United States Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE FISCAL YEAR ENDED JUNE 30, 2002

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM ______ TO ______

COMMISSION FILE NUMBER 0-14278

MICROSOFT CORPORATION

WASHINGTON **(STATE OF INCORPORATION)**	**91-1144442** **(I.R.S. ID)**

ONE MICROSOFT WAY, REDMOND, WASHINGTON 98052-6399

(425) 882-8080

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

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

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

The aggregate market value of common stock held by non-affiliates of the registrant as of July 31, 2002 was $215,553,343,213.

The number of shares outstanding of the registrant's common stock as of July 31, 2002 was 5,378,746,853.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held November 5, 2002 are incorporated by reference into Part III.

Microsoft Corporation

FORM 10-K

For The Fiscal Year Ended June 30, 2002

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PART I

ITEM 1. BUSINESS

GENERAL

Microsoft Corporation (the “Company” or “Microsoft”) was founded as a partnership in 1975 and incorporated in 1981. Microsoft’s mission is to enable people and businesses throughout the world to realize their full potential, and the Company’s vision is empowering people through great software—any time, any place, and on any device. Microsoft develops, manufactures, licenses, and supports a wide range of software products for a multitude of computing devices. Microsoft software products include scalable operating systems for servers, personal computers (PCs), and intelligent devices; server applications for client/server environments; information worker productivity applications; business solutions applications; and software development tools. During fiscal 2002, Microsoft launched Xbox, the Company’s next-generation video game system. The Company’s online efforts include the MSN network of Internet products and services and alliances with companies involved with broadband access and various forms of digital interactivity. Microsoft licenses consumer software programs; sells hardware devices; provides consulting services; and trains and certifies system integrators and developers.

Microsoft also researches and develops advanced technologies for future software products. A significant portion of the Company’s focus is on Microsoft’s .NET architecture. Using common industry standards based on XML, a universal language for describing and exchanging data, the Company’s goal is to enable seamless sharing of information across many platforms and programming languages, and over the Internet, with XML Web services. In addition, Microsoft has embarked on a long-term initiative called Trustworthy Computing, which aims to bring an enhanced level of security, privacy, reliability, and business integrity to computer systems.

PRODUCTS

During fiscal 2002, Microsoft had four operating segments based on its product and service offerings: Desktop and Enterprise Software and Services; Consumer Software, Services, and Devices; Consumer Commerce Investments; and Other. See Note 20 of the Notes to Financial Statements for financial information regarding segment reporting.

DESKTOP AND ENTERPRISE SOFTWARE AND SERVICES

Desktop and Enterprise Software and Services includes Desktop Applications; Desktop Platforms; and Enterprise Software and Services. For segment reporting purposes, Desktop Applications includes revenue from Microsoft Office; Microsoft Project; Visio; client access licenses (CALs) for Windows NT Server and Windows 2000 Server, Exchange, and BackOffice; Microsoft Great Plains; and bCentral. Desktop Platforms includes revenue from Windows XP Professional and Home; Windows 2000 Professional; Windows NT Workstation; Windows Millennium Edition; Windows 98; and other desktop operating systems. Enterprise Software and Services includes Server Platforms; Server Applications; Developer Tools and Services; and Enterprise Services.

DESKTOP APPLICATIONS

Microsoft Office. Microsoft Office is a software product featuring commonly used desktop functionality. The product is based upon a document-centric concept, with common commands and extensive use of cross-application capabilities. Microsoft Office is available in several versions for the Windows and Macintosh operating systems. Microsoft Office XP, the latest Microsoft Office release, helps users complete common business tasks, including word processing, electronic mail (e-mail), presentations, and data management, with features like smart tags, task panes, integrated e-mail, document recovery, and send for review. The various versions of Microsoft Office include the word processor Microsoft Word, Microsoft Excel spreadsheet, Microsoft Outlook personal information management and e-mail communication client, Microsoft PowerPoint presentation graphics program, and may include Microsoft Access database management application, Microsoft FrontPage Web site creation and management tool, and Microsoft Publisher business desktop publishing program. Most of these applications are also licensed separately.

Other Desktop Application Products. The Company also offers other stand-alone desktop application products. Microsoft Project is a project management program for scheduling, organizing, and analyzing tasks, deadlines, and resources. Visio is a diagramming program that helps people visualize and communicate ideas, information, and systems.

Client Access Licenses. A client access license gives its holder the legal right to access a computer running a Microsoft server product and the services supported by the server using a client computer.

Microsoft Great Plains. Microsoft Great Plains offers a range of integrated business and accounting products, including Dynamics, Solomon, and eEnterprise. Dynamics provides Internet-ready accounting and business management capabilities for small- to mid-sized companies. Solomon offers a full range of e-business and accounting applications for small- to mid-sized companies. eEnterprise supports mid-sized to larger companies by providing a collaborative environment for information management and sharing.

bCentral. Microsoft's small businesses portal, bCentral, includes Site Manager, a Web site management and hosting service which empowers small businesses to easily create and manage their own Web sites, while allowing for higher-end editing in Microsoft FrontPage, and LinkExchange, which provides services to small businesses and Web site owners to increase their online traffic and sales with free advertising banner ads on their site in exchange for placing ads on other network sites.

DESKTOP PLATFORMS

Windows XP. Microsoft launched Windows XP in October 2001. Windows XP extends the personal computing experience by uniting PCs, devices, and services, while enhancing reliability, security, and performance. Windows XP Home Edition is designed for individuals or families and includes experiences for digital photo, music, video, home networking, and communications. Windows XP Professional includes all the features of Home Edition, plus remote access, security, performance, manageability, and multilingual features to help users improve productivity and connectivity.

Windows 2000 Professional. The successor to Windows NT Workstation, Windows 2000 Professional operating system combines features to create a mainstream operating system for desktop and notebook computing in all organizations. Windows 2000 Professional contains the enhanced business features of Windows 98 such as Plug and Play, easy-to-use user interface, and power management and integrates the strengths of Windows NT Workstation including standards-based security, manageability, and reliability.

Windows NT Workstation. A fully integrated, multitasking 32-bit PC operating system, Windows NT Workstation provides improved security features, robustness, and portability. Windows NT Workstation combines the Windows 98 operating system interface and usability features with the reliability and security of Windows NT for the business environment.

Windows Millennium Edition. Windows Millennium Edition (Me) operating system is designed specifically for home users, including capabilities to manage digital photos and music, work with video, create a home network, and communicate with other consumers.

Windows 98. The successor to Windows 95, Windows 98 is a personal computer operating system that provides a Web-oriented user interface and better system performance along with easier system diagnostics and maintenance. Windows 98 supports graphics, sound, and multimedia technologies and provides the ability to easily add and remove peripheral devices and support for Universal Serial Bus (USB).

ENTERPRISE SOFTWARE AND SERVICES

Windows 2000 Server, Advanced Server, and Datacenter Server. Windows 2000 Server is a multipurpose network operating system for businesses of all sizes. Windows 2000 Advanced Server operating system is ideal for e-commerce and line-of-business applications and provides enhanced performance and scalability through symmetric multiprocessing (SMP) and extended memory support. Windows Datacenter Server operating system is built for large-scale line-of-business and enterprise backend usage and supports server consolidation and enhanced scalability.

Microsoft .NET Enterprise Servers. Microsoft .NET Enterprise Servers include Microsoft SQL Server, Exchange Server, Application Center, BizTalk Server, Commerce Server, Content Management Server, Host Integration Server, Internet Security and Acceleration Server, Microsoft Operations Manager, Mobile Information Server, and SharePoint Portal Server.

SQL Server is a comprehensive data management and analysis platform that enables rapid delivery, dependable performance and secure operation of connected applications.

Exchange Server is a messaging and collaboration server that provides e-mail, group scheduling, task management, contact management and document routing capabilities.

Application Center is Microsoft's deployment and management tool for high-availability Web applications built on the Microsoft Windows 2000 operating system.

BizTalk Server enables companies to rapidly build and deploy integrated business processes within their organizations and with partners.

Commerce Server provides a comprehensive set of features for building scalable, user-centric, business-to-consumer, and business-to-business e-commerce sites.

Content Management Server is the enterprise Web content management system that enables companies to quickly and efficiently build, deploy, and maintain highly dynamic Internet, intranet, and extranet Web sites.

Host Integration Server extends Microsoft Windows applications to other systems by providing application, data, and network integration.

Internet Security and Acceleration Server provides secure, fast, and manageable Internet connectivity. It integrates an extensible, multilayer enterprise firewall and a scalable high-performance Web cache.

Microsoft Operations Manager delivers enterprise-class solutions for operations management of Windows 2000, the Microsoft Active Directory service, and other component services in Windows 2000, as well as other Microsoft .NET Enterprise Server applications such as Exchange and SQL Server.

Mobile Information Server mobile-enables the enterprise, extending the reach of Microsoft .NET Enterprise applications, enterprise data, and intranet content to the mobile user.

SharePoint Portal Server extends the capabilities of Microsoft Windows and Microsoft Office by offering information workers a powerful new way to easily organize, find, and share information. It combines the ability to easily create corporate Web portals with document management, content searching, and team collaboration features.

Other Servers. Small Business Server is the flexible network solution designed to help businesses with up to 50 computers. Systems Management Server helps centrally manage the distributed environment with integrated features, including hardware inventory, software inventory and metering, software distribution and installation, and remote troubleshooting tools.

Developer Tools and Services. Software development tools and computer languages allow software developers to write programs in a particular computer language and translate programs into a binary machine-readable set of commands that activate and instruct various hardware devices. The Company develops and markets a number of software development environments and language compilers. In February 2002, Microsoft launched Visual Studio .NET, a comprehensive tool for rapidly building and deploying XML Web services and applications. Visual Studio .NET provides software developers with powerful tools to rapidly design broad-reach Web applications for any device and any platform, and to build powerful Windows applications. Microsoft Visual C++ is the Company's development system for Windows-based application development. Microsoft Visual C# offers beginning and intermediate developers with C++ or Java experience a modern language and robust development environment for creating XML Web services and Microsoft .NET-based applications for Windows and the Web. The Microsoft Visual Basic development system provides easy access to a wide variety of data sources by integrating the Microsoft Access database engine and the ability to take advantage of investments in commercial applications. The Microsoft Visual InterDev development system includes integrated, team-based development tools for building Web-based applications based on HTML, Script, and components written in any language. Developers can subscribe to the Microsoft Developer Network (MSDN) information service and receive periodic updates via CD-ROMs, magazines, and several online information services. In addition, Microsoft receives certification fees through the Microsoft Certified Professional (MCP) program, a program that provides credentials for those who have demonstrated in-depth knowledge of at least one Microsoft product.

Enterprise Services. Microsoft Enterprise Services assist organizations with every stage of technology planning, building, deployment, and support. Specializing in IT solutions for the enterprise, Microsoft offers a full range of consulting services for advance technology requirements, including custom solutions services, enterprise application planning, architecture and design services, and proof-of-concept services. The Company provides product support services aligned to customer segments, partner segments, and communities.

CONSUMER SOFTWARE, SERVICES, AND DEVICES

Consumer Software, Services, and Devices includes Xbox video game system, MSN Internet Access, MSN Network Services, PC and Online Games, Learning and Productivity Software, Mobility, and Embedded Systems.

Xbox. Microsoft Xbox, released in fiscal 2002, is Microsoft's next-generation video game console system that delivers high quality graphics and audio gameplay experiences. For information on Xbox manufacturing, see "Manufacturing" below. Games for the Xbox are developed by Microsoft Game Studios, such as Halo and Project Gotham Racing, and by third-party game development partners, such as Tecmo's Dead or Alive 3. Xbox Live, an online service available to owners of Xbox systems, is expected to be launched in the second quarter of fiscal 2003 and will allow online game play among users of online-enabled Xbox games.

MSN Internet Access. MSN Internet access is Microsoft's service for accessing the Web and experiencing a wide range of rich online services and content. MSN Internet access subscribers can access their account from multiple sources, including a computer, television, Internet appliances, and Personal Data Assistants.

MSN Network Services. The MSN network provides services, content and advertising on the Internet, encompassing MSN Search, Messenger, eShop, Hotmail, Money, and Music, as well as other services and content. MSN Search makes Web searches more useful by providing users with the most relevant results for the most popular search queries on the Web. MSN Messenger is a free Internet messaging service that enables users to see when others are online and exchange instant messages with them. MSN eShop is a one-stop online shopping resource. MSN Hotmail is the world's leading free Web-based e-mail service. MSN Money is a complete online personal financial service that combines finance tools and content from Microsoft with exclusive investment news and analysis from CNBC. MSN Music provides consumers with one place online to find old favorites, as well as discover new music, and delivers a high quality listening experience.

PC and Online Games. The Company offers a line of entertainment products from classic software games to online games, simulations, sport products, and strategy games. Microsoft Flight Simulator is a popular aircraft flight simulation product. Other games include Age of Empires, Dungeon Siege, MechWarrior, Microsoft Links, Train Simulator, Zoo Tycoon, and other action and sports titles. Zone.com is a gaming community on the Internet allowing multiplayer gaming competitions of Microsoft's popular CD-ROM games and classic card, board, and puzzle games.

Learning and Productivity Software. Learning titles include Microsoft Encarta Reference Library, a complete research and reference source with a multimedia encyclopedia database with interactive information, an interactive world atlas with three-dimensional maps, a world English dictionary, Encarta Africana, Researcher, and an online version with monthly updates. Titles for children include a series of products based on the popular children's book and television series, Scholastic's The Magic School Bus. Microsoft's productivity offerings include Microsoft Works, an integrated software program that contains basic word processing, spreadsheet, and database capabilities that allows the easy exchange of information from one tool to another. Microsoft Picture It! brand of products includes Picture It! Photo, with photo editing tools and wizards to easily capture, correct and create photos, and Picture It! Publishing, used to create greeting cards and other print and Web based products. Microsoft Money offers leading tools and resources to conduct a wide range of financial activities. The

Works Suite provides a comprehensive collection of software, including Microsoft Works, Microsoft Word, Microsoft Money, Microsoft Encarta encyclopedia, Microsoft Picture It! Photo, and Microsoft Streets & Trips.

Mobility and Embedded Systems. Microsoft develops a number of software platforms for mobile computing. Products such as Pocket PC, Pocket PC Phone Edition, and Microsoft Windows Powered Smartphone are designed to enable a variety of mobile scenarios. Microsoft's embedded offerings include two embedded operating systems, Microsoft Windows CE and Microsoft Windows NT Embedded, as well as device specific solutions. Microsoft Windows CE, a robust real-time embedded operating system, is targeted at mobile 32-bit devices. Microsoft Windows NT Embedded, based on the desktop and server versions of Microsoft's operating systems, is targeted at higher-end embedded products and devices. Both embedded operating systems offer integrated tool sets to enable embedded system developers to quickly create sophisticated embedded device and application solutions. Microsoft Mobile Information Server is a scalable and reliable mobile applications server that provides enterprise customers and mobile operators with a rich platform for extending .NET Enterprise application and securely delivering real-time, wireless data to mobile devices.

CONSUMER COMMERCE INVESTMENTS

Consumer Commerce Investments include the HomeAdvisor online real estate service and the CarPoint online automotive service.

HomeAdvisor online real estate service. The HomeAdvisor online real estate service is a complete guide to the home-buying process and provides comprehensive tools for finding homes and loans on the Internet. The service includes customized search features, worksheets and calculators, and editorial content and home-buying advice.

CarPoint online automotive service. The CarPoint online automotive service is the leading online automotive marketplace, visited by more than 7 million consumers each month. With details on more than 10,000 car models and 100,000 used vehicles, users can research and compare cars of virtually every make and model, identify local dealers, and receive instructions for post-purchase service and maintenance.

Expedia, Inc. Expedia was included in the Consumer Commerce Investments segment until Microsoft sold its interest in Expedia to USA Networks, Inc. in February 2002. Expedia, Inc. operates Expedia.com, a leading online travel service. Expedia.com provides air, car, and hotel booking, vacation package and cruise offerings, destination information, and mapping.

OTHER

Hardware. The Hardware Group develops and markets several PC accessories including the Microsoft IntelliMouse family of hand-held pointing devices using the IntelliEye optical technology. Hardware also markets several types of keyboards including the Microsoft Natural Keyboard, an ergonomically designed keyboard, the Internet Keyboard featuring two USB ports and Internet hot keys, and a new Wireless Desktop product including wireless keyboard and mouse. Also included in the Hardware Group's portfolio of devices are SideWinder game controllers and force feedback joysticks with realistic performance technology to use with PC games.

Microsoft Press. Microsoft Press offers comprehensive learning and training resources to help new users, power users, and professionals get the most from Microsoft technology through books, CDs, self-paced training kits, and videos that are created to accommodate different learning styles and preferences. Microsoft Press books are authored by professional and technical writers, both by Microsoft employees and independent authors.

SEGMENT REPORTING

In fiscal 2003, the Company will begin reporting the following operating segments: Client; Information Worker; MSN; Home and Entertainment; CE Mobility; Server and Tools; and Business Solutions. These changes are designed to provide a comprehensive end-to-end financial view of Microsoft's key businesses; promote better alignment of strategies and objectives between development, sales, marketing, and services organizations; provide for more timely and rational allocation of development, sales, and marketing resources within businesses; and focus strategic planning efforts on key objectives and initiatives and give business owners more autonomy in detailed planning.

EQUITY METHOD INVESTMENTS

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

PRODUCT DEVELOPMENT

During fiscal years 2000, 2001, and 2002, research and development expense was $3.77 billion, $4.38 billion, and $4.31 billion, respectively. Those amounts represented 16.4%, 17.3%, and 15.2%, respectively, of revenue in each of those years. In accordance with Statement of Financial Accounting Standards (SFAS) 142, *Goodwill and Other Intangible Assets,* the amortization of goodwill was discontinued in fiscal 2002. The amount of goodwill amortization included in research and development expense in fiscal years 2000 and 2001 was $232 million and $272 million, respectively. The Company plans to continue significant expenditures for research and product development.

Most of the Company's software products are developed internally. The Company also purchases technology, licenses intellectual property rights, and oversees third-party development and localization of certain products. Internal development allows Microsoft to maintain closer technical control over its products and gives the Company the freedom to designate which modifications and enhancements are most important and when they should be implemented. Microsoft works on devising innovative solutions to computer science problems, such as making computers easier to use, designing software for the next generation of hardware, improving the software design process, and investigating the mathematical underpinnings of computer science. The Company has created a substantial body of proprietary development tools and has evolved development methodologies for creating and enhancing its products. These tools and methodologies are also designed to simplify a product's portability among different operating systems, microprocessors, or computing devices. Product documentation is generally created internally. The Company strives to become informed at the earliest possible time about changing usage patterns and hardware advances that may affect software design. Before releasing new software platforms, Microsoft provides to software vendors a range of development, training, testing resources, and guidelines for developing applications.

The software industry is characterized by rapid technological change, which requires constant attention to computing technology trends, shifting consumer demand, and rapid product innovation. The pace of change is accelerating as the computing needs of our customers move beyond the PC toward intelligent devices and appliances, such as the Tablet PC. Tablet PCs extend the power of laptop computers running Windows XP with enhanced capabilities such as handwriting and speech input.

The Company believes that making its products trustworthy is critical to their success and has launched a company-wide effort called Trustworthy Computing. Trustworthy Computing has four pillars: reliability, security, privacy, and business integrity. Reliability means that a computer system is dependable, is available when needed, and performs as expected and at appropriate levels. Security means that a system is resilient to attack, and that the confidentiality, integrity and availability of both the system and its data are protected. Privacy means that individuals have the ability to control data about themselves and that those using such data faithfully adhere to fair information principles. Business integrity, in this context, is about being responsible to customers and helping them find appropriate solutions for their business issues, addressing problems with products or services, and being open in interactions with customers. While the Company is continuing to invest significantly in delivering new capabilities that customers ask for, Microsoft is making security improvements a high priority.

Microsoft .NET is Microsoft's platform for XML Web services. XML Web services allow applications to communicate and share data over the Internet or an intranet, regardless of operating system or programming language. The Microsoft .NET platform includes a comprehensive family of products, built on XML and other Internet industry standards, which provide for each aspect of developing, managing, using, and experiencing XML Web services. There are five areas where Microsoft is building the .NET platform today: Tools, Servers, XML Web Services, Clients, and .NET Experiences. In the Tools area, Visual Studio .NET and the Microsoft .NET framework supply a complete solution for developers to build, deploy, and run XML Web services. They maximize the performance, reliability, and security of XML Web services. The .NET Enterprise Servers, including the Windows 2000 Server family, make up Microsoft .NET's server infrastructure for deploying, managing, and orchestrating XML Web services. Designed with mission-critical performance in mind, they provide enterprises with the agility they need to integrate their systems, applications, and partners through XML Web services, and the flexibility to adapt to changing business requirements. Clients are PCs, laptops, workstations, phones, handheld computers, Tablet PCs, game consoles, and other smart devices. These smart devices use software that supports XML Web services, which enable users to access their data regardless of the location, type, and number of clients used. Smart clients and devices leverage XML Web services to create .NET experiences that allow users to access information across the Internet and from stand-alone applications in an integrated way.

To best serve the needs of users around the world, Microsoft "localizes" many of its products to reflect local languages and conventions and to improve the quality and usability of the product in international markets. Localizing a product might require modifying the user interface, altering dialog boxes, and translating text. In Japanese versions, for example, all user messages and documentation are in Japanese with monetary references in the Japanese yen. Various Microsoft products have been localized into more than 30 languages.

MANUFACTURING

Microsoft contracts out most of its manufacturing activities to third parties. Outside manufacturers produce the Xbox, various retail software packaged products, and hardware. There are other custom manufacturers Microsoft could use in the event outsourced manufacturing becomes unavailable from current vendors. The Company generally has multiple sources for raw materials, supplies, and components and is often able to acquire component parts and materials on a volume discount basis. The graphics processing unit (GPU) for the Xbox was custom designed and is produced by NVIDIA Corporation. Quality control tests are performed on purchased parts, CD-ROMs, and other products.

OPERATIONS

The Company has regional operations centers in Ireland, Singapore, and the Greater Seattle area. The regional centers support all operations, including information processing, vendor management and logistics by geographical regions. The regional center in Dublin, Ireland supports the European, African, and Middle East regions, the center in Singapore supports the Asia Pacific region, and the center in the Greater Seattle area supports North and South America. Microsoft Licensing, Inc. (MSLI), a wholly-owned subsidiary in Reno, Nevada, manages the Company's original equipment manufacturer (OEM) and certain organizational licensing operations.

DISTRIBUTION, SALES AND MARKETING

Microsoft distributes its products primarily through the following channels: OEM; volume licensing; online services and products; and distributors and retailers. In fiscal 2002, Microsoft had three major geographic sales and marketing regions: the South Pacific and Americas Region; the Europe, Middle East, and Africa Region; and the Asia Region. Beginning with fiscal 2003, the Company's geographic sales and marketing organization was modified to remove the South Pacific region from the Americas organization, and combine it with Asia. Sales of volume licenses and packaged software products via these channels are primarily to distributors and resellers.

OEM. Microsoft operating systems are licensed primarily to OEMs under agreements that grant the OEMs the right to distribute copies of the Company's products with their computing devices, principally PCs. The Company also markets and licenses certain server operating systems, desktop applications, hardware devices, and consumer software programs to OEMs under similar arrangements. In almost all cases, the products are distributed under Microsoft trademarks. The Company has OEM agreements covering one or more of its products with virtually all of the major PC OEMs, including Acer, Actebis, Dell, eMachines, Fujitsu, Fujitsu Siemens Computers, Gateway, HP, IBM, NEC, Samsung, Sony, and Toshiba. A substantial amount of OEM business is also conducted with system builders, which are low-volume customized PC vendors.

Volume Licensing. The Microsoft Enterprise Agreement program is a licensing program designed to provide a flexible licensing and service solution tailored to customers making a long-term licensing commitment. The agreements are designed to simplify license administration, payment terms, and the contract process. The Microsoft Select program offers flexible software acquisition, licensing, and maintenance options specially customized to meet the needs of large multinational organizations. Marketing efforts and fulfillment are generally coordinated with large account resellers. The Microsoft Open program is a licensing program that is targeted for small- and medium-sized organizations. It is available through the reseller channel and offers discounts based on initial purchase volumes. The Microsoft Enterprise Agreement and Software Assurance under the Select and Open programs provide customers the right to install any new release of products covered in the licensing agreement during the term of their coverage.

Network Service Providers. Microsoft Network Service Providers (NSP) work with a variety of companies worldwide to help them develop and deploy end-to-end network solutions based on Microsoft platforms. NSPs focus on key network service industries including telecommunications and wireless companies and hosts.

Online Services and Products. Microsoft distributes online content and services through MSN Access, MSN Network Services, bCentral small business portal, and other online services. MSN Access delivers simple, personalized Internet access, useful content, services and tools using MSN Internet Explorer. MSN Network Services delivers advertising and other services including online search, shopping, and messaging capabilities to Internet users. bCentral provides the tools and expertise for small-business owners to build, market and manage their businesses online. Other services delivered online include MSDN subscription content and updates, periodic product updates, and online technical and practice readiness resources to support Microsoft partners in developing and selling Microsoft products and solutions.

Distributors and Resellers. The Company distributes products in the finished goods channels primarily to independent non-exclusive distributors and resellers. Distributors and resellers include Ingram Micro, Tech Data, Level 3 Communications, SOFTBANK, Software House International, ASAP Software Express, and Happinet Corporation. Microsoft has a network of field sales representatives and field support personnel who solicit orders from distributors and resellers and provide product training and sales support.

CUSTOMERS

The Company's customers include individual consumers, small- and medium-sized organizations, enterprises, educational institutions, Internet Service Providers (ISPs), application developers, and OEMs. Consumers and organizations obtain Microsoft products primarily through resellers and OEMs, which include certain Microsoft products with their computing devices. No single customer accounted for 10% or more of revenue in 2000, 2001, or 2002.

COMPETITION

The software business is intensely competitive and subject to rapid technological change. As the company pursues its largest strategic initiative, Microsoft .NET, the Company could experience more intense competition during the transition from the traditional core businesses to its new products based on the .NET architecture. The Company continues to face movement from PC-based applications to server-based applications or Web-based application hosting services, from proprietary software to open source software such as the Linux operating system, and from PCs to Internet-based devices. A number of Microsoft's most significant competitors, including IBM, Sun Microsystems, Oracle, and AOL-Time Warner, are collaborating with one another on various initiatives directed at competing with Microsoft. These initiatives relate in part to efforts to move software from individual PCs to centrally managed servers, which would present significant challenges to the Company's historical business model. Other competitive collaborative efforts include the development of new platform technologies that are intended to replicate much of the value of Microsoft Windows operating systems. New computing form factors, including non-PC information devices, are gaining popularity and competing with PCs running Microsoft's software products.

Microsoft faces formidable competition in these new areas and in all areas of its current business activities. The rapid pace of technological change, particularly in the area of Internet platforms and services, continually creates new opportunities for existing competitors and start-ups and can quickly render existing technologies less valuable. Global software piracy—the unlawful copying and distribution of Microsoft's copyrighted software products—deprives the Company of large amounts of revenue on an annual basis.

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

DESKTOP AND ENTERPRISE SOFTWARE AND SERVICES

The Company's competitors include many software application vendors, such as IBM, Oracle, Apple, Sun Microsystems, Corel, Qualcomm, and local application developers in Europe and Asia. IBM and Corel have large installed bases with their spreadsheet and word processor products, respectively, and both have aggressive pricing strategies. Also, IBM and Apple preinstall certain of their application software products on various models of their PCs, competing directly with Microsoft's desktop application software. Sun Microsystems' Star Office is aggressively priced. Additionally, Web-based application hosting services provide an alternative to PC-based applications such as Microsoft Office.

Microsoft's PC and server operating system products face substantial competition from a wide variety of companies. Competitors such as IBM, Apple Computer, Sun Microsystems, and others are vertically integrated in both software development and hardware manufacturing and have developed operating systems that they preinstall on their own computers. Many of these operating system software products are also licensed to third-party OEMs for preinstallation on their computers. Microsoft's operating system products compete with UNIX-based operating systems from a wide range of companies, including IBM, Hewlett-Packard, Sun Microsystems, and others. Variants of UNIX run on a wide variety of computer platforms and have gained increasing acceptance as desktop operating systems. The Linux open source operating system has gained increasing acceptance as well. Several computer manufacturers preinstall Linux on PC servers and many leading software developers have written applications that run on Linux. Microsoft Windows operating systems also face competition from alternative platforms such as those based on Internet browsing software and Java technology promoted by AOL-Time Warner and Sun Microsystems.

The Company competes in the business of providing enterprise-wide computing solutions with several competitors who enjoy a larger share of sales and larger installed bases. Many companies offer operating system software for mainframes and midrange computers, including IBM, HP, and Sun Microsystems. Since legacy business systems are typically support-intensive, these competitors also offer substantial support services. Software developers that provide competing server applications for PC-based distributed client/server environments include Oracle, IBM, Computer Associates, Sybase, and Informix. There are also several software vendors who offer connectivity servers. As mentioned above, there are numerous companies and organizations that offer Internet and intranet server software, which compete against the Company's business systems. Additionally, IBM has a large installed base of Lotus Notes and cc:Mail, both of which compete with the Company's collaboration and e-mail products.

The Company's developer products compete against offerings from BEA Systems, Borland, IBM, Macromedia, Oracle, Sun Microsystems, Sybase, and other companies.

CONSUMER SOFTWARE, SERVICES, AND DEVICES

Microsoft's online services network, MSN, faces formidable competition from AOL-Time Warner, Yahoo!, and a vast array of Web sites and portals that offer content of all types and e-mail, instant messaging, calendaring, chat, and search and shopping services, among other things.

Xbox competes head-to-head against game systems from Nintendo and Sony, both of which have a large established base of game system users. Game developers like Activision, Capcom, Electronic Arts, Sega, Tecmo, and THQ, to name a few, are both partners and competitors.

Microsoft faces many competitors in the mobile devices space, including Palm, Symbian, Nokia, and Openwave. The embedded operating system market is highly fragmented with many competitive offerings. Key competitors include Wind River and versions of embeddable Linux from commercial Linux vendors such as Red Hat, Lineo, and MontaVista.

CONSUMER COMMERCE INVESTMENTS

Microsoft faces many competitors in the online real estate and online automotive service spaces, including Homestore, AOL's House and Home channel, Autobytel, AOL autos, and Yahoo! autos.

OTHER

PC input devices face substantial competition from computer manufacturers, since computers are typically sold with a keyboard and mouse, and other manufacturers of these devices. Microsoft Press competes in the retail book and eLearning markets with publishers that also create content on Microsoft technologies. A few of the retail competitors are Pearson, WROX, Sybex, and Wiley. The major eLearning competitors are Smartforce and NetG.

EMPLOYEES

As of June 30, 2002, the Company employed approximately 50,500 people on a full-time basis, 34,600 in the United States and 15,900 internationally. Of the total, 20,800 were in product research and development, 23,500 in sales, marketing, and support, 2,200 in manufacturing and distribution, and 4,000 in finance and administration. Microsoft's success is highly dependent on its ability to attract and retain qualified employees. Competition for employees is intense in the software industry. To date, the Company believes it has been successful in its efforts to recruit qualified employees, but there is no assurance that it will continue to be as successful in the future. None of the Company's employees are subject to collective bargaining agreements. The Company believes relations with its employees are excellent.

ITEM 2. PROPERTIES

The Company's corporate offices consist of approximately 8.4 million square feet of office building space located in King County, Washington, of which 5.7 million square feet of corporate campus space situated on slightly more than 300 acres of land is owned and approximately 2.7 million square feet is leased. The Company is constructing three buildings with approximately 392,000 square feet of space that will be occupied in the Fall of 2003. To accommodate expansion needs the Company purchased approximately 38 acres, and has an option to purchase approximately 112 additional acres, of land in Issaquah, Washington, which can accommodate 2.95 million square feet of additional office space. The Company leases many sites domestically totaling approximately 3.0 million square feet of office building space.

The Company leases many sites internationally totaling approximately 4.1 million square feet, including the Company's European Operations Center and localization division which leases a 382,000 square-foot campus in Dublin, Ireland, a 45,000 square-foot disk duplication facility in Humacao, Puerto Rico and a 36,000 square-foot facility in Singapore for the Company's Asia Pacific Operations Center. Leased office building space includes the following locations: Tokyo, Japan 343,000 square feet; Unterschleissheim, Germany 253,000 square feet; United Kingdom campus 242,000 square feet; Les Ulis, France 229,000 square feet; and Beijing, China 115,000 square feet.

The Company's facilities are fully used for current operations of all segments and suitable additional space is available to accommodate expansion needs.

ITEM 3. LEGAL PROCEEDINGS

See Note 19—Contingencies of the Notes to Financial Statements (Item 8) for information regarding legal proceedings.

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

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 2002.

EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of Microsoft as of July 31, 2002 were as follows:

Name	Age	Position with the Company
William H. Gates, III	46	Chairman of the Board; Chief Software Architect
Steven A. Ballmer	46	Chief Executive Officer
James E. Allchin	50	Group Vice President, Platforms Group
Orlando Ayala	46	Group Vice President, Worldwide Sales, Marketing, and Services Group
Robert J. (Robbie) Bach	40	Senior Vice President, Games Division
Douglas J. Burgum	46	Senior Vice President, Business Solutions
David W. Cole	40	Senior Vice President, MSN and Personal Services Group
John G. Connors	43	Senior Vice President; Chief Financial Officer
Jean-Philippe Courtois	41	Senior Vice President; President, Microsoft Europe, Middle East, and Africa
Jon Stephan DeVaan	41	Senior Vice President, TV Division
Richard P. Emerson	40	Senior Vice President, Corporate Development and Strategy
Paul Flessner	43	Senior Vice President, .NET Enterprise Servers
Kevin R. Johnson	41	Senior Vice President, Microsoft Americas
Robert L. Muglia	42	Senior Vice President, Enterprise Storage Division
Craig J. Mundie	53	Senior Vice President; Chief Technical Officer, Advanced Strategies and Policy
Jeffrey S. Raikes	44	Group Vice President, Productivity and Business Services
Richard F. Rashid	50	Senior Vice President, Research
Eric D. Rudder	35	Senior Vice President, Developer and Platform Evangelism
Steven J. Sinofsky	36	Senior Vice President, Office
Bradford L. Smith	43	Senior Vice President and General Counsel
Brian Valentine	42	Senior Vice President, Windows
David Vaskevitch	49	Senior Vice President; Chief Technical Officer, Business Platform
Deborah N. Willingham	46	Senior Vice President, Human Resources

Mr. Gates co-founded Microsoft in 1975 and served as its Chief Executive Officer from the time the original partnership was incorporated in 1981 until January 2000, when he resigned as Chief Executive Officer and assumed the position of Chief Software Architect. Mr. Gates has served as Chairman of the Board since the Company's incorporation.

Mr. Ballmer was named Chief Executive Officer and a director of the Company in January 2000. He served as President from July 1998 to February 2001. Previously, he had served as Executive Vice President, Sales and Support since February 1992. He joined Microsoft in 1980.

Mr. Allchin was named Group Vice President, Platforms Group in December 1999. He had been Senior Vice President, Platforms since March 1999. He was previously Senior Vice President, Personal and Business Systems since February 1996. Mr. Allchin joined Microsoft in 1990.

Mr. Ayala was named Group Vice President, Worldwide Sales, Marketing, and Services Group in August 2000. He had been Senior Vice President, South Pacific and Americas since February 1998, and before holding that position, was Vice President of the developing markets of Africa, India, the Mediterranean and Middle East, Latin America, Southeast Asia and the South Pacific. He joined Microsoft in 1991 as Senior Director of the Latin America Region.

Mr. Bach was named Senior Vice President, Games Division in March 2000. He had been Vice President, Home and Retail since March 1999. Before holding that position, he had been Vice President, Learning, Entertainment and Productivity since 1996. Mr. Bach joined Microsoft in 1988.

Mr. Burgum joined the Company upon Microsoft's acquisition of Great Plains Software, Inc. in April 2001. Mr. Burgum became Great Plains' first outside investor in March 1983. He was named President of Great Plains in 1984 and subsequently named Chairman and Chief Executive Officer.

Mr. Cole was named Senior Vice President, MSN and Personal Services Group in November 2001. Before holding that position, he had been Senior Vice President, Services Platform Division since August 2000. He had been Senior Vice President, Consumer Services since December 1999 and Vice President, Consumer Windows since March 1999. Previously, he was Vice President, Web Client and Consumer Experience and Vice President, Internet Client and Collaboration. Mr. Cole joined Microsoft in 1986.

Mr. Connors was named Senior Vice President and Chief Financial Officer in December 1999. He had been Vice President, Enterprise since March 1999. Mr. Connors had been Vice President, Information Technology, and Chief Information Officer since July 1996. He joined Microsoft in 1989.

Mr. Courtois was named Senior Vice President and President, Microsoft Europe, Middle East, and Africa in July 2000. He had been Vice President, Customer Marketing since July 1998. Before holding that position, he had been Vice President of Microsoft Europe since 1997 and General Manager for Microsoft France since 1994. Mr. Courtois joined Microsoft in 1984.

Mr. DeVaan was named Senior Vice President, TV Division in December 1999. He had been Senior Vice President, Consumer and Commerce since September 1999. Mr. DeVaan had been Vice President, Consumer and Commerce since March 1999. He had been Vice President, Desktop Applications since 1995. Mr. DeVaan joined Microsoft in 1985.

Mr. Emerson joined Microsoft in November 2000 as Senior Vice President, Corporate Development and Strategy. Prior to joining Microsoft, he was Managing Director and co-head of Technology and Telecommunications Advisory Services at international investment bank Lazard Freres & Co. LLC. He spent 12 years in San Francisco and New York with Lazard and Morgan Stanley, specializing in advising clients in the technology and telecommunications sectors on mergers, acquisitions, and strategic partnerships.

Mr. Flessner was named Senior Vice President, .NET Enterprise Servers in December 1999. He had been Vice President, Database and Data Access. Since joining the Company, Mr. Flessner's primary responsibilities have been the development of Microsoft's database business. He joined Microsoft in 1994.

Mr. Johnson was named Senior Vice President, Microsoft Americas in February 2002. He had been Senior Vice President, U.S. Sales, Marketing, and Services since August 2001, and before that, Vice President, U.S. Sales, Marketing and Services. Mr. Johnson was named Vice President, Product Support Services in July 1998. He joined Microsoft in 1992.

Mr. Muglia was named Senior Vice President, Enterprise Storage Division in November 2001. Before holding that position, he had been Group Vice President, Personal Services Group since August 2000. He had been Group Vice President, Business Productivity since December 1999. He was named Senior Vice President, Business Productivity in March 1999 and was named Senior Vice President, Applications and Tools in February 1998. He had been Vice President, Server Applications since 1997. He joined Microsoft in 1988.

Mr. Mundie was named Senior Vice President and Chief Technical Officer, Advanced Strategies and Policy in August 2001. He was named Senior Vice President, Consumer Platforms in February 1996. He joined Microsoft as General Manager, Advanced Consumer Technology in 1992.

Mr. Raikes was named Group Vice President, Productivity and Business Services in August 2000. He had been Group Vice President, Sales and Support since July 1998. Before holding that position, he had been Group Vice President, Sales and Marketing since July 1996. Mr. Raikes joined Microsoft in 1981.

Mr. Rashid was named Senior Vice President, Research in May 2000. He had been Vice President, Research since July 1994. He joined Microsoft in 1991.

Mr. Rudder was named Senior Vice President, Developer and Platform Evangelism in October 2001. He had been Vice President, Technical Strategy. Mr. Rudder joined Microsoft in 1988 and has worked in several areas, including networking, operating systems and developer tools, where he previously served as General Manager for the Visual Studio development system.

Mr. Sinofsky was named Senior Vice President, Office in December 1999. He had been Vice President, Office since December 1998. Mr. Sinofsky joined the Office team in 1994, increasing his responsibility with each subsequent release of the desktop suite. He joined Microsoft in 1989.

Mr. Smith was named Senior Vice President and General Counsel in November 2001. He had been Deputy General Counsel for Worldwide Sales and previously was responsible for managing the Company's European Law and Corporate Affairs Group, based in Paris. He joined Microsoft in 1993.

Mr. Valentine was named Senior Vice President, Windows in December 1999. He had been Vice President, Business and Enterprise since March 1999. He had been Vice President, Windows since December 1998. Before managing the Windows group, Mr. Valentine managed the server applications division and had been responsible for the Exchange product unit. He joined Microsoft in 1987.

Mr. Vaskevitch was named Senior Vice President and Chief Technical Officer, Business Platform in August 2001. He was named Senior Vice President, Business Applications in March 2000. He had been Senior Vice President, Developer since December 1999. Before holding that position, he had been Vice President, Distributed Applications Platform. He joined Microsoft in 1986.

Ms. Willingham was named Senior Vice President, Human Resources in February 2001. She had been Vice President, Human Resources since April 2000. Ms. Willingham had been Vice President, Business and Enterprise Division Marketing and was responsible for Windows operating system client and server marketing strategy and training, as well as for providing centralized marketing services for the Consumer Windows Marketing and Streaming Media Marketing teams. She joined Microsoft in 1993.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company's common stock is traded on The Nasdaq Stock Market under the symbol MSFT. On June 30, 2002, there were 117,730 registered holders of record of the Company's common stock. The Company has not paid cash dividends on its common stock. The high and low common stock prices per share were as follows:

Quarter Ended	**Sept. 30**	**Dec. 31**	**Mar. 31**	**June 30**	**Year**
Fiscal 2001					
Common stock price per share:					
High	$ 82.00	$ 70.88	$ 64.69	$ 73.68	$ 82.00
Low	60.31	41.50	43.38	51.94	41.50
Fiscal 2002					
Common stock price per share:					
High	**$ 72.57**	**$ 69.49**	**$ 69.86**	**$ 60.38**	**$ 72.57**
Low	**49.71**	**51.79**	**57.99**	**48.62**	**48.62**

ITEM 6. SELECTED FINANCIAL DATA

FINANCIAL HIGHLIGHTS

In millions, except earnings per share

Year Ended June 30	**1998**	**1999**	**2000**	**2001(1)**	**2002(2)**
Revenue	$ 15,262	$ 19,747	$ 22,956	$ 25,296	**$ 28,365**
Operating income	6,585	10,010	11,006	11,720	**11,910**
Income before accounting change	4,490	7,785	9,421	7,721	**7,829**
Net income	4,490	7,785	9,421	7,346	**7,829**
Diluted earnings per share before accounting change	0.84	1.42	1.70	1.38	**1.41**
Diluted earnings per share	0.84	1.42	1.70	1.32	**1.41**
Cash and short-term investments	13,927	17,236	23,798	31,600	**38,652**
Total assets	22,357	38,321	51,694	58,830	**67,646**
Stockholders' equity	16,627	28,438	41,368	47,289	**52,180**

(1) Fiscal year 2001 includes an unfavorable cumulative effect of accounting change of $375 million or $0.06 per diluted share, reflecting the adoption of SFAS No. 133, and $4.80 billion (pre-tax) in impairments of certain investments, primarily cable and telecommunication investments.
(2) Fiscal year 2002 includes $4.32 billion (pre-tax) in impairments of certain investments, primarily related to the Company's AT&T investment and further declines in the fair values of European cable and telecommunications holdings, and a $1.25 billion (pre-tax) gain on the sale of Expedia, Inc.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

RESULTS OF OPERATIONS FOR 2000, 2001, AND 2002

Management's Discussion and Analysis contains statements that are forward-looking. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of factors discussed in "Issues and Uncertainties."

REVENUE

The Company's revenue growth rate was 16% in fiscal 2000, 10% in fiscal 2001, and 12% in fiscal 2002. Revenue growth in fiscal 2002 was led by the addition of Xbox video game system revenue and the strong penetration of Microsoft Windows XP Professional and Home operating systems. Revenue growth in fiscal 2001 was driven primarily by licensing of Microsoft Windows 2000 Professional, Microsoft SQL Server, and the other .NET Enterprise Servers. Revenue growth in fiscal 2000 was driven by strong licensing of Microsoft Windows NT Workstation, Windows 2000 Professional, Windows NT Server, Windows 2000 Server, Microsoft Office 2000, and SQL Server.

Microsoft continued to see a mix shift to volume licensing programs. On October 1, 2001, Microsoft launched Licensing 6.0 to simplify and improve its volume licensing programs, including a simplified approach to software upgrades. One feature of Licensing 6.0 is Software Assurance which gives customers the right to install any new release of products covered in the licensing agreement during the term of their coverage. The success of Microsoft's new volume licensing programs will continue to affect the mix of multi-year licensing agreements with a resulting impact on the timing of revenue recognition. In addition, the timing and extent of a recovery in consumer and corporate spending on PCs and information technology (IT) will be factors affecting revenue growth.

PRODUCT REVENUE

In fiscal 2002, Microsoft had four segments: Desktop and Enterprise Software and Services; Consumer Software, Services, and Devices; Consumer Commerce Investments; and Other. The revenue figures in this Management's Discussion and Analysis (MD&A) differ from those reported in the Company's Segment Information appearing in Note 20 of the Notes to Financial Statements. The revenue figures in the Segment Information represent amounts reported internally for management reporting, while the revenue figures in the MD&A reflect revenue recognized in accordance with generally accepted accounting principles. On July 1, 2002, Microsoft revised its product segments and will begin reporting the new segments in fiscal 2003.

Desktop and Enterprise Software and Services. Desktop and Enterprise Software and Services revenue was $20.40 billion, $22.41 billion, and $24.01 billion in 2000, 2001, and 2002. Desktop and Enterprise Software and Services includes Desktop Applications; Desktop Platforms; and Enterprise Software and Services.

Desktop Applications revenue was $9.30 billion, $9.54 billion, and $9.60 billion in 2000, 2001, and 2002. Desktop Applications includes revenue from Microsoft Office; Microsoft Project; Visio; client access licenses (CALs) for Windows NT Server and Windows 2000 Server, Exchange, and BackOffice; Microsoft Great Plains; and bCentral. In fiscal 2002, Office licensing revenue declined during the year due to a strong mix shift to multi-year annuity licensing agreements, which deferred revenue recognition to future years, and a decrease in consumer purchases in the Asia region, most notably Japan, partially offset by strong OEM licensing. Revenue from client access licenses grew 3% in fiscal 2002 and revenue from Great Plains contributed to the growth in Desktop Applications. In fiscal 2001, revenue from client access licenses increased 14% reflecting strong licensing growth of Windows NT Server and Windows 2000 Server CALs. Office revenue growth was flat during fiscal 2001. In fiscal 2000, revenue growth from Microsoft Office integrated suites, including the Premium, Professional, Small Business, and Standard Editions was very solid.

Desktop Platforms revenue was $7.02 billion, $8.04 billion, and $9.30 billion in 2000, 2001, and 2002. Desktop Platforms includes revenue from Windows XP Professional and Home, Windows 2000 Professional, Windows NT Workstation, Windows Me, Windows 98, and other desktop operating systems. In fiscal 2002, the growth in Desktop Platforms revenue reflected strong multi-year licensing revenue growth and a continued mix shift to the higher priced Windows 2000 and Windows XP Professional operating system through OEMs, despite a decline in reported OEM unit shipments. Fiscal 2001 revenue growth reflected the strong adoption of Windows 2000 Professional, partially offset by flat revenue growth from Windows Me and Windows 98 operating systems, reflecting the slowdown in consumer PC shipments and a higher mix of Windows 2000 Professional and Windows NT Workstation. In fiscal 2000, Desktop Platforms revenue growth was modest due to soft demand for business PCs during most of the year; a slowdown in shipments in anticipation of the post mid-year availability of Windows 2000 operating systems; and, as expected, a longer business migration cycle for the newest Windows operating system offerings. The rate of growth in PC shipments and the mix of Windows 2000 and Windows XP Professional as a percentage of all 32-bit operating systems will continue to impact revenue growth in the future.

Enterprise Software and Services revenue was $4.08 billion, $4.83 billion, and $5.11 billion in 2000, 2001, and 2002. Enterprise Software and Services includes Server Platforms, Server Applications, Developer Tools and Services, and Enterprise Services. In fiscal 2002, Server Applications, including Microsoft SQL Server and .NET Enterprise Servers, increased 10% compared to fiscal 2001. Server Platform revenue, which includes Windows 2000 Server and Windows NT Server operating systems, increased 10% versus fiscal 2001 driven by a modest overall increase in Windows-based server shipments and increased deployment of Windows 2000 Server. Enterprise Services revenue, representing consulting and product support services, was up 17% compared to fiscal 2001, while revenue from Developer Tools and Services was down 19% from fiscal 2001. In fiscal 2001, Server Applications revenue increased 31% versus the prior year as a result of the continued adoption of Microsoft's .NET Enterprise Server offerings. Enterprise Services revenue in fiscal 2001, was up 34% compared to fiscal 2000 and Server Platforms increased 10% while revenue from Developer Tools and Services was flat. In fiscal 2000, Server Platforms revenue growth was particularly strong led by increased adoption by customers of Windows NT Server and Windows 2000 Server. Revenue from Server Applications grew strongly in fiscal 2000, largely due to the strong success of SQL Server 7.0, while Software Developer Tools and Services revenue declined, due to increased suite licensing versus stand-alone licenses, and the lack of a release upgrade of the Visual Studio development system.

Consumer Software, Services, and Devices. Consumer Software, Services, and Devices revenue was $1.63 billion, $1.95 billion, and $3.59 billion in 2000, 2001, and 2002. Consumer Software, Services, and Devices includes the Xbox video game system; MSN Internet access; MSN network service; PC and online games; learning and productivity software; mobility; and embedded systems. The majority of the revenue growth from fiscal 2001 stemmed from sales of the Xbox video game system released in fiscal 2002. MSN Internet access revenue increased as a result of both a higher subscriber base and higher average revenue per subscriber due to a reduction in promotional subscriber programs. Revenue from MSN network services increased despite a declining Internet advertising market. Revenue from embedded systems in fiscal 2002 grew nicely, however learning and productivity software revenue and PC and online games declined compared to fiscal 2001. In fiscal 2001, revenue from MSN network services grew strongly despite a decline in the online advertising market. MSN Internet access revenue also grew solidly from fiscal 2000 as a result of an increased subscriber base, partially offset by a decline in the average revenue per subscriber due to a larger mix of subscribers contracted under rebate programs. Revenue from embedded systems grew strongly from the prior year, while learning and productivity software revenue and PC and online games revenue declined, reflecting softness in the overall consumer market. In fiscal 2000, online revenue growth was very strong and reflected higher subscriber totals, offset by lower net prices for Internet access subscriptions compared to the prior year. Additionally, strong sales of entertainment software in fiscal 2000 produced robust revenue growth in PC and online games.

Consumer Commerce Investments. Consumer Commerce Investments revenue was $182 million, $299 million, and $242 million in 2000, 2001, and 2002. Consumer Commerce Investments include Expedia, Inc., the HomeAdvisor online real estate service, and the CarPoint online automotive service. The decline in revenue compared to fiscal 2001 reflects the sale of Microsoft's majority ownership of Expedia, Inc. to USA Networks, Inc. on February 4, 2002. Acquisitions of Travelscape.com and VacationSpot.com by Expedia, Inc., and increased product offerings from Expedia led to the strong revenue growth in fiscal 2001. The increased overall reach of all properties led to the strong revenue growth in fiscal 2000.

Other. Other revenue, which primarily includes Hardware and Microsoft Press, was $754 million, $630 million, and $530 million in 2000, 2001, and 2002. In fiscal 2002, continued declines in the IT book and consumer market led to a decline in Microsoft Press and Hardware sales. Lower sales of gaming devices and other hardware peripherals as a result of weakness in the consumer market caused the decline in revenue in fiscal 2001. Continued success of the Company's new hardware device offerings led to revenue growth in fiscal 2000.

DISTRIBUTION CHANNELS

Microsoft distributes its products primarily through the following channels: OEM; volume licensing; online services and products; and distributors and retailers. OEM channel revenue represents license fees from original equipment manufacturers who preinstall Microsoft products, primarily on PCs. Microsoft has three major geographic sales and marketing regions: the South Pacific and Americas Region; the Europe, Middle East, and Africa Region; and the Asia Region. Sales of volume licenses and packaged software products via these channels are primarily to distributors and resellers.

OEM revenue was $7.01 billion in 2000, $7.86 billion in 2001, and $9.00 billion in 2002. In fiscal 2002, reported licenses declined compared to fiscal 2001. However, a strong increase in the mix of the higher priced Windows 2000 and Windows XP Professional licenses, and healthy growth in direct and system builder OEMs licenses, led to higher average revenue per license and contributed to the overall OEM revenue growth over fiscal 2001. In fiscal 2001, while total licenses were also impacted by a slowdown in PC shipments, the mix of the higher priced Windows 2000 Professional and Windows NT Workstation increased substantially resulting in higher average revenue per license. A relatively low growth rate in fiscal 2000 was due to lower business PC shipment growth combined with post mid-year availability of Windows 2000 Professional. Average earned revenue per license also declined in fiscal 2000 compared to the prior year, due in part to a mix shift to the lower-priced Windows 98 operating system reflecting the softness in demand for business PCs and lower prices on operating systems licensed through certain OEM channel sectors.

South Pacific and Americas Region revenue was $8.33 billion, $9.52 billion, and $11.41 billion in 2000, 2001, and 2002. In fiscal 2002, the majority of the revenue growth was driven by sales of the Xbox video game system released during the year, as well as strong Windows XP Professional licensing, MSN subscription revenue, and revenue from Microsoft Great Plains. In fiscal 2001, revenue growth was led by strong licensing of Windows 2000 Professional and the family of .NET Enterprise Servers, particularly SQL Server 2000 and Exchange 2000 Server. Revenue from Enterprise services and MSN subscription and services also grew strongly in fiscal 2001. In fiscal 2000, Office 2000 integrated suites, Windows 2000 Server, online revenue, and SQL Server sales were the primary drivers of the revenue growth. Strong retail sales of hardware devices and consumer software also contributed to the growth over the prior year.

Europe, Middle East, and Africa Region revenue was $5.02 billion, $4.86 billion, and $5.13 billion in 2000, 2001, and 2002. In fiscal 2002, the majority of the growth was a result of strong multi-year licensing revenue of Windows XP Home and Professional operating systems and Enterprise Software, as well as the addition of Xbox video game system revenue in the second half of the year. In fiscal 2001, weakening local currencies negatively impacted translated revenue compared to the prior year, while revenue from Windows 2000 Professional and the .NET Enterprise Server family of products was very healthy. In fiscal 2000, retail sales of Windows operating systems and

Office licensing produced moderate growth in the region. Growth from SQL Server licensing, new hardware device offerings, and entertainment software was especially strong.

Asia Region revenue was $2.60 billion in 2000, $3.06 billion in 2001, and $2.83 billion in 2002. In fiscal 2002, Asia region revenue declined most notably due to lower consumer PC shipments, which hampered revenue from localized versions of Microsoft Office 2000 and Microsoft Office XP, especially the Office Personal Edition. Xbox video game system sales partially offset the decline in Office revenue. In fiscal 2001, the region's growth rate reflected strong revenue from localized versions of Microsoft Office 2000 and Microsoft Office XP, especially the Office Personal Edition. This growth was also attributable to Windows 2000 Professional and .NET Server applications licensing. In fiscal 2000, the region's growth rate reflected strong performance resulting from improved local economic conditions. Revenue growth was also influenced by robust growth of localized versions of Microsoft Office 2000, especially the Office Personal Edition sold in Japan, Windows platform and server licensing, and strong adoption of SQL Server.

The Company's operating results are affected by foreign exchange rates. Approximately 30%, 27%, and 25% of the Company's revenue was collected in foreign currencies during 2000, 2001, and 2002. Since a portion of local currency revenue is hedged and much of the Company's international manufacturing costs and operating expenses are also incurred in local currencies, the impact of exchange rates is partially mitigated.

OPERATING EXPENSES

Cost of Revenue. Cost of revenue as a percent of revenue was 13.1% in 2000, 13.7% in 2001, and 18.3% in 2002. Cost of revenue in fiscal 2002 increased primarily due to costs related to Xbox. In fiscal 2001, higher support and service costs associated with the MSN Internet access and MSN network services were partially offset by the lower relative costs associated with organizational licensing and the drop in the mix of packaged product versus the prior year. Cost of revenue in fiscal 2000 reflected lower costs associated with WebTV Networks' operations, partially offset by the growth in hardware peripherals costs.

Research and Development. The discontinuation of goodwill amortization in fiscal 2002 in accordance with Statement of Financial Accounting Standards (SFAS) 142, *Goodwill and Other Intangible Assets,* offset the growth in headcount and development costs. In fiscal 2001, the increase in R&D expense was the result of higher headcount-related costs and investments in new product initiatives. The increase in fiscal 2000 was driven primarily by higher headcount-related costs. Prospectively, increased headcount and increased spending in Server Platforms, Home & Entertainment, Business Solutions and CE are currently expected to be significant factors affecting future research and development expense growth.

Sales and Marketing. Sales and marketing expense as a percentage of revenue was 18.0% in 2000, 19.3% in 2001, and 19.1% in 2002. In fiscal 2002, sales and marketing expense as a percentage of revenue decreased due to lower relative MSN customer acquisition marketing and the large relative increase associated with the onset of Xbox video game system revenue. In fiscal 2001, sales and marketing expenses as a percentage of revenue increased due to higher relative headcount-related costs, higher marketing and sales expenses associated with MSN, the Microsoft Agility advertising campaign, and other new sales initiatives. In fiscal 2000, sales and marketing expenses as a percentage of revenue increased due to higher relative marketing costs associated with new product releases and online marketing. Microsoft expects that it will increase spending on Information Worker, Server Platforms, and Business Solutions sales forces and Windows Client, MSN and Home & Entertainment marketing.

General and Administrative. General and administrative expenses in fiscal 2002 increased due to a charge of approximately $660 million for estimated expenses related to the Company's consumer class action lawsuits and higher legal fees. In fiscal 2001, general and administrative costs decreased due to a charge related to the settlement of the lawsuit with Caldera, Inc. recorded in fiscal 2000. Excluding this charge in fiscal 2000, general and administrative expenses in fiscal 2001 increased from the prior year due to higher headcount-related costs and legal fees. For fiscal 2000, besides the settlement of the lawsuit, general and administrative expenses also reflected increased legal fees and certain employee stock option-related expenses.

NON-OPERATING ITEMS, INVESTMENT INCOME/(LOSS), AND INCOME TAXES

Losses on equity investees and other consists of Microsoft's share of income or loss from investments accounted for using the equity method, and income or loss attributable to minority interests. The decrease in losses on equity investees and other in fiscal 2002 was attributed to the divestiture of certain equity investments in fiscal 2002. The increase in losses on equity investees and other in fiscal 2001 reflects an increase in the number of such investments during the year. In fiscal 2000 losses on equity investees and other decreased reflecting smaller losses from the MSNBC entities.

The Company recorded net investment income/(loss) in each year as follows:

In Millions

Year Ended June 30	2000	2001	2002
Dividends	$ 363	$ 377	**$ 357**
Interest	1,231	1,808	**1,762**
Net recognized gains/(losses) on investments:			
Net gains on the sales of investments	1,780	3,175	**2,379**
Other-than-temporary impairments	(29)	(4,804)	**(4,323)**
Net unrealized losses attributable to derivative instruments	(19)	(592)	**(480)**
Net recognized gains/(losses) on investments	1,732	(2,221)	**(2,424)**
Investment income/(loss)	$ 3,326	$ (36)	**$ (305)**

In fiscal 2002, other-than-temporary impairments primarily related to the Company's investment in AT&T and other cable and telecommunication investments. Net gains on the sales of investments included a $1.25 billion gain on the sale of the Company's share of Expedia. Interest and dividend income decreased $66 million from fiscal 2001 as a result of lower interest rates and dividend income.

In fiscal 2001, other-than-temporary impairments primarily related to cable and telecommunication investments. Net gains from the sales of investments in fiscal 2001 included a gain from Microsoft's investment in Titus Communications (which was merged with Jupiter Telecommunications) and the closing of the sale of Transpoint to CheckFree Holdings Corp. Interest and dividend income increased $591 million from fiscal 2000, reflecting a larger investment portfolio. In fiscal year 2000, investment income increased primarily as a result of a larger investment portfolio generated by cash from operations coupled with realized gains from the sale of securities.

At June 30, 2002, unrealized losses on Equity and Other Investments of $623 million were deemed to be temporary in nature. The following, among other factors, could result in some investments being deemed other-than-temporarily impaired in future periods: changes in the duration and extent to which the fair value is less than cost; 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; and the Company's intent and ability to hold the investment.

In connection with the definitive agreement to combine AT&T Broadband with Comcast in a new company to be called AT&T Comcast Corporation, Microsoft has agreed to exchange its AT&T 5% convertible preferred debt securities for approximately 115 million shares of AT&T Comcast Corporation. It is expected that the transaction will close by December 31, 2002. While it is possible that Microsoft could incur a loss on this exchange transaction up to the carrying value of the AT&T debt securities, management believes that the ultimate loss, if any, will be significantly less. As management is unable to predict whether there will be a gain or loss on the exchange, no loss has been recorded related to this contingent exchange transaction as of June 30, 2002.

The Company's effective tax rate for fiscal 2002 was 32%. The effective tax rate for fiscal 2001 and fiscal 2000 was 33% and 34%, respectively. The decrease in the effective tax rate is due primarily to lower taxes on foreign earnings.

ACCOUNTING CHANGES

Effective July 1, 2001, Microsoft adopted SFAS 141, *Business Combinations,* and SFAS 142, *Goodwill and Other Intangible Assets.* SFAS 141 requires business combinations to be accounted for using the purchase method of accounting. It also specifies the types of acquired intangible assets that are required to be recognized and reported separate from goodwill. SFAS 142 requires that goodwill and certain intangibles no longer be amortized, but instead tested for impairment at least annually. There was no impairment of goodwill upon adoption of SFAS 142. Goodwill amortization (on a pre-tax basis) was $234 million in fiscal 2000 and $311 million in fiscal 2001.

Effective July 1, 2000, Microsoft adopted SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. The adoption of SFAS 133 resulted in a cumulative pre-tax reduction to income of $560 million ($375 million after-tax) and a cumulative pre-tax reduction to other comprehensive income (OCI) of $112 million ($75 million after-tax). The reduction to income was mostly attributable to a loss of approximately $300 million reclassified from OCI for the time value of options and a loss of approximately $250 million reclassified from OCI for derivatives not designated as hedging instruments. The reduction to OCI was mostly attributable to losses of approximately $670 million on cash flow hedges offset by the reclassifications out of OCI of the approximately $300 million loss for the time value of options and the approximately $250 million loss for derivative instruments not designated as hedging instruments.

FINANCIAL CONDITION

The Company's cash and short-term investment portfolio totaled $38.65 billion at June 30, 2002. The portfolio consists primarily of fixed-income securities, diversified among industries and individual issuers. Microsoft's investments are generally liquid and investment grade. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions in order to diversify financial risk. The portfolio is primarily invested in short-term securities to minimize interest rate risk and facilitate rapid deployment for immediate cash needs.

Cash flow from operations was $14.51 billion for fiscal 2002, an increase of $1.09 billion from fiscal 2001. The increase reflects strong growth in unearned revenue. Cash used for financing was $4.57 billion in fiscal 2002, a decrease of $1.01 billion from the prior year. The decrease reflects the repurchase of put warrants in the prior year. The Company repurchased 122.8 million shares of common stock under its share repurchase program in fiscal 2002, compared to 89.0 million shares repurchased in the prior year. In addition, 5.1 million shares of common stock were acquired in fiscal 2002 under a structured stock repurchase transaction. The Company entered into the structured stock repurchase transaction in fiscal 2001, giving it the right to acquire 5.1 million of its shares in exchange for an up-front net payment of $264 million. Cash used for investing was $10.85 billion in fiscal 2002, an increase of $2.11 billion from fiscal 2001.

Cash flow from operations was $13.42 billion in fiscal 2001, an increase of $2.00 billion from the prior year. The increase was primarily attributable to the growth in revenue and other changes in working capital, partially offset by the decrease in the stock option income tax benefit, reflecting decreased stock option exercises by employees. Cash used for financing was $5.59 billion in fiscal 2001, an increase of $3.39 billion from the prior year. The increase primarily reflects the repurchase of put warrants in fiscal 2001, compared to the sale of put warrants in the prior fiscal year, as well as an increase in common stock repurchased. All outstanding put warrants were either retired or exercised during fiscal 2001. During fiscal 2001, the Company repurchased 89.0 million shares. Cash used for investing was $8.73 billion in fiscal 2001, a decrease of $658 million from the prior year. In fiscal 2000, cash flow from operations was $11.43 billion, a decrease of $720 million from the prior year, reflecting working capital changes partially offset by the increase in the stock option income tax benefit. Cash used for financing was $2.19 billion in fiscal 2000, an increase of $1.33 billion from the prior year, reflecting an increase in common stock repurchased versus the prior year. During fiscal 2000, the Company repurchased 55.2 million shares. Cash used for investing was $9.39 billion in fiscal 2000, a decrease of $808 million from the prior year.

Microsoft has no material long-term debt. Stockholders' equity at June 30, 2002 was $52.18 billion. Microsoft will continue to invest in sales, marketing, and product support infrastructure. Additionally, research and development activities will include investments in existing and advanced areas of technology, including using cash to acquire technology. Additions to property and equipment will continue, including new facilities and computer systems for R&D, sales and marketing, support, and administrative staff. Commitments for constructing new buildings were $111 million on June 30, 2002. The Company has not engaged in any transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to affect materially liquidity or the availability of or requirements for capital resources. Since fiscal 1990, Microsoft has repurchased 982 million common shares while 2.23 billion shares were issued under the Company's employee stock option and purchase plans. The Company's convertible preferred stock matured on December 15, 1999. Each preferred share was converted into 1.1273 common shares.

Management believes existing cash and short-term investments together with funds generated from operations should be sufficient to meet operating requirements. The Company's cash and short-term investments are available for strategic investments, mergers and acquisitions, other potential large-scale needs and to fund the share repurchase program. Microsoft has not paid cash dividends on its common stock.

SUBSEQUENT EVENT

On July 11, 2002, Microsoft acquired Navision a/s as a result of the successful close of a tender offer. Microsoft purchased Navision's shares for approximately $1.45 billion in stock and cash. Navision is a provider of integrated business software solutions for small and medium-sized companies.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Microsoft's financial statements and accompanying notes are prepared in accordance with generally accepted accounting principles in the United States. 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 Microsoft include revenue recognition, impairment of investment securities, accounting for research and development costs, accounting for legal contingencies, and accounting for income taxes.

Microsoft accounts for the licensing of software in accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition.* The application of SOP 97-2 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. End users receive certain elements of the Company's products over a period of time. These elements include browser technologies updates and technical support, the fair value of which is recognized over the product's estimated life cycle. 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.

SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities,* and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) 59, *Accounting for Noncurrent Marketable Equity Securities,* provide guidance on determining when an investment is other-than-temporarily impaired, which also requires judgment. In making this judgment, Microsoft evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost; the financial health of and business outlook for the investee, including factors such as industry and sector performance, changes in technology, and operational and financing cash flow; and the Company's intent and ability to hold the investment.

Microsoft accounts for research and development costs in accordance with several accounting pronouncements, including SFAS 2, *Accounting for Research and Development Costs,* and SFAS 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Other-*

wise Marketed. SFAS 86 specifies that costs incurred internally in creating a computer software product should be charged to expense when incurred as research and development until technological feasibility has been established for the product. Once technological feasibility is established, all software costs should be capitalized until the product is available for general release to customers. Judgment is required in determining when the technological feasibility of a product is established. Microsoft has determined that technological feasibility for its products is reached shortly before the products are released to manufacturing. Costs incurred after technological feasibility is established are not material, and accordingly, the Company expenses all research and development costs when incurred.

Microsoft is subject to various legal proceedings and claims, the outcomes of which are subject to significant uncertainty. SFAS 5, *Accounting for Contingencies,* requires that an estimated loss from a loss contingency should be 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. The Company evaluates, 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 the Company's financial position or its results of operations.

SFAS 109, *Accounting for Income Taxes,* establishes financial accounting and reporting standards for the effect of 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. Judgment is required in assessing the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could materially impact the Company's financial position or its results of operations.

ISSUES AND UNCERTAINTIES

The following issues and uncertainties, among others, should be considered in evaluating the Company's financial outlook.

Challenges to the Company's Business Model. Since its inception, the Company's business model has been based upon customers agreeing to pay a fee to license software developed and distributed by Microsoft. Under this commercial software development ("CSD") model, software developers bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenues received from the distribution of their products. The Company believes that the CSD model has had substantial benefits for users of software, allowing them to rely on the expertise of the Company and other software developers that have powerful incentives to develop innovative software that is useful, reliable and compatible with other software and hardware. In recent years, there has been a growing challenge to the CSD model, often referred to as the Open Source movement. Under the Open Source model, software is produced by global "communities" of programmers, and the resulting software and the intellectual property contained therein is licensed to end users at little or no cost. The Company believes that there are significant problems with the Open Source model, the principal drawback being that no single entity is responsible for the Open Source software, and thus users have no recourse if a product does not work properly or at all. Further, without the market incentives associated with the CSD model, the Company believes that the vigorous innovation and growth of the software industry over the last 25 years would not have occurred. Nonetheless, the popularization of the Open Source movement continues to pose a significant challenge to the Company's business model, including recent efforts by proponents of the Open Source model to convince governments worldwide to mandate the use of Open Source software in their purchase and deployment of software products. To the extent the Open Source model gains increasing market acceptance, sales of the Company's products may decline, the Company may have to reduce the prices it charges for its products, and revenues and operating margins may consequently decline.

New Products and Services. The Company has made significant investments in research and development for new products, services and technologies, including Microsoft .NET, Xbox, business applications, MSN, mobile and wireless technologies, and television. Significant revenue from these investments may not be achieved for a number of years, if at all. Moreover, these products and services may never be profitable, and even if they are profitable, operating margins for these businesses are not expected to be as high as the margins historically experienced in our Desktop and Enterprise Software and Services businesses.

Declines in Demand for Software. If overall market demand for PCs, servers and other computing devices declines significantly, and consumer and corporate spending for such products declines, Microsoft's revenue growth will be adversely affected. Additionally, the Company's revenues would be unfavorably impacted if customers reduce their purchases of new software products or upgrades to existing products if such new offerings are not perceived to add significant new functionality or other value to prospective purchasers.

Product Development Schedule. 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. Significant delays in new product releases or significant problems in creating new products could negatively impact the Company's revenues.

International Operations. Microsoft develops and sells products throughout the world. The prices of the Company's products in countries outside of the United States are generally higher than the Company's prices in the United States because of the cost incurred in localizing software for non-U.S. markets. The costs of producing and selling the Company's products in these countries also are higher. Pressure to globalize Microsoft's pricing structure might require that the Company reduce the sales price of its software in other countries, even though the costs of the software continue to be higher than in the United States. Unfavorable changes in trade protection laws, policies and measures, and other regulatory requirements affecting trade and investment; unexpected changes in regulatory requirements for software; social, political, labor, or economic conditions in a specific country or region, including foreign exchange rates; difficulties in staffing and managing foreign operations; and potential adverse foreign tax consequences, among other factors, could also have a negative effect on the Company's business and results of operations outside of the United States.

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

Taxation of Extraterritorial Income. In August 2001, a World Trade Organization ("WTO") dispute panel determined that the extraterritorial tax ("ETI") provisions of the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 constitute an export subsidy prohibited by the WTO Agreement on Subsidies and Countervailing Measures Agreement. The U.S. government appealed the panel's decision and lost its appeal. On January 29, 2002, the WTO Dispute Settlement Body adopted the Appellate Body report. President Bush has stated the U.S. will bring its tax laws into compliance with the WTO ruling, but the Administration and Congress have not decided on a solution for this issue. In July 2002, Representative Bill Thomas, Chairman of the House Ways and Means Committee, introduced the American Competitiveness and Corporate Accountability Act of 2002. If enacted, that bill would repeal the ETI regime and introduce broad-based international reform. The proposed reforms would not materially affect the Company. On August 30, 2002, a WTO arbitration panel determined that the European Union may impose up to $4.04 billion per year in countermeasures if the U.S. rules are not brought into compliance. The WTO decision does not repeal the ETI tax benefit and it does not require the European Union to impose trade sanctions, so it is not possible to predict what impact the WTO decision will have on future results pending final resolution of these matters. If the ETI exclusion is repealed and replacement legislation is not enacted, the loss of tax benefit to the Company could be significant.

Litigation. As discussed in Note 19—Contingencies of the Notes to Financial Statements, the Company is subject to a variety of claims and lawsuits. While the Company believes that none of the litigation matters in which the Company is currently involved will have a material adverse impact on the Company's financial position or results of operations, it is possible that one or more of these matters could be resolved in a manner that would ultimately have a material adverse impact on the business of the Company, and could negatively impact its revenues and operating margins.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to foreign currency, interest rate, and equity price risks. A portion of these risks is hedged, but fluctuations could impact the Company's results of operations and financial position. The Company hedges the exposure of accounts receivable and a portion of anticipated revenue to foreign currency fluctuations, primarily with option contracts. The Company monitors its foreign currency exposures daily to maximize the overall effectiveness of its foreign currency hedge positions. Principal currencies hedged include the Euro, Japanese yen, British pound, and Canadian dollar. Fixed income securities are subject to interest rate risk. The portfolio is diversified and consists primarily of investment grade securities to minimize credit risk. The Company routinely uses options to hedge its exposure to interest rate risk in the event of a catastrophic increase in interest rates. Many securities held in the Company's equity and other investments portfolio are subject to price risk. The Company uses options to hedge its price risk on certain highly volatile equity securities.

The Company uses a value-at-risk (VAR) model to estimate and quantify its market risks. VAR is the expected loss, for a given confidence level, in fair value of the Company's portfolio due to adverse market movements over a defined time horizon. The VAR model is not intended to represent actual losses in fair value, but is used as a risk estimation and management tool. The model used for currencies and equities is geometric Brownian motion, which allow incorporation of optionality of these exposures. For interest rates, the mean reverting geometric Brownian motion is used to reflect the principle that fixed-income securities prices over time revert to maturity value.

Value-at-risk is calculated by, first, simulating 10,000 market price paths over 20 days for equities, interest rates and foreign exchange rates, taking into account historical correlations among the different rates and prices. Each resulting unique set of equities prices, interest rates, and foreign exchange rates is applied to substantially all individual holdings to re-price each holding. The 250th worst performance (out of 10,000) represents the value-at-risk over 20 days at the 97.5th percentile. Several risk factors are not captured in the model, including liquidity risk, operational risk, credit risk, and legal risk.

A substantial amount of the Company's equity portfolio is held for strategic purposes. The Company attempts to hedge the value of these securities through the use of derivative contracts such as collars. The Company has incurred substantial impairment charges related to certain of these securities in fiscal 2002 and fiscal 2001. Such impairment charges have been incurred primarily for strategic equity holdings that the Company has not been able to hedge. The VAR amounts disclosed below are not necessarily reflective of potential accounting losses, as they are used as a risk management tool and reflect an estimate of potential reductions in fair value of the Company's portfolio. Losses in fair value over a 20-day holding period can exceed the reported VAR by significant amounts and can also accumulate over a longer time horizon than the 20-day holding period used in the VAR analysis.

The VAR numbers are shown separately for interest rate, currency, and equity risks. These VAR numbers include the underlying portfolio positions and related hedges. Historical data is used to estimate VAR. Given reliance on historical data, VAR is most effective in estimating risk exposures in markets in which there are no fundamental changes or shifts in market conditions. An inherent limitation in VAR is that the distribution of past changes in market risk factors may not produce accurate predictions of future market risk.

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The following table sets forth the VAR calculations for substantially all of the Company's positions:

In Millions

	As of June 30,		Year ended June 30, 2002		
Risk Categories	**2002**	**2001**	**Average**	**High**	**Low**
Interest rates	**$ 472**	$ 363	**$ 435**	**$ 535**	**$ 333**
Currency rates	**310**	58	**162**	**310**	**58**
Equity prices	**602**	520	**584**	**757**	**488**

The total VAR for the combined risk categories is $908 million at June 30, 2002 and $759 million at June 30, 2001. The total VAR is 34% less at June 30, 2002 and 19% less at June, 30 2001 than the sum of the separate risk categories for each of those years in the above table, due to the diversification benefit of the combination of risks. The reasons for the change in risk in portfolios include: larger investment portfolio size, higher foreign exchange exposure due to stronger non-U.S. currencies, and asset allocation shifts.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INCOME STATEMENTS

In millions, except earnings per share

Year Ended June 30	**2000**	**2001**	**2002**
Revenue	$ 22,956	$ 25,296	**$ 28,365**
Operating expenses:			
Cost of revenue	3,002	3,455	**5,191**
Research and development	3,772	4,379	**4,307**
Sales and marketing	4,126	4,885	**5,407**
General and administrative	1,050	857	**1,550**
Total operating expenses	11,950	13,576	**16,455**
Operating income	11,006	11,720	**11,910**
Losses on equity investees and other	(57)	(159)	**(92)**
Investment income/(loss)	3,326	(36)	**(305)**
Income before income taxes	14,275	11,525	**11,513**
Provision for income taxes	4,854	3,804	**3,684**
Income before accounting change	9,421	7,721	**7,829**
Cumulative effect of accounting change (net of income taxes of $185)	–	(375)	**–**
Net income	$ 9,421	$ 7,346	**$ 7,829**
Basic earnings per share:			
Before accounting change	$ 1.81	$ 1.45	**$ 1.45**
Cumulative effect of accounting change	–	(0.07)	**–**
	$ 1.81	$ 1.38	**$ 1.45**
Diluted earnings per share:			
Before accounting change	$ 1.70	$ 1.38	**$ 1.41**
Cumulative effect of accounting change	–	(0.06)	**–**
	$ 1.70	$ 1.32	**$ 1.41**
Weighted average shares outstanding:			
Basic	5,189	5,341	**5,406**
Diluted	5,536	5,574	**5,553**

See accompanying notes.

BALANCE SHEETS

In millions

June 30	2001	2002
Assets		
Current assets:		
Cash and equivalents	$ 3,922	**$ 3,016**
Short-term investments	27,678	**35,636**
Total cash and short-term investments	31,600	**38,652**
Accounts receivable, net	3,671	**5,129**
Inventories	83	**673**
Deferred income taxes	1,522	**2,112**
Other	2,334	**2,010**
Total current assets	39,210	**48,576**
Property and equipment, net	2,309	**2,268**
Equity and other investments	14,361	**14,191**
Goodwill	1,511	**1,426**
Intangible assets, net	401	**243**
Other long-term assets	1,038	**942**
Total assets	$ 58,830	**$ 67,646**
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 1,188	**$ 1,208**
Accrued compensation	742	**1,145**
Income taxes	1,468	**2,022**
Short-term unearned revenue	4,395	**5,920**
Other	1,461	**2,449**
Total current liabilities	9,254	**12,744**
Long-term unearned revenue	1,219	**1,823**
Deferred income taxes	409	**398**
Other long-term liabilities	659	**501**
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital—shares authorized 12,000; Shares issued and outstanding 5,383 and 5,359	28,390	**31,647**
Retained earnings, including accumulated other comprehensive income of $587 and $583	18,899	**20,533**
Total stockholders' equity	47,289	**52,180**
Total liabilities and stockholders' equity	$ 58,830	**$ 67,646**

See accompanying notes.

CASH FLOWS STATEMENTS

In millions

Year Ended June 30	**2000**	**2001**	**2002**
Operations			
Net income	$ 9,421	$ 7,346	**$ 7,829**
Cumulative effect of accounting change, net of tax	–	375	**–**
Depreciation, amortization, and other noncash items	1,250	1,536	**1,084**
Net recognized (gains)/losses on investments	(1,732)	2,221	**2,424**
Stock option income tax benefits	5,535	2,066	**1,596**
Deferred income taxes	(425)	(420)	**(416)**
Unearned revenue	6,177	6,970	**11,152**
Recognition of unearned revenue	(5,600)	(6,369)	**(8,929)**
Accounts receivable	(944)	(418)	**(1,623)**
Other current assets	(775)	(482)	**(264)**
Other long-term assets	(864)	(330)	**(9)**
Other current liabilities	(992)	774	**1,449**
Other long-term liabilities	375	153	**216**
Net cash from operations	11,426	13,422	**14,509**
Financing			
Common stock issued	2,245	1,620	**1,497**
Common stock repurchased	(4,896)	(6,074)	**(6,069)**
Sales/(repurchases) of put warrants	472	(1,367)	**–**
Preferred stock dividends	(13)	–	**–**
Other, net	–	235	**–**
Net cash used for financing	(2,192)	(5,586)	**(4,572)**
Investing			
Additions to property and equipment	(879)	(1,103)	**(770)**
Purchases of investments	(42,290)	(66,346)	**(89,386)**
Maturities of investments	4,025	5,867	**8.654**
Sales of investments	29,752	52,848	**70,657**
Net cash used for investing	(9,392)	(8,734)	**(10,845)**
Net change in cash and equivalents	(158)	(898)	**(908)**
Effect of exchange rates on cash and equivalents	29	(26)	**2**
Cash and equivalents, beginning of year	4,975	4,846	**3,922**
Cash and equivalents, end of year	$ 4,846	$ 3,922	**$ 3,016**

See accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS

In millions

Year Ended June 30	**2000**	**2001**	**2002**
Convertible preferred stock			
Balance, beginning of year	$ 980	$ –	**$ –**
Conversion of preferred to common stock	(980)	–	**–**
Balance, end of year	–	–	**–**
Common stock and paid-in capital			
Balance, beginning of year	13,844	23,195	**28,390**
Common stock issued	3,554	5,154	**1,801**
Common stock repurchased	(210)	(394)	**(676)**
Sales/(repurchases) of put warrants	472	(1,367)	**–**
Stock option income tax benefits	5,535	2,066	**1,596**
Other, net	–	(264)	**536**
Balance, end of year	23,195	28,390	**31,647**
Retained earnings			
Balance, beginning of year	13,614	18,173	**18,899**
Net income	9,421	7,346	**7,829**
Other comprehensive income:			
Cumulative effect of accounting change	–	(75)	**–**
Net gains/(losses) on derivative instruments	–	634	**(91)**
Net unrealized investment gains/(losses)	(283)	(1,460)	**5**
Translation adjustments and other	23	(39)	**82**
Comprehensive income	9,161	6,406	**7,825**
Preferred stock dividends	(13)	–	**–**
Immaterial pooling of interests	97	–	**–**
Common stock repurchased	(4,686)	(5,680)	**(6,191)**
Balance, end of year	18,173	18,899	**20,533**
Total stockholders' equity	$ 41,368	$ 47,289	**$ 52,180**

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 ACCOUNTING POLICIES

ACCOUNTING PRINCIPLES

The financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America.

PRINCIPLES OF CONSOLIDATION

The financial statements include the accounts of Microsoft Corporation and its subsidiaries (Microsoft). Intercompany transactions and balances have been eliminated. Equity investments in which Microsoft owns at least 20% of the voting securities are accounted for using the equity method, except for investments in which the Company is not able to exercise significant influence over the investee, in which case, the cost method of accounting is used. Issuances of shares by a subsidiary are accounted for as capital transactions.

ESTIMATES AND ASSUMPTIONS

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples include estimates of loss contingencies and product life cycles, and assumptions such as the elements comprising a software arrangement, including the distinction between upgrades/enhancements and new products; when the Company reaches technological feasibility for its products; the potential outcome of the future tax consequences of events that have been recognized in the Company's financial statements or tax returns; and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from these estimates and assumptions.

FOREIGN CURRENCIES

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

REVENUE RECOGNITION

Microsoft accounts for the licensing of software in accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition.* The Company recognizes revenue when (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the sales price is fixed or determinable; and (iv) collectibility is reasonably assured. For software arrangements with multiple elements, revenue is recognized dependent upon whether vendor-specific objective evidence (VSOE) of fair value exists for each of the elements. When VSOE does not exist for all the elements of a software arrangement and the only undelivered element is postcontract customer support (PCS), the entire licensing fee is recognized ratably over the contract period. Revenue attributable to undelivered elements, including technical support and Internet browser technologies, is based on the average sales price of those elements when sold separately, and is recognized ratably on a straight-line basis over the product's life cycle. PCS and subscription revenue is recognized ratably over the contract period.

Revenue from products licensed to original equipment manufacturers (OEMs) is based on the licensing agreement with an OEM and has historically been recognized when OEMs ship licensed products to their customers. Licensing provisions were modified with the introduction of Windows XP in 2002 and revenue for certain products is recorded upon shipment of the product to OEMs. The effect of this change in licensing provisions was not material. Revenue from packaged product sales to distributors and resellers is usually recorded when related products are shipped. However, when the revenue recognition criteria required for distributor and reseller arrangements are not met, revenue is recognized as payments are received. Revenue related to the Company's Xbox game console is recognized upon shipment of the product to retailers. Online advertising revenue is recognized as advertisements are displayed. Costs related to insignificant obligations, which include telephone support for certain products, are accrued. Provisions are recorded for estimated returns, concessions, and bad debts.

COST OF REVENUE

Cost of revenue includes direct costs to manufacture and distribute product and direct costs to provide online services, consulting, product support, and training and certification of system integrators.

RESEARCH AND DEVELOPMENT

Technological feasibility for Microsoft's software products is reached shortly before the products are released to manufacturing. Costs incurred after technological feasibility is established are not material, and accordingly, the Company expenses all research and development costs when incurred.

ADVERTISING COSTS

Advertising costs are expensed as incurred. Advertising expense was $1.23 billion in 2000, $1.36 billion in 2001, and $1.27 billion in 2002.

INCOME TAXES

Income tax expense includes U.S. and international income taxes, plus the provision for U.S. taxes on undistributed earnings of international subsidiaries not deemed to be permanently invested. Certain items of income and expense are not reported in tax returns and financial statements in the same year. The tax effect of this difference is reported as deferred income taxes.

FINANCIAL INSTRUMENTS

The Company considers all liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. Short-term investments generally mature between three months and six years from the purchase date. Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. All cash and short-term investments are classified as available for sale and are recorded at market value using the specific identification method; unrealized gains and losses are reflected in OCI.

Equity and other investments include debt and equity instruments. Debt securities and publicly traded equity securities are classified as available for sale and are recorded at market using the specific identification method. Unrealized gains and losses (excluding other-than-temporary impairments) are reflected in OCI. All other investments, excluding those accounted for using the equity method, are recorded at cost.

Microsoft lends certain fixed income and equity securities to enhance investment income. Collateral and/or security interest is determined based upon the underlying security and the creditworthiness of the borrower. The fair value of collateral that Microsoft is permitted to sell or repledge was $499 million at both June 30, 2001 and 2002.

Investments are considered to be impaired when a decline in fair value is judged to be other-than-temporary. The Company employs a systematic methodology that considers available evidence in evaluating potential impairment of its investments. In the event that the cost of an investment exceeds its fair value, the Company evaluates, among other factors, the duration and extent to which the fair value is less than cost; 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; and the Company's intent and ability to hold the investment. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis in the investment is established. In 2001, the Company recognized $4.80 billion in impairments of certain investments, primarily in the cable and telecommunication industries. In 2002, Microsoft recognized $4.32 billion in impairments of certain investments, primarily related to further declines in the fair values of U.S. and European cable and telecommunications holdings.

The Company uses derivative instruments to manage exposures to foreign currency, security price, and interest rate risks. The Company's objectives for holding derivatives are to minimize these risks using the most effective methods to eliminate or reduce the impact of these exposures.

Foreign Currency Risk. Certain forecasted transactions and assets are exposed to foreign currency risk. The Company monitors its foreign currency exposures daily to maximize the overall effectiveness of its foreign currency hedge positions. Principal currencies hedged include the Euro, Japanese yen, British pound, and Canadian dollar. Options used to hedge a portion of forecasted international revenue for up to three years in the future are designated as cash flow hedging instruments. Options and forwards not designated as hedging instruments under SFAS 133 are also used to hedge the impact of the variability in exchange rates on accounts receivable and collections denominated in certain foreign currencies.

Securities Price Risk. Strategic equity investments are subject to market price risk. From time to time, the Company uses and designates options to hedge fair values and cash flows on certain equity securities. The security, or forecasted sale thereof, selected for hedging is determined by market conditions, up-front costs, and other relevant factors. Once established, the hedges are not dynamically managed or traded, and are generally not removed until maturity.

Interest Rate Risk. Fixed-income securities are subject to interest rate risk. The fixed-income portfolio is diversified and consists primarily of investment grade securities to minimize credit risk. The Company routinely uses options, not designated as hedging instruments, to hedge its exposure to interest rate risk in the event of a catastrophic increase in interest rates.

Other Derivatives. In addition, the Company may invest in warrants to purchase securities of other companies as a strategic investment. Warrants that can be net share settled are deemed derivative financial instruments and are not designated as hedging instruments.

For options designated either as fair value or cash flow hedges, changes in the time value are excluded from the assessment of hedge effectiveness.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

The allowance for doubtful accounts reflects management's best estimate of probable losses inherent in the account receivable balance. Management determines the allowance based on known troubled accounts, historical experience, and other currently available evidence. Activity in the allowance for doubtful accounts is as follows:

In Millions

Year Ended June 30	Balance at beginning of period	Charged to costs and expenses	Write-offs and other	Balance at end of period
2002	$ 174	$ 192	$ 157	$ 209
2001	186	157	169	174
2000	204	77	95	186

INVENTORIES

Inventories are stated at the lower of cost or market, using the average cost method. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories.

PROPERTY AND EQUIPMENT

Property and equipment is stated at cost and depreciated using the straight-line method over the shorter of the estimated life of the asset or the lease term, ranging from one to 15 years. Computer software developed or obtained for internal use is depreciated using the straight-line method over the estimated useful life of the software, generally not in excess of three years.

GOODWILL

Beginning in fiscal 2002 with the adoption of SFAS 142, *Goodwill and Other Intangible Assets,* goodwill is no longer amortized, but instead tested for impairment at least annually. Prior to fiscal 2002, goodwill was amortized using the straight-line method over its estimated period of benefit.

INTANGIBLE ASSETS

Intangible assets are amortized using the straight-line method over their estimated period of benefit, ranging from three to seven years. The Company periodically evaluates the recoverability of intangible assets and takes into account events or circumstances that warrant revised estimates of useful lives or that indicate that an impairment exists. All of Microsoft's intangible assets are subject to amortization.

RECLASSIFICATIONS

Certain reclassifications have been made for consistent presentation.

NOTE 2 ACCOUNTING CHANGES

Effective July 1, 2000, the Company adopted SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. The adoption of SFAS 133 on July 1, 2000, resulted in a cumulative pre-tax reduction to income of $560 million ($375 million after-tax) and a cumulative pre-tax reduction to OCI of $112 million ($75 million after-tax). The reduction to income was mostly attributable to a loss of approximately $300 million reclassified from OCI for the time value of options and a loss of approximately $250 million reclassified from OCI for derivatives not designated as hedging instruments. The reduction to OCI was mostly attributable to losses of approximately $670 million on cash flow hedges offset by reclassifications out of OCI of the approximately $300 million loss for the time value of options and the approximately $250 million loss for derivative instruments not designated as hedging instruments. The net derivative losses included in OCI as of July 1, 2000 were reclassified into earnings during the twelve months ended June 30, 2001. The change in accounting from the adoption of SFAS 133 did not materially affect net income in 2001.

Effective July 1, 2001, Microsoft adopted SFAS 141, *Business Combinations,* and SFAS 142, *Goodwill and Other Intangible Assets.* SFAS 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting. It also specifies the types of acquired intangible assets that are required to be recognized and reported separate from goodwill. SFAS 142 requires that goodwill and certain intangibles no longer be amortized, but instead tested for impairment at least annually. There was no impairment of goodwill upon adoption of SFAS 142.

Net income and earnings per share for fiscal 2000 and fiscal 2001 adjusted to exclude amortization expense (net of taxes) is as follows:

In Millions, Except Earnings Per Share

Year Ended June 30	**2000**	**2001**
Net income:		
Reported net income	$ 9,421	$ 7,346
Goodwill amortization	203	252
Equity method goodwill amortization	1	26
Adjusted net income	$ 9,625	$ 7,624
Basic earnings per share:		
Reported basic earnings per share	$ 1.81	$ 1.38
Goodwill amortization	0.04	0.05
Equity method goodwill amortization	–	–
Adjusted basic earnings per share	$ 1.85	$ 1.43
Diluted earnings per share:		
Reported diluted earnings per share	$ 1.70	$ 1.32
Goodwill amortization	0.04	0.05
Equity method goodwill amortization	–	–
Adjusted diluted earnings per share	$ 1.74	$ 1.37

NOTE 3 UNEARNED REVENUE

A portion of Microsoft's revenue under volume licensing programs is earned ratably over the period of the license agreement. Also, revenue attributable to undelivered elements, including technical support and Internet browser technologies, is based on the average sales price of those elements when sold separately, and is recognized ratably on a straight-line basis over the product's life cycle. The percentage of revenue recognized ratably for undelivered elements ranges from approximately 20% to 25% for Windows XP Home, approximately 10% to 15% for Windows XP Professional, and approximately 10% to 15% for desktop applications, depending on the terms and conditions of the license and prices of the elements. Product life cycles are currently estimated at three years for Windows operating systems and 18 months for desktop applications.

The components of unearned revenue were as follows:

In Millions

June 30	**2001**	**2002**
Volume licensing programs	$ 1,922	**$ 4,158**
Undelivered elements	2,818	**2,830**
Other	874	**755**
Unearned revenue	$ 5,614	**$ 7,743**

Unearned revenue by product was as follows:

In Millions

June 30	**2001**	**2002**
Desktop Applications	$ 2,189	**$ 3,489**
Desktop Platforms	2,586	**3,198**
Enterprise Software and Services	391	**791**
Desktop and Enterprise Software and Services	5,166	**7,478**
Consumer Software, Services, and Devices, and Other	448	**265**
Unearned revenue	$ 5,614	**$ 7,743**

Of the $7.74 billion of unearned revenue at June 30, 2002, $2.28 billion is expected to be recognized in the first quarter of fiscal 2003, $1.64 billion in the second quarter of fiscal 2003, $1.18 billion in the third quarter of fiscal 2003, $817 million in the fourth quarter of fiscal 2003, and $1.82 billion thereafter.

NOTE 4 CASH AND SHORT-TERM INVESTMENTS

In Millions

June 30, 2001	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis
Cash and equivalents:				
Cash	$ 1,145	$ –	$ –	$ 1,145
Commercial paper	894	–	–	894
Certificates of deposit	286	–	–	286
U.S. government and agency securities	400	–	–	400
Corporate notes and bonds	1,130	–	–	1,130
Municipal securities	67	–	–	67
Cash and equivalents	3,922	–	–	3,922
Short-term investments:				
Commercial paper	635	3	–	638
U.S. government and agency securities	7,355	9	(42)	7,322
Corporate notes and bonds	17,256	214	(149)	17,321
Municipal securities	1,662	41	–	1,703
Certificates of deposit	694	–	–	694
Short-term investments	27,602	267	(191)	27,678
Cash and short-term investments	**$31,524**	**$ 267**	**$ (191)**	**$ 31,600**

In Millions

June 30, 2002	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis
Cash and equivalents:				
Cash	**$ 1,114**	**$ –**	**$ –**	**$ 1,114**
Commercial paper	**260**	–	–	**260**
Certificates of deposit	**31**	**–**	**–**	**31**
Money market mutual funds	**714**	**–**	**–**	**714**
Corporate notes and bonds	**560**	**–**	**–**	**560**
Municipal securities	**337**	–	–	**337**
Cash and equivalents	**3,016**	–	–	**3,016**
Short-term investments:				
Commercial paper	**552**	**–**	**–**	**552**
U.S. government and agency securities	**10,726**	**114**	**(13)**	**10,827**
Corporate notes and bonds	**18,822**	**255**	**(241)**	**18,836**
Municipal securities	**4,462**	**86**	**–**	**4,548**
Certificates of deposit	**873**	**–**	**–**	**873**
Short-term investments	**35,435**	**455**	**(254)**	**35,636**
Cash and short-term investments	**$38,451**	**$ 455**	**$ (254)**	**$ 38,652**

Realized gains and (losses) from cash and short-term investments were $80 million and $(226) million in 2000, $541 million and $(369) million in 2001, and $816 million and $(558) million in 2002.

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NOTE 5 INVENTORIES

In Millions

June 30	**2001**	**2002**
Finished goods	$ 78	**$ 505**
Raw materials and work in process	5	**168**
Inventories	$ 83	**$ 673**

NOTE 6 PROPERTY AND EQUIPMENT

In Millions

June 30	**2001**	**2002**
Land	$ 185	**$ 197**
Buildings	1,584	**1,701**
Computer equipment and software	2,292	**2,621**
Other	1,214	**1,372**
Property and equipment – at cost	5,275	**5,891**
Accumulated depreciation	(2,966)	**(3,623)**
Property and equipment – net	$ 2,309	**$ 2,268**

During 2000, 2001, and 2002, depreciation expense, of which the majority related to computer equipment, was $668 million, $764 million, and $820 million.

NOTE 7 EQUITY AND OTHER INVESTMENTS

In Millions

June 30, 2001	**Cost Basis**	**Unrealized Gains**	**Unrealized Losses**	**Recorded Basis**
Debt securities recorded at market, maturing:				
Within one year	$ 500	$ –	$ –	$ 500
Between 2 and 10 years	643	12	(3)	652
Between 10 and 15 years	513	–	(9)	504
Beyond 15 years	4,754	–	(829)	3,925
Debt securities recorded at market	6,410	12	(841)	5,581
Common stock and warrants	5,555	2,030	(285)	7,300
Preferred stock	881	–	–	881
Other investments	599	–	–	599
Equity and other investments	$13,445	$ 2,042	$ (1,126)	$ 14,361

In Millions

June 30, 2002	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis
Debt securities recorded at market, maturing:				
Within one year	$ 485	$ 26	$ –	$ 511
Between 2 and 10 years	893	46	(4)	935
Between 10 and 15 years	541	19	(2)	558
Beyond 15 years	3,036	–	–	3,036
Debt securities recorded at market	4,955	91	(6)	5,040
Common stock and warrants	6,930	1,287	(617)	7,600
Preferred stock	1,382	–	–	1,382
Other investments	169	–	–	169
Equity and other investments	$13,436	$ 1,378	$ (623)	$ 14,191

Debt securities include corporate and government notes and bonds and derivative securities. Debt securities maturing beyond 15 years are composed entirely of AT&T 5% convertible preferred debt with a contractual maturity of 30 years. The debt is convertible at the Company's option into AT&T common stock on or after December 1, 2000, or may be redeemed by AT&T upon satisfaction of certain conditions on or after June 1, 2002. In connection with the definitive agreement to combine AT&T Broadband with Comcast in a new company to be called AT&T Comcast Corporation, Microsoft has agreed to exchange its AT&T 5% convertible preferred debt securities for approximately 115 million shares of AT&T Comcast Corporation. It is expected that the transaction will close by December 31, 2002. While it is possible that Microsoft could incur a loss on this exchange transaction up to the carrying value of the AT&T debt securities, management believes that the ultimate loss, if any, will be significantly less. As management is unable to predict whether there will be a gain or loss on the exchange, no loss has been recorded related to this contingent exchange transaction as of June 30, 2002.

Equity securities that are restricted for more than one year or not publicly traded are recorded at cost. At June 30, 2001 the estimated fair value of these investments in excess of their recorded basis was $161 million. At June 30, 2002 the recorded basis of these investments in excess of their estimated fair value was $34 million. This excess of cost over estimated fair value was deemed temporary in nature. The estimate of fair value is based on publicly available market information or other estimates determined by management. Realized gains and (losses) from equity and other investments (excluding impairments discussed previously) were $1.94 billion and $(10) million in 2000, $3.03 billion and $(23) million in 2001, and $2.24 billion and $(121) million in 2002.

NOTE 8 GOODWILL

During fiscal 2002, goodwill was reduced by $85 million, principally in connection with Microsoft's exchange of all of its 33.7 million shares and warrants of Expedia, Inc. to USA Networks, Inc. No goodwill was acquired or impaired during fiscal 2002. As of June 30, 2002, Desktop and Enterprise Software and Services goodwill was $1.1 billion, Consumer Software, Services, and Devices goodwill was $258 million, and Consumer Commerce Investments goodwill was $72 million.

NOTE 9 INTANGIBLE ASSETS

During fiscal 2002, changes in intangible assets primarily relates to the Company's acquisition of $25 million in patents and licenses and $27 million in existing technology, which will be amortized over approximately 3 years. No significant residual value is estimated for these intangible assets. Intangible assets amortization expense was $202 million for fiscal 2001 and $194 million for fiscal 2002. The components of intangible assets were as follows:

In Millions

June 30	2001		2002	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Patents and licenses	$ 407	$ (177)	$ 421	$ (290)
Existing technology	157	(27)	172	(71)
Trademarks, tradenames and other	83	(42)	15	(4)
Intangible assets	$ 647	$ (246)	$ 608	$ (365)

Amortization expense for the net carrying amount of intangible assets at June 30, 2002 is estimated to be $115 million in fiscal 2003, $90 million in fiscal 2004, $36 million in fiscal 2005, and $2 million in fiscal 2006.

NOTE 10 DERIVATIVES

For fiscal 2001, investment income included a net unrealized loss of $592 million, comprised of a $214 million gain for changes in the time value of options for fair value hedges, $211 million loss for changes in the time value of options for cash flow hedges, and $595 million loss for changes in the fair value of derivative instruments not designated as hedging instruments. For fiscal 2002, investment income included a net unrealized loss of $480 million, comprised of a $30 million gain for changes in the time value of options for fair value hedges, $331 million loss for changes in the time value of options for cash flow hedges, and $179 million net loss for changes in the fair value of derivative instruments not designated as hedging instruments.

Derivative gains and losses included in OCI are reclassified into earnings at the time forecasted revenue or the sale of an equity investment is recognized. During fiscal 2001, $214 million of derivative gains were reclassified to revenue and $416 million of derivative losses were reclassified to investment income/(loss). During fiscal 2002, $234 million of derivative gains were reclassified to revenue and $10 million of derivative losses were reclassified to investment income/(loss). The derivative losses reclassified to investment income/(loss) were offset by gains on the item being hedged. The Company estimates that $63 million of net derivative gains included in other comprehensive income will be reclassified into earnings within the next twelve months.

For instruments designated as hedges, hedge ineffectiveness, determined in accordance with SFAS 133, had no impact on earnings for the fiscal 2001 and 2002. No fair value hedges or cash flow hedges were derecognized or discontinued for fiscal 2001 and 2002.

NOTE 11 INVESTMENT INCOME/(LOSS)

The components of investment income/(loss) are as follows:

In Millions

Year Ended June 30	2000	2001	2002
Dividends	$ 363	$ 377	**$ 357**
Interest	1,231	1,808	**1,762**
Net recognized gains/(losses) on investments:			
Net gains on the sales of investments	1,780	3,175	**2,379**
Other-than-temporary impairments	(29)	(4,804)	**(4,323)**
Net unrealized losses attributable to derivative instruments	(19)	(592)	**(480)**
Net recognized gains/(losses) on investments	1,732	(2,221)	**(2,424)**
Investment income/(loss)	$ 3,326	$ (36)	**$ (305)**

NOTE 12 INCOME TAXES

The provision for income taxes consisted of:

In Millions

Year Ended June 30	2000	2001	2002
Current taxes:			
U.S. and state	$ 4,744	$ 3,243	**$ 3,644**
International	535	514	**575**
Current taxes	5,279	3,757	**4,219**
Deferred taxes	(425)	47	**(535)**
Provision for income taxes	$ 4,854	$ 3,804	**$ 3,684**

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

In Millions

Year Ended June 30	2000	2001	2002
U.S.	$ 11,860	$ 9,189	**$ 8,920**
International	2,415	2,336	**2,593**
Income before income taxes	$ 14,275	$ 11,525	**$ 11,513**

In 2000, the effective tax rate was 34.0%, and included the effect of a 2.5% reduction from the U.S. statutory rate for tax credits and a 1.5% increase for other items. In 2001, the effective tax rate was 33.0%, and included the effect of a 3.1% reduction from the U.S. statutory rate for tax credits and a 1.1% increase for other items. The effective tax rate in 2002 was 32.0%, and included the effect of a 2.4% reduction from the U.S. statutory rate for the extraterritorial income exclusion tax benefit and a 0.6% reduction for other items.

Deferred income taxes were:

In Millions

June 30	**2001**	**2002**
Deferred income tax assets:		
Revenue items	$ 1,469	**$ 2,261**
Expense items	691	**945**
Impaired investments	1,070	**2,016**
Deferred income tax assets	$ 3,230	**$ 5,222**
Deferred income tax liabilities:		
Unrealized gain on investments	$ (395)	**$ (887)**
International earnings	(1,667)	**(1,818)**
Other	(55)	**(803)**
Deferred income tax liabilities	$(2,117)	**$(3,508)**

Microsoft has not provided for U.S. deferred income taxes or foreign withholding taxes on $780 million of its undistributed earnings for certain non-U.S. subsidiaries, all of which relate to fiscal 2002 earnings, since these earnings are intended to be reinvested indefinitely.

On September 15, 2000, the U.S. Tax Court issued an adverse ruling with respect to Microsoft's claim that the Internal Revenue Service (IRS) incorrectly assessed taxes for 1990 and 1991. The Company has filed an appeal with the Ninth Circuit Court of Appeals on this matter. Income taxes, except for items related to the 1990 and 1991 assessments, have been settled with the IRS for all years through 1996. The IRS is examining the Company's 1997 through 1999 U.S. income tax returns. Management believes any adjustments which may be required will not be material to the financial statements. Income taxes paid were $800 million in 2000, $1.3 billion in 2001, and $1.9 billion in 2002.

NOTE 13 STOCKHOLDERS' EQUITY

Shares of common stock outstanding were as follows:

In Millions

Year Ended June 30	**2000**	**2001**	**2002**
Balance, beginning of year	5,109	5,283	**5,383**
Issued	229	189	**104**
Repurchased	(55)	(89)	**(128)**
Balance, end of year	5,283	5,383	**5,359**

The Company repurchases its common shares in the open market to provide shares for issuance to employees under stock option and stock purchase plans. In 2002, the Company acquired 5.1 million of its shares as a result of a structured stock repurchase transaction entered into in 2001, which gave it the right to acquire such shares in exchange for an up-front net payment of $264 million. To enhance its stock repurchase program, Microsoft has sold put warrants to independent third parties. These put warrants entitled the holders to sell shares of Microsoft common stock to the Company on certain dates at specified prices. In the third quarter of fiscal 2001, the Company issued 2.8 million shares to settle a portion of the outstanding put warrants. At June 30, 2001 and 2002, there were no outstanding put warrants.

During 1996, Microsoft issued 12.5 million shares of 2.75% convertible exchangeable principal-protected preferred stock. The Company's convertible preferred stock matured on December 15, 1999. Each preferred share was converted into 1.1273 common shares.

NOTE 14 OTHER COMPREHENSIVE INCOME

In Millions

Year Ended June 30	**2000**	**2001**	**2002**
Cumulative effect of accounting change, net of tax effect of $(37)	$ –	$ (75)	**$ –**
Net gains/(losses) on derivative instruments:			
Unrealized gains, net of tax effect of $246 in 2001 and $30 in 2002	–	499	**55**
Reclassification adjustment for (gains)/losses included in net income, net of tax effect of $67 in 2001 and $(79) in 2002	–	135	**(146)**
Net gains/(losses) on derivative instruments	–	634	**(91)**
Net unrealized investment gains/(losses):			
Unrealized holding gains/(losses), net of tax effect of $248 in 2000, $(351) in 2001, and $(955) in 2002	531	(1,200)	**(1,774)**
Reclassification adjustment for (gains)/losses included in net income, net of tax effect of $(420) in 2000, $(128) in 2001, and $958 in 2002	(814)	(260)	**1,779**
Net unrealized investment gains/(losses)	(283)	(1,460)	**5**
Translation adjustments and other	23	(39)	**82**
Other comprehensive income/(loss)	$ (260)	$ (940)	**$ (4)**

The components of accumulated other comprehensive income were:

In Millions

June 30	**2001**	**2002**
Net gains on derivative instruments	$ 177	**$ 86**
Net unrealized investment gains	598	**603**
Translation adjustments and other	(188)	**(106)**
Accumulated other comprehensive income	$ 587	**$ 583**

NOTE 15 EMPLOYEE STOCK AND SAVINGS PLANS

EMPLOYEE STOCK PURCHASE PLAN

The Company has an employee stock purchase plan for all eligible employees. Under the plan, shares of the Company's common stock may be purchased at six-month intervals at 85% of the lower of the fair market value on the first or the last day of each six-month period. Employees may purchase shares having a value not exceeding 15% of their gross compensation during an offering period. During 2000, 2001, and 2002, employees purchased 2.5 million, 5.7 million, and 5.4 million shares at average prices of $72.38, $36.87, and $50.52 per share. At June 30, 2002, 56.8 million shares were reserved for future issuance.

SAVINGS PLAN

The Company has a savings plan, which qualifies under Section 401(k) of the Internal Revenue Code. Participating employees may contribute up to 25% of their pretax salary, but not more than statutory limits. The Company contributes fifty cents for each dollar a participant contributes, with a maximum contribution of 3% of a participant's earnings. Matching contributions were $47 million, $63 million, and $77 million in 2000, 2001, and 2002.

STOCK OPTION PLANS

The Company has stock option plans for directors, officers, and employees, which provide for nonqualified and incentive stock options. Options granted prior to 1995 generally vest over four and one-half years and expire 10 years from the date of grant. Options granted between 1995 and 2001 generally vest over four and one-half years and expire seven years from the date of grant, while certain options vest either over four and one-half years or over seven and one-half years and expire after 10 years. Options granted during 2002 vest over four and one-half years and expire 10 years from the date of grant. At June 30, 2002, options for 371 million shares were vested and 543 million shares were available for future grants under the plans.

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Stock options outstanding were as follows:

In Millions, Except Per Share Amounts

		Price per Share	
	Shares	Range	Weighted Average
Balance, June 30, 1999	766	$ 0.56 – $ 83.28	$ 23.87
Granted	304	65.56 – 119.13	79.87
Exercised	(198)	0.56 – 82.94	9.54
Canceled	(40)	4.63 – 116.56	36.50
Balance, June 30, 2000	832	0.56 – 119.13	41.23
Granted	224	41.50 – 80.00	60.84
Exercised	(123)	0.59 – 85.81	11.13
Canceled	(35)	13.83 – 119.13	63.57
Balance, June 30, 2001	898	0.56 – 119.13	49.54
Granted	**41**	**48.62 – 72.57**	**62.50**
Exercised	**(99)**	**1.02 – 69.81**	**12.82**
Canceled	**(38)**	**1.15 – 116.56**	**68.67**
Balance, June 30, 2002	**802**	**0.79 – 119.13**	**53.75**

For various price ranges, weighted average characteristics of outstanding stock options at June 30, 2002 were as follows:

In Millions, Except Per Share Amounts

	Outstanding Options			Exercisable Options	
Range of Exercise Prices	Shares	Remaining Life (Years)	Weighted Average Price	Shares	Weighted Average Price
$ 0.79 – $ 5.97	**36**	**1.6**	**$ 4.83**	**35**	**$ 4.82**
5.98 – 13.62	**44**	**0.5**	**11.19**	**42**	**11.18**
13.63 – 29.80	**90**	**2.0**	**15.02**	**84**	**14.97**
29.81 – 43.62	**73**	**2.7**	**32.19**	**66**	**32.09**
43.63 – 60.00	**191**	**6.9**	**55.81**	**41**	**54.03**
60.01 – 69.50	**146**	**6.4**	**66.24**	**35**	**66.53**
69.51 – 83.28	**80**	**5.1**	**71.17**	**21**	**71.84**
83.29 – 119.13	**142**	**4.2**	**89.87**	**47**	**89.29**

The Company follows Accounting Principles Board Opinion 25, *Accounting for Stock Issued to Employees,* to account for stock option and employee stock purchase plans. An alternative method of accounting for stock options is SFAS 123, *Accounting for Stock-Based Compensation.* Employee stock options are valued at grant date using the Black-Scholes valuation model, and this compensation cost is recognized ratably over the vesting period.

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Had compensation cost for the Company's stock option and employee stock purchase plans been determined as prescribed by SFAS 123, pro forma income statements for 2000, 2001, and 2002 would have been as follows:

In Millions, Except Per Share Amounts

Year Ended June 30	**2000**		**2001**		**2002**	
	Reported	**Pro Forma**	**Reported**	**Pro Forma**	**Reported**	**Pro Forma**
Revenue	$ 22,956	$ 22,956	$ 25,296	$ 25,296	**$ 28,365**	**$ 28,365**
Operating expenses:						
Cost of revenue	3,002	3,277	3,455	3,775	**5,191**	**5,699**
Research and development	3,772	4,814	4,379	6,106	**4,307**	**6,299**
Sales and marketing	4,126	4,468	4,885	5,888	**5,407**	**6,252**
General and administrative	1,050	1,284	857	1,184	**1,550**	**1,843**
Total operating expenses	11,950	13,843	13,576	16,953	**16,455**	**20,093**
Operating income	11,006	9,113	11,720	8,343	**11,910**	**8,272**
Losses on equity investees and other	(57)	(57)	(159)	(159)	**(92)**	**(92)**
Investment income/(loss)	3,326	3,326	(36)	(36)	**(305)**	**(305)**
Income before income taxes	14,275	12,382	11,525	8,148	**11,513**	**7,875**
Provision for income taxes	4,854	4,210	3,804	2,689	**3,684**	**2,520**
Income before accounting change	9,421	8,172	7,721	5,459	**7,829**	**5,355**
Cumulative effect of accounting change	–	–	(375)	(375)	**–**	**–**
Net income	$ 9,421	$ 8,172	$ 7,346	$ 5,084	**$ 7,829**	**$ 5,355**
Basic earnings per share	$ 1.81	$ 1.57	$ 1.38	$ 0.95	**$ 1.45**	**$ 0.99**
Diluted earnings per share	$ 1.70	$ 1.48	$ 1.32	$ 0.91	**$ 1.41**	**$ 0.98**

The weighted average Black-Scholes value of options granted under the stock option plans during 2000, 2001, and 2002 was $36.67, $29.31, and $31.57. Value was estimated using a weighted average expected life of 6.2 years in 2000, 6.4 years in 2001, and 7.0 years in 2002, no dividends, volatility of .33 in 2000, .39 in 2001, and .39 in 2002, and risk-free interest rates of 6.2%, 5.3%, and 5.4% in 2000, 2001, and 2002.

NOTE 16 EARNINGS PER SHARE

Basic earnings per share is computed on the basis of the weighted average number of common shares outstanding. Diluted earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding preferred shares using the "if-converted" method, outstanding put warrants using the "reverse treasury stock" method, and outstanding stock options using the "treasury stock" method.

The components of basic and diluted earnings per share were as follows:

In Millions, Except Per Share Amounts

Year Ended June 30	**2000**	**2001**	**2002**
Income before accounting change	$ 9,421	$ 7,721	**$ 7,829**
Preferred stock dividends	13	–	–
Net income available for common shareholders	$ 9,408	$ 7,721	**$ 7,829**
Weighted average outstanding shares of common stock	5,189	5,341	**5,406**
Dilutive effect of:			
Put warrants	2	21	**–**
Preferred stock	7	–	**–**
Employee stock options	338	212	**147**
Common stock and common stock equivalents	5,536	5,574	**5,553**
Earnings per share before accounting change:			
Basic	$ 1.81	$ 1.45	**$ 1.45**
Diluted	$ 1.70	$ 1.38	**$ 1.41**

For the years ended June 30, 2000, 2001 and 2002, 45 million, 351 million, and 373 million shares attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because the effect was antidilutive.

NOTE 17 OPERATIONAL TRANSACTIONS

In January 2000, the Company acquired Visio Corporation in a transaction that was accounted for as a pooling of interests. Microsoft issued 14 million shares valued at approximately $1.5 billion in the exchange for the outstanding stock of Visio. Visio's assets and liabilities, which were nominal, are included with those of Microsoft as of the merger. Operating results for Visio from periods prior to the merger were not material to the combined results of the two companies. Accordingly, the financial statements for such periods have not been restated.

In April 2001, the Company acquired Great Plains Software, Inc. for approximately $1.1 billion in stock. Great Plains is a leading supplier of mid-market business applications. The acquisition was accounted for by the purchase method and operating results for Great Plains subsequent to the date of acquisition are included with those of Microsoft. The pro forma impact of Great Plains' operating results prior to the date of acquisition was not material.

NOTE 18 COMMITMENTS

The Company has operating leases for most U.S. and international sales and support offices and certain equipment. Rental expense for operating leases was $201 million, $281 million, and $318 million in 2000, 2001, and 2002. Future minimum rental commitments under noncancellable leases, in millions of dollars, are: 2003, $260; 2004, $219; 2005, $197; 2006, $170; 2007, $135; and thereafter, $302. Microsoft has committed $111 million for constructing new buildings. In addition, the Company has guaranteed $536 million in debt of its equity investees.

NOTE 19 CONTINGENCIES

The Company is a defendant in *U.S. v. Microsoft*, a lawsuit filed by the Antitrust Division of the U.S. Department of Justice (DOJ) and a group of eighteen state Attorneys General alleging violations of the Sherman Act and various state antitrust laws. After the trial, the District Court entered Findings of Fact and Conclusions of Law stating that Microsoft had violated Sections 1 and 2 of the Sherman Act and various state antitrust laws. A Judgment was entered on June 7, 2000 ordering, among other things, the breakup of Microsoft into two companies.

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The Judgment was stayed pending an appeal. On June 28, 2001, the U.S. Court of Appeals for the District of Columbia Circuit affirmed in part, reversed in part, and vacated the Judgment in its entirety and remanded the case to the District Court for a new trial on one Section 1 claim and for entry of a new judgment consistent with its ruling. In its ruling, the Court of Appeals substantially narrowed the bases of liability found by the District Court, but affirmed some of the District Court's conclusions that Microsoft had violated Section 2. On October 12, 2001, the trial court held a status conference and entered orders requiring the parties to engage in settlement discussions until November 2, 2001. Microsoft entered into a settlement with the United States on November 2, 2001. Nine states (New York, Ohio, Illinois, Kentucky, Louisiana, Maryland, Michigan, North Carolina and Wisconsin) agreed to settle on substantially the same terms on November 6, 2001. A hearing on the settlement was held by the Court on March 6, 2002. The Court will now decide whether to approve the settlement as being in the public interest. Nine states and the District of Columbia continue to litigate the remedies phase of *U.S. v. Microsoft*. The non-settling states are seeking imposition of a remedy that would impose much broader restrictions on Microsoft's business than the proposed settlement with the DOJ and nine other states. The Court conducted an evidentiary hearing related to the non-settling states' proposed remedies from March 18 to June 19, 2002. A decision is anticipated later in calendar 2002.

In other ongoing investigations, the DOJ and several state Attorneys General have requested information from Microsoft concerning various issues. In addition, the European Commission has instituted proceedings in which it alleges that Microsoft has failed to disclose information that Microsoft competitors claim they need to interoperate fully with Windows 2000 clients and servers and has engaged in discriminatory licensing of such technology, as well as improper bundling of multimedia playback technology in the Windows operating system. The remedies sought, though not fully defined, include mandatory disclosure of Microsoft Windows operating system technology and imposition of fines. Microsoft denies the European Commission's allegations and intends to contest the proceedings vigorously.

A large number of overcharge class action lawsuits have been initiated against Microsoft in various state and Federal courts. These cases allege that Microsoft has competed unfairly and unlawfully monopolized alleged markets for operating systems and certain software applications and seek to recover alleged overcharges that the complaints contend Microsoft charged for these products. Microsoft believes the claims are without merit and is vigorously defending the cases. To date, Microsoft has won dismissals of all claims for damages by indirect purchasers under Federal law and in 17 separate state court proceedings, of which seven have been affirmed and one has been reversed. Claims on behalf of foreign purchasers have also been dismissed. Appeals of several of these rulings are still pending. No trials or other proceedings have been held concerning any liability issues. Courts in several states have ruled that these cases may proceed as class actions, while two courts have denied class certification status to the claims in that state proceeding and another has ruled that no class action is available for claims in that state. In fiscal 2002, the Company recorded a contingent liability of approximately $660 million representing management's estimate of the costs of resolving the contingency. Management's contingent liability estimate is based upon a proposed settlement between Microsoft and lead counsel for the Federal plaintiffs. While the proposed settlement was not approved by the District Court, management believes that the proposal represents the best estimate of the costs of resolving the contingency based on currently available information. The Company intends to continue vigorously defending these lawsuits.

Netscape Communications Inc., a subsidiary of AOL-Time Warner Inc., filed suit against Microsoft on January 22, 2002 in Federal court in the District of Columbia, alleging violations of antitrust and unfair competition laws and other tort claims relating to Netscape and its Navigator browser. The complaint includes claims of unlawful monopolization or attempted monopolization of alleged markets for operating systems and Web browsers, illegal tying of operating systems and browsers, and tortuous interference with Netscape's business relations. Netscape seeks injunctive relief, unquantified treble damages and its fees and costs. Microsoft denies these allegations and will vigorously defend this action. The case has been transferred for pretrial purposes to the District Court in Baltimore, Maryland and is being coordinated with the overcharge class actions described above.

Be Incorporated, a former software development company whose assets were acquired by Palm Incorporated in August 2001, filed suit against Microsoft on February 18, 2002 in Federal court in San Francisco, alleging violations of Federal and state antitrust and unfair competition laws and other tort claims. Be alleges that Microsoft's license agreements with computer manufacturers, pricing policies, and business practices interfered with Be's relationships with computer manufacturers and discouraged them from adopting Be's own operating system for their products. Be is seeking unquantified treble and punitive damages for its alleged injuries along with its fees and costs. Microsoft denies these allegations and will vigorously defend this action. The case has been transferred for pretrial purposes to the District Court in Baltimore, Maryland and is being coordinated with the overcharge class actions described above.

On March 8, 2002, Sun Microsystems, Inc. filed suit against Microsoft alleging violations of Federal and state antitrust and unfair competition laws as well as claims under the Federal Copyright Act. Sun seeks injunctive relief and unspecified treble damages along with its fees and costs. Microsoft denies these allegations and will vigorously defend this action. The case has been transferred for pretrial purposes to the District Court in Baltimore, Maryland and is being coordinated with the overcharge class actions described above.

On June 3, 2002, Microsoft and the Securities and Exchange Commission entered into an administrative settlement resolving a non-public investigation of certain of Microsoft's accounting and record keeping practices during fiscal years 1995 through 1998 (SEC File No. 3-10789). The settlement provides that Microsoft will not violate securities regulations that require companies to make accurate filings and maintain sufficient records and controls. The settlement has no impact on the Company's financial results.

The Company is also subject to a variety of other claims and suits that arise from time to time in the ordinary course of its business.

Management currently believes that resolving all of these matters will not have a material adverse impact on the Company's financial position or its results of operations.

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NOTE 20 SEGMENT INFORMATION

In Millions

Year Ended June 30	Desktop and Enterprise Software and Services	Consumer Software, Services, and Devices	Consumer Commerce Investments	Other	Reconciling Amounts	Consolidated
2000						
Revenue	$ 20,410	$ 1,654	$ 182	$ 691	$ 19	$ 22,956
Operating income/(loss)	13,210	(1,090)	(60)	86	(1,140)	11,006
2001						
Revenue	$ 22,720	$ 1,961	$ 522	$ 652	$ (559)	$ 25,296
Operating income/(loss)	14,261	(1,666)	(222)	97	(750)	11,720
2002						
Revenue	**$ 23,786**	**$ 3,531**	**$ 245**	**$ 537**	**$ 266**	**$ 28,365**
Operating income/(loss)	**14,671**	**(1,778)**	**23**	**59**	**(1,065)**	**11,910**

Desktop and Enterprise Software and Services Revenue:

In Millions

Year Ended June 30	2000	2001	2002
Desktop Applications	$ 9,013	$ 9,580	**$ 9,327**
Desktop Platforms	7,383	8,265	**9,276**
Desktop Software	16,396	17,845	**18,603**
Enterprise Software and Services	4,014	4,875	**5,183**
Total Desktop and Enterprise Software and Services	$ 20,410	$ 22,720	**$ 23,786**

In fiscal 2002, Microsoft had four segments: Desktop and Enterprise Software and Services; Consumer Software, Services, and Devices; Consumer Commerce Investments; and Other. Desktop and Enterprise Software and Services operating segment includes Desktop Applications, Desktop Platforms, and Enterprise Software and Services. Desktop Applications include Microsoft Office; Microsoft Project; Visio; client access licenses for Windows NT Server and Windows 2000 Server, Exchange, and BackOffice; Microsoft Great Plains; and bCentral. Desktop Platforms include Windows XP Professional and Home, Windows 2000 Professional, Windows NT Workstation, Windows Millennium Edition (Windows Me), Windows 98, and other desktop operating systems. Enterprise Software and Services includes Server Platforms; Server Applications; developer tools and services; and Enterprise services. Consumer Software, Services, and Devices operating segment includes Xbox video game system, MSN Internet access, MSN network services, PC and online games, learning and productivity software, mobility, and embedded systems. Consumer Commerce Investments operating segment includes Expedia, Inc., the HomeAdvisor online real estate service, and the CarPoint online automotive service. Other primarily includes Hardware and Microsoft Press.

Segment information is presented in accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information.* This standard is based on a management approach, which requires segmentation based upon the Company's internal organization and disclosure of revenue and operating income based upon internal accounting methods. The Company's financial reporting systems present various data for management to run the business, including internal profit and loss statements (P&Ls) prepared on a basis not consistent with U.S. generally accepted accounting principles. Assets are not allocated to segments for internal reporting presentations.

Reconciling items for revenue include certain elements of unearned revenue and the treatment of certain channel inventory amounts and estimates. In addition to the reconciling items for revenue, reconciling items for operating income/(loss) include general and administrative expenses ($1.05 billion in 2000, $857 million in 2001, and $1.55 billion in 2002), certain research expenses ($141 million in 2000, $154 million in 2001, and $166 million in 2002), and other corporate level adjustments. The internal P&Ls use accelerated methods of depreciation and amortization. Additionally, losses on equity investees and minority interests are classified in operating income for internal reporting presentations.

Revenue attributable to U.S. operations includes shipments to customers in the United States, licensing to OEMs and certain multinational organizations, and exports of finished goods, primarily to Asia, Latin America, and Canada. Revenue from U.S. operations totaled $15.7 billion, $17.8 billion, and $20.9 billion in 2000, 2001, and 2002. Revenue from outside the United States, excluding licensing to OEMs and certain multinational organizations and U.S. exports, totaled $7.3 billion, $7.5 billion, and $7.5 billion in 2000, 2001, and 2002. No single customer accounted for 10% or more of revenue in 2000, 2001, or 2002.

Long-lived assets (principally property and equipment) totaled $2.2 billion and $2.0 billion in the United States in 2001 and 2002 and $154 million and $220 million in other countries in 2001 and 2002.

NOTE 21 SUBSEQUENT EVENT

On July 11, 2002, Microsoft acquired Navision a/s as a result of the successful close of a tender offer. Microsoft purchased Navision's shares for approximately $1.45 billion in stock and cash. Navision is a provider of integrated business software solutions for small and medium-sized companies. The purchase price allocation is currently being developed for this acquisition.

QUARTERLY INFORMATION

In millions, except per share amounts (Unaudited)

Quarter Ended	**Sept. 30**	**Dec. 31**	**Mar. 31**	**June 30**	**Year**
Fiscal 2000					
Revenue	$ 5,384	$ 6,112	$ 5,656	$ 5,804	$ 22,956
Gross profit	4,672	5,356	4,904	5,022	19,954
Net income	2,191	2,436	2,385	2,409	9,421
Basic earnings per share	0.43	0.47	0.46	0.46	1.81
Diluted earnings per share	0.40	0.44	0.43	0.44	1.70
Fiscal 2001					
Revenue	$ 5,766	$ 6,550	$ 6,403	$ 6,577	$ 25,296
Gross profit	4,941	5,686	5,504	5,710	21,841
Net income	2,206(1)	2,624	2,451	65(2)	7,346
Basic earnings per share	0.42(1)	0.49	0.46	0.01	1.38
Diluted earnings per share	0.40(1)	0.47	0.44	0.01	1.32
Fiscal 2002					
Revenue	**$ 6,126**	**$ 7,741**	**$ 7,245**	**$ 7,253**	**$ 28,365**
Gross profit	**5,242**	**6,197**	**5,850**	**5,885**	**23,174**
Net income	**1,283(3)**	**2,283**	**2,738(4)**	**1,525(5)**	**7,829**
Basic earnings per share	**0.24**	**0.42**	**0.51**	**0.28**	**1.45**
Diluted earnings per share	**0.23**	**0.41**	**0.49**	**0.28**	**1.41**

(1) Includes an unfavorable cumulative effect of accounting change of $375 million or $0.07 per basic share and $0.06 per diluted share, reflecting the adoption of SFAS No. 133.
(2) Includes $3.92 billion (pre-tax) in impairments of certain investments.
(3) Includes $1.82 billion (pre-tax) in impairments of certain investments.
(4) Includes $1.25 billion (pre-tax) gain on the sale of Expedia, Inc. and $1.19 billion (pre-tax) in impairments of certain investments.
(5) Includes $1.19 billion (pre-tax) in impairments of certain investments.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of Microsoft Corporation:

We have audited the accompanying consolidated balance sheets of Microsoft Corporation and subsidiaries (the Company) as of June 30, 2001 and 2002, and the related consolidated statements of income, cash flows, and stockholders' equity for each of the three years in the period ended June 30, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Microsoft Corporation and subsidiaries as of June 30, 2001 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2002 in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2 to the financial statements, the Company adopted Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, effective July 1, 2000, and Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, effective July 1, 2001.

/S/ DELOITTE & TOUCHE LLP
Deloitte & Touche LLP
Seattle, Washington
July 18, 2002

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

PART III

ITEM 10. DIRECTORS OF THE REGISTRANT

Information with respect to Directors may be found under the caption "Election of Directors and Management Information" of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held November 5, 2002 (the "Proxy Statement"). Such information is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions "Information Regarding Executive Officer Compensation" and "Information Regarding the Board and its Committees" is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

EQUITY COMPENSATION PLAN INFORMATION

In Millions, Except Per Share Amounts

June 30, 2002 Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	802	$ 53.75	600
Equity compensation plans not approved by security holders	–	–	–
Total	802	$ 53.75	600

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

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information set forth under the captions "Certain Relationships and Related Transactions" of the Proxy Statement is incorporated herein by reference.

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PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Financial Statements and Schedules
The financial statements are set forth under Item 8 of this report on Form 10-K. Financial statement schedules have been omitted since they are either not required, not applicable, or the information is otherwise included.
(b) Reports on Form 8-K
The Company filed no reports on Form 8-K during the quarter ended June 30, 2002.
(c) Exhibit Listing

Exhibit Number	**Description**
3.1	Restated Articles of Incorporation of Microsoft Corporation (1)
3.2	Bylaws of Microsoft Corporation
10.1	Microsoft Corporation 2001 Stock Plan (2)
10.2	Microsoft Corporation 1991 Stock Option Plan (3)
10.3	Microsoft Corporation 1981 Stock Option Plan (4)
10.4	Microsoft Corporation 1999 Stock Option Plan for Non-Employee Directors (5)
10.5	Microsoft Corporation Stock Option Plan for Consultants and Advisors
10.6	Microsoft Corporation 1997 Employee Stock Purchase Plan (6)
10.7	Microsoft Corporation Savings Plus Plan (7)
10.8	Trust Agreement dated June 1, 1993 between Microsoft Corporation and First Interstate Bank of Washington
10.9	Form of Indemnification Agreement
10.10	Resignation Agreement between Richard Belluzzo and Microsoft Corporation
21.	Subsidiaries of Registrant
23.	Independent Auditors' Consent
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference to Annual Report on Form 10-K For The Fiscal Year Ended June 30, 1999.
(2) Incorporated by reference to Registration Statement 333-52-852 on Form S-8.
(3) Incorporated by reference to Annual Report on Form 10-K For The Fiscal Year Ended June 30, 1997.
(4) Incorporated by reference to Registration Statement 33-37623 on Form S-8.
(5) Incorporated by reference to Registration Statement 333-91755 on Form S-8.
(6) Incorporated by reference to Annual Report on Form 10-K For The Fiscal Year Ended June 30, 2001.
(7) Incorporated by reference to Annual Report on Form 10-K For The Fiscal Year Ended June 30, 2000.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned; thereunto duly authorized, in the City of Redmond, State of Washington, on September 5, 2002.

MICROSOFT CORPORATION

By /S/ JOHN G. CONNORS

John G. Connors
Senior Vice President; Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on September 5, 2002.

Signature	Title
/S/ WILLIAM H. GATES, III William H. Gates, III	Chairman of the Board of Directors and Chief Software Architect
/S/ STEVEN A. BALLMER Steven A. Ballmer	Chief Executive Officer
/S/ JAMES I. CASH, JR. James I. Cash, Jr.	Director
/S/ RAYMOND V. GILMARTIN Raymond V. Gilmartin	Director
/S/ ANN MCLAUGHLIN KOROLOGOS Ann McLaughlin Korologos	Director
/S/ DAVID F. MARQUARDT David F. Marquardt	Director
/S/ WM. G. REED, JR. Wm. G. Reed, Jr.	Director
/S/ JON A. SHIRLEY Jon A. Shirley	Director
/S/ JOHN G. CONNORS John G. Connors	Senior Vice President; Chief Financial Officer (Principal Financial and Accounting Officer)

CERTIFICATIONS

I, Steven A. Ballmer, certify that:

1. I have reviewed this annual report on Form 10-K of Microsoft Corporation;

2. Based on my knowledge, this annual 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 annual report; and

3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report.

Date: September 5, 2002

/S/ STEVEN A. BALLMER

Steven A. Ballmer
Chief Executive Officer

I, John G. Connors, certify that:

1. I have reviewed this annual report on Form 10-K of Microsoft Corporation;

2. Based on my knowledge, this annual 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 annual report; and

3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report.

Date: September 5, 2002

/S/ JOHN G. CONNORS

John G. Connors
Chief Financial Officer

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Exhibit 3.2

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 or an authorized committee of the Board of Directors.

1.3 Place of Meetings. Meetings of shareholders shall be held at such place within or without the State of Washington as determined by the Board of Directors, or an authorized committee of the Board, pursuant to proper notice.

1.4 Notice. Written or electronic notice of each shareholders' meeting stating the date, time, and place and, in case of a special meeting, the purpose(s) for which such 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.

1.5 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 of that meeting unless a new record date is or must be set for the adjourned meeting. At such reconvened meeting, any business may be transacted that might have been transacted at the meeting as originally notified.

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.

1.6 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 such reconvened meeting at which a quorum is present any business may be transacted at the meeting as originally notified. 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 a new record date for the adjourned meeting is or must be fixed in accordance with the WBCA, notice of the adjourned meeting must be given to persons who are shareholders as of the new record date.

1.7 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, such date in any case to be not 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 thereof, 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.

1.8 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 such 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. Such record 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 for the purposes thereof.

1.9 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 submission of (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.

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

1.11 Order of Business. The Chairman of a meeting of shareholders, determined in accordance with Section 1.10, shall have discretion to establish the order of business for such meeting subject to any specific order established by the Board of Directors.

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. The directors shall be elected by the shareholders at each annual shareholders' meeting 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.

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 such waiver shall be deemed to be the equivalent of giving notice. The waiver must be in given in accordance with the requirements of 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 said 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 President, or the Secretary of the Corporation. Any such 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, 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 applied to the Board; and

c. To the extent provided in such resolution, shall have and may exercise all the authority of the Board, except no such committee shall have the authority to:

(1) Authorize or approve a distribution except according to a general formula or method prescribed by the Board;

(2) Approve or propose to shareholders action which the WBCA requires to be approved by shareholders;

(3) Fill vacancies on the Board or on any of its committees;

(4) Amend the Articles of Incorporation;

(5) Adopt, amend, or repeal the Bylaws;

(6) Approve a plan of merger not requiring shareholder approval; or

(7) 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 such 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; telegraph or teletype; 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 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, a President, 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 such 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 such 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, may also 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 appoint a successor or successors who shall hold office for the unexpired term 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:

(1) The Articles or Restated Articles of Incorporation and all amendments to them currently in effect;

(2) The Bylaws or Restated Bylaws and all amendments to them currently in effect;

(3) The minutes of all shareholders' meetings, and records of all actions taken by shareholders without a meeting, for the past three (3) years;

(4) 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;

(5) All communications to shareholders generally within the past three (3) years;

(6) A list of the names and business addresses of its current directors and officers; and

(7) 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.

Adopted: August 22, 2002.

Exhibit 10.5

MICROSOFT CORPORATION

STOCK OPTION PLAN
FOR CONSULTANTS AND ADVISORS

1. Purposes of the Plan. The purposes of this Stock Option Plan are to attract and maintain a long-term relationship with the best available consultants and advisors, to provide additional incentive to such individuals, and to promote the success of the Company's business. Options granted hereunder shall be Nonqualified Stock Options, and shall be evidenced by written Stock Option Agreements.

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

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

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

(c) "Committee" shall mean the Committee appointed by the Board of Directors in accordance with paragraph (a) of Section 4 of the Plan, if one is appointed.

(d) "Common Stock" shall mean the common stock of Microsoft Corporation.

(e) "Company" shall mean Microsoft Corporation, a Washington corporation.

(f) "Continuous Status as a Consultant or Advisor" shall mean the absence of any interruption, expiration, or termination of an Optionee's consulting or advisory relationship, with the Company. Continuous Status as a Consultant or Advisor shall not be considered interrupted in the case of any temporary interruption in such person's availability to provide services to the Company which has been authorized in writing by a Vice President of the Company prior to its commencement; provided, however, that the Company may require suspension of vesting in such cases. Continuous Status as a Consultant or Advisor shall not be considered terminated if such person accepts employment with the Company, and thereafter a person's Continuous Status as an Employee, and the effects of an interruption or termination thereof (including by reason of death or disability), shall be determined with reference to the Company's 1991 Stock Option Plan.

(g) "Nonqualified Stock Option" shall mean an Option not intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.

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

(i) "Optioned Stock" shall mean the Common Stock subject to an Option.

(j) "Optionee" shall mean any consultant or advisor who receives an Option.

(k) "Plan" shall mean this Stock Option Plan for Consultants and Advisors.

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

3. Stock Subject to the Plan. Subject to the provisions of Section 11 of the Plan, the maximum aggregate number of shares which may be optioned and sold under the Plan is 2,400,000 shares of Common Stock. The Shares may be authorized, but unissued, or reacquired Common Stock.

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

4. Administration of the Plan.

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

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

(2) The Board of Directors may, from time to time, increase the size of the Committee and appoint additional members thereof, remove members (with or without cause) and appoint new members in substitution therefor, fill vacancies however caused, or remove all members of the Committee and thereafter directly administer the Plan.

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

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

5. Eligibility.

(a) Options may be granted to consultants and advisors who provide consulting services to the Company. In no event shall any employees (full-time or part-time) of the Company be eligible for the grant of an Option under the Plan. Notwithstanding the foregoing, the fact that an Optionee subsequently becomes an employee of the Company shall not affect such Optionee's Option, so long as the Optionee's Continuous Status as a Consultant or Advisor was uninterrupted prior to his or her commencement of employment with the Company.

(b) Nothing in the Plan or any Option granted hereunder shall confer upon any Optionee any right to continue or require the continuance of the Optionee's consulting or advisory relationship with the Company, nor shall it interfere in any way with the Optionee's right or the Company's right to terminate such relationship at any time, with or without cause.

6. Term of Plan. The Plan shall become effective upon its adoption by the Board and shall continue in effect for ten (10) years, unless sooner terminated under Section 14 of the Plan.

7. Term of option. The term of each Option shall be no more than ten (10) years from the date of grant.

8. Exercise Price and Consideration.

(a) The per Share exercise price under each Option shall be such price as is determined by the Board, which price may be less than, equal to, or greater than the fair market value per Share on the date of grant.

(b) The fair market value per Share shall be the closing price per share of the Common Stock on the National Association of Securities Dealers Automated Quotation ("NASDAQ") National Market System on the date of grant. If the Common Stock ceases to be listed on the NASDAQ National Market System, the Board shall designate an alternative method of determining the fair market value of the Common Stock.

(c) The consideration to be paid for the Shares to be issued upon exercise; of an Option, including the method of payment, shall be determined by the Board at the time of grant and may consist of cash and/or check. Payment may also be made by delivering a properly executed exercise notice, together with irrevocable instructions to a broker to promptly deliver to the Company the amount of sale proceeds necessary to pay the exercise price.

(d) Prior to issuance of the Shares upon exercise of an Option, the Optionee shall pay any federal, state, and local withholding obligations of the Company, if applicable.

9. Exercise of Option.

(a) Procedure for Exercise; Rights as a Stockholder. Any Option granted hereunder shall be exercisable at such times and under such conditions as determined by the Board at the time of grant, and as shall be permissible under the terms of the Plan. An Option may not be exercised for a fraction of a Share.

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

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

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

(c) Termination of Consulting Relationship Due to Disability of Optionee. Notwithstanding the provisions of Section 9(b) above, in the event of termination of an Optionee's Continuous Status as a Consultant or Advisor as a result of total and permanent disability (i.e., the inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of twelve (12) months), such Optionee may exercise stock options to the extent exercisable on the date of termination. Such exercise must occur within eighteen (18) months (or such shorter time as may be specified in the grant), after the date of such termination (but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement). To the extent that the Optionee was not entitled to exercise such Option within the time specified herein, the Option shall terminate.

(d) Death of Optionee. Notwithstanding the provisions of Section 9 (b) above, In the event of the death of an Optionee:

(i) who is at the time of death a consultant or advisor to the Company, the Option may be exercised, at any time within six (6) months following the date of death (but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement), by the Optionee's Personal Representative or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent of the right to exercise that had accrued as of the date of death; or

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

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

10. Non-Transferability of Options. The Option may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Optionee, only by the Optionee.

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

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

12. Time of Granting Options. The date of grant of an Option shall, for all purposes, be the date on which the Board makes the determination granting such Option. Notice of the determination shall be given to each consultant or advisor to whom an Option is so granted within a reasonable time after the date of such grant.

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

14. Amendment and Termination of the Plan.

(a) Amendment and Termination. The Board may amend or terminate the Plan from time to time in such respects as the Board may deem advisable.

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

15. Conditions Upon Issuance of Shares. Shares shall not be issued pursuant to the exercise of an Option unless the exercise of such Option and the issuance and delivery of such shares pursuant to thereto shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the rules and regulations promulgated thereunder, and the requirements of any stock exchange upon which the Shares may then be listed, and shall be further subject of the approval of counsel for the Company with respect to such compliance.

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

[The number of shares in Section 3 has been adjusted for stock splits in 1992, 1994, 1996, 1998, and 1999.]

Exhibit 10.8

TRUST AGREEMENT

This TRUST AGREEMENT is made on June 1, 1993, between MICROSOFT CORPORATION, a Delaware corporation ("Grantor"), and FIRST INTERSTATE BANK OF WASHINGTON, N.A. ("Trustee"), whose address is P.O. Box 21927, Seattle, Washington 98111, and William G. Reed, Jr. (the initial "Beneficiaries' Representative").

WHEREAS Grantor has agreed to indemnify "Beneficiaries" as defined in Section 1.1, including but not limited to the Directors and certain executive officers listed in Exhibit A, in accordance with its statutory and contractual obligations, including, but not limited to, those assumed in indemnification agreements in the form attached as Exhibit B to this Agreement or such other forms of indemnification agreement as may be entered into between Grantor and Beneficiaries; and

WHEREAS Grantor desires to create a trust (the "Trust") to fund its obligations for indemnification of the foregoing directors and officers.

NOW, THEREFORE, the Trustee accepts the trust created hereby and agrees that it will hold all property which it may receive hereunder, IN TRUST, for the purposes and upon the terms and conditions hereinafter stated and Grantor and Trustee agree as follows:

ARTICLE I

THE BENEFICIARIES AND THE

BENEFICIARIES' REPRESENTATIVE

1.1 The Beneficiaries. All present and future members of the Board of Directors or executive officers of Grantor who are specifically given the benefits of this Trust Agreement pursuant to an indemnification agreement substantially similar to the form attached as Exhibit B shall be "Beneficiaries" of the Trust, provided, however, that if there is a "Change in Control" of Grantor no officers or directors elected or appointed after or in connection with such Change in Control shall be entitled to be Beneficiaries who were not Beneficiaries prior to such Change in Control. For purposes of this Agreement, the term "Change of Control" shall mean (a) a tender offer or exchange offer where the purpose of such offer is to take over and control the Company and such offer is accepted by owners of securities of the Company representing 50% or more of the combined voting power of the Company's then outstanding voting securities, (b) the Company is merged or consolidated with another corporation and as a result of such merger or consolidation less than 50% of the outstanding voting securities of the surviving or resulting corporation shall then be owned in the aggregate by the former stockholders of the Company, (c) the Company transfers substantially all of its assets to another corporation which is not a wholly owned subsidiary of the Company, or (d) during any period of twelve consecutive months, individuals who at the beginning of such twelve month period were directors of the Company cease for any reason to constitute at least a majority of the Board of Directors of the Company. The Beneficiaries' Representative shall promptly notify the Trustee of a Change in Control. A list of the Beneficiaries as of the date of this Agreement is annexed hereto as Exhibit A. Any individual who is or becomes a Beneficiary shall remain so despite his resignation, removal, or other failure to continue to be an officer or member of the Board of Directors during the term of this Agreement.

1.2 New Beneficiaries. If an individual not listed in Exhibit A is duly elected to the Board of Directors of Grantor or appointed as an executive officer, Grantor agrees to notify the Trustee promptly of such election or appointment by delivering to the Trustee an updated Exhibit A which has been certified by the Secretary of Grantor to be accurate and to have been prepared in good faith. The Trustee shall have the right to rely on the accuracy and completeness of the most recent Exhibit A so provided.

1.3 Beneficiaries' Representative. All communications or demands made by and among the Trustee and the Beneficiaries are to be made through the individual then designated as the Beneficiaries' Representative. The Beneficiaries' Representative shall have the exclusive right to make demands from time to time on the Trustee to direct payment to one or more of the Beneficiaries.

1.4 Identity of Beneficiaries' Representative. The Beneficiaries' Representative shall be a present or past non-employee director of Grantor, designated in writing to the Trustee and Grantor by a majority of the then living past and present nonemployee directors who are Beneficiaries under this Agreement. The Trustee and Grantor shall be entitled to rely on the original appointment of that individual as the Beneficiaries' Representative unless notified in writing of a change in the Beneficiaries' Representative, which writing must be signed by at least a majority of the then living past and present nonemployee directors who are Beneficiaries under this Agreement. The Trustee shall then be entitled to rely on such subsequent appointment as of the date such writing is received by the Trustee. The Trustee shall be entitled to rely on the accuracy and completeness of a written list delivered to the Trustee by Grantor, and certified by the Secretary of Grantor to be accurate and to have been prepared in good faith, identifying the individuals who constitute the then living past and present nonemployee directors who are Beneficiaries under this Agreement. In the absence of an effective appointment of a Beneficiaries' Representative, the Trustee or any Beneficiary may, after ten days' written notice to all Beneficiaries, petition a court of competent jurisdiction at the expense of the Trust for appointment of a Beneficiaries' Representative who need not be a Beneficiary (if none are willing or able to serve), but shall in no event be an officer or director elected or appointed after a Change in Control who was not a Beneficiary prior to such Change in Control. The designation or appointment of a successor Beneficiaries' Representative shall become effective only upon the execution of a counterpart of this Trust Agreement whereby such successor Beneficiaries'

Representative shall assume and become bound by all the duties and responsibilities under this Trust Agreement and each indemnification agreement covered by this Trust Agreement.

1.5 Right of Beneficiaries to Receive Payments. The rights of the Beneficiaries to demand and receive distributions from the Trustee shall not be affected or diminished in any way by the existence of any dispute between Beneficiaries and Grantor, and the Trustee shall be entitled to rely upon the simple demand of the Beneficiaries' Representative pursuant to Section 2.7 in making distributions from the Trust Fund. Such distributions shall be made notwithstanding any notice or demand by or on behalf of Grantor that the distributions should not be made, whether based on Grantor's claim that any Beneficiary is not entitled to some or all of the amount of such distributions or otherwise. The Trustee shall have no responsibility or liability to Grantor for making any payment despite having received any such notice or demand by or on behalf of Grantor. The Trustee shall have no responsibility to inquire into the accuracy or truthfulness of any such notice or demand, whether from the Grantor or the Beneficiaries' Representative.

ARTICLE II

THE TRUST FUND

2.1 Trust Fund. The Trustee shall hold all property received by it hereunder as one fund which, together with the income and gains therefrom and additions thereto, shall constitute the Trust Fund.

2.2 Minimum Balance. Grantor hereby delivers to the Trustee the sum of $7,000,000 in cash (the "Minimum Balance"), the receipt of which is hereby acknowledged by the Trustee, to be held IN TRUST in accordance with the terms of this Agreement. Nothing contained herein shall preclude Grantor from making additional deliveries of funds from time to time to the Trustee, whether required under the terms of this Agreement or not, to be held IN TRUST as part of the Trust Fund.

2.3 Maintenance of Minimum Balance. The Trustee agrees to provide monthly reports to Grantor and the Beneficiaries' Representative showing the current fair market value of the Trust Fund. If any such report shows that the current fair market Value of the Trust Fund is less than the Minimum Balance, then within ten days after such report, Grantor agrees to deliver cash funds to the Trustee equal to the difference between the fair market value of the Trust Fund and the Minimum Balance so that the thrust fund balance is at least equal to the Minimum Balance. Notwithstanding the foregoing, Grantor shall have no obligation to make payments to the Trustee in excess of $100,000,000 over the term of this Trust Agreement.

2.4 Additional Contributions. Subject to the aggregate limitations of $100,000,000 for all Beneficiaries as set forth in Section 2.3, Grantor further agrees to make additional contributions to the Trust Funds within ten (10) days after receipt of a written request from the Beneficiaries' Representative certifying in good faith that Claims have or are reasonably expected to be asserted against Beneficiaries and that estimated Losses and Expenses for all pending, threatened or anticipated Claims against all the Beneficiaries are reasonably expected to exceed the then Trust Fund balance. A copy of such written certification shall be provided to the Trustee at the same time and in the same manner as it is provided to Grantor. Such written certification shall be accompanied by an opinion of independent counsel to the effect that based on the information made known to such counsel that the Claims are not Excluded Claims and that the amount requested is reasonable. Independent counsel shall be selected by the Beneficiaries' Representative and shall have no present or past professional relationship to the Beneficiaries who are the subject of the Claims. The terms "Claims," "Losses," "Expenses" and "Excluded Claims" shall have the same meaning as defined in the Indemnification Agreement attached as Exhibit B.

2.5 Excess Balance. If the fair market value of the Trust Fund shall exceed the Minimum Balance, plus any additional contributions which continue to be required pursuant to Section 2.4, Grantor shall be entitled to withdraw an amount equal to the excess over the Minimum Balance with the written consent of the Beneficiaries' Representative.

2.6 Direction of Investment. Notwithstanding anything contained herein to the contrary, Grantor retains the right to direct the investment of the Trust Fund and the Trustee shall have no duty to review or recommend investments. In the event the Trustee is required to make a distribution pursuant to Section 2.7 hereof at a time when the Trust Fund has insufficient cash to cover such distribution, the Trustee shall seek the advice of the Grantor with regard to which Trust investments to liquidate in order to cover the required distribution; if the Grantor does not respond to the Trustee's inquiry within forty-eight (48) hours the Trustee shall use its discretion in choosing which investments to liquidate.

2.7 Distributions From Trust Fund. The Trustee shall make distributions to a Beneficiary from the Trust Fund only upon demand of the Beneficiaries' Representative. Each such demand shall be submitted to the Trustee, in writing, signed by the Beneficiaries' Representative, and shall state (i) that such demand is being made pursuant to an indemnification agreement between Grantor and the Beneficiary, (ii) that the demand is for satisfaction of indemnification obligations and the amount being demanded by a Beneficiary, (iii) that, pursuant to the Indemnification agreement, the Beneficiary has certified that he or she is entitled to payment of at least the amount demanded, (iv) that the Beneficiary has previously made demand for payment upon Grantor, and (v) that no part of the amount then being demanded from the Trust Fund has been previously received from the Grantor. A copy of each demand shall be delivered to Grantor by the Trustee. As soon as practicable after such demand is made by the Beneficiaries' Representative, subject to the provisions of Section 1.5, the Trustee shall distribute funds to the Beneficiary specified in such demand in the amount and manner set forth therein. If the Trustee does not have sufficient funds to satisfy all pending demands of Beneficiaries in full, the Trustee shall make all reasonable efforts to make pro rata payments, less any amounts due the Trustee, to the Beneficiaries as specified by the Beneficiaries' Representative. Upon the replenishment of the Trust Fund, in accordance with Section 2.3, the Trustee shall continue to make pro rata distributions, less any amounts due the Trustee, until such demand is satisfied or to satisfy subsequent demands.

2.8 Taxes. The Grantor agrees to pay any and all taxes on the Trust Fund or the income thereof or which the Beneficiaries or the Trustee would otherwise be required to pay with respect to the interest of any person or persons therein, and to provide the Trustee with proof of payment.

2.9 Duties and Responsibilities of Beneficiaries' Representative. The Beneficiaries' Representative (and any successor Beneficiaries Representative) shall have the following affirmative duties and responsibilities:

2.9.l to demand deposits from the Grantor so as to maintain the Minimum Balance of the Trust in accordance with Section 2.3 and any Additional Contributions required by section 2.4 and any indemnification agreement with any Beneficiary;

2.9.2 to demand payment by the Trustee to a Beneficiary who has made a demand and who, in the good faith judgment of the Beneficiaries' Representative, has satisfied the conditions for indemnification as set forth in this Agreement and the indemnification agreement between the Beneficiary and the Grantor;

2.9.3 to generally cause the Grantor and Trustee to discharge their respective responsibilities under this Agreement and the responsibilities of the Grantor under each indemnification agreement, including the bringing of legal actions and proceedings to enforce such agreement.

2.10 Investment Powers of the Trustee. In addition to any powers which the Trustee may have under Washington law, the Trustee shall have, with respect to any property at any time held by him and constituting part of the Trust Fund, the power (subject to Grantor's right pursuant to Section 2.6 to direct the investment of the Trust Fund) to do any of the following:

2.10.1 To retain any property at any time received by the Trustee;

2.10.2 To sell or exchange any property at public or private sale for cash or on credit and to grant options for the purchase or exchange thereof;

2.10.3 To participate in any plan of reorganization, consolidation, merger, combination, liquidation, or other similar plan relating to any property held in the Trust Fund, and to consent to or oppose any such plan or any action thereunder, or any contract, lease, mortgage, purchase, sale, or other action by any person or corporation;

2.10.4 To exercise conversion and subscription rights pertaining to any property held in the Trust Fund;

2.10.5 To extend the time of payment of any obligation held in the Trust Fund;

2.10.6 To enter into stand-by agreements for future Investment, either with or without a standby fee;

2.10.7 To lend securities held in any Investment Fund to broker-dealers with whom the Trustee may from time to time conclude securities lending agreements on behalf of the Trust Fund, and to receive collateral for such securities; provided, however, the Trustee shall not lend securities if such lending activity would violate any State or Federal law;

2.10.8 To exercise all voting rights with respect to any investment and to grant proxies, discretionary or otherwise;

2.10.9 To settle, compromise, or submit to arbitration any claims, debts, or damages due or owing to or from the Trust; to commence or defend suits or legal proceedings to protect any interest of the Trust; and to represent or cause to be represented the Trust in all suits or legal proceedings in any court or before any other body or tribunal; and

2.10.10 For the purpose of the Trust, to borrow money from others, to issue its promissory note or notes therefor, and to secure the repayment thereof by pledging any property in Trustee's possession; provided, however, that no such loan or advance shall be made by the Trustee hereunder other than temporary advances to the Trust Fund, on a cash or overdraft basis, on which no interest is payable.

2.11 Administrative Powers of Trustee. The Trustee shall have power, in its sole discretion, to do any of the following:

2.11.1 To cause any investment to be registered and held in the name of one or more of its nominees, or one or more nominees of any system for the central handling of securities, without increase or decrease of liability;

2.11.2 To collect and receive any and all money and other property due to the Trust Fund and to give full discharge therefor;

2.11.3 To organize under the laws of any state a corporation for the purpose of acquiring and holding title to any property which Trustee is authorized to acquire under this Agreement and to exercise with respect thereto any or all of the powers set forth in this Agreement; and

2.11.4 To hold uninvested, without liability for interest thereon, such monies received by the Trustee as the Trustee considers necessary to meet anticipated and imminent disbursements.

ARTICLE III

RESIGNATION, REMOVAL, OR DEATH OF TRUSTEE

3.1 Resignation of Trustee. The Trustee may resign at any time by filing his written resignation with Grantor. Such resignation shall take effect sixty days from the date of such filing or upon appointment of a successor pursuant to Section 3.3, whichever shall first occur.

3.2 Removal of Trustee. Grantor and the Beneficiaries' Representative may remove the Trustee at any time by delivering to the Trustee a written notice of his removal and an appointment of a successor pursuant to Section 3.3.

3.3 Appointment of Successor Trustee.

3.3.1 Removal of the Trustee and the appointment of a successor Trustee shall take effect sixty days following delivery to the Trustee of (i) an instrument in writing removing the Trustee and appointing such successor, executed by Grantor and accompanied by an instrument in writing signed by the Beneficiaries' Representative certifying that two-thirds of the then living Beneficiaries agree to such removal and appointment, and (ii) an acceptance in writing, executed by such successor, both acknowledged in the same form as this Agreement. The Trustee may agree to an earlier effective date. In the event of the death or dissolution of the Trustee, the successor trustee shall be appointed by the Grantor with the approval of the Beneficiaries' Representative, which approval shall not be unreasonably withheld, and a writing to such effect and an acceptance in writing, as referred to above, shall be delivered to the Trustee's legal representative.

3.3.2 All of the provisions set forth herein with respect to the Trustee shall relate to each successor with the same force and effect as if such successor had been originally named as Trustee hereunder.

3.3.3 If a successor is not appointed within sixty days after the Trustee gives notice of his resignation pursuant to Section 3.1, or within sixty days after the Trustee's death, the Trustee or the Beneficiaries' Representative may apply to any court of competent jurisdiction at the expense of the trust for appointment of a successor.

3.4 Transfer of Fund to Successor. Upon appointment of a successor trustee as set forth above, and after the final account of the Trustee has been settled as provided in Section 5.4, the Trustee shall transfer and deliver the Trust Fund to such successor.

ARTICLE IV

DURATION, TERMINATION, AND AMENDMENT OF TRUST

4.1 Term. This trust shall terminate upon the written consent of the Grantor and two-thirds of the then living Beneficiaries. The Grantor's Board of Directors shall have the right to terminate the Trust unilaterally as of each anniversary of the execution of this Agreement. Any such termination, whether by written consent of two-thirds of the then living Beneficiaries or unilaterally by the Grantor shall be on a prospective basis only, and all provisions of this Agreement shall remain in fu1l force and effect as to any "Claim" relating to a "Covered Act" (as those two terms are defined in the indemnification agreement attached as Exhibit B) which Covered Act occurs prior to the effective date of such termination. Notice of such termination shall be given to the Trustee by an instrument in writing executed by the Grantor and the Beneficiaries' Representative together with a certified copy of the resolution of the Board of Directors of Grantor authorizing such termination. Copies of such notice shall also be given to each individual Beneficiary, the provisions of Section 1.3 notwithstanding. Termination shall be effective when such notices are effective pursuant to Section 6.6.

4.2 Distribution Upon Termination. When this Trust is terminated in accordance with Section 4.1, the Trustee shall distribute the Trust Fund to Grantor less any full and adequate provision for any distributions to be made pursuant to any outstanding demands under Section 2.7 and any deductions authorized or required by Section 5.3 hereof.

4.3 Amendment of Trust Instrument. This trust may not be amended by Grantor except upon the written consent of two-thirds of the then living Beneficiaries and the Trustee, provided that no such amendment shall deny, limit or otherwise modify the then existing rights of any Beneficiary who does not so consent. Notice of such amendment shall be given to the Trustee by an instrument in writing executed by the Grantor and the Beneficiaries' Representative acknowledged in the same form as this Agreement, together with a certified copy of the resolution of the Board of Directors of Grantor authorizing such amendment. The Grantor shall send a copy of such notice to each individual Beneficiary, the provisions of Section 1.3 notwithstanding.

ARTICLE V

RIGHTS AND OBLIGATIONS OF THE TRUSTEE

5.1 Duties of Trustees. The duties and liabilities of the Trustee shall at all times be limited to those expressly stated in this Agreement. The Trustee shall discharge his duties hereunder with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

The Trustee shall not be liable for any loss sustained by the Trust Fund by reason of the purchase, retention, sale, or exchange or any investment in good faith and in accordance with the Grantor's directions and the provisions of this Agreement.

5.2 Indemnification of Trustee. The Trustee shall not be liable for any action taken or omitted by him in good faith and believed by him to be authorized hereby or within the rights or powers conferred upon him hereunder, or taken or omitted by him in accordance with advice of counsel (which counsel may be of the Trustee's own choosing and which may be house counsel of the Trustee), and shall not be liable for any mistake of fact or error of judgment or for any acts or omissions of any kind unless caused by willful misconduct or gross negligence. Grantor agrees to indemnify the Trustee and hold him harmless against any and all liabilities, losses, claims, expenses, (including reasonable attorneys' fees), and damages incurred by him hereunder, except for liabilities, losses, claims, expenses, and damages incurred by the Trustee resulting from his own willful misconduct or gross negligence.

5.3 Expenses and Compensation. The Trustee shall pay from the Trust Fund, to the extent not paid by Grantor, the Trustee's reasonable expenses of administration of the Trust, including reasonable compensation of counsel (including house counsel) and any agents engaged by the Trustee to assist him in such administration. The Grantor shall pay the Trustee reasonable compensation for his services as Trustee hereunder and the Trustee shall have a lien on the Trust Fund for such compensation and expenses until paid.

5.4 Settlement of Accounts of Trustees. The Trustee shall keep full accounts of all of his receipts and disbursements. His financial statements, books, and records with respect to the Trust fund shall be open to inspection by the Grantor or the Beneficiaries' Representative or their representatives at all reasonable times during business hours of the Trustee and may be audited not more frequently than once in each fiscal year by an independent certified public accountant engaged by the Beneficiaries' Representative.

Within ninety days after the close of each fiscal year, or any termination of the duties of the Trustee, the Trustee shall prepare, sign, and submit in duplicate to Grantor an account of his acts and transactions as Trustee hereunder. If Grantor finds the account to be correct, Grantor shall sign the instrument of settlement annexed to one counterpart of the account and return such counterpart to the Trustee, whereupon the account shall become an account stated as between the Trustee and Grantor. If within ninety days after receipt of the account or any amended account Grantor has not signed and returned a counterpart to the Trustee, nor filed with the Trustee notice of any objection to any act or transaction of the Trustee, the account or amended account shall become an account stated as between the Trustee and Grantor. If any objection has been filed, and if Grantor is satisfied that it should be withdrawn or if the account is adjusted to its satisfaction, Grantor shall deliver to the Trustee its written approval of the account and it shall become an account stated as between the Trustee and the Grantor.

When an account becomes an account stated, such account shall be finally settled, and the Trustee shall be completely discharged and released, as if such account had been settled and allowed by a judgment or decree of a court of competent jurisdiction in any action or proceeding in which the Trustee and Grantor were parties.

The Trustee, the Beneficiaries' Representative, or Grantor shall have the right to apply at any time to a court of competent jurisdiction for judicial settlement of any account of the Trustee not previously settled as hereinabove provided. In any such action or proceeding it shall be necessary to join as parties only the Trustee, the Beneficiaries' Representative, and Grantor (although the Trustee may also join such other parties as he may deem appropriate), and any judgment or decree entered therein shall be conclusive.

ARTICLE VI

MISCELLANEOUS

6.1 Governing Law. The validity, interpretation, performance, and enforcement of this Agreement and the Trust created hereby shall be governed by the laws of the state of Washington. Notwithstanding the foregoing, the rights of the Beneficiaries to receive indemnification from Grantor are governed by the laws of the state of incorporation of Grantor. The parties irrevocably submit to the jurisdiction and venue of any Washington

State or United States Federal Court sitting in Seattle, Washington.

4.2 Successors. This Agreement and the Trust created hereby shall be binding upon and shall inure to the benefit of the spouses, heirs, personal and legal representatives, estates, successors, and assigns of the parties hereto and of the Beneficiaries.

6.3 Third Party Beneficiaries. The Beneficiaries are specifically acknowledged as third party beneficiaries of this Agreement and shall have the right to bring actions to enforce this Agreement where the Beneficiaries' Representative fails to bring such an action or fails to prosecute an action in good faith.

6.4 Enforcement Expenses. Grantor shall be responsible for all costs and expenses, including reasonable attorneys' fees and costs, incurred in any action brought to enforce or interpret this Agreement, whether brought by the Beneficiaries' Representative, a Beneficiary, the Trustee, or otherwise, unless the court determines that such Claim for enforcement was not brought in good faith or was frivolous.

6.5 Titles and Headings Not to Control. The titles to Articles and headings of Sections in this Agreement are placed herein for convenience of reference only and in case of any conflict the text of this Agreement, rather than such titles or headings, shall control.

6.6 Notices, Consents and Other Communications. All notices, consents, or other communications required or contemplated by this Agreement shal1 be in writing and shall be deemed to have been given when delivered either by (a) personal delivery, (b) overnight courier, or (c) postage prepaid return receipt requested certified mail to the last address given to the Trustee by each respective Beneficiary. Notice by personal delivery shall be effective upon the date service is made and notice by certified mail or overnight courier shall be effective on the date it is recorded as delivered by the U.S. Postal Service or the overnight courier, respectively.

IN WITNESS WHEREOF, the parties hereto have executed this agreement as of the day and year first above written.

Attest:

FIRST INTERSTATE BANK OF WASHINGTON, N.A.
("Trustee")

/s/ Joan Robinson
Attest: Assistant Corporate Secretary

By: /s/ Pamela A. Jorgenson

MICROSOFT CORPORATION

("Grantor")

By: /s/ William H. Neukom

By: /s/ William H. Gates

("Beneficiaries' Representative")

/s/ William G. Reed, Jr.
WILLIAM G. REED, JR.

Exhibit 10.9

INDEMNIFICATION AGREEMENT

This Agreement is made this 1st day of June, 1993, by and between Microsoft Corporation, a Delaware corporation (the "Company") and ______________ ("Indemnitee"), a director and/or executive officer of the Company and William G. Reed, Jr. (the initial "Beneficiaries' Representative").

WHEREAS, there is a general awareness that competent and experienced persons are becoming more reluctant to serve as directors or executive officers of publicly-held corporations unless they are protected by comprehensive policies of insurance or indemnification, due to the increasing number of lawsuits against such corporations and their directors and officers, the attendant expense of defending against such lawsuits, and the exposure of such directors and officers to unreasonably high damages;

WHEREAS, present laws and interpretations are frequently too uncertain to provide such officers and directors with adequate, reliable knowledge of the legal risks to which they may be exposed as a result of serving the corporation;

WHEREAS, the Board of Directors has concluded that its directors and executive officers should be provided with protection against such risks in order to insure that the most capable persons will be attracted to such positions; and, therefore, has determined to contractually obligate itself to indemnify in a reasonable manner its directors and executive officers and to assume for itself the liability for expenses and damages in connection with claims lodged against its directors and executive officers as a result of their service to the Company.

WHEREAS, applicable law empowers corporations to indemnify persons serving as a director, officer, employee, or agent of the corporation or a person who serves at the request of the corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise, and further empowers a corporation to purchase and maintain insurance (on behalf of such persons) against liability which may be asserted against Indemnitee or incurred by Indemnitee in any such capacity, or arising out of Indemnitee's status as such, whether or not the corporation would have the power to indemnify against such liability under the provisions of said laws;

WHEREAS, the Board of Directors has concluded that, due to the high cost and other negative features of the coverage under presently available directors and officers liability insurance, at this time it would not be in the best interest of its shareholders for the Company to purchase and maintain such insurance in the amounts customarily held by similar corporations and that its shareholders' interest would be better served by contracting to indemnify its executive officers and directors thereby reasonably self-insuring against such potential liabilities;

WHEREAS, the Company desires to have Indemnitee serve or continue to serve as a director or executive officer of the Company free from undue concern for damages by reason of Indemnitee being a director and/or executive officer of the Company or by reason of his or her decision or actions on its behalf, and Indemnitee is willing to serve, or to continue to serve, only if he or she is furnished the indemnity provided for hereinafter in one or more of such capacities; and

WHEREAS, the parties believe it appropriate to memorialize and reaffirm the Company's indemnification obligations to Indemnitee and, in addition, to set forth the agreements contained herein.

NOW, THEREFORE, in consideration of the promises, conditions, representations, and warranties set forth herein, including the Indemnitee's continued service to the Company, the Company and Indemnitee hereby agree as follows:

1. Definitions. The following terms, as used herein, shall have the following respective meanings:

"Beneficiary" or "Beneficiaries" means an officer or director of the Company who qualifies as a Beneficiary under Section 1.1 of the Trust Agreement.

"Beneficiaries' Representative" means a non-employee director of the Company, or other individual selected in accordance with the procedures set forth in Section 1.4 of the Trust Agreement.

"Claim or Claims" includes without limitation any threatened, pending, or completed action, suit, or proceeding whether civil, derivative, criminal, administrative, investigative, or otherwise, and includes any Claims by or in the right of the Company.

"Covered Amount" means Loss and Expenses which, in type or amount, are not insured under any D&O Insurance.

"Covered Act" means any act or omission (including without limitation any breach of duty, neglect, error, misstatement, misleading statement, or otherwise, or appearing as or preparing to be a witness) by Indemnitee, and any Claim against Indemnitee, by reason of the fact that Indemnitee is or was a director or officer of the Company, or of any subsidiary or division, or is or was serving at the request of the Company as a director, officer, partner, trustee, employee, or agent of another corporation, partnership, joint venture, trust, employee benefit plan, or other enterprise.

"D&O Insurance" means any directors' and officers' liability insurance issued to the Company the proceeds of which are available for, and are tendered to, the Indemnitee.

"Determination" means a determination, based on the facts known at the time, made by:

(i) A majority vote of a quorum of disinterested directors; or

(ii) Independent legal counsel in a written opinion prepared at the request of a majority of a quorum of disinterested directors; or

(iii) A majority of the disinterested stockholders of the Company; or

(iv) A final order by a court of competent jurisdiction from which there is no further right of appeal.

"Determined" shall have a correlative meaning.

"Excluded Claim" means any payment for Losses or Expenses in connection with any Claim the payment of which is Ultimately Determined to be prohibited by the Delaware General Corporation Law, public policy, or other applicable law (including binding regulations and orders of, and undertakings or other commitments with, any governmental entity or agency) as the same exists or may hereafter be amended (but, in the case of any such amendment, only to the extent that such amendment permits the corporation to provide broader indemnification rights than said law permitted the corporation to provide prior to such amendment).

"Expenses" means any reasonable expenses incurred by Indemnitee as a result of a Claim or Claims made against him for Covered Acts including, without limitation, counsel fees and costs of investigative, judicial, or administrative proceedings and any appeals.

"Fines" shall include any fine, penalty or, with respect to an employee benefit plan, any excise tax or penalty assessed with respect thereto.

"Loss" means any amount which Indemnitee is legally obligated to pay as a result of any Claim or Claims made against him or her for Covered Acts including, without limitation, Fines, damages, judgments, and sums paid in settlement of any Claim or Claims.

"Trust Agreement" shall mean the Trust established between the Company and First Interstate Bank of Washington, N.A. ("Trustee") attached as Exhibit A.

"Ultimate Determination" means the method of Determination set forth in clause (i), (ii), or (iii) of the above definition of Determination as selected by the Company, except that a final order from which there is no further right of appeal in any action in which Indemnitee seeks indemnification shall constitute the Ultimate Determination of the Indemnitee's right to indemnification from the Company "Ultimately Determined" shall have a correlative meaning.

2. Indemnification. The Company agrees to indemnify and defend Indemnitee and hold him or her harmless from and against any and all Losses and Expenses subject, in each case, to the further provisions of this Agreement.

3. Excluded Coverage. The Company shall have no obligation to indemnify Indemnitee for and hold him or her harmless from any Loss or Expense which has been Ultimately Determined to constitute an Excluded Claim or to the extent that Indemnitee has received the proceeds of D&O Insurance or to the extent that Indemnitee has otherwise been indemnified.

4. Indemnification Procedures.

4.1 Notice. Promptly after receipt by Indemnitee of notice of the commencement of or the threat of commencement of any Claim, Indemnitee shall, if Indemnitee intends to seek indemnification with respect thereto from the Company under this Agreement, promptly notify the Company and the Beneficiaries, Representative of the commencement thereof and shall keep the Company generally informed of, and consult with the Company with respect to, the status of any such Claim.

4.2 D&O Insurance Applicable. If, at the time of the receipt of such notice, the Company has D&O Insurance in effect, the Company shall give prompt notice of the commencement of such Claim to the insurers in accordance with the procedures set forth in the respective policies in favor of Indemnitee. The Company shall thereafter take all necessary or desirable action to cause such insurers to pay, on behalf of Indemnitee, all Losses and Expenses payable as a result of such Claim in accordance with the terms of such policies.

4.3 Advances of Expenses. The Company agrees to pay the Expenses of any such Claim in advance of the final disposition thereof to the extent payment for such Expenses is not promptly received from D&O Insurance or any other source of indemnity. The Company, if appropriate, shall be entitled to assume the defense of any Claim, with counsel satisfactory to Indemnitee, upon the delivery to Indemnitee of written notice of its election to assume the defense. After delivery of such notice and so long as the Company continues such defense, the Company will not be liable to Indemnitee under this Aqreement for any legal or other Expenses subsequently incurred by the Indemnitee in connection with such defense other than Expenses of investigation and any out-of-pocket personal expenses incurred in preparing for and participating in the Claim. Indemnitee shall have the right to employ his or her counsel in any such Claim but the fees and expenses of such counsel incurred after delivery of notice from the Company of its assumption of such defense shall be at the Indemnitee's expense provided that if (i) the employment of counsel by Indemnitee has been previously authorized by the Company, (ii) Indemnitee shall have reasonably concluded that there may be a conflict of interest between the Company and Indemnitee in the conduct of any such defense or (iii) the Company shall not, in fact, have employed counsel which has assumed and continues the defense of such action, the fees and expenses of counsel shall be at the expense of the Company.

4.4 Payment of Expenses. All payments on account of the Company's indemnification obligations under this Agreement shall be made within sixty (60) days of Indemnitee's written request therefor unless an Ultimate Determination is made that the claims giving rise to Indemnitee's request are Excluded Claims or otherwise not payable under this Agreement, provided that all payments on account of the Company's obligations under Section 4.3 of this Agreement prior to the final disposition of any Claim shall be made within 20 days of Indemnitee's written request therefor and such obligation shall not be subject to any such Ultimate Determination but shall be subject to this Agreement.

4.5 Indemnitee's Obligation to Reimburse. Indemnitee agrees that he will reimburse the Company for all Losses and Expenses paid by the Company, or any Trustee of a Trust created by the Company, in connection with any Claim against Indemnitee in the event and only to the extent that an Ultimate Determination shall have been made that the Indemnitee is not entitled to be indemnified by the Company for such Expenses because the claim is an Excluded Claim or because Indemnitee is otherwise not entitled to payment under this Agreement.

5. Settlement. The Company shall have no obligation to indemnify Indemnitee under this Agreement for any amounts paid in settlement of any Claim effected without the Company's prior written consent except to the extent it is Ultimately Determined that such settlement is reasonable and in good faith. The Company shall not settle any Claim in any manner which would impose any Fine or any obligation on Indemnitee without Indemnitee's written consent. Neither the Company nor Indemnitee shall unreasonably withhold their consent to any proposed settlement.

6. Partial Indemnification. If Indemnitee is entitled under any provisions of this Agreement to indemnification by the Company for some or a portion of Expenses and Losses but not, however, for the total amount thereof, the Company shall

nevertheless indemnify Indemnitee for the portion of such Expenses and Losses to which Indemnitee is entitled.

7. Enforcement.

7.1 Burden of Proof. Indemnitee's right to indemnification shall be enforceable by Indemnitee in any court of competent jurisdiction and shall be enforceable notwithstanding any adverse Determination (pursuant to clauses (i), (ii) or (iii) but not (iv) of the definition of Determination in Section 1). In any action in which Indemnitee seeks indemnification, the Company shall have the burden of proving that indemnification is not required under this Agreement. The termination of any Claim by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not of itself create a presumption that Indemnitee did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

7.2 Enforcement Expenses. In the event that any action is instituted in which Indemnitee or the Beneficiaries' Representative seeks indemnification of Indemnitee under this Agreement, or to enforce or interpret any of the terms of this Agreement, Indemnitee shall be entitled to be paid all costs and expenses, including reasonable attorneys' fees and costs, incurred by Indemnitee with respect to such action, unless the court determines that such action was not brought in good faith or was frivolous.

8. Severability. In the event that any provision of this Agreement is determined by a court to require the Company to do or to fail to do an act which is in violation of applicable law, such provision shall be limited or modified in its application to the minimum extent necessary to avoid a violation of law, and, as so limited or modified, such provision and the balance of this Agreement shall be enforceable in accordance with their terms.

9. Choice of Law. This Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Delaware.

10. Successors and Assigns. This Agreement shall be (i) binding upon all successors and assigns of the Company (including any transferee of all or substantially all of its assets and any successor by merger or otherwise by operation of law) and of the Beneficiaries' Representative and (ii) shall be binding on and inure to the benefit of the spouses, heirs, personal representatives, and estate of Indemnitee. The Company shall not effect any sale of substantially all of its assets, merger consolidation, or other reorganization unless the surviving entity agrees in writing to assume all the obligations of the company under this Agreement and to indemnify Indemnitee and advance Expenses in accordance with this Agreement.

11. Amendment. No amendment, modification, termination, or cancellation of this Agreement shall be effective unless made in

a writing signed by each of the parties hereto. No waiver of any of the provisions of this Agreement shall be deemed or shall constitute a waiver of any other provision of this Agreement (whether or not similar) nor shall such waiver constitute a continuing waiver.

12. Deposit in Trust. The Company has created a Trust (the "Trust") for the benefit of the Indemnitee and others (Collectively, including Indemnitee, the "Beneficiaries") in the form of Exhibit A (the 'Trust Agreement"). Indemnitee is specifically acknowledqed as a third party beneficiary of the Trust Agreement, and therefore, in addition to Indemnitee's rights under this Agreement and any applicable insurance policy, Indemnitee shall also have the right to receive indemnification from the Trust in accordance with the terms of this Agreement and of the Trust Agreement. The Company agrees to fund and maintain the Trust Fund in accordance with the procedures set forth in Article II of the Trust Agreement and to discharge all its other ,obligations pursuant to the Trust Agreement.

13. Procedure for Making Demand. Indemnitee shall first make demand upon the Company in accordance with the Indemnification Procedures of Section 4 to honor its indemnity obligation under this Agreement. If the Company shall fail to indemnify on a timely basis, the Beneficiary shall deliver a certificate to the Beneficiaries' Representative settinq forth the information required pursuant to Section 2.7 of the Trust Agreement. Indemnitee shall not be required to institute a

lawsuit or take other actions against the Company or any insurer to recover the unpaid amount prior to the Beneficiaries' Representative making a demand and receiving payment from the Trustee on his or her behalf.

14. Duties and Responsibilities of Beneficiaries' Representative. The Beneficiaries' Representative (and any successor Beneficiaries' Representative) shall have the following affirmative duties and responsibilities:

14.1 to demand deposits from the Company so as to maintain the Minimum Balance and make any Additional Contribution as required by Sections 2.3 and 2.4 of the Trust Agreement;

14.2 to demand payments by the Trustee to Indemnitee upon demand by Indemnitee where, in the good faith judgment of the Beneficiaries' Representative, the Indemnitee has satisfied the conditions for indemnification as set forth in this Agreement and the Trust Agreement.

14.3 to generally cause the Company and Trustee to discharge their respective responsibilities under this Agreement and the Trust Agreement, including the bringing of legal actions and proceedings to enforce such Agreement.

15. Other Indemnity. The provisions in this Agreement are intended to be nonexclusive of indemnity granted pursuant to the Company's Certificate of Incorporation, Bylaws, other agreements, vote of stockholders or disinterested directors, or otherwise. All applicable indemnity shall be interpreted and applied so as

to provide Indemnitee with the broadest but nonduplicative indemnity to which he or she is entitled.

16. Notices, Consents, and Other Communications. All notices, consents, or other communications required or contemplated by this Agreement shall be in writing and shall be deemed to have been given when delivered either by (a) personal delivery, (b) overnight courier, or (c) postage prepaid return receipt requested certified mail to the last address given to the Trustee by each respective Beneficiary. Notice by personal delivery shall be effective upon the date service is made and notice by certified mail or overnight courier shall be effectiive on the date it is recorded as delivered by the U.S. Postal Service or the overnight courier, respectively.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the day and year first above written.

Attest: MICROSOFT CORPORATION

BY ____________________________ Secretary

By _______________________________ Chairman

____
Indemnitee

Indemnitee's Address:

____
____

____
WILLIAM G. REED, JR.,
Beneficiaries' Representatives

Exhibit 10.10

Resignation Agreement

RESIGNATION AGREEMENT dated as of July 23, 2002, between Richard Belluzzo ("Belluzzo") residing at 1622 38/th/ Avenue East, Seattle, Washington and Microsoft Corporation ("Microsoft") ("Agreement").

1. Resignation. Belluzzo hereby acknowledges his voluntary and irrevocable resignation from the offices of President and Chief Operating Officer effective May 1, 2002. In addition, Belluzzo voluntarily and irrevocably resigns his employment with Microsoft effective August 23, 2002 ("Resignation Date"). Except as expressly modified by paragraphs 2, 3 and 4 of this Agreement, Belluzzo's existing compensation and benefits shall remain in place until the Resignation Date. In the event that Belluzzo elects to resign his employment prior to the Resignation Date, any and all compensation and stock option vesting will cease on the last day of his employment with Microsoft except as set forth below in paragraph 2. In consideration of Belluzzo signing this Agreement and his executing a general release of claims in a form acceptable to Microsoft ("Release"), Microsoft has agreed to undertake the commitments described in Paragraphs 2 and 3 below, some or all to which Belluzzo would not otherwise be entitled.

2. Bonus and Other Consideration. In consideration of Belluzzo irrevocably resigning his employment and office as set forth in Section 1, signing this Agreement, delivering an effective and timely Release and honoring the commitments undertaken herein, and conditioned upon each of the foregoing events having occurred, Microsoft agrees to: (1) take the actions described in Paragraph 3 below; and (2) award Belluzzo a bonus under the Partner Bonus Plan for the fiscal year ending June 30, 2002 in the amount of $350,000, which amount exceeds the amount to which Belluzzo would be entitled as of right under the Partner Bonus Plan. This bonus shall be payable on August 15, 2002 in accordance with Microsoft's regular payroll procedures for payment of such bonuses (including tax withholding). Belluzzo acknowledges and agrees that he is not eligible for and waives any and all rights to a bonus under the Partner Bonus Plan for the fiscal year beginning July 1, 2002 and ending June 30, 2003. Nothing in this Agreement represents a waiver by Belluzzo of any rights he might otherwise have, including to be paid accrued vacation, receive health or other insurance, or exercise his stock options in accordance with Microsoft's stock option plans except as set forth in Paragraph 3.

3. Cancellation of Options. In connection with option grants made September 1, 1999 for 1,000,000 shares, March 6, 2000 for 1,000,000 shares, May 30, 2000 for 500,000 shares and May 30, 2000 for 1,000,000 shares (the "99/00 Options"), on December 12, 2000 Microsoft and Belluzzo entered into an arrangement whereby Belluzzo was advanced the sum of $15,000,000 which represented a minimum benefit to be received from the potential exercise of the 99/00 Options unless Microsoft terminated his employment with cause or Belluzzo terminated without good reason. The advance was acknowledged by a promissory note a copy of which is attached as Exhibit A (the "Note"). In lieu of the provisions in the Note, the parties have parties have agreed that the 99/00 Options shall be cancelled as of the Resignation Date and Belluzzo shall retain all funds previously advanced. Microsoft shall forgive the remaining unpaid balance of interest and principal owing under the Note. Microsoft will thereafter promptly cancel the Note and return it to Belluzzo. Belluzzo will execute such instruments as are reasonably requested by Microsoft to evidence surrender and cancellation of the 99/00 Options. The forgoing arrangements shall supercede any conflicting terms of the Note or any other oral or written agreement between the parties. Belluzzo understands that forgiveness of the Note and cancellation of the 99/00 Options will constitute ordinary income taxable to him, and which will be reported by Microsoft as income to him. Accordingly, Belluzzo agrees to pay to Microsoft not later than October 1, 2002, and Microsoft shall timely pay to the United States Treasury the amount of federal tax and employment withholding Microsoft is required to withhold with respect to the debt forgiven. The parties will execute such instruments and documentation as is reasonably necessary to evidence withholding and payment of the withheld sum.

4. Miscellaneous. This Agreement and the Release contain the entire agreements and all the promises and covenants exchanged by the parties and merge any and all prior written and oral communications concerning the financial terms relating to Belluzzo's resignation. In executing this Agreement, each party warrants that he or it is relying solely upon his or its own judgment and knowledge, and that he or it is signing in the absence of any caercion or duress whatsoever. The parties agree that the provisions of this Agreement are severable. In the event that any provision is found to be unlawful or unenforceable, the remaining provisions shall remain in full force and effect. The parties further agree that all questions with respect to the construction of this Agreement and the rights and liabilities under it shall be governed by the laws of the State of Washington, and any dispute arising in connection with the execution and/or operation of this Agreement shall be determined in a Washington court of competent jurisdiction, to whose personal jurisdiction Belfuzzo consents to submit. In the event suit is commenced to enforce this Agreement, the substantially prevailing party shall be entitled to an award of his or its reasonable attorneys' fees and costs. This Agreement shall bind the heirs, successors, representatives, and assigns of each party.

Microsoft Corporation

/s/ Richard Belluzzo	By /s/ Steven A. Ballmer
- --------------------	---------------------------------
Richard Belluzzo	Steven A. Ballmer, Chief Executive Officer

EXHIBIT A
PROMISSORY NOTE

$15,000,000.00 Redmond, Washington December 12, 2000

Subject to the terms and conditions herein, MICROSOFT CORPORATION ("Company") agrees to lend RICHARD BELLUZZO ("Maker") the principal amount to Fifteen Million Dollars (U.S.) ($15,000,000.00) (the "Principal") and, for value received, Maker promises to pay Company, or its assigns or order ("Payee"), the principal sum of Fifteen Million Dollars (U.S.)($15,000,000.00), with interest as provided herein. Unless otherwise provided herein, both Principal and Interest, defined below, shall be payable in lawful money of the United States of America, which shall be legal tender for public and private debts.

1. Interest. Interest shall accrue from the date of payment on the unpaid Principal outstanding, and shall be compounded annually until this Note is paid in full, at the lowest applicable federal interest rate available in the month of December 2000 (i.e., 5.87%)(the "Interest"). Interest will be calculated based on a 365 day year and applied to the actual number of days elapsed. The sum of Principal and Interest accrued as of any date shall constitute the "Total Obligations" as of such date.

2. Maturity Date. Absent a Default Event, and subject to the terms limiting the Company's recourse hereunder, the Total Obligation, if not sooner paid, shall be due and payable in a single installment on the fifth (5/th/) anniversary of the date hereof, or the date on which Maker's employment with the Company terminates, whichever is earlier ("Maturity Date"). Maker and any endorsers of this Note hereby waive demand, grace, notice, presentment for payment, and protest, and agree and consent that the Company may renew this Note, and extend the time of payment, without notice, and without releasing any party hereto.

3. Prepayment. Maker may prepay the Total Obligation, in whole or in part ,at any time before the Maturity Date, in cash, without being required to pay any penalty or premium for such priviledge.

4. Payment Method.

4.1 On or after the Maturity Date, the payment of amounts owed under this Note may be made, at Maker's discretion, in cash and/or by forefeiting vested Company stock options subject to the 99/00 Grants having an aggregate Vested Value (defined below in Subsection 6.1) equal to the amount being repaid. For purposes of this Note, the term of September 1, 1999 for 1,000,000 shares; (ii) grant of March 6, 2000 for 1,000,000 shares; (iii) grant of May 30, 2000 for 500,000 shares; and (iv) grant of May 30, 2000 for 1,000,000 shares.

4.2 If Maker fails to repay the Adjusted Total Obligation (defined in Subsection 6.2) within one hundred twenty (120) days after the Maturity Date, Company may thereafter obtain repayment utilizing, at its discretion, any of the applicable repayment methods or combinations thereof as set forth in Section 5. In the event that the Company elects to cancel options subject to the 99/00 Grants in order to satisfy any part of the Adjusted Total Obligation, Company shall use the Vested Value of such options as defined in Subsection 6.1 to determine the aggregate pre-tax value of said options.

4.3 If the Company forgives any portion of the Total Obligation, pursuant to the terms limiting recourse hereunder, then such amount shall be treated as a forgiveness of debt owed by Maker, and shall be reported by the Company as income to Maker.

5. Recourse. The Company's recourse against Maker for repayment of the Principal and Interest shall be only as follows:

5.1 If Maker is still in the employ of Company on the fifth anniversary of this Note, or if Maker's employment is terminated by the Company without Cause or Maker resigns for Good Reason at any time, the Company may obtain repayment of the Adjusted Total Obligation by one or a combination of the following methods: (i) by canceling the minimum necessary number of options subject to the 99/00 Grants to cover the amount being repaid, and (ii) through limited personal recourse against Maker to the extent Maker has exercised any part of the 99/00 Grants; namely, the excess aggregate fair market value (i.e. the closing price on the date of exercise) of the Company common stock obtained as a result of such exercise over the aggregate exercise price thereof. For purposes of this Note, the term "Cause" shall mean Maker's commission of a felony, or gross negligence or willfull misconduct resulting in material damage to the Company; and "Good Reason" shall mean that: (i) Maker's responsibilities to Company were significantly diminished; (ii) Makers job location is moved by Company out of King Country, Washington; (iii) the Company is split into two or more independent companies for any reason, whether or not pursuant to a final, non-appealable judgment or settlement in the Company's pending action with the Department of Justice or otherwise; or (iv) there is a change in control of the Company, which for the purposes of this Note means the acquisition, directly or indirectly, by any person or related group of persons of beneficial ownership of securities possessing more than fifty (50%) percent of the total combined voting power of the Company's outstanding securities, or a merger or consolidation in which securities possessing at least fifty (50%) percent of the total combined voting power of the Company's outstanding securities are transferred to a person or persons different from the persons holding those securities immediately prior to such transaction or sale, or the sale transfer or other disposition of seventy-five(75%) percent or more of the Company's assets in liquidation or dissolution of the Company.

5.2 If Maker is not in the employ of the Company and has been terminated by the Company for Cause, or resigned without Good Reason, the Company may obtain repayment of the Adjusted Total Obligation by one or a combination of the following methods, at its discretion: (i) by canceling the minimum necessary number of options subject to the 99/00 Grants to cover the amount being repaid, and (ii) through full personal recourse against Maker.

5.3 If Maker's employment is terminated by the Company due to death or Disability prior to the fifth anniversary of this Note, the Company may obtain repayment of the Total Obligation by one or a combination of the following methods, at its discretion: (i) by canceling the minimum necessary number of options subject to the 99/00 Grants to cover the amount being repaid, and (ii) through full personal recourse against Maker or Maker's estate, as the case may be; provided, however, that if the after-tax value of the 99/00 Grants, minus the Total Obligation, is less than Five Million Dollars ($5,000,000), the Company will forgive such portion of the Adjusted Total Obligation as is necessary to leave Maker or Maker's estate, respectively, with a net amount of Five Million Dollars ($5,000,000) after repayment to the Company. For purposes of this Note, "Disability" has the meaning set fourth in the Company's 1991 Stock Option Plan

6. Valuation Payment Mechanism. The Vested Value of the 99/00 Grants shall be determined in accordance with the following "Valuation Payment Mechanism":

6.1 Vested Value Determination: As soon as practicable after the Maturity Date, the Company shall determine the Vested Value of the 99/00 Grants. The "Vested Value" of the 99/00 Grants shall equal the sum of the Vested Values of each respective option grant comprising the 99/00 Grants. The "Vested Value" of any stock option grant shall be equal to: (i) the excess of) (y) the average closing price of Company stock on the twenty (20) trading days immediately preceding the Maturity Date over (z) the exercise price of the respect grant, multiplied by (ii) the number of shares of the respective grant that are then vested; provided that the Vested Value of any options that have been exercised shall be equal to the excess of the closing price (as of the date of exercise) of Company common stock obtained as a result of such exercise over the exercise price thereof.

6.2 Adjusted Total Obligation Determination: Effective on the Maturity Date, the Total Obligation shall be adjusted and repaid in accordance with the following terms (as so adjusted, the "Adjusted Total Obligation"):

(a) If Maker's employment is terminated on or before the second anniversary of the Note, Maker shall immediately repay the Total Obligation in full.

(b) If Maker's Employment terminates after the second and on or before the third anniversaries of the Note, repayment shall be as follows: If the Vested Value of the 99/00 Grants exceeds the Total Obligation, Maker shall immediately repay the Total Obligation in full. If the Vested Value of the 99/00 Grants is less than the Total Obligation, the company shall forgive that portion of the Total Obligation that exceeds the Vested Value of the 99/00 Grants, provided, however, that the amount of forgiveness shall not exceed Four Million Dollars ($4,000,000) plus interest to the date of repayment, and Maker shall immediately repay the balance of the Total Obligation not forgiven.

(c) If Maker's Employment terminates after the third and on or before the fourth anniversaries of the Note, repayment shall be as follows: If the Vested Value of the 99/00 Grants exceeds the Total obligation, Maker shall immediately repay the Total Obligation in full. If the Vested Value of the 99/00 Grants is less than the Total Obligation, the Company shall forgive that portion of the Total Obligation that exceeds the Vested Value of the 99/00 Grants, provided, however, that the amount of forgiveness shall not exceed Nine Million Dollars ($9,000,000) plus interest to the date of repayment, and Maker shall immediately repay the balance of the Total Obligation not forgiven.

(d) If Maker's employment terminates after the fourth and on or before the fifth anniversaries of the Note, repayment shall be as follows: If the Vested Value of the 99/00 Grants exceeds the Total Obligation, Maker shall immediately repay the Total Obligation in full. If the Vested Value of the 99/00 Grants is less than the Total Obligation, the Company shall forgive that portion of the Total Obligation that exceeds the Vested Value of the 99/00 Grants, provided, however, that the amount of forgiveness shall not exceed Twelve Million Dollars ($12,000,000) plus interest to the date of repayment, and Maker shall immediately repay the balance of the Total Obligation not forgiven.

(e) If Maker remains employed by Company on the fifth anniversary of the date of the Note, repayment shall be as follows: If the Vested Value of the 99/00 Grants exceeds the Total Obligation, Maker shall immediately repay the Total Obligation in full. If the Vested Value of the 99/00 Grants is less than the Total Obligation, the Company shall forgive that portion of the Total Obligation that exceeds the Vested Value of the 99/00 Grants, and Maker shall immediately repay the balance of the Total Obligation not forgiven.

7. Default. Upon the commencement of any proceedings under any bankruptcy or insolvency laws by or against Maker ("Default Event"), the Company, or other holder or owner of this Note, may at its option accelerate the Maturity Date of this Note, including all Principal and Interest thereon, without presentment, demand, or notice to Maker or to any person obligated hereon: Upon the occurrence of a Default Event and acceleration of the Maturity Date, the amount of the Adjusted Total Obligation shall

become due and payable immediately. Interest shall accrue at the same rate of Interest specified above until this Note is paid in full, regardless of any Default Event.

8. Attorneys' Fees. If this Note is placed in the hands of an attorney for collection or collected through bankruptcy or other judicial proceedings, or if suit is brought hereon, Maker agrees to pay, in addition to all other amounts owing hereunder, all expenses and costs of collection, including reasonable attorneys' fees incurred by the Company.

9. Governing Law/Severability. All terms, obligations, and provisions of this Note are to be determined and governed by the laws of the State of Washington, excluding its choice of law provisions. Should any term or provision of this Note be declared invalid, such determination shall not affect the remaining provisions hereof, which shall remain in full force and effect. Notwithstanding any provision contained herein to the contrary, the holder shall not be entitled to receive, collect, or apply as interest on the obligation evidenced hereby, any amount in excess of the maximum rate of interest permitted by applicable law.

Maker is on notice that ORAL AGREEMENTS OR ORAL COMMITMENTS TO LOAN MONEY, EXTEND CREDIT, OR TO FORBEAR FROM ENFORCING REPAYMENT OF A DEBT ARE NOT ENFORCEABLE UNDER WASHINGTON LAW.

"Maker"

/s/ Richard Belluzzo

Richard Belluzzo

Exhibit 21

Subsidiaries

Microsoft Corporation
One Microsoft Way
Redmond, WA 98052-6399
Microsoft Capital Corporation (NEVADA)
Microsoft FSC Corporation (U.S. VIRGIN ISLANDS)
Microsoft Investments, Inc. (NEVADA)
Microsoft Ireland Operations Limited (IRELAND)
Microsoft Licensing, Inc. (NEVADA)
MSLI, GP (NEVADA)
Microsoft Operations Pte Ltd. (SINGAPORE)
Microsoft Product Development Ltd. (NEVADA)
Microsoft Regional Sales Corporation (NEVADA-SINGAPORE BRANCH)
Microsoft Risk Company (NEVADA)
Microsoft Puerto Rico, Inc. (DELAWARE)
The Microsoft Network L.L.C. (DELAWARE)
Microsoft Treasury, Inc (NEVADA)
GraceMac Corporation (NEVADA)
Microsoft Algerie S.A.R.L. (ALGERIA)
Microsoft de Argentina S.A.
Microsoft Pty. Limited (AUSTRALIA)
Microsoft Gesellschaft m.b.H. (AUSTRIA)
Microsoft B.V.B.A. (BELGIUM)
Microsoft Bolivia S.R.L.
Microsoft Informatica Limitada (BRAZIL)
Microsoft Bulgaria EOOD
Microsoft Canada Co.
NCompass Labs, Inc. (CANADA)
Microsoft Chile S.A.
Microsoft Colombia, Inc. (DELAWARE)
Microsoft de Centroamerica S.A. (COSTA RICA)
Microsoft Hrvatska d.o.o. (CROATIA)
Microsoft s.r.o. (CZECH REPUBLIC)
Microsoft Danmark ApS (DENMARK)
Microsoft Dominicana, S.A. (DOMINICAN REPUBLIC)
Microsoft Del Ecuador S.A.
Microsoft Egypt, Limited Liability Company
Microsoft El Salvador S.A. de C.V.
Microsoft Oy (FINLAND)
Microsoft France S.A.R.L.
Microsoft G.m.b.H. (GERMANY)
Microsoft Hellas S.A. (GREECE)
Microsoft de Guatemala, S.A.
Microsoft Hong Kong Limited
Microsoft Hungary Kft.
Microsoft Corporation (India) Private Limited
Microsoft India (R&D) Private Limited
PT Microsoft Indonesia
Microsoft Finance Company Limited (IRELAND)
Microsoft Israel Ltd.
Microsoft SRL (ITALY)
Microsoft Cote d'Ivoire SARL (IVORY COAST)
Microsoft Jamaica, Inc.
Microsoft Company Limited (JAPAN)
Microsoft Asia Ltd (NEVADA-JAPAN BRANCH)
East Africa Software Limited (KENYA)
Microsoft CH (KOREA)
Microsoft Kuwait Representative Office
SIA Microsoft Latvija (LATVIA)

Microsoft Corporation Lebanon Representative Office
Microsoft (Malaysia) Sdn. Bhd.
Microsoft Indian Ocean Islands Limited (MAURITIUS)
Microsoft Mexico, S.A. de C.V.
Microsoft Maroc S.A.R.L. (MOROCCO)
Microsoft Namibia (Proprietary) Limited
Microsoft B.V. (THE NETHERLANDS)
Microsoft International B.V. (THE NETHERLANDS)
Microsoft Manufacturing B.V. (THE NETHERLANDS)
Microsoft New Zealand Limited
Microsoft Nigeria Limited
Microsoft Norge AS (NORWAY)
Microsoft Corporation-Pakistan Liaison Office
Microsoft de Panama, S.A.
Microsoft (China) Company Limited (THE PEOPLE'S REPUBLIC OF CHINA)
Microsoft Peru, S.R.L.
Microsoft Philippines, Inc.
Microsoft sp. z.o.o. (POLAND)
MSFT-Software Para Microcomputadores, LDA (PORTUGAL)
Microsoft Caribbean, Inc. (DELAWARE)
Microsoft Romania SRL
Microsoft ZAO (RUSSIA)
Moscow Microsoft Ireland Operations Limited (Representative Office) (RUSSIA)
Microsoft Arabia Limited (SAUDI ARABIA, 60% owned)
Microsoft Singapore Pte Ltd
Microsoft Slovakia s.r.o.
Microsoft d.o.o., Ljubljana (SLOVENIA)
Microsoft (S.A.) (Proprietary) Limited (SOUTH AFRICA)
Microsoft Iberica S.R.L. (SPAIN)
Microsoft Aktiebolag (SWEDEN)
Microsoft AG (SWITZERLAND)
Microsoft Taiwan Corporation
Microsoft (Thailand) Limited
Microsoft Trinidad & Tobago Limited
Microsoft Tunisie, S.A.R.L. (TUNISIA)
Microsoft Bilgisayar Yazilim Hizmetleri Limited Sirketi (TURKEY)
Microsoft Corporation (UNITED ARAB EMIRATES)
Microsoft Gulf FZ-LLC (UNITED ARAB EMIRATES)
Microsoft Limited (UNITED KINGDOM)
Microsoft Research Limited (UNITED KINGDOM)
Microsoft Uruguay S.A.
Microsoft Venezuela S.A.
The Resident Representative Office of MICROSOFT
Corporation in Hanoi (VIETNAM)
Microsoft Corporation, Zimbabwe Liaison Office
Ensemble Studios Corporation (DELAWARE)
Great Plains Software, Inc. (MINNESOTA)
FRx Software Corporation (DELAWARE)
HomeAdvisor Holdings, Inc. (NEVADA)
Visio International Incorporated (WASHINGTON)
WebAppoint.com, Inc. (DELAWARE)
CarPoint, Inc. (WASHINGTON, 75% owned)
WebTV Networks K.K. (JAPAN, 75% owned)
MSNBC Cable, L.L.C. (DELAWARE, 50% owned)
MSNBC Interactive News, L.L.C. (DELAWARE, 50% owned)
T1MSN, Corp. (DELAWARE, 50% owned)
ninemsn Pty Limited (AUSTRALIA, 50% owned)

Exhibit 23

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement Numbers 33-06335, 33-18381, 33-25575, 33-33695, and 33-37623 (Microsoft Corporation 1981 Stock Option Plan), 33-44302, 33-51583, and 333-06298 (Microsoft Corporation 1991 Stock Option Plan), 33-37622 (Microsoft Corporation 1991 Employee Stock Purchase Plan), 33-10732 (Microsoft Corporation Savings Plus Plan), 33-36498 (Microsoft Corporation Stock Option Plan for Non-Employee Directors), 33-45617 (Microsoft Corporation Stock Option Plan for Consultants and Advisors), 333-16665 (Microsoft Corporation 1997 Employee Stock Purchase Plan), 333-61729 (Microsoft Corporation 1998 Special Stock Award Program), 333-75243 (Microsoft Corporation Savings Plus 401(k) Plan), 333-91755 (Microsoft Corporation 1999 Stock Option Plan for Non-Employee Directors), 33-06298, 333-52852 (Microsoft Corporation 2001 Stock Plan) of Microsoft Corporation on Forms S-8 and 33-29823, 33-34794, 33-36347, 33-46958, 33-49496, 33-56039, 33-57277, 33-57899, 33-58867, 33-62725, 33-63471, 33-64870, 333-00857, 333-01177, 333-02759, 333-05961, 333-8081, 333-12441, 333-17143, 333-18055, 333-18195, 333-23621, 333-31803, 333-37841, 333-41387, 333-43449, 333-45989, 333-52377, 333-61507, 333-65813, 333-69027, 333-75389, 333-79461, 333-89793 333-94499, 333-38694, 333-40998, 333-47814, 333-53378, and 333-60782 of Microsoft Corporation on Forms S-3, and 333-26411, 333-90119, and 333-54810 of Microsoft Corporation on Forms S-4 of our report dated July 18, 2002 (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the adoption of Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, and Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets) appearing in this Annual Report on Form 10-K of Microsoft Corporation for the year ended June 30, 2002.

/s/ Deloitte & Touche LLP
Deloitte & Touche LLP
Seattle, Washington
September 5, 2002

Exhibit 99.1

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

In connection with the Annual Report of Microsoft Corporation, a Washington corporation (the "Company"), on Form 10-K for the year ending June 30, 2002 as filed with the Securities and Exchange Commission (the "Report"), I, Steven A. Ballmer, Chief Executive Officer of the Company, certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that to my 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
September 5, 2002

Exhibit 99.2

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

In connection with the Annual Report of Microsoft Corporation, a Washington corporation (the “Company”), on Form 10-K for the year ending June 30, 2002 as filed with the Securities and Exchange Commission (the “Report”), I, John G. Connors, Chief Financial Officer of the Company, certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that to my 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/ JOHN G. CONNORS

John G. Connors
Chief Financial Officer
September 5, 2002