on June 1 and December 1 of each year to holders of record on the preceding May 15 and November 15. The Notes are senior unsecured obligations and rank equally with our other unsecured and unsubordinated debt outstanding.

We are using the net proceeds from sales of the debt securities for general corporate purposes, which may include funding for working capital, capital expenditures, repurchases of our capital stock, and acquisitions.

### Unearned Revenue

Unearned revenue at December 31, 2009 comprised mainly unearned revenue from volume licensing programs. Unearned revenue from volume licensing programs represents customer billings for multi-year licensing arrangements, paid either upfront or annually at the beginning of each billing coverage period, which are accounted for as subscriptions with revenue recognized ratably over the billing coverage period. Unearned revenue at December 31, 2009 also included payments for: unspecified upgrades/enhancements of Microsoft Internet Explorer on a when-and-if-available basis for Windows XP; post-delivery support and consulting services to be performed in the future; Xbox LIVE subscriptions; Microsoft Dynamics business solutions products; unspecified enhancements for Zune HD; the Windows 7 Upgrade Option program; online advertising for which the advertisement has yet to be displayed; Mediaroom; and other offerings for which we have been paid upfront and earn the revenue when we provide the service or software, or otherwise meet the revenue recognition criteria.

The following table outlines the expected future recognition of unearned revenue as of December 31, 2009:

(In millions)

| Three Months Ending, |           |
|----------------------|-----------|
| March 31, 2010       | \$ 4,975  |
| June 30, 2010        | 3,384     |
| September 30, 2010   | 1,924     |
| December 31, 2010    | 1,078     |
| Thereafter           | 1,167     |
| Total                | \$ 12,528 |

See Note 13 – Unearned Revenue of the Notes to Financial Statements (Part I, Item 1).

### Retained Deficit

As a result of the special dividend paid in the second quarter of fiscal year 2005 and common stock repurchased, our retained deficit, including accumulated other comprehensive income, was \$18.3 billion at December 31, 2009. Our retained deficit is not expected to affect our future ability to operate, pay dividends, or repay our debt given our continuing profitability and strong cash and financial position.

## Cash Flows

Cash flow from operations increased \$1.9 billion to \$11.1 billion for the six months ended December 31, 2009. This increase was due mainly to payment of approximately \$3.1 billion to the Internal Revenue Service in the prior year as a result of our settlement of the 2000-2003 audit examination, offset in part by a decrease in cash received from customers in the current year.

Cash used for financing was \$6.5 billion for the six months ended December 31, 2009, a decrease of \$2.6 billion from the corresponding period of the prior year. This decrease was due mainly to a \$3.9 billion decrease in common stock repurchases, offset in part by a \$1.7 billion decrease in net proceeds from debt and short-term borrowings.

Cash used in investing was \$1.3 billion for the six months ended December 31, 2009, a decrease of \$613 million from the corresponding period of the prior year. This decrease reflects lower additions to property and equipment.

## Share Repurchases

During the three months and six months ended December 31, 2009, we repurchased 125 million and 183 million shares of Microsoft common stock for \$3.6 billion and \$5.0 billion, respectively, under the repurchase plan we announced on September 22, 2008. As of December 31, 2009, approximately \$29.5 billion remained of the \$40.0 billion approved repurchase amount. All repurchases were made using cash resources. The repurchase program expires September 30, 2013 but may be suspended or discontinued at any time without notice.

## Dividends

Our Board of Directors declared the following dividends during the periods presented:

| Declaration Date        | Per Share Dividend | Record Date       | Total Amount | Payment Date      |
|-------------------------|--------------------|-------------------|--------------|-------------------|
| (in millions)           |                    |                   |              |                   |
| <b>Fiscal year 2010</b> |                    |                   |              |                   |
| September 18, 2009      | \$ 0.13            | November 19, 2009 | \$ 1,152     | December 10, 2009 |
| December 9, 2009        | \$ 0.13            | February 18, 2010 | \$ 1,145     | March 11, 2010    |
| <b>Fiscal year 2009</b> |                    |                   |              |                   |
| September 19, 2008      | \$ 0.13            | November 20, 2008 | \$ 1,157     | December 11, 2008 |
| December 10, 2008       | \$ 0.13            | February 19, 2009 | \$ 1,155     | March 12, 2009    |

## Other Planned Uses of Capital

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology. Additions to property and equipment will continue, including new facilities, data centers, and computer systems for research and development, sales and marketing, support, and administrative staff. We have operating leases for most U.S. and international sales and support offices and certain equipment. We have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of capital resources.

We believe existing cash, cash equivalents and short-term investments, together with funds generated from operations, should be sufficient to meet operating requirements, regular quarterly dividends, debt repayment schedules, and share repurchases. Our philosophy regarding the maintenance of a balance sheet with a large component of cash and cash equivalents, short-term investments, and equity and other investments, reflects our views on potential future capital requirements relating to research and development, creation and expansion of sales distribution channels, investments and acquisitions, share dilution management, legal risks, and challenges to our business model. We regularly assess our investment management approach in view of our current and potential future needs.

## Off-Balance Sheet Arrangements

We provide indemnifications of varying scope and amount to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products and certain other matters. In evaluating estimated losses on these indemnifications, we consider factors such as the degree of probability of an unfavorable outcome and our ability to make a reasonable estimate of the amount of loss. To date, we have not encountered significant costs as a result of these obligations and have not accrued any liabilities related to these indemnifications in our financial statements.

## RECENT ACCOUNTING GUIDANCE

### Recently Adopted Accounting Guidance

On July 1, 2009, we adopted guidance issued by the Financial Accounting Standards Board ("FASB") on business combinations. The guidance retains the fundamental requirements that the acquisition method of accounting (previously referred to as the purchase method of accounting) be used for all business combinations, but requires a number of changes, including changes in the way assets and liabilities are recognized and measured as a result of business combinations. It also requires the capitalization of in-process research and development at fair value and requires the expensing of acquisition-related costs as incurred. We have applied this guidance to business combinations completed since July 1, 2009.

On July 1, 2009, we adopted the guidance issued by the FASB that changes the accounting and reporting for non-controlling interests. Non-controlling interests are to be reported as a component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control are to be accounted for as equity transactions. In addition, net income attributable to a non-controlling interest is to be included in net income and, upon a loss of control, the interest sold, as well as any interest retained, is to be recorded at fair value with any gain or loss recognized in net income. Adoption of the new guidance did not have a material impact on our financial statements.

On July 1, 2009, we adopted the guidance on fair value measurement for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Adoption of the new guidance did not have a material impact on our financial statements.

### Recent Accounting Guidance Not Yet Adopted

In January 2010, the FASB issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance will become effective for us with the reporting period beginning January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for us with the reporting period beginning July 1, 2011. Other than requiring additional disclosures, adoption of this new guidance will not have a material impact on our financial statements.

In October 2009, the FASB issued guidance on revenue recognition that will become effective for us beginning July 1, 2010, with earlier adoption permitted. Under the new guidance on arrangements that include software elements, tangible products that have software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. Additionally, the FASB issued guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. We believe adoption of this new guidance will not have a material impact on our financial statements.

In June 2009, the FASB issued guidance on the consolidation of variable interest entities, which is effective for us beginning July 1, 2010. The new guidance requires revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities, and additional disclosures for variable interests. We believe adoption of this new guidance will not have a material impact on our financial statements.

## APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our financial statements and accompanying notes are prepared in accordance with U.S. GAAP. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies. Critical accounting policies for us include revenue recognition, impairment of investment securities, impairment of goodwill, accounting for research and development costs, accounting for contingencies, accounting for income taxes, accounting for stock-based compensation, and accounting for product warranties.



## Revenue Recognition

Software revenue recognition requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence ("VSOE") of fair value exists for those elements.

A portion of the revenue related to Windows XP is recorded as unearned due to undelivered elements including, in some cases, free post-delivery telephone support and the right to receive unspecified upgrades/enhancements of Microsoft Internet Explorer on a when-and-if-available basis. The amount of revenue allocated to undelivered elements is based on the VSOE of fair value for those elements using the residual method or relative fair value method. Unearned revenue due to undelivered elements is recognized ratably on a straight-line basis over the related products' life cycles. Revenue related to Windows Vista is not subject to a similar deferral because there are no significant undelivered elements. However, Windows Vista revenue is subject to deferral as a result of the Windows 7 Upgrade Option program which started June 26, 2009. The program allowed customers who purchased certain versions of Windows Vista to receive an upgrade to the corresponding version of Windows 7 at minimal or no cost. In addition, purchasers of retail packaged Windows Vista from participating retailers in participating markets may have qualified for a free or discounted upgrade to the equivalent Windows 7 product when the product became generally available in the second quarter of fiscal year 2010. Accordingly, previously deferred revenue related to the undelivered Windows 7 product sold was recognized in the second quarter of fiscal year 2010 once the product had been delivered.

Changes to the elements in a software arrangement, the ability to identify VSOE for those elements, the fair value of the respective elements, and changes to a product's estimated life cycle could materially impact the amount of earned and unearned revenue. Judgment is also required to assess whether future releases of certain software represent new products or upgrades and enhancements to existing products.

## Impairment of Investment Securities

Investments are reviewed quarterly for indicators of other-than-temporary impairment. This determination requires significant judgment. In making this judgment, we employ a systematic methodology quarterly that considers available quantitative and qualitative evidence in evaluating potential impairment of our investments. If the cost of an investment exceeds its fair value, we evaluate, among other factors, general market conditions, credit quality of debt instrument issuers, the duration and extent to which the fair value is less than cost, and for equity securities, our intent and ability to hold, or plans to sell, the investment. For fixed income securities, we also evaluate whether we have plans to sell the security or it is more likely than not that we will be required to sell the security before recovery. We also consider specific adverse conditions related to the financial health of and business outlook for the investee, including industry and sector performance, changes in technology, and operational and financing cash flow factors. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded to other income (expense) and a new cost basis in the investment is established. If market, industry, and/or investee conditions deteriorate, we may incur future impairments.

## Goodwill

Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated using a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur, and determination of our weighted average cost of capital. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit. We allocate goodwill to reporting units based on the reporting unit expected to benefit from the business combination. We evaluate our reporting units on an annual basis and, if necessary, reassign goodwill using a relative fair value allocation approach.



In connection with the disposal of Razorfish, we performed an interim impairment analysis of our Online Services Division goodwill balance during the first quarter of fiscal year 2010. No impairment of goodwill was identified.

### **Research and Development Costs**

Costs incurred internally in researching and developing a computer software product are charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, all software costs are capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our software products is reached after all high-risk development issues have been resolved through coding and testing. Generally, this occurs shortly before the products are released to manufacturing. The amortization of these costs is included in cost of revenue over the estimated life of the products.

### **Legal and Other Contingencies**

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our financial statements.

### **Income Taxes**

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting literature also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our financial statements.

### **Stock-Based Compensation**

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period. Determining the fair value of stock-based awards at the grant date requires judgment, including estimating expected dividends. In addition, judgment is also required in estimating the amount of stock-based awards that are expected to be forfeited. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be impacted.

### **Product Warranties**

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

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### RISKS

We are exposed to economic risk from foreign currency exchange rates, interest rates, credit risk, equity prices, and commodity prices. A portion of these risks is hedged, but they may impact our results of operations, cash flows, and financial condition.

#### **Foreign Currency**

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily and use hedges where practicable to offset the risks and maximize the economic effectiveness of our foreign currency positions. Principal currencies hedged include the euro, Japanese yen, British pound, and Canadian dollar.

#### **Interest Rate**

Our fixed-income portfolio is diversified across credit sectors and maturities, consisting primarily of investment-grade securities. The credit risk and average maturity of the fixed-income portfolio is managed to achieve economic returns that correlate to certain global and domestic fixed-income indices. In addition, we use "To Be Announced" forward purchase commitments of mortgage-backed assets to gain exposure to agency mortgage-backed securities.

#### **Equity**

Our equity portfolio consists of global, developed, and emerging market securities that are subject to market price risk. We manage the securities relative to certain global and domestic indices and expect their economic risk and return to correlate with these indices.

#### **Commodity**

We use broad-based commodity exposures to enhance portfolio returns and facilitate portfolio diversification. Our investment portfolio has exposure to a variety of commodities, including precious metals, energy, and grain. We manage these exposures relative to global commodity indices and expect their economic risk and return to correlate with these indices.

### VALUE-AT-RISK

We use a value-at-risk ("VaR") model to estimate and quantify our market risks. VaR is the expected loss, for a given confidence level, in the fair value of our portfolio due to adverse market movements over a defined time horizon. The VaR model is not intended to represent actual losses in fair value, including determinations of other-than-temporary losses in fair value in accordance with U.S. GAAP, but is used as a risk estimation and management tool. The distribution of the potential changes in total market value of all holdings is computed based on the historical volatilities and correlations among foreign currency exchange rates, interest rates, equity prices, and commodity prices, assuming normal market conditions.

The VaR is calculated as the total loss that will not be exceeded at the 97.5 percentile confidence level or, alternatively stated, the losses could exceed the VaR in 25 out of 1,000 cases. Several risk factors are not captured in the model, including liquidity risk, operational risk, and legal risk.

The following table sets forth the one-day VaR for substantially all of our positions as of December 31, 2009 and June 30, 2009 and for the three months ended December 31, 2009:

(In millions)

| Risk Categories  | December 31,<br>2009 | June 30,<br>2009 | Three Months Ended<br>December 31,<br>2009 |        |        |
|------------------|----------------------|------------------|--|--------|--------|
|                  |                      |                  | Average                                    | High   | Low    |
| Foreign currency | \$ 37                | \$ 68            | \$ 50                                      | \$ 67  | \$ 37  |
| Interest rate    | \$ 49                | \$ 42            | \$ 48                                      | \$ 51  | \$ 45  |
| Equity           | \$ 194               | \$ 157           | \$ 186                                     | \$ 194 | \$ 172 |
| Commodity        | \$ 19                | \$ 16            | \$ 17                                      | \$ 19  | \$ 15  |

Total one-day VaR for the combined risk categories was \$228 million at December 31, 2009 and \$211 million at June 30, 2009. The total VaR is 24% less at December 31, 2009, and 25% less at June 30, 2009, than the sum of the separate risk categories in the above table due to the diversification benefit of the combination of risks.

#### ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting during the quarter ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### PART II. OTHER INFORMATION

##### ITEM 1. LEGAL PROCEEDINGS

On December 16, 2009, the European Commission announced it had adopted a decision that makes legally binding commitments offered by Microsoft to address the Commission's concerns regarding competition in Web browsing software. This decision ends the Commission's investigation. It does not address whether a violation of European Commission competition law occurred. The commitments we offered broadly ensure that computer manufacturers will remain free to install any browser on the PCs they ship, and they provide for a Web browser "choice screen" to be offered to end users throughout Europe. The Commission had opened its investigation in January 2008 following a complaint filed with the Commission by Opera Software ASA.

In January 2008, the Commission also opened a competition law investigation that relates primarily to interoperability with respect to our Microsoft Office family of products. This investigation resulted from complaints filed with the Commission by a trade association of Microsoft's competitors. We made a number of proposals to address the Commission's competition law concerns. The Commission announced on December 16, 2009 that it welcomed and would consider these proposals.

See Note 15 – Contingencies of the Notes to Financial Statements (Part I, Item 1) for information regarding other legal proceedings in which we are involved.

## ITEM 1A. RISK FACTORS

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

**Challenges to our business model may reduce our revenues and operating margins.** Our business model has been based upon customers paying a fee to license software that we develop and distribute. Under this license-based software model, software developers bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from the distribution of their products. Certain “open source” software business models challenge our license-based software model. Open source commonly refers to software whose source code is subject to a license allowing it to be modified, combined with other software and redistributed, subject to restrictions set forth in the license. A number of commercial firms compete with us using an open source business model by modifying and then distributing open source software to end users at nominal cost and earning revenue on complementary services and products. These firms do not bear the full costs of research and development for the software. In some cases, their products may infringe patents granted to Microsoft for our inventions. In addition, some of these products may build on Microsoft ideas that we provide to them free or at low royalties in connection with our interoperability initiatives. To the extent open source software gains increasing market acceptance, our sales, revenue, and operating margins may decline.

Another development is the business model under which companies provide software and content over the Internet in exchange for revenues primarily from advertising or subscriptions. An example of an advertising-funded business model is Internet search, where providing a robust alternative is particularly important and challenging due to the scale effects enjoyed by a single market dominant competitor. Advances in computing and communications technologies have made this model viable and enabled the rapid growth of some of our competitors. We are devoting significant resources to develop our own competing software plus services strategies. For users, this includes improvements to our Windows Live service and creation of online companion applications to certain Microsoft Office products. For developers, this includes our recent commercial release of the Windows Azure Platform, our hosted computing platform that is designed to facilitate rapid, flexible and scalable development of cloud-based services. It is uncertain whether these strategies will be successful.

An important element of our business model has been to create platform-based ecosystems on which many participants can build diverse solutions. A competing vertically-integrated model, in which a single firm controls both the software and hardware elements of a product has been successful with certain consumer products such as personal computers, mobile phones, and digital music players. We also offer vertically-integrated hardware and software products; however, efforts to compete with the vertically integrated model may increase our cost of sales and reduce our operating margins.

**We face intense competition.** We continue to experience intense competition across all markets for our products and services. Our competitors range in size from Fortune 100 companies to small, specialized single-product businesses and open source community-based projects. Although we believe the breadth of our businesses and product portfolio is a competitive advantage, our competitors that are focused on narrower product lines may be more effective in devoting technical, marketing, and financial resources to compete with us. In addition, barriers to entry in our businesses generally are low and products, once developed, can be distributed broadly and quickly at relatively low cost. Open source software vendors are devoting considerable efforts to developing software that mimics the features and functionality of our products, in some cases in violation of our intellectual property rights or on the basis of technical specifications for Microsoft technologies that we make available at little or no cost. In response to competition, we are developing versions of our products with basic functionality that are sold at lower prices than the standard versions. These competitive pressures may result in decreased sales volumes, price reductions, and/or increased operating costs, such as for marketing and sales incentives, resulting in lower revenue, gross margins, and operating income.

**We may not be able to adequately protect our intellectual property rights.** Protecting our global intellectual property rights and combating unlicensed copying and use of software and other intellectual property is difficult. While piracy adversely affects U.S. revenue, the impact on revenue from outside the U.S. is more significant, particularly in countries where laws are less protective of intellectual property rights. Similarly, the absence of harmonized patent laws makes it more difficult to ensure consistent respect for patent rights. Throughout the world, we actively educate consumers about the benefits of licensing genuine products and obtaining indemnification benefits for intellectual property risks, and we educate lawmakers about the advantages of a business climate where intellectual property rights are protected. However, continued educational and enforcement efforts may fail to enhance revenue. Reductions in the legal protection for software intellectual property rights could adversely affect revenue.

**Third parties may claim we infringe their intellectual property rights.** From time to time we receive notices from others claiming we infringe their intellectual property rights. The number of these claims may grow. To resolve these claims we may enter into royalty and licensing agreements on less favorable terms, stop selling or redesign affected products, or pay damages to satisfy indemnification commitments with our customers. Such agreements may cause operating margins to decline. We have made and expect to continue making significant expenditures to settle claims related to the use of technology and intellectual property rights as part of our strategy to manage this risk.

**We may not be able to protect our source code from copying if there is an unauthorized disclosure of source code.** Source code, the detailed program commands for our operating systems and other software programs, is critical to our business. Although we license portions of our application and operating system source code to a number of licensees, we take significant measures to protect the secrecy of large portions of our source code. If an unauthorized disclosure of a significant portion of our source code occurs, we could potentially lose future trade secret protection for that source code. This could make it easier for third parties to compete with our products by copying functionality, which could adversely affect our revenue and operating margins. Unauthorized disclosure of source code also could increase the security risks described in the next paragraph.

**Security vulnerabilities in our products could lead to reduced revenues or to liability claims.** Maintaining the security of computers and computer networks is a critical issue for us and our customers. Hackers develop and deploy viruses, worms, and other malicious software programs that attack our products. Although this is an industry-wide problem that affects computers across all platforms, it affects our products in particular because hackers tend to focus their efforts on the most popular operating systems and programs and we expect them to continue to do so. We devote significant resources to address security vulnerabilities through:

- engineering more secure products;
- enhancing security and reliability features in our products;
- helping our customers make the best use of our products and services to protect against computer viruses and other attacks;
- improving the deployment of software updates to address security vulnerabilities;
- investing in mitigation technologies that help to secure customers from attacks even when such software updates are not deployed; and
- providing customers online automated security tools, published security guidance, and security software such as firewalls and anti-virus software.

The cost of these steps could reduce our operating margins. Despite these efforts, actual or perceived security vulnerabilities in our products could lead some customers to seek to return products, to reduce or delay future purchases, or to use competing products. Customers may also increase their expenditures on protecting their existing computer systems from attack, which could delay adoption of new technologies. Any of these actions by customers could adversely affect our revenue. In addition, actual or perceived vulnerabilities may lead to claims against us. Although our license agreements typically contain provisions that eliminate or limit our exposure to such liability, there is no assurance these provisions will withstand all legal challenges.

**We are subject to government litigation and regulatory activity that affects how we design and market our products.** As a leading global software maker, we receive close scrutiny from government agencies under U.S. and foreign competition laws. Some jurisdictions also provide private rights of action for competitors or consumers to assert claims of anti-competitive conduct. For example, we have been involved in the following actions.

Lawsuits brought by the U.S. Department of Justice, 18 states, and the District of Columbia in two separate actions were resolved through a Consent Decree that took effect in 2001 and a Final Judgment entered in 2002. These proceedings imposed various constraints on our Windows operating system businesses. These constraints include limits on certain contracting practices, mandated disclosure of certain software program interfaces and protocols, and rights for computer manufacturers to limit the visibility of certain Windows features in new PCs. We believe we are in full compliance with these rules. However, if we fail to comply with them, additional restrictions could be imposed on us that would adversely affect our business.

The European Commission closely scrutinizes the design of high-volume Microsoft products and the terms on which we make certain technologies used in these products, such as file formats, programming interfaces, and protocols, available to other companies. In 2004, the Commission ordered us to create new versions of Windows that do not include certain multimedia technologies and to provide our competitors with specifications for how to implement certain proprietary Windows communications protocols in their own products. In 2009, the Commission accepted a set of commitments offered by Microsoft to address the Commission's concerns relating to competition in Web browsing software. The Commission's impact on product design may limit our ability to innovate in Windows or other products in the future, diminish the developer appeal of the Windows platform, and increase our product development costs. The availability of licenses related to protocols and file formats may enable competitors to develop software products that better mimic the functionality of our own products which could result in decreased sales of our products.

Government regulatory actions and court decisions such as these may hinder our ability to provide the benefits of our software to consumers and businesses, thereby reducing the attractiveness of our products and the revenues that come from them. New actions could be initiated at any time, either by these or other governments or private claimants, including with respect to new versions of Windows or other Microsoft products. The outcome of such actions, or steps taken to avoid them, could adversely affect us in a variety of ways, including:

- We may have to choose between withdrawing products from certain geographies to avoid fines or designing and developing alternative versions of those products to comply with government rulings, which may entail a delay in a product release and removing functionality that customers want or on which developers rely.
- We may be required to make available licenses to our proprietary technologies on terms that do not reflect their fair market value or do not protect our associated intellectual property.
- The rulings described above may be cited as a precedent in other competition law proceedings.

Our software and services online offerings are subject to government regulation of the Internet domestically and internationally in many areas, including user privacy, telecommunications, data protection, and online content. The application of these laws and regulations to our business is often unclear and sometimes may conflict. Compliance with these regulations may involve significant costs or require changes in business practices that result in reduced revenue. Noncompliance could result in penalties being imposed on us or orders that we stop the alleged noncompliant activity.

**Our business depends on our ability to attract and retain talented employees.** Our business is based on successfully attracting and retaining talented employees. The market for highly skilled workers and leaders in our industry is extremely competitive. We are limited in our ability to recruit internationally by restrictive domestic immigration laws. If we are less successful in our recruiting efforts, or if we are unable to retain key employees, our ability to develop and deliver successful products and services may be adversely affected. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees could hinder our strategic planning and execution.

**Delays in product development schedules may adversely affect our revenues.** The development of software products is a complex and time-consuming process. New products and enhancements to existing products can require long development and testing periods. Our increasing focus on software plus services also presents new and complex development issues. Significant delays in new product or service releases or significant problems in creating new products or services could adversely affect our revenue.

**We make significant investments in new products and services that may not be profitable.** Our growth depends on our ability to innovate by offering new, and adding value to our existing, software and service offerings. We will continue to make significant investments in research, development, and marketing for new products, services, and technologies, including the Windows PC operating system, the Microsoft Office system, Xbox 360, Live Search, Windows Server, Zune, Windows Live, the Windows Azure Services platform, and other software plus services offerings. Investments in new technology are speculative. Commercial success depends on many factors, including innovativeness, developer support, and effective distribution and marketing. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of new software products or upgrades, unfavorably impacting revenue. We may not achieve significant revenue from new product and service investments for a number of years, if at all. Moreover, new products and services may not be profitable, and even if they are profitable, operating margins for new products and businesses may not be as high as the margins we have experienced historically.

**Adverse economic conditions may harm our business.** Unfavorable changes in economic conditions, including inflation, recession, or other changes in economic conditions, may result in lower information technology spending and adversely affect our revenue. If demand for PCs, servers, and other computing devices declines, or consumer or business spending for those products declines, our revenue will be adversely affected. Our product distribution system also relies on an extensive partner network. The impact of economic conditions on our partners, such as the bankruptcy of a major distributor, could result in sales channel disruption. Challenging economic conditions also may impair the ability of our customers to pay for products and services they have purchased. As a result, reserves for doubtful accounts and write-offs of accounts receivable may increase. We maintain an investment portfolio of various holdings, types, and maturities. These investments are subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by unusual events that have affected global financial markets. If global credit and equity markets experience prolonged periods of decline, our investment portfolio may be adversely impacted and we could determine that more of our investments have experienced an other-than-temporary decline in fair value, requiring impairment charges that could adversely impact our financial results.

**We have claims and lawsuits against us that may result in adverse outcomes.** We are subject to a variety of claims and lawsuits. Adverse outcomes in some or all of these claims may result in significant monetary damages or injunctive relief that could adversely affect our ability to conduct our business. Although management currently believes resolving all of these matters, individually or in the aggregate, will not have a material adverse impact on our financial statements, the litigation and other claims are subject to inherent uncertainties and management's view of these matters may change in the future. A material adverse impact on our financial statements also could occur for the period in which the effect of an unfavorable final outcome becomes probable and reasonably estimable.

**We may have additional tax liabilities.** We are subject to income taxes in the United States and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We regularly are under audit by tax authorities. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material effect on our financial statements in the period or periods for which that determination is made. In addition, there have been proposals to reform U.S. tax laws that would significantly impact how U.S. multinational corporations are taxed on foreign earnings. We earn a substantial portion of our income in foreign countries. Although we cannot predict whether or in what form this proposed legislation will pass, if enacted it could have a material adverse impact on our tax expense and cash flow.

**Our vertically-integrated hardware and software products may experience quality or supply problems.** Our hardware products such as the Xbox 360 console are highly complex and can have defects in design, manufacture, or associated software. We could incur significant expenses, lost revenue, and reputational harm if we fail to detect or effectively address such issues through design, testing, or warranty repairs. We obtain some components of our hardware devices from sole suppliers. If a component delivery from a sole-source supplier is delayed or becomes unavailable or industry shortages occur, we may be unable to obtain timely replacement supplies, resulting in reduced sales. Either component shortages or excess or obsolete inventory may require us to record charges to cost of revenue. Xbox 360 consoles are assembled in Asia; disruptions in the supply chain may result in console shortages that would affect our revenues and operating margins. These same risks would apply to any other vertically-integrated hardware and software products we may offer.

**If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings.** Under generally accepted accounting principles, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is tested for impairment at least annually. Factors that may be considered a change in circumstances, indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable, include a decline in stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in our industry. We may be required to record a significant charge in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively impacting our results of operations.

**We operate a global business that exposes us to additional risks.** We operate in over 100 countries and a significant part of our revenue comes from international sales. Pressure to make our pricing structure uniform might require that we reduce the sales price of our software in the United States and other countries. Operations outside the United States may be affected by changes in trade protection laws, policies and measures, and other regulatory requirements affecting trade and investment, including the Foreign Corrupt Practices Act and local laws prohibiting



corrupt payments. Emerging markets are a significant focus of our international growth strategy. The developing nature of these markets presents a number of risks. Deterioration of social, political, labor, or economic conditions in a specific country or region and difficulties in staffing and managing foreign operations may also adversely affect our operations or financial results. Although we hedge a portion of our international currency exposure, significant fluctuations in exchange rates between the U.S. dollar and foreign currencies may adversely affect our net revenues.

**Catastrophic events or geo-political conditions may disrupt our business.** A disruption or failure of our systems or operations in the event of a major earthquake, weather event, cyber-attack, terrorist attack, or other catastrophic event could cause delays in completing sales, providing services, or performing other mission-critical functions. Our corporate headquarters, a significant portion of our research and development activities, and certain other critical business operations are located in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are near major earthquake faults. A catastrophic event that results in the destruction or disruption of any of our critical business or information technology systems could harm our ability to conduct normal business operations and our operating results. Abrupt political change, terrorist activity, and armed conflict pose a risk of general economic disruption in affected countries, which may increase our operating costs. These conditions also may add uncertainty to the timing and budget for technology investment decisions by our customers.

**Acquisitions and joint ventures may have an adverse effect on our business.** We expect to continue making acquisitions or entering into joint ventures as part of our long-term business strategy. These transactions involve significant challenges and risks including that the transaction does not advance our business strategy, that we don't realize a satisfactory return on our investment, or that we experience difficulty in the integration of new employees, business systems, and technology, or diversion of management's attention from our other businesses. These events could harm our operating results or financial condition.

**Improper disclosure of personal data could result in liability and harm our reputation.** We store and process large amounts of personally identifiable information. It is possible that our security controls over personal data, our training of employees and vendors on data security, and other practices we follow may not prevent the improper disclosure of personally identifiable information. Improper disclosure of this information could harm our reputation, lead to legal exposure to customers, or subject us to liability under laws that protect personal data, resulting in increased costs or loss of revenue. Our software products and services also enable our customers to store and process personal data. Perceptions that our products or services do not adequately protect the privacy of personal information could inhibit sales of our products or services.

**We may experience outages, data loss and disruptions of our online services if we fail to maintain an adequate operations infrastructure.** Our increasing user traffic and complexity of our products and services demand more computing power. We have spent and expect to continue to spend substantial amounts to purchase or lease data centers and equipment and to upgrade our technology and network infrastructure to handle increased traffic on our Web sites and to introduce new products and services and support existing services such as Exchange Online, Sharepoint Online, Xbox LIVE, Windows Live, and Office Live. We also are growing our business of providing a platform and back-end hosting for services provided by third-party businesses to their end customers. Maintaining and expanding this infrastructure is expensive and complex. Inefficiencies or operational failures, including temporary or permanent loss of customer data, could diminish the quality of our products, services, and user experience resulting in contractual liability, claims by customers and other third parties, damage to our reputation and loss of current and potential users, subscribers, and advertisers, each of which may harm our operating results and financial condition.



**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Items 2(a) and (b) are not applicable.

**(c) STOCK REPURCHASES**

| Period                               | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares (or Approximate Dollar Value of Shares) that May Yet be Purchased under the Plans or Programs |
|--------------------------------------|--------------------------------------|----------------------------------|--|--|
|                                      |                                      |                                  |  | (in millions)  |
| October 1, 2009 – October 31, 2009   | 28,643,300                           | \$ 25.62                         | 28,643,300   | \$ 32,335  |
| November 1, 2009 – November 30, 2009 | 41,038,704                           | \$ 29.37                         | 41,038,704   | \$ 31,129  |
| December 1, 2009 – December 31, 2009 | 54,942,038                           | \$ 29.92                         | 54,942,038   | \$ 29,485  |
|                                      | 124,624,042                          |                                  | 124,624,042  |  |

During the second quarter of fiscal year 2010, we repurchased 124.6 million shares of Microsoft common stock for \$3.6 billion using cash resources. The repurchases occurred in the open market and pursuant to a trading plan under Rule 10b5-1 of the Securities Exchange Act of 1934. As of December 31, 2009, approximately \$29.5 billion remained of our \$40.0 billion repurchase program that we announced on September 22, 2008. The program expires September 30, 2013 but may be suspended or discontinued at any time without notice.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Annual Meeting of Shareholders was held on November 19, 2009.

The following proposals were adopted by the margins indicated:

- To elect a Board of Directors to hold office until the next annual meeting of shareholders and until their successors are elected and qualified.

|                      | Number of Shares |             |            |                 |
|----------------------|------------------|-------------|------------|-----------------|
|                      | For              | Against     | Abstain    | Broker non-vote |
| William H. Gates III | 7,552,484,807    | 94,511,488  | 9,260,956  | 147             |
| Steven A. Ballmer    | 7,566,955,125    | 77,856,616  | 11,445,506 | 150             |
| Dina Dublon          | 7,567,954,251    | 72,575,214  | 15,727,575 | 357             |
| Raymond V. Gilmartin | 7,533,959,553    | 105,550,574 | 16,746,221 | 1,049           |
| Reed Hastings        | 7,569,376,630    | 70,444,899  | 16,435,516 | 353             |
| Maria Klawe          | 7,571,087,643    | 69,093,173  | 16,076,234 | 348             |
| David F. Marquardt   | 7,557,831,460    | 82,232,928  | 16,192,660 | 349             |
| Charles H. Noski     | 7,564,445,736    | 75,178,398  | 16,632,907 | 357             |
| Helmut Panke         | 7,566,091,453    | 72,672,449  | 17,493,146 | 350             |

- To ratify selection of Deloitte & Touche LLP as Microsoft Corporation's independent auditor for fiscal year 2010.

|                 |               |
|-----------------|---------------|
| For             | 7,564,844,143 |
| Against         | 77,903,886    |
| Abstain         | 13,509,349    |
| Broker non-vote | 20            |

3. To approve amendments to Amended and Restated Articles of Incorporation.

|                 |               |
|-----------------|---------------|
| For             | 7,592,530,300 |
| Against         | 40,364,220    |
| Abstain         | 23,362,606    |
| Broker non-vote | 272           |

4. Advisory vote on Executive Compensation.

|                 |               |
|-----------------|---------------|
| For             | 7,526,160,375 |
| Against         | 80,999,808    |
| Abstain         | 49,095,442    |
| Broker non-vote | 1,772         |

The following proposals were not adopted by the margins indicated:

5. Shareholder proposal to adopt healthcare reform principles.

|                 |               |
|-----------------|---------------|
| For             | 192,678,109   |
| Against         | 5,227,471,937 |
| Abstain         | 917,923,497   |
| Broker non-vote | 1,318,183,855 |

6. Shareholder proposal to disclose charitable contributions.

|                 |               |
|-----------------|---------------|
| For             | 247,760,136   |
| Against         | 5,336,657,314 |
| Abstain         | 753,651,391   |
| Broker non-vote | 1,318,188,557 |

**ITEM 6. EXHIBITS**

|           |   |
|-----------|---|
| 3.1       | Amended and Restated Articles of Incorporation of Microsoft Corporation                             |
| 3.2       | Bylaws of Microsoft Corporation   |
| 10.20     | Resignation Agreement between Christopher Liddell and Microsoft Corporation dated December 1, 2009  |
| 12        | Computation of Ratio of Earnings to Fixed Charges   |
| 15        | Letter regarding unaudited interim financial information  |
| 31.1      | Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2      | Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1*     | Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 32.2*     | Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 101.INS** | XBRL Instance Document  |
| 101.SCH** | XBRL Taxonomy Extension Schema  |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase  |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase   |
| 101.LAB** | XBRL Taxonomy Extension Label Linkbase  |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase   |

\* *Furnished, not filed.*

\*\* *Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.*

**Items 3 and 5 are not applicable and have been omitted.**

**SIGNATURE**

Pursuant to the requirements 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.

MICROSOFT CORPORATION

/S/ FRANK H. BROD

Frank H. Brod  
Corporate Vice President, Finance and Administration;  
Chief Accounting Officer (Duly Authorized Officer)

January 28, 2010

**AMENDED AND RESTATED ARTICLES OF INCORPORATION  
OF MICROSOFT CORPORATION**

Pursuant to RCW 23B.10.070, the following Amended and Restated Articles of Incorporation are hereby submitted for filing:

**ARTICLE I  
NAME**

The name of the corporation is Microsoft Corporation.

**ARTICLE II  
REGISTERED OFFICE AND AGENT**

The address of the registered office of the "Corporation" is 925 Fourth Avenue, Suite 2900, Seattle, Washington 98104, and the name of the registered agent at such address is PTSGE Corp.

**ARTICLE III  
PURPOSE**

The Corporation is organized for the purposes of transacting any and all lawful business for which a corporation may be incorporated under the Washington Business Corporation Act, Title 23B of the Revised Code of Washington, now or hereafter in force (the "Act").

**ARTICLE IV  
CAPITAL SHARES**

**4.1 Authorized Shares** The total number of shares of stock that the Corporation shall have authority to issue is 24,100,000,000 shares, which shall consist of 24,000,000,000 shares of common stock, \$0.00000625 par value per share ("Common Shares") and 100,000,000 shares of preferred stock, \$.01 par value per share ("Preferred Shares"). Except as otherwise provided in accordance with these Articles of Incorporation, the Common Shares shall have unlimited voting rights, with each share being entitled to one vote, and the rights to receive the net assets of the Corporation upon dissolution, with each share participating on a pro rata basis.

**4.2 Issuance of Preferred Shares** The Board of Directors is hereby authorized from time to time, without shareholder action, to provide for the issuance of Preferred Shares in one or more series not exceeding in the aggregate the number of Preferred Shares authorized by these Articles of Incorporation, as amended from time to time; and to determine with respect to each such series the voting powers, if any (which voting powers, if granted, may be full or limited), designations, preferences, and relative, participating, option, or other special rights, and the qualifications, limitations, or restrictions relating thereto, including without limiting the generality of the foregoing, the voting rights relating to Preferred Shares of any series (which may be one or more votes per share or a fraction of a vote per share, which may vary over time, and which may be applicable generally or only upon the

happening and continuance of stated events or conditions), the rate of dividend to which holders of Preferred Shares of any series may be entitled (which may be cumulative or noncumulative), the rights of holders of Preferred Shares of any series in the event of liquidation, dissolution, or winding up of the affairs of the Corporation, the rights, if any, of holders of Preferred Shares of any series to convert or exchange such Preferred Shares of such series for shares of any other class or series of capital stock or for any other securities, property, or assets of the Corporation or any subsidiary (including the determination of the price or prices or the rate or rates applicable to such rights to convert or exchange and the adjustment thereof, the time or times during which the right to convert or exchange shall be applicable, and the time or times during which a particular price or rate shall be applicable), whether or not the shares of that series shall be redeemable, and if so, the terms and conditions of such redemption, including the date or dates upon or after which they shall be redeemable, and the amount per share payable in case of redemption, which amount may vary under different conditions and at different redemption dates, and whether any shares of that series shall be redeemed pursuant to a retirement or sinking fund or otherwise and the terms and conditions of such obligation.

**4.3 Filings and Effectiveness** Before the Corporation shall issue any Preferred Shares of any series, Articles of Amendment or Restated Articles of Incorporation, fixing the voting powers, designations, preferences, the relative, participating, option, or other rights, if any, and the qualifications, limitations, and restrictions, if any, relating to the Preferred Shares of such series, and the number of Preferred Shares of such series authorized by the Board of Directors to be issued shall be filed with the secretary of state in accordance with the Washington Business Corporation Act ("WBCA") and shall become effective without any shareholder action. The Board of Directors is further authorized to increase or decrease (but not below the number of such shares of such series then outstanding) the number of shares of any series subsequent to the issuance of shares of that series.

#### **ARTICLE V NO PREEMPTIVE RIGHTS**

Shareholders of the Corporation have no preemptive rights to acquire additional shares of stock or securities convertible into shares of stock issued by the Corporation.

#### **ARTICLE VI DIRECTORS**

**6.1 Number.** The number of directors of the Corporation shall be fixed in the manner specified by the bylaws of the Corporation.

**6.2 Vacancies.** Vacancies and newly created directorships resulting from any increase in the authorized number of directors shall be filled only by a majority of the directors then in office, although less than a quorum, or by a sole remaining director, unless for any reason there are no directors in office in which case they shall be filled by a special election by shareholders.

**ARTICLE VII  
ELECTION OF DIRECTORS**

Shareholders of the Corporation shall not have the right to cumulate votes in the election of directors.

**ARTICLE VIII  
SPECIAL SHAREHOLDER MEETINGS**

Special meetings of the shareholders of the Corporation for any purpose or purposes may be called at any time by

- (a) the Board of Directors,
- (b) a committee of the Board of Directors that has been duly designated by the Board of Directors and whose powers and authority, as provided in a resolution of the Board of Directors or in the bylaws of the Corporation, include the power to call such meetings, or by
- (c) shareholders holding twenty five percent (25%) of the then outstanding shares of the Corporation entitled to vote, provided the request is in proper form as prescribed in the bylaws of the Corporation or as otherwise required by applicable law.

Such special meetings may not be called by any other person or persons.

**ARTICLE IX  
AMENDMENT OF BYLAWS**

In furtherance and not in limitation of the powers conferred by statute, the Board of Directors is expressly authorized to make, adopt, repeal, alter, amend, and rescind the bylaws of the Corporation by a resolution adopted by a majority of the directors.

**ARTICLE X  
LIMITATION OF DIRECTOR LIABILITY**

A director of the Corporation shall not be personally liable to the Corporation or its shareholders for monetary damages for conduct as a director, except for:

- (a) Acts or omissions involving intentional misconduct by the director or a knowing violation of law by the director;
- (b) Conduct violating Section 23B.08.310 of the Act (which involves distributions by the Corporation); or
- (c) Any transaction from which the director will personally receive a benefit in money, property, or services to which the director is not legally entitled.

If the Washington Business Corporation Act is amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent not prohibited by the WBCA, as so amended. The provisions of this Article shall be deemed to be a contract with each Director of the Corporation who serves as such at any time while such provisions are in effect, and each such Directors shall be deemed to be serving as such in reliance on the provisions of this Article. Any repeal or modification of the foregoing paragraph by the shareholders of the Corporation shall not adversely affect any right or protection of a director of the Corporation with respect to any acts or omissions of such director occurring prior to such repeal or modification.

**ARTICLE XI  
MERGERS, SHARE EXCHANGES, AND OTHER TRANSACTIONS**

A merger, share exchange, sale of substantially all of the Corporation's assets, or dissolution must be approved by the affirmative vote of a majority of the Corporation's outstanding shares entitled to vote, or if separate voting by voting groups is required then by not less than a majority of all the votes entitled to be cast by that voting group.

**ARTICLE XII  
INDEMNIFICATION**

**12.1 Definitions.** As used in this Article:

- (a) "Agent" means an individual who is or was an agent of the Corporation or an individual who, while an agent of the Corporation, is or was serving at the Corporation's request as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan, or other enterprise. "Agent" includes, unless the context requires otherwise, the spouse, heirs, estate and personal representative of an agent.
- (b) "Corporation" means the Corporation, and any domestic or foreign predecessor entity which, in a merger or other transaction, ceased to exist.
- (c) "Director" means an individual who is or was a director of the Corporation or an individual who, while a director of the Corporation, is or was serving at the Corporation's request as a director officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other enterprise. "Director" includes, unless the context requires otherwise, the spouse, heirs, estate and personal representative of a director.
- (d) "Employee" means an individual who is or was an employee of the Corporation or an individual, while an employee of the Corporation, is or was serving at the Corporation's request as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan, or other enterprise. "Employee" includes, unless the context requires otherwise, the spouse, heirs, estate and personal representative of an employee.



- (e) "Expenses" include counsel fees.
- (f) "Indemnitee" means an individual made a party to a proceeding because the individual is or was a Director, Officer, Employee, or Agent of the Corporation, and who possesses indemnification rights pursuant to these Articles or other corporate action. "Indemnitee" includes, unless the context requires otherwise, the spouse, heirs, estate, and personal representative of such individuals.
- (g) "Liability" means the obligation to pay a judgment, settlement penalty, fine, including an excise tax with respect to an employee benefit plan, or reasonable Expenses incurred with respect to a proceeding.
- (h) "Officer" means an individual who is or was an officer of the Corporation (regardless of whether or not such individual was also a Director) or an individual who, while an officer of the Corporation, is or was serving at the Corporation's request as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan, or other enterprise. "Officer" includes, unless the context requires otherwise, the spouse, heirs, estate and personal representative of an officer.
- (i) "Party" includes an individual who was, is, or is threatened to be named a defendant, respondent or witness in a proceeding.
- (j) "Proceeding" means any threatened, pending, or completed action, suit, or proceeding, whether civil, derivative, criminal, administrative, or investigative, and whether formal or informal.

**12.2 Indemnification Rights of Directors and Officers.** The Corporation shall indemnify its Directors and Officers to the full extent not prohibited by applicable law now or hereafter in force against liability arising out of a Proceeding to which such individual was made a Party because the individual is or was a Director or an Officer. However, such indemnity shall not apply on account of:

- (a) Acts or omissions of a Director or Officer finally adjudged to be intentional misconduct or a knowing violation of law;
- (b) Conduct of a Director or Officer finally adjudged to be in violation of Section 23B.08.310 of the Act relating to distributions by the Corporation; or
- (c) Any transaction with respect to which it was finally adjudged that a Director or Officer personally received a benefit in money, property, or services to which the Director or Officer was not legally entitled.

Subject to the foregoing, it is specifically intended that Proceedings covered by indemnification shall include Proceedings brought by the Corporation (including derivative actions); Proceedings by government entities and governmental officials or other third party actions.

**12.3 Indemnification of Employees and Agents of the Corporation.** The Corporation may, by action of its Board of Directors from time to time, provide indemnification and pay Expenses in advance of the final disposition of a Proceeding to Employees and Agents of the Corporation who are not also Directors, in each case to the same extent as to a Director with respect to the indemnification and advancement of Expenses pursuant to rights granted under these Articles, or provided by the Act, or otherwise.

**12.4 Partial Indemnification.** If an Indemnitee is entitled to indemnification by the Corporation for some or a portion of Expenses, liabilities, or losses actually and reasonably incurred by Indemnitee in an investigation, defense, appeal or settlement but not, however, for the total amount thereof, the Corporation shall nevertheless indemnify Indemnitee for the portion of such Expenses, liabilities or losses to which Indemnitee is entitled.

**12.5 Procedure for Seeking Indemnification and/or Advancement of Expenses.** The following procedures shall apply in the absence of (or at the option of the Indemnitee, in lieu thereof), specific procedures otherwise applicable to an Indemnitee pursuant to a contract, trust agreement, or general or specific action of the Board of Directors:

**12.5.1 Notification and Defense of Claim.** Indemnitee shall promptly notify the Corporation in writing of any proceeding for which indemnification could be sought under this Article. In addition, Indemnitee shall give the Corporation such information and cooperation as it may reasonably require and as shall be within Indemnitee's power.

With respect to any such proceeding as to which Indemnitee has notified the Corporation:

- (a) The Corporation will be entitled to participate therein at its own expense; and
- (b) Except as otherwise provided below, to the extent that it may wish, the Corporation, jointly with any other indemnifying party similarly notified, will be entitled to assume the defense thereof, with counsel satisfactory to Indemnitee. Indemnitee's consent to such counsel may not be unreasonably withheld.

After notice from the Corporation to Indemnitee of its election to assume the defense, the Corporation will not be liable to Indemnitee under this Article for any legal or other Expenses subsequently incurred by Indemnitee in connection with such defense. However, Indemnitee shall continue to have the right to employ its counsel in such proceeding, at Indemnitee's expense; and if:

- (i) The employment of counsel by Indemnitee has been authorized by the Corporation;
- (ii) Indemnitee shall have reasonably concluded that there may be a conflict of interest between the Corporation and Indemnitee in the conduct of such defense; or
- (iii) The Corporation shall not in fact have employed counsel to assume the defense of such proceeding, the fees and Expenses of Indemnitee's counsel shall be at the expense of the Corporation.

The Corporation shall not be entitled to assume the defense of any proceeding brought by or on behalf of the Corporation or as to which Indemnitee shall reasonably have made the conclusion that a conflict of interest may exist between the Corporation and the Indemnitee in the conduct of the defense.

**12.5.2 Information to be Submitted and Method of Determination and Authorization of Indemnification.** For the purpose of pursuing rights to indemnification under this Article, the Indemnitee shall submit to the Board a sworn statement requesting indemnification and reasonable evidence of all amounts for which such indemnification is requested (together, the sworn statement and the evidence constitute an "Indemnification Statement").

Submission of an Indemnification Statement to the Board shall create a presumption that the Indemnitee is entitled to indemnification hereunder, and the Corporation shall, within sixty (60) calendar days thereafter, make the payments requested in the Indemnification Statement to or for the benefit of the Indemnitee, unless: (1) within such sixty (60) calendar day period it shall be determined by the Corporation that the Indemnitee is not entitled to indemnification under this Article; (2) such determination shall be based upon clear and convincing evidence (sufficient to rebut the foregoing presumption); and (3) the Indemnitee shall receive notice in writing of such determination, which notice shall disclose with particularity the evidence upon which the determination is based.

The foregoing determination may be made: (1) by the Board of Directors by majority vote of a quorum of Directors who are not at the time parties to the proceedings; (2) if a quorum cannot be obtained, by majority vote of a committee duly designated by the Board of Directors (in which designation Directors who are parties may participate) consisting solely of two (2) or more Directors not at the time parties to the proceeding; (3) by special legal counsel; or (4) by the shareholders as provided by Section 23B.08.550 of the Act.

Any determination that the Indemnitee is not entitled to indemnification, and any failure to make the payments requested in the Indemnification Statement, shall be subject to judicial review by any court of competent jurisdiction.

**12.5.3 Special Procedure Regarding Advance for Expenses.** An Indemnitee seeking payment of Expenses in advance of a final disposition of the proceeding must furnish the Corporation, as part of the Indemnification Statement:

- (a) A written affirmation of the Indemnitee's good faith belief that the Indemnitee has met the standard of conduct required to be eligible for indemnification; and
- (b) A written undertaking, constituting an unlimited general obligation of the Indemnitee, to repay the advance if it is ultimately determined that the Indemnitee did not meet the required standard of conduct.

Upon satisfaction of the foregoing the Indemnitee shall have a contractual right to the payment of such Expenses.

**12.5.4 Settlement.** The Corporation is not liable to indemnify Indemnitee for any amounts paid in settlement of any proceeding without the Corporation's written consent. The Corporation shall not settle any proceeding in any manner which would impose any penalty or limitation on Indemnitee without Indemnitee's written consent. Neither the Corporation nor Indemnitee may unreasonably withhold its consent to a proposed settlement.

## **12.6. Contract and related rights**

**12.6.1 Contract Rights.** The right of an Indemnitee to indemnification and advancement of Expenses is a contract right upon which the Indemnitee shall be presumed to have relied in determining to serve or to continue to serve in his or her capacity with the Corporation. Such right shall continue as long as the Indemnitee shall be subject to any possible proceeding. Any amendment to or repeal of this Article shall not adversely affect any right or protection of an Indemnitee with respect to any acts or omissions of such Indemnitee occurring prior to such amendment or repeal.

**12.6.2 Optional Insurance, Contracts, and Funding.** The Corporation may:

- (a) Maintain insurance, at its expense, to protect itself and any Indemnitee against any liability, whether or not the Corporation would have power to indemnify the individual against the same liability under Section 23B.08.5 10 or .520 of the Act;
- (b) Enter into contracts with any Indemnitee in furtherance of this Article and consistent with the Act; and
- (c) Create a trust fund, grant a security interest, or use other means (including without limitation a letter of credit) to ensure the payment of such amounts as may be necessary to effect indemnification as provided in this Article.

**12.6.3 Severability.** If any provision or application of this Article shall be invalid or unenforceable, the remainder of this Article and its remaining applications shall not be affected thereby, and shall continue in full force and effect.

**12.6.4 Right of Indemnitee to Bring Suit.** If (1) a claim under this Article for indemnification is not paid in full by the Corporation within sixty (60) days after a written claim has been received by the Corporation; or (2) a claim under this Article for advancement of Expenses is not paid in full by the Corporation within twenty (20) days after a written claim has been received by the Corporation, then the Indemnitee may, but need not, at any time thereafter bring suit against the Corporation to recover the unpaid amount of the claim. To the extent successful in whole or in part, the Indemnitee shall be entitled to also be paid the expense (to be proportionately prorated if the Indemnitee is only partially successful) of prosecuting such claim. Neither (1) the failure of the Corporation (including its Board of Directors, its shareholders, or independent legal counsel) to have made a determination prior to the commencement of such proceeding that indemnification or reimbursement or advancement of Expenses to the Indemnitee is proper in the circumstances; nor (2) an actual determination by the Corporation (including its Board of Directors, its shareholders, or independent legal counsel that the Indemnitee is not entitled to indemnification or to the reimbursement or advancement of Expenses, shall be a defense to the proceeding or create a presumption that the Indemnitee is not so entitled.

**12.6.5 Nonexclusivity of Rights.** The right to indemnification and the payment of Expenses incurred in defending a Proceeding in advance of its final disposition granted in this Article shall not be exclusive of any other right which any Indemnitee may have or hereafter acquire under any statute, provision of this Article or the Bylaws, agreement, vote of shareholders or disinterested directors, or otherwise. The

Corporation shall have the express right to grant additional indemnity without seeking further approval or satisfaction by the shareholders. All applicable indemnity provisions and any applicable law shall be interpreted and applied so as to provide an Indemnitee with the broadest but nonduplicative indemnity to which he or she is entitled.

**12.7 Contribution.** If the indemnification provided in Section 12.2 of this Article is not available to be paid to Indemnitee for any reason other than those set forth in subparagraphs 12.2(a), 12.2(b), and 12.2(c) of Section 12.2 of this Article (for example, because indemnification is held to be against public policy even though otherwise permitted under Section 12.2) then in respect of any proceeding in which the Corporation is jointly liable with Indemnitee (or would be if joined in such proceeding), the Corporation shall contribute to the amount of loss paid or payable by Indemnitee in such proportion as is appropriate to reflect:

The relative benefits received by the Corporation on the one hand and the Indemnitee on the other hand from the transaction from which such proceeding arose, and

The relative fault of the Corporation on the one hand and the Indemnitee on the other hand in connection with the events which resulted in such loss, as well as any other relevant equitable consideration.

The relative benefits received by and fault of the Corporation on the one hand and the Indemnitee on the other shall be determined by a court of appropriate jurisdiction (which may be the same court in which the proceeding took place) with reference to, among other things, the parties' relative intent, knowledge, access to information, and opportunity to correct or prevent the circumstances resulting in such loss. The Corporation agrees that it would not be just and equitable if a contribution pursuant to this Article was determined by pro rata allocation or any other method of allocation which does not take account of the foregoing equitable considerations.

**12.8 Exceptions.** Any other provision herein to the contrary notwithstanding, the Corporation shall not be obligated pursuant to the terms of these Articles to indemnify or advance Expenses to Indemnitee with respect to any proceeding.

**12.8.1 Claims Initiated by Indemnitee.** Initiated or brought voluntarily by Indemnitee and not by way of defense, but such indemnification or advancement of Expenses may be provided by the Corporation in specific cases if the Board of Directors finds it to be appropriate. Notwithstanding the foregoing, the Corporation shall provide indemnification including the advancement of Expenses with respect to Proceedings brought to establish or enforce a right to indemnification under these Articles or any other statute or law or as otherwise required under the statute.

**12.8.2 Lack of Good Faith.** Instituted by Indemnitee to enforce or interpret this Article, if a court of competent jurisdiction determines that each of the material assertions made by Indemnitee in such proceeding was not made in good faith or was frivolous.

**12.8.3 Insured Claims.** For which any of the Expenses or liabilities for indemnification is being sought have been paid directly to Indemnitee by an insurance carrier under a policy of officers' and directors' liability insurance maintained by the Corporation.

**12.8.4 Prohibited by Law.** If the Corporation is prohibited by the Act or other applicable law as then in effect from paying such indemnification and/or advancement of Expenses. For example, the Corporation and Indemnitee acknowledge that the Securities and Exchange Commission ("SEC") has taken the position that indemnification is not possible for liabilities arising under certain federal securities laws. Indemnitee understands and acknowledges that the Corporation has undertaken or may be required in the future to undertake with the SEC to submit the question of indemnification to a court in certain circumstances for a determination of the Corporation's right to indemnify Indemnitee.

**12.9 Successors and Assigns.** All obligations of the Corporation to indemnify any Director or Officer shall be binding upon all successors and assigns of the Corporation (including any transferee of all or substantially all of its assets and any successor by merger or otherwise by operation of law). The Corporation shall not effect any sale of substantially all of its assets, merger, consolidation, or other reorganization, in which it is not the surviving entity, unless the surviving entity agrees in writing to assume all such obligations of the Corporation.

### **ARTICLE XIII CORPORATION'S ACQUISITION OF ITS OWN SHARES**

The Corporation may purchase, redeem, receive, take or otherwise acquire, own and hold, sell, lend, exchange, transfer or otherwise dispose of, pledge, use and otherwise deal with and in its own shares. As a specific modification of Section 23B.06.310 of the Act, pursuant to the authority in Section 23B.02.020(5)(c) of the Act, to include provisions related to the management of the business and the regulation of the affairs of the Corporation, shares of the Corporation's stock acquired by it pursuant to this Article shall be considered "Treasury Stock" and so held by the Corporation. The shares so acquired by the Corporation shall not be considered as authorized and unissued but rather as authorized, issued, and held by the Corporation. The shares, so acquired shall not be regarded as cancelled or as a reduction to the authorized capital of the Corporation unless specifically so designated by the Board of Directors in an amendment to these Articles of Incorporation. The provisions of this Article do not alter or effect the status of the Corporation's acquisition of its shares as a "distribution" by the Corporation as defined in Section 23B.01.400(6) of the Act, nor alter or effect the limitations on distributions by the Corporation as set forth in Section 23B.06.400 of the Act. Any shares so acquired by the Corporation, unless otherwise specifically designated by the Board of Directors, at the time of acquisition, shall be considered on subsequent disposition, as transferred rather than reissued. Nothing in this Article limits or restricts the right of the Corporation to resell or otherwise dispose of any of its shares previously acquired for such consideration and according to such procedures as established by the Board of Directors.

The undersigned, as assistant secretary of Microsoft Corporation, has signed these Amended and Restated Articles of Incorporation on November 24, 2009.

MICROSOFT CORPORATION

*/s/ John A. Seethoff*

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John A. Seethoff

Assistant Secretary

**BYLAWS  
OF  
MICROSOFT CORPORATION**

**ARTICLE I**

**Shareholders**

**1.1 Annual Meeting.** The annual meeting of the shareholders of the Corporation for the election of directors and for the transaction of such other business as properly may be submitted to such annual meeting, shall be held at the hour and on the date designated by the Board of Directors or an authorized committee of the Board of Directors, such date to be within 150 days of the end of the fiscal year.

**1.2 Special Meetings.** Special meetings of the shareholders of the Corporation, for any purpose or purposes, may be called at any time by the Board of Directors, an authorized committee of the Board of Directors, or one or more shareholders to the extent permitted by the Articles of Incorporation. To be in proper form, a request for a special meeting of shareholders submitted by one or more shareholders must:

- (a) be in writing and be delivered in person or by registered mail to the secretary of the Corporation;
- (b) specify in reasonable detail the purpose(s) of and the business proposed to be conducted at the special meeting;
- (c) suggest a date for the special meeting, which date shall be no fewer than thirty (30) and no more than ninety (90) days from the date on which the request is delivered to the secretary of the Corporation; and
- (d) contain the information required of a Noticing Shareholder by Section 1.13(b) of these Bylaws.

If the Board of Directors determines a shareholder request for a special meeting complies with the Articles of Incorporation and the provisions of these Bylaws, the Board shall call and send notice of a special meeting for the purpose set forth in such request within 30 days of receipt of the request. The Board of Directors shall determine the date for such special meeting and the record date for shareholders entitled to notice of and to vote at such meeting.

Given the expense and resource commitment of holding a special meeting, in making the decision to call a special meeting per shareholder request, the Board shall have discretion as to the call and purposes of a meeting, where demands are repetitious or overlapping, and may refuse to call a meeting for a purpose identical or similar to a purpose for which a previous special meeting was held in the previous 120 days. Similarly, the Board may decline to call a special meeting when, in the good faith judgment of the Board, the purpose of the proposed meeting does not present a time sensitive issue that must be addressed before the next scheduled annual meeting.



**1.3 Business at Annual and Special Meetings.** No business may be transacted at an annual or special meeting of shareholders other than business that is

- (a) specified in a notice of meeting given by or at the direction of the Board of Directors or an authorized committee thereof,
- (b) otherwise brought before the meeting by or at the direction of the Board of Directors or an authorized committee thereof,
- (c) specified in a notice of meeting stated in a shareholder special meeting request pursuant to Section 1.2 of these Bylaws, or
- (d) otherwise brought before an annual meeting:
  - (i) by (1) a shareholder that holds of record stock of the Corporation entitled to vote at the meeting on such business (including any election of a director) (a "Record Holder") or (2) a person (a "Nominee Holder") that holds such stock through a nominee or "street name" holder of record of such stock and can demonstrate to the Corporation such indirect ownership of such stock and such Nominee Holder's entitlement to vote such stock on such business, and
  - (ii) who complies with the notice procedures set forth in Section 1.13 (Record Holders and Nominee Holders are referred to as "Noticing Shareholders").

Clauses (c) and (d) of this Section 1.3 shall be the exclusive means for a Noticing Shareholder to make director nominations or submit other business before a meeting of shareholders (other than proposals brought under Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the "Exchange Act") and included in the Corporation's notice of meeting, which proposals are not governed by these Bylaws).

**1.4 Place of Meetings.** Meetings of shareholders shall be held at such place within or outside the State of Washington as determined by the Board of Directors, or an authorized committee of the Board, pursuant to proper notice.

**1.5 Notice.** Written or electronic notice of each shareholders' meeting stating the date, time, and place and, for a special meeting, the purpose(s) for which the meeting is called, shall be given by the Corporation not less than ten (10) (unless a greater period of notice is required by law in a particular case) nor more than sixty (60) days prior to the date of the meeting, to each shareholder of record, to the shareholder's address as it appears on the current record of shareholders of the Corporation.

**1.6 Quorum of Shareholders.** At any meeting of the shareholders, a majority in interest of all the shares entitled to vote on a matter, represented by shareholders of record in person or by proxy, shall constitute a quorum of that voting group for action on that matter.

Once a share is represented at a meeting, other than to object to holding the meeting or transacting business, it is deemed to be present for quorum purposes for the remainder of the meeting and for any adjournment to a new date, time, or place unless a new record date is or must be set for the adjourned meeting.

If a quorum exists, action on a matter is approved by a voting group if the votes cast within the voting group favoring the action exceed the votes cast within the voting group opposing the action, unless the question is one upon which by express provision of the Washington Business Corporation Act, as amended ("WBCA"), or of the Articles of Incorporation or of these Bylaws a different vote is required.

**1.7 Adjournment.** A majority of the shares represented at the meeting, even if less than a quorum, may adjourn the meeting from time to time. At a reconvened meeting at which a quorum is present any business may be transacted at the meeting as may have been brought at the adjourned meeting in accordance with Section 1.3. If a meeting is adjourned to a different date, time, or place, notice need not be given of the new date, time, or place if a new date, time, or place is announced at the meeting before adjournment; however, if the WBCA requires that a new record date for the adjourned meeting must be fixed, then notice of the adjourned meeting must be given to persons who are shareholders as of the new record date.

**1.8 Record Date and Transfer Books.** For the purpose of determining shareholders who are entitled to notice of or to vote at any meeting of shareholders or any adjournment thereof, or entitled to receive payment of any dividend, or in order to make a determination of shareholders for any other proper purpose, the Board of Directors may fix in advance a record date for any such determination of shareholders, which date shall not be more than seventy (70) days and, in case of a meeting of shareholders, not less than ten (10) days prior to the date on which the particular action, requiring such determination of shareholders, is to be taken.

If no record date is fixed for such purposes, the date on which notice of the meeting is given or the date on which the resolution of the Board of Directors declaring such dividend is adopted, as the case may be, shall be the record date for such determination of shareholders.

When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this section, such determination shall apply to any adjournment of the meeting, unless the Board of Directors fixes a new record date, which it must do if the meeting is adjourned more than one hundred twenty (120) days after the date is fixed for the original meeting.

**1.9 Voting Record.** The officer or agent having charge of the stock transfer books for shares of the Corporation shall make at least ten (10) days before each meeting of shareholders a complete record of the shareholders entitled to vote at the meeting or any adjournment thereof, arranged by any applicable voting groups and in alphabetical order, with the address of and the number of shares held by each shareholder. The record of shareholders shall be produced and kept open at the time and place of the meeting and shall be subject to the inspection of any shareholder or any shareholder's agent during the whole time of the meeting.

**1.10 Proxies.** Shareholders of record may vote at any meeting either in person or by proxy. A shareholder may appoint a proxy to vote for the shareholder by submitting (a) an appointment form signed by the shareholder or the shareholder's attorney-in-fact, or (b) an electronic transmission sent in accordance with the provisions for electronic notice under Section 3.3. An appointment of proxy is effective when an appointment form or an electronic transmission (or documentary evidence thereof, including verification information) is received by the person authorized to tabulate votes for the Corporation. The proxy has the same power to vote as that possessed by the shareholder, unless the appointment form or electronic transmission contains an express limitation on the power to vote or direction as to how to vote the shares on a particular matter, in which event the Corporation must tabulate the votes in a manner consistent with that limitation or direction. An appointment of proxy is valid for eleven (11) months unless a longer period is expressly provided in the appointment form or electronic transmission.

**1.11 Organization of Meeting.** The officer designated by the Chief Executive Officer (or in the absence of a designation by the Chief Executive Officer, any other officer designated by the Board of Directors) may call any meeting of shareholders to order and shall be the Chairman of the meeting. The Secretary of the Corporation, if present at any meeting of its shareholders, shall act as the Secretary of the meeting. If the Secretary is absent from any meeting of shareholders, the Chairman of the meeting may appoint a Secretary for the meeting.

**1.12 Order of Business.** The Chairman of a meeting of shareholders, determined in accordance with Section 1.11, shall have discretion to establish the order of business for the meeting subject to any specific order established by the Board of Directors.

**1.13 Notice of Shareholder Business to be Conducted at an Annual Meeting of Shareholders.** In order for a Noticing Shareholder to properly bring any item of business before an annual meeting of shareholders, the Noticing Shareholder must give timely notice thereof in writing to the Secretary of the Corporation in compliance with the requirements of this Section 1.13. This Section 1.13 shall constitute an "advance notice provision" for annual meetings for purposes of Rule 14a-4(c)(1) under the Exchange Act.

- (a) To be timely, a Noticing Shareholder's notice shall be delivered to the Secretary at the principal executive offices of the Corporation: not earlier than the close of business on the 120th day and not later than the close of business on the 90th day prior to the first anniversary of the preceding year's annual meeting; provided, however, that in the event the date of the annual meeting is more than 30 days before or more than 60 days after such anniversary date, notice by the shareholder to be timely must be so delivered not earlier than the close of business on the 120th day prior to the date of such annual meeting and not later than the close of business on the later of the 90th day prior to the date of such annual meeting or, if the first public announcement of the date of such annual meeting is less than 100 days prior to the date of such annual meeting, the 10th day following the day on which public announcement of the date of such meeting is first made by the Corporation. In no event shall any adjournment or postponement of an annual meeting, or the announcement thereof, commence a new time period for the giving of a shareholder's notice as described above.
- (b) To be in proper form, whether in regard to a nominee for election to the Board of Directors or other business, a Noticing Shareholder's notice to the Secretary must:
  - (i) Set forth, as to the Noticing Shareholder and, if the Noticing Shareholder holds for the benefit of another, the beneficial owner on whose behalf the nomination or proposal is made, the following information together with a representation as to the accuracy of the information:
    - (A) the name and address of the Noticing Shareholder as they appear on the Corporation's books and, if the Noticing Shareholder holds for the benefit of another, the name and address of such beneficial owner (collectively "Holder"),
    - (B) the class or series and number of shares of the Corporation that are, directly or indirectly, owned beneficially and/or of record,
    - (C) any option, warrant, convertible security, stock appreciation right, or similar right with an exercise or conversion privilege or a settlement payment or mechanism at a price related to any class or series of shares of the Corporation or with a value derived in whole or in part from the value of any class or series of shares of the Corporation, whether or not the instrument or right shall be subject to settlement in the underlying class or series of capital stock of the Corporation or otherwise (a "Derivative Instrument") that is directly or indirectly owned beneficially by the Holder and any other direct or indirect opportunity to profit or share in any profit derived from any increase or decrease in the value of shares of the Corporation,

- (D) any proxy, contract, arrangement, understanding, or relationship pursuant to which the Holder has a right to vote or has granted a right to vote any shares of any security of the Corporation,
- (E) any short interest in any security of the Corporation (for purposes of these Bylaws a person shall be deemed to have a short interest in a security if the Holder directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has the opportunity to profit or share in any profit derived from any decrease in the value of the subject security),
- (F) any rights to dividends on the shares of the Corporation owned beneficially by the Holder that are separated or separable from the underlying shares of the Corporation,
- (G) any proportionate interest in shares of the Corporation or Derivative Instruments held, directly or indirectly, by a general or limited partnership or limited liability company or similar entity in which the Holder is a general partner or, directly or indirectly, beneficially owns an interest in a general partner, is the manager, managing member or directly or indirectly beneficially owns an interest in the manager or managing member of a limited liability company or similar entity,
- (H) any performance-related fees (other than an asset-based fee) that the Holder is entitled to based on any increase or decrease in the value of shares of the Corporation or Derivative Instruments, if any,
- (I) any arrangements, rights, or other interests described in Sections 1.13(b)(i)(C)-(H) held by members of such Holder's immediate family sharing the same household,
- (J) any other information relating to the Holder that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for, as applicable, the proposal and/or for the election of directors in a contested election pursuant to Section 14 of the Exchange Act and the rules and regulations thereunder, and
- (K) any other information as reasonably requested by the Corporation.

Such information shall be provided as of the date of the notice and shall be supplemented by the Holder not later than 10 days after the record date for the meeting to disclose such ownership as of the record date.

- (ii) If the notice relates to any business other than a nomination of a director or directors that the shareholder proposes to bring before the meeting, the notice must set forth:
  - (A) a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting, and any material interest of the Holder, in such business, and
  - (B) a description of all agreements, arrangements and understandings, direct and indirect, between the Holder, and any other person or persons (including their names) in connection with the proposal of such business by the Holder.

- (iii) Set forth, as to each person, if any, whom the Holder proposes to nominate for election or reelection to the Board of Directors:
  - (A) all information relating to the Holder that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors in a contested election pursuant to Section 14 of the Exchange Act and the rules and regulations thereunder (including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected), and
  - (B) a description of all direct and indirect compensation and other material monetary agreements, arrangements, and understandings during the past three years, and any other material relationships, between or among the Holder and respective affiliates and associates, or others acting in concert therewith, on the one hand, and each proposed nominee, and his or her respective affiliates and associates, or others acting in concert therewith, on the other hand, including, without limitation all information that would be required to be disclosed pursuant to Item 404 of Regulation S-K if the Holder making the nomination or on whose behalf the nomination is made, if any, or any affiliate or associate thereof or person acting in concert therewith, were the "registrant" for purposes of Item 404 and the nominee were a director or executive officer of such registrant.
- (iv) A representation that the Noticing Shareholder intends to vote or cause to be voted such stock at the meeting and intends to appear in person or by a representative at the meeting to nominate the person or propose the business specified in the notice.
- (v) With respect to each nominee for election or reelection to the Board of Directors, the Noticing Shareholder shall include a completed and signed questionnaire, representation, and agreement required by Section 1.14. The Corporation may require any proposed nominee to furnish such other information as may reasonably be required by the Corporation to determine the eligibility of the proposed nominee to serve as an independent director of the Corporation or that could be material to a reasonable shareholder's understanding of the independence, or lack thereof, of the nominee.
- (c) Notwithstanding anything in Section 1.13(a) to the contrary, if the number of directors to be elected to the Board of Directors is increased and there is no public announcement by the Corporation naming all of the nominees for director or specifying the size of the increased Board of Directors at least 100 days prior to the first anniversary of the preceding year's annual meeting, a shareholder's notice required by these Bylaws shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the close of business on the 10th day following the day on which the public announcement naming all nominees or specifying the size of the increased Board of Directors is first made by the Corporation.
- (d) For purposes of these Bylaws, "public announcement" shall mean disclosure in a press release reported by a national news service or in a document publicly filed by the Corporation with the Securities and Exchange Commission pursuant to Section 13, 14, or 15(d) of the Exchange Act and the rules and regulations thereunder.

- (e) Only those persons who are nominated in accordance with the procedures set forth in these Bylaws shall be eligible to serve as directors. Only such business shall be conducted at a meeting of shareholders as shall have been brought before the meeting in accordance with the procedures set forth in these Bylaws. Except as otherwise provided by law, the Articles of Incorporation, or these Bylaws, the Chairman of the meeting shall have the power and duty to determine whether a nomination or any business proposed to be brought before the meeting was made or proposed, as the case may be, in compliance with the procedures set forth in these Bylaws and, if any proposed nomination or business is not in compliance with these Bylaws, to declare that such proposal or nomination shall be disregarded.
- (f) Notwithstanding the foregoing provisions of these Bylaws, a Noticing Shareholder also shall comply with all applicable requirements of the Exchange Act and the rules and regulations thereunder with respect to the matters set forth in these Bylaws; provided, however, that any references in these Bylaws to the Exchange Act or the rules thereunder are not intended to and shall not limit the requirements applicable to nominations or proposals as to any other business to be considered pursuant to Section 1.3 or Section 1.13.
- (g) Nothing in these Bylaws shall be deemed to affect any rights of shareholders to request inclusion of proposals in the Corporation's proxy statement pursuant to Rule 14a-8 under the Exchange Act. Notice of shareholder proposals that are, or that the Noticing Shareholder intends to be, governed by Rule 14a-8 under the Exchange Act are not governed by these Bylaws.

**1.14 Submission of Questionnaire, Representation and Agreement.** To be eligible to be a nominee for election or reelection as a director of the Corporation by a Holder, a person must complete and deliver (in accordance with the time periods prescribed for delivery of notice under Section 1.13) to the Secretary at the principal executive offices of the Corporation a written questionnaire providing the information requested about the background and qualifications of such person and the background of any other person or entity on whose behalf the nomination is being made and a written representation and agreement (the questionnaire, representation, and agreement to be in the form provided by the Secretary upon written request) that such person:

- (a) is not and will not become a party to:
  - (i) any agreement, arrangement or understanding with, and has not given any commitment or assurance to, any person or entity as to how the person, if elected as a director of the Corporation, will act or vote on any issue or question (a "Voting Commitment") that has not been disclosed to the Corporation, or
  - (ii) any Voting Commitment that could limit or interfere with the person's ability to comply, if elected as a director of the Corporation, with the person's fiduciary duties under applicable law,
- (b) is not and will not become a party to any agreement, arrangement or understanding with any person or entity other than the Corporation with respect to any direct or indirect compensation, reimbursement, or indemnification in connection with service or action as a director that has not been disclosed therein, and
- (c) in the person's individual capacity and on behalf of any person or entity on whose behalf the nomination is being made, would be in compliance, if elected as a director of the Corporation, and will comply with all applicable publicly disclosed corporate governance, conflict of interest, confidentiality, and stock ownership and trading policies and guidelines of the Corporation.

**1.15 Bylaw Amendments.** The shareholders may amend or repeal these Bylaws, or adopt new bylaws, even though the Bylaws also may be amended or repealed, or new bylaws also may be adopted, by the Board of Directors, by action taken in the manner provided by the WBCA and the Articles of Incorporation.

## ARTICLE II

### Board of Directors

**2.1 Number and Qualifications.** The business affairs and property of the Corporation shall be managed by a Board of not less than three directors nor more than eleven directors. The number of directors may at any time be increased or decreased by resolution of the Board of Directors or by the shareholders at the annual meeting. Directors need not be shareholders of the Corporation or residents of the State of Washington.

**2.2 Election - Term of Office.** At each annual shareholders' meeting the shareholders shall elect the directors to hold office until the next annual meeting of the shareholders and until their respective successors are elected and qualified. If, for any reason, the directors shall not have been elected at any annual meeting, they may be elected at a special meeting of shareholders called for that purpose in the manner provided by these Bylaws.

Except as provided in Section 2.10 and in this paragraph, each director shall be elected by the vote of the majority of the votes cast. A majority of votes cast means that the number of shares cast "for" a director's election exceeds the number of votes cast "against" that director. The following shall not be votes cast: (a) a share whose ballot is marked as withheld; (b) a share otherwise present at the meeting but for which there is an abstention; and (c) a share otherwise present at the meeting as to which a shareholder gives no authority or direction. In a contested election, the directors shall be elected by the vote of a plurality of the votes cast.

A contested election is one in which (a) on the last day for delivery of a notice under Section 1.13(a), a Noticing Shareholder has complied with the requirements of Section 1.13 with respect to one or more nominees; and (b) prior to the date that notice of the meeting is given, the board of directors has not made a determination that none of the candidacies of the Noticing Shareholder's nominees creates a bona fide election contest. For purposes of these Bylaws, it is assumed that on the last day for delivery of a notice under Section 1.13(a), there is a candidate nominated by the board of directors for each of the director positions to be voted on at the meeting. The following procedures apply in a non-contested election. A nominee who does not receive a majority vote shall not be elected. Except as otherwise provided in this paragraph, an incumbent director who is not elected because he or she does not receive a majority vote shall continue to serve as a holdover director until the earliest of (a) 90 days after the date on which an inspector determines the voting results as to that director pursuant to RCW 23B.07.290; (b) the date on which the Board of Directors appoints an individual to fill the office held by such director, which appointment shall constitute the filling of a vacancy by the Board of Directors pursuant to Section 2.10; or (c) the date of the director's resignation. Any vacancy resulting from the non-election of a director under this Section 2.2 may be filled by the Board of Directors as provided in Section 2.10. The Governance and Nominating Committee will consider promptly whether to fill the office of a nominee failing to receive a majority vote and make a recommendation to the Board of Directors about filling the office. The Board of Directors will act on the Governance and Nominating Committee's recommendation and within ninety (90) days after the certification of the shareholder vote will disclose publicly its decision. Except as provided in the next sentence, no director who failed to

receive a majority vote for election will participate in the Governance and Nominating Committee recommendation or Board of Directors decision about filling his or her office. If no director receives a majority vote in an uncontested election, then the incumbent directors (a) will nominate a slate of directors and hold a special meeting for the purpose of electing those nominees as soon as practicable, and (b) may in the interim fill one or more offices with the same director(s) who will continue in office until their successors are elected.

**2.3 Regular Meetings.** Regular meetings of the Board of Directors shall be held at such places, and at such times as the Board may determine, and, if so determined, no notice thereof need be given. A regular meeting of the Board of Directors may be held without notice immediately after the annual meeting of shareholders at the same place at which such meeting was held.

**2.4 Special Meetings.** Special meetings of the Board of Directors may be held at any time or place upon the call of a majority of directors, the Chief Executive Officer or the Chief Operating Officer.

**2.5 Notice.** No notice is required for regular meetings of the Board of Directors. Notice of special meetings of the Board of Directors, stating the date, time, and place thereof, shall be given in a manner described in Section 3.3 at least two (2) days prior to the date of the meeting. The purpose of the meeting need not be given in the notice.

**2.6 Waiver of Notice.** A director may waive notice of a special meeting of the Board of Directors either before or after the meeting, and the waiver shall be deemed to be the equivalent of giving notice. The waiver must be given in accordance with the requirements for written or electronic notice in Section 3.3. Attendance or participation of a director at a meeting shall constitute waiver of notice of that meeting unless the director attends or participates for the express purpose of objecting to the transaction of business because the meeting has not been lawfully called or convened.

**2.7 Quorum of Directors.** A majority of the members of the Board of Directors shall constitute a quorum for the transaction of business, but if at any meeting of the Board there shall be less than a quorum present, a majority of those present may adjourn the meeting from time to time until a quorum shall have been obtained. When a quorum is present at any meeting, a majority of the members present shall decide any question brought before such meeting, except as otherwise provided by the Articles of Incorporation or by these Bylaws.

**2.8 Adjournment.** A majority of the directors present, even if less than a quorum, may adjourn a meeting and continue it to a later time. Notice of the adjourned meeting or of the business to be transacted thereat, other than by announcement, shall not be necessary. At any adjourned meeting at which a quorum is present, any business may be transacted which could have been transacted at the meeting as originally called.

**2.9 Resignation.** Any director of the Corporation may resign at any time by giving written notice to the Board of Directors, the Chairman, the Chief Executive Officer, or the Secretary of the Corporation. Any director resignation is effective when the notice is delivered, unless the notice specifies a later effective date.

**2.10 Vacancies.** Unless otherwise provided by the WBCA, in case of any vacancy in the Board of Directors, including a vacancy resulting from an increase in the number of directors or non-election of a director pursuant to Section 2.2, the remaining directors, whether constituting a quorum or not, may fill the vacancy.

**2.11 Compensation.** The Board of Directors shall have the sole authority to fix the amount of compensation of directors.



**2.12 Committees.** The Board of Directors, by resolution adopted by a majority of the full Board, may designate from among its members one or more committees, each of which:

- (a) Shall have two (2) or more members;
- (b) Shall be governed by the same rules regarding meetings, action without meetings, notice, and waiver of notice, and quorum and voting requirements as are applied to the Board; and
- (c) To the extent provided in the resolution, shall have and may exercise all the authority of the Board, except no such committee shall have the authority to:
  - (i) Authorize or approve a distribution except according to a general formula or method prescribed by the Board;
  - (ii) Approve or propose to shareholders action which the WBCA requires to be approved by shareholders;
  - (iii) Fill vacancies on the Board or on any of its committees;
  - (iv) Amend the Articles of Incorporation;
  - (v) Adopt, amend, or repeal these Bylaws;
  - (vi) Approve a plan of merger not requiring shareholder approval; or
  - (vii) Authorize or approve the issuance or sale or contract for sale of shares, or determine the designation and relative rights, preferences, and limitations on a class or series of shares, except that the Board may authorize a committee, or a senior executive officer of the Corporation, to do so within limits specifically prescribed by the Board.

### **ARTICLE III**

#### **Special Measures Applying to Meetings of Shareholders, the Board of Directors and Committees of the Board**

**3.1 Action by Unanimous Consent.** Any action required or permitted to be taken at a meeting of the Board of Directors or a committee of the Board may be accomplished without a meeting if the action is taken by all the members of the Board or all the members of the committee, as the case may be. The action must be evidenced by one or more consents describing the action to be taken, given by all directors or all members of the committee, as the case may be, to the Corporation for inclusion in the minutes in a manner equivalent to written or electronic notice under Section 3.3. Directors' consents may be given either before or after the action taken.

Action taken by unanimous consent is effective when the last director consents to the action, unless the consent specifies a later effective date.

**3.2 Use of Communications Equipment.** Meetings of the shareholders, the Board of Directors, and committees of the Board may be effectuated by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other during the meeting. Participation by such means shall constitute presence in person at the meeting.

**3.3 Oral, Written and Electronic Notice.** Terms used in this Bylaw shall be as defined in the WBCA.

Oral notice may be communicated in person or by telephone, wire, or wireless equipment that does not transmit a facsimile of the notice. Oral notice is effective when communicated if communicated in a comprehensible manner.

Written notice may be transmitted by mail, private carrier, or personal delivery; or telephone, wire, or wireless equipment that transmits a facsimile of the notice and provides the transmitter with an electronically generated receipt. Written notice is effective at the earliest of the following: (a) when received; (b) five (5) days after its deposit in the U.S. mail if mailed with first-class postage to the address as it appears on the current records of the Corporation; (c) on the date shown on the return receipt, if sent by registered or certified mail, return receipt requested, and the receipt is signed by or on behalf of the addressee. Written notice to a shareholder is effective (a) when mailed, if mailed with first class postage prepaid; and (b) when dispatched, if prepaid, by air courier.

Notices to directors and shareholders from the Corporation and from directors and shareholders to the Corporation may be provided in an electronic transmission which contains or is accompanied by information from which it can be reasonably verified that the transmission was authorized by the director, the shareholder, or by the shareholder's attorney-in-fact. Subject to contrary provisions in the WBCA, notice to shareholders or directors in an electronic transmission shall be effective only with respect to shareholders and directors that have consented, in the form of a record, to receive electronically transmitted notices and that have designated in the consent the address, location, or system to which these notices may be electronically transmitted and with respect to a notice that otherwise complies with any other requirements of the WBCA and any applicable federal law. A shareholder or director who has consented to receipt of electronically transmitted notices may revoke this consent by delivering a revocation to the Corporation in the form of a record. The consent of any shareholder or director is revoked if (a) the Corporation is unable to electronically transmit two consecutive notices given by the Corporation in accordance with the consent, and (b) this inability becomes known to the Secretary, the transfer agent, or any other person responsible for giving the notice. The inadvertent failure by the Corporation to treat this inability as a revocation does not invalidate any meeting or other action.

**ARTICLE IV**

**Officers**

**4.1 Positions.** The officers of the Corporation may consist of a Chairman, a Chief Executive Officer, one or more Presidents, one or more Vice Presidents (who may be designated as Corporate Vice Presidents, Senior Vice Presidents, Executive Vice Presidents or Group Vice Presidents), a Secretary, and a Treasurer as appointed by the Board of Directors or the Chief Executive Officer. The Corporation may have such additional or assistant officers (sometimes referred to as "additional officers") as the Board of Directors, Chief Executive Officer, or Chief Operating Officer may deem necessary for its business and may appoint from time to time. The Board of Directors shall also have the authority, but shall not be required, to designate officers as the Chief Operating Officer, the Chief Financial Officer or similar such titles. Any two or more offices may be held by the same person.

If a director/officer has not been designated as Chairman, or if the designated Chairman is not present at a meeting, the Board of Directors shall elect a Chairman from amongst its members to serve as Chairman of the Board of Directors for such meeting. The Chairman shall preside at all meetings of the Board of Directors, and shall have such other powers as the Board may determine.

**4.2 Appointment and Term of Office.** The officers of the Corporation shall be appointed annually by the Board of Directors at the first meeting of the Board held after each annual meeting of the shareholders. If officers are not appointed at such meeting, such appointment shall occur as soon as possible thereafter, or may be left vacant. Each officer shall hold office until a successor shall have been appointed and qualified or until said officer's earlier death, resignation, or removal.

**4.3 Authority and Duties of the Chief Executive Officer.** The Chief Executive Officer shall have general charge and supervision of the business of the Corporation, shall see that all orders, actions and resolutions of the Board of Directors are carried out, and shall have such other authority and shall perform such other duties as set forth in these Bylaws or, to the extent consistent with the Bylaws, such other authorities and duties as prescribed by the Board.

**4.4 Authority and Duties of Other Officers.** Each officer other than the Chief Executive Officer shall have the authority and shall perform the duties set forth in these Bylaws or, to the extent consistent with the Bylaws, the duties prescribed by the Board of Directors, by the Chief Executive Officer, or by an officer authorized by the Board to prescribe the duties of such officer. Any designation of duties by the Chief Executive Officer or other officer shall be subject to review by the Board of Directors but shall be in full force and effect in the absence of such review.

**4.5 Compensation and Contract Rights.** The Board of Directors shall have authority (a) to fix the compensation, whether in the form of salary, bonus, stock options or otherwise, of all officers and employees of the Corporation, either specifically or by formula applicable to particular classes of officers or employees, and (b) to authorize officers of the Corporation to fix the compensation of subordinate employees. The Board of Directors shall have authority to appoint a Compensation Committee and may delegate to that committee any or all of its authority relating to compensation. The appointment of an officer shall not of itself create contract rights.

**4.6 Resignation or Removal.** Any officer of the Corporation may resign at any time by giving notice to the Board of Directors or the Corporation. Any such resignation is effective when the notice is given, unless the notice specifies a later date, and shall be without prejudice to the contract rights, if any, of the officer.

The Board of Directors, by majority vote of the entire Board, may remove any officer or agent, with or without cause. An officer or assistant officer, if appointed by another officer, also may be removed by any officer authorized to appoint officers or assistant officers. The removal shall be without prejudice to the contract rights, if any, of the person so removed.

**4.7 Vacancies.** If any office becomes vacant by any reason, the directors may (a) appoint a successor or successors who shall hold office for the unexpired term (b) or leave such office vacant.

## ARTICLE V

### Certificates of Shares and Their Transfer

**5.1 Issuance; Certificates of Shares.** No shares of the Corporation shall be issued unless authorized by the Board of Directors. Such authorization shall include the maximum number of shares to be issued, the consideration to be received, and a statement that the Board of Directors considers the consideration to be adequate. Shares may but need not be represented by certificates. Certificates for shares of the Corporation shall be in such form as is consistent with the provisions of the WBCA or the law of a predecessor corporation and after the effective date of these Bylaws shall state:

- (a) The name of the Corporation and that the Corporation is organized under the laws of the State of Washington;
- (b) The name of the person to whom issued; and

- (c) The number and class of shares and the designation of the series, if any, which such certificate represents.

The certificate shall be signed by original or facsimile signature of two officers of the Corporation, and the seal of the Corporation may be affixed thereto.

**5.2 Rules and Regulations Concerning the Issue, Transfer and Registration of Shares.** The Board of Directors shall have power and authority to make all such rules and regulations as the Board may deem proper or expedient concerning the issue, transfer and registration of shares of stock. In case of the loss, mutilation, or destruction of a certificate of stock, a duplicate certificate may be issued upon such terms as the Board of Directors shall authorize. The Board of Directors shall have power and authority to appoint from time to time one or more transfer agents and registrar of the shares of stock.

**5.3 Shares without Certificates.** The Board of Directors may authorize the issue of some or all of the shares without certificates. Within a reasonable time after the issue or transfer of shares without certificates, the Corporation shall send the shareholder a written statement of the information required on certificates by the WBCA.

## ARTICLE VI

### Books and Records

**6.1 Books of Accounts, Minutes, and Share Register.** Except as otherwise provided by law the Corporation:

- (a) Shall keep as permanent records minutes of all meetings of its shareholders and Board of Directors, a record of all actions taken by the Board without a meeting, and a record of all actions taken by a committee of the Board exercising the authority of the Board on behalf of the Corporation;
- (b) Shall maintain appropriate accounting records;
- (c) Or its agent shall maintain a record of its shareholders, in a form that permits preparation of a list of the names and addresses of all shareholders, in alphabetical order by class of shares showing the number and class of shares held by each; and
- (d) Shall keep a copy of the following records at its principal office:
  - (i) The Articles or Restated Articles of Incorporation and all amendments to them currently in effect;
  - (ii) The Bylaws or Restated Bylaws and all amendments to them currently in effect;
  - (iii) The minutes of all shareholders' meetings, and records of all actions taken by shareholders without a meeting, for the past three (3) years;
  - (iv) Its financial statements for the past three (3) years, including balance sheets showing in reasonable detail the financial condition of the Corporation as of the close of each fiscal year, and an income statement showing the results of its operations during each fiscal year prepared on the basis of generally accepted accounting principles or, if not, prepared on a basis explained therein;

- (v) All communications to shareholders generally within the past three (3) years;
- (vi) A list of the names and business addresses of its current directors and officers; and
- (vii) Its most recent annual report delivered to the Secretary of State of Washington.

**6.2 Copies of Resolutions.** Any person dealing with the Corporation may rely upon a copy of any of the records of the proceedings, resolutions, or votes of the Board of Directors or shareholders, when certified by the Secretary, an assistant secretary, or other officer authorized by the Board.

As amended effective November 24, 2009.

**RESIGNATION AGREEMENT AND FULL AND FINAL RELEASE OF CLAIMS**

Presentation Date: November 23, 2009; Return to Lisa Brummel on December 20, 2009

1. I, Christopher P. Liddell, have resigned from the position of Chief Financial Officer of Microsoft Corporation ("Microsoft") effective November 24, 2009. I have resigned from employment effective December 31, 2009 ("Resignation Date") and will remain employed through December 31. Between November 24 and December 31, I wish to receive the consideration described in paragraph 2 below, to which I would not be otherwise entitled, and in exchange for that consideration I have chosen to sign this Resignation Agreement and Full and Final Release of Claims ("Agreement"). I acknowledge that my execution of this Agreement is knowing and voluntary. I have had a reasonable period of time in which to consider whether to sign this Agreement.

2. Upon my timely execution of this Agreement and in exchange for my full compliance with this Agreement and honoring the commitments undertaken herein, Microsoft agrees to: (a) pay me the lump sum of \$950,000, less taxes and withholding, and any other deductions taken pursuant to paragraph 11 below, on December 31, 2009; and (b) pay me the lump sum of \$950,000, less taxes and withholding, on March 31, 2010. The payments described in sub-paragraphs (a) and (b) are subject to forfeiture for my violation or breach of any part of this Agreement. I agree to provide Michele A. Gammer, Associate General Counsel, Microsoft Corporation, One Microsoft Way, Redmond, WA 98052, with my current home address and telephone number through December 31, 2010.

3. I understand my rights and obligations under applicable law, and I agree, on behalf of myself and my marital community, heirs, executors, successors and assigns, to release (i.e., give up) all known and unknown claims that I currently have against Microsoft and any of its current and former parents, subsidiaries, affiliates, related companies, joint ventures, their predecessors and successors, and with respect to each such entity, all of its past, present and future officers, directors, agents and/or employees (collectively referred to as the "Released Parties"), except claims that the law does not permit me to waive by signing this Agreement. I understand and agree that this release includes, but is not limited to, any and all claims or causes of action arising under: (1) any federal, state, local or foreign law relating to employment discrimination (including the Age Discrimination in Employment Act, 29 U.S.C. § 621 et seq., if applicable); (2) any federal, state, local or foreign law relating to employment or termination rights and/or benefits (including the Employee Retirement Income Security Act of 1974); and (3) any other basis for legal or equitable relief whether based on express or implied contract, tort, statute or other legal or equitable ground. I further acknowledge that termination of my employment is permanent and the Released Parties have no obligation to notify me of employment opportunities or to offer me employment in any capacity after the Resignation Date. I understand that I am not waiving any claims arising from events occurring after the date I sign this Agreement. For purposes of the preceding sentence, and by way of example and not limitation, my separation from Microsoft is not an event occurring after the date I sign this Agreement, in as much as I have tendered my resignation and agreed to the separation in advance of signing this Agreement.

Microsoft and its current and former parents, subsidiaries, affiliates, related companies, joint ventures, and successors release me, my marital community, heirs, executors, and assigns from all known and unknown claims that they might currently have against us relating to my employment with and separation from Microsoft.

4. I agree that this Agreement is not an admission of guilt or wrongdoing by the Released Parties and I acknowledge that the Released parties do not believe or admit that they have done anything wrong. I represent that I have not filed or caused to be filed any lawsuit, complaint, or charge against Microsoft or any of the Released Parties with respect to any claim this Agreement purports to waive with any governmental agency or in any court, and that I will not file, cause to file, initiate, or pursue (except as otherwise provided in this Agreement or required by law) in such complaints, charges, or lawsuits at any time hereafter other than to enforce my rights under this Agreement.

5. I agree to keep the details surrounding and the terms of this Agreement in strict confidence except to: (a) my immediate family and financial and legal advisors on a need-to-know basis or (b) to the extent the company discloses the terms of the Agreement in any filing with the Securities & Exchange Commission pursuant to the applicable securities laws and regulations. I also agree that I will not communicate with the media or press, directly or indirectly, except with the approval of Lisa Brummel, and that I will not blog or otherwise author in any manner any online or printed publications or writings (including but not limited to any blog, posting, article, or book) or participate in any interviews, broadcasts, podcasts, or similar audio interviews about Microsoft or its officers relating to any information or data considered confidential or proprietary under Microsoft's Confidential Information Policy or the Employee Agreement that I previously signed on April 21, 2005. The signature page of that Employee Agreement is attached as Exhibit A, along with the remainder of the form of agreement (pages 1 and 2) as Exhibit B.

I further agree that the confidentiality and non-disparagement obligations set forth in this Agreement are material terms of the Agreement, that Microsoft would not have entered into this Agreement without my agreement to them, and that breach of these obligations could cause Microsoft irreparable injury. If Microsoft establishes a breach of these obligations, I agree that Microsoft shall be entitled to recover from me, at Microsoft's option, either the sum of \$285,000 as liquidated damages, or actual damages, but not both types of damages, as well as reasonable attorney's fees and costs incurred to enforce the Agreement.

6. I agree not to make any disparaging remarks about Microsoft, its officers or directors, or the Released Parties, including but not limited to statements relating to my employment with or separation from Microsoft. If asked about my departure from Microsoft, I will respond only that "I have resigned to pursue other opportunities."

I also agree, at Microsoft's reasonable request, to cooperate with Microsoft, its subsidiaries and affiliates, and any of their officers, directors, agents, employees, attorneys and advisors in Microsoft's investigation of, preparation for, and prosecution or defense of any matter(s) brought by or against Microsoft or any Released Party, including without limitation litigation concerning: (a) facts or circumstances about which I have any actual or alleged knowledge or expertise that was obtained during my employment with Microsoft or (b) any of my acts or omissions, real or alleged, of my employment with Microsoft. I further agree not to engage in any conduct creating a conflict of interest between myself and Microsoft in any such matter. I agree that, upon reasonable notice, I will appear and provide full and truthful testimony in proceedings associated with the above referenced matters, provided that Microsoft shall reimburse me for all reasonable travel expenses associated with the giving of testimony and shall work with me as reasonably practicable to schedule the activities contemplated by this paragraph so as not to unreasonably interfere with my other commitments.

Nothing in this Agreement, the Microsoft Confidential Information Policy, or the Employee Agreement shall be construed to prohibit me from testifying pursuant to a valid subpoena, court order, or as otherwise required by a governmental agency. I agree that before doing so, I will first provide Microsoft with notice in accordance with paragraph 7 of this Agreement.

7. I agree not to provide assistance to any current, former, or future Microsoft employee to initiate, pursue, or raise any complaints, concerns, claims, or litigation of any kind against the Released Parties, unless compelled to do so by a valid subpoena or court order. If compelled to testify or otherwise provide evidence in any proceeding, I will provide Microsoft with immediate notice of receipt of an order or other demand for my participation by giving notice to Michele A. Gammer, Associate General Counsel, Microsoft Corporation, One Microsoft Way, Redmond, WA 98052, in sufficient time for Microsoft to oppose such testimony or participation. To the extent prohibited by law, this paragraph does not prevent me from participating in government investigations.

8. I understand and agree that, as a condition of receiving the consideration described in paragraph (2), I will not be entitled to any future employment with Microsoft or its subsidiaries. I further agree that I will not apply for or otherwise seek future employment with Microsoft or its subsidiaries.

9. As required by my Microsoft Corporation Employee Agreement, I agree to return to Microsoft by the Resignation Date my Microsoft cardkey(s), corporate American Express card and phone card, if any, and any other Microsoft property in my possession or control, including but not limited to hardware, software, email files, source code, financial data, status reports, and any other proprietary or confidential data, documents and materials in any form or media. I acknowledge and agree that nothing in this Agreement is intended to, nor shall it, relieve me of any obligation I have under the Microsoft Corporation Employee Agreement, which is attached as Exhibit A, that I previously signed and such agreement remains fully binding and enforceable according to its terms.

10. I acknowledge that this Agreement contains the entire agreement of Microsoft and me as to matters discussed in it except as set forth in paragraph 9 and that it merges any and all prior written and oral communications concerning those matters. Other than what is expressly stated in this Agreement, no different or additional promises or representations of any kind have been made to induce me to sign this Agreement, which I sign freely and in the absence of any coercion or duress whatsoever. I understand that the terms of this Agreement may not be modified, amended or superseded except by a subsequent written agreement signed by myself and the undersigned Microsoft representative.

11. I authorize Microsoft to withhold from any monies owed to me by Microsoft at the time of my termination, via payroll deductions any and all monies due to Microsoft from me, including without limitation cash and travel advances, amounts due the Company Store, employee benefit plan deductions, other advances and any unpaid credit or phone card charges. I understand that any such payroll deductions are for my convenience and for my full benefit.

12. I agree that the laws of the State of Washington will govern in any action brought by either myself or Microsoft to interpret or enforce the terms of this Agreement, without regard to principles of conflicts of laws that would call for the application of the substantive law of any jurisdiction other than the State of Washington. I further agree that any dispute arising in connection with the interpretation of this Agreement or otherwise arising from or relating to this Agreement, shall be resolved in the following manner unless otherwise agreed to by the parties: (a) The parties agree to first attempt to resolve all



disputes through informal negotiations. The parties contending there is a breach or other issue arising from or related to this Agreement shall provide written notice to the other party describing with specificity the nature of the breach or other issue. Within five (5) days after delivery of the written notice, the other party shall respond in writing stating its position. (b) If the parties are unable to resolve the dispute through informal negotiations, the parties agree to resolve all disputes by binding arbitration before a qualified mutually selected arbitrator. If the parties are unable to mutually agree upon an arbitrator, they shall request a panel of seven (7) arbitrators located in the State of Washington from the American Arbitration Association and alternately strike from that panel until only one is left. The party initiating the arbitration shall bear the burden of proof of breach and actual damages; provided, however, that no actual damages need to be proven for the arbitrator to award the liquidated damages provided for in this Agreement. The prevailing party shall be entitled to reasonable attorney's fees and cost and the non-prevailing party shall bear the arbitration costs, including the fees of the arbitrator. The arbitrator shall issue a written decision within fifteen (15) days of the end of the hearing. The decision of the arbitrator shall be final and binding and may be enforced and a judgment entered in any court of competent jurisdiction. The arbitration itself, and all testimony, documents, briefs, and arguments therein, shall be kept confidential. (c) Notwithstanding the foregoing agreements in (a) and (b), the parties agree that breach of the confidentiality and non-disparagement provisions set forth in Paragraphs 5 and 6 could cause irreparable injury to Microsoft and that it will have the right to seek immediate injunctive relief or other equitable relief enjoining any threatened or actual breach in a court in King County or the Western District of Washington.

13. The provisions of this Agreement are severable, and if any part of this Agreement is found to be unenforceable (with the exception of the Release contained in paragraph 3), the remainder of this Agreement will remain fully valid and enforceable. To the extent any terms of this Agreement are called into question, all provisions shall be interpreted in a manner that would make them consistent with current law. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which taken together shall constitute one and the same instrument.

14. In compliance with the terms of the Age Discrimination in Employment Act and the Older Workers Benefit Protection Act, I expressly acknowledge that I have been given twenty-one (21) days to review this Agreement before signing it. By executing and delivering this Agreement prior to the expiration of the twenty-one days, I agree that I have waived my rights to the full review period and acknowledge I have had adequate time to review this Agreement. I also understand that I have the right to revoke this Agreement for a period of seven (7) days following my signature of it I understand that any such revocation must be in writing and must be received within the seven-day period by Michele A. Gammer. Should I revoke, I will not be entitled to receive the payments described in Paragraph 2. I understand that I am advised to seek legal counsel prior to signing this Agreement.

**I ACKNOWLEDGE THAT I HAVE CAREFULLY READ AND HAVE VOLUNTARILY SIGNED THIS AGREEMENT AND RELEASE, THAT I FULLY UNDERSTAND ITS FINAL AND BINDING EFFECT, THAT BY SIGNING I INTENDED TO FULLY AND FINALLY RELEASE ANY AND ALL CLAIMS I MAY HAVE AGAINST MICROSOFT AND THE OTHER RELEASED PARTIES DESCRIBED IN PARAGRAPH THREE (3) ABOVE, AND THAT, PRIOR TO SIGNING THIS AGREEMENT AND RELEASE, I HAVE BEEN ADVISED OF MY RIGHT TO CONSULT, AND HAVE BEEN GIVEN ADEQUATE TIME TO REVIEW MY LEGAL RIGHTS WITH AN ATTORNEY OF MY CHOICE.**

EMPLOYEE:

/s/ Christopher P. Liddell

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12/1/09

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Christopher P. Liddell

Date

MICROSOFT CORPORATION:

By /s/ Lisa Brummel

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12/1/09

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Lisa Brummel  
Sr. Vice President, HR

Date

## COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES

| (In millions, except ratios)                            | Six Months<br>Ended<br>December 31, |                  |                  |                  | Fiscal Year Ended June 30, |                  |
|---|-------------------------------------|------------------|------------------|------------------|----------------------------|------------------|
|   | 2009                                | 2009             | 2008             | 2007             | 2006                       | 2005             |
| <b>Earnings <sup>(1)</sup> :</b>                        |                                     |                  |                  |                  |                            |                  |
| Earnings from continuing operations before income taxes | \$ 13,648                           | \$ 19,821        | \$ 23,814        | \$ 20,101        | \$ 18,262                  | \$ 16,628        |
| Add: Fixed charges                                      | 104                                 | 88               | 151              | 271              | 331                        | 247              |
| Add: Cash distributions from equity method investments  | 8                                   | 85               | 10               | —                | 51                         | 11               |
| Subtract: Income from equity method investments         | 11                                  | 81               | 62               | 62               | (161)                      | 19               |
| <b>Total Earnings</b>                                   | <b>\$ 13,749</b>                    | <b>\$ 19,913</b> | <b>\$ 23,913</b> | <b>\$ 20,310</b> | <b>\$ 18,805</b>           | <b>\$ 16,867</b> |
| <b>Fixed Charges <sup>(2)</sup> :</b>                   |                                     |                  |                  |                  |                            |                  |
| Interest expense  | \$ 74                               | \$ 38            | \$ 106           | \$ 230           | \$ 295                     | \$ 209           |
| Capitalized debt related expenses                       | 2                                   | —                | —                | —                | —                          | —                |
| Interest component of rent expense                      | 28                                  | 50               | 45               | 41               | 36                         | 38               |
| <b>Total Fixed Charges</b>                              | <b>\$ 104</b>                       | <b>\$ 88</b>     | <b>\$ 151</b>    | <b>\$ 271</b>    | <b>\$ 331</b>              | <b>\$ 247</b>    |
| <b>Ratio of Earnings to Fixed Charges</b>               | <b>132</b>                          | <b>226</b>       | <b>158</b>       | <b>75</b>        | <b>57</b>                  | <b>68</b>        |

(1) Earnings represent earnings from continuing operations before income taxes and before income (losses) from equity method investments plus: (a) fixed charges; and (b) cash distributions from equity method investments.

(2) Fixed charges include: (a) interest expense; (b) capitalized debt issuance costs; and (c) the portion of operating rental expense which management believes is representative of the interest component of rent expense.

Microsoft Corporation One Microsoft Way Redmond, Washington

We have reviewed, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the unaudited interim financial information of Microsoft Corporation and subsidiaries for the periods ended December 31, 2009, and 2008, as indicated in our report dated January 28, 2010; because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, which is included in your Quarterly Report on Form 10-Q for the quarter ended December 31, 2009, is incorporated by reference in Registration Statement Nos. 333-120511, 333-109185, 333-06298, 333-16665, 333-118764, 333-91755, 333-52852, 333-102240, 33-36498, 33-45617, 333-132100, and 333-161516 of Microsoft Corporation on Forms S-8 and Registration Statement Nos. 333-43449, 333-110107, 333-108843, and 333-155495 of Microsoft Corporation Forms S-3.

We also are aware that the aforementioned report, pursuant to Rule 436(c) under the Securities Act of 1933, is not considered a part of the Registration Statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of that Act.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington

January 28, 2010

**CERTIFICATIONS**

I, Steven A. Ballmer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Microsoft Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ STEVEN A. BALLMER

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Steven A. Ballmer  
Chief Executive Officer

January 28, 2010

**CERTIFICATIONS**

I, Peter S. Klein, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Microsoft Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ PETER S. KLEIN

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Peter S. Klein  
Chief Financial Officer

January 28, 2010

**CERTIFICATIONS PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of Microsoft Corporation, a Washington corporation (the "Company"), on Form 10-Q for the quarter ended December 31, 2009, as filed with the Securities and Exchange Commission (the "Report"), Steven A. Ballmer, Chief Executive Officer of the Company, does hereby certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that to his knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ STEVEN A. BALLMER

Steven A. Ballmer  
Chief Executive Officer

January 28, 2010

[A signed original of this written statement required by Section 906 has been provided to Microsoft Corporation and will be retained by Microsoft Corporation and furnished to the Securities and Exchange Commission or its staff upon request.]

**CERTIFICATIONS PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of Microsoft Corporation, a Washington corporation (the "Company"), on Form 10-Q for the quarter ended December 31, 2009, as filed with the Securities and Exchange Commission (the "Report"), Peter S. Klein, Chief Financial Officer of the Company, does hereby certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that to his knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ PETER S. KLEIN

Peter S. Klein  
Chief Financial Officer

January 28, 2010

[A signed original of this written statement required by Section 906 has been provided to Microsoft Corporation and will be retained by Microsoft Corporation and furnished to the Securities and Exchange Commission or its staff upon request.]