MICROSOFT CORP
Form 10-K
August 02, 2017

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, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From to

Commission File Number 001-37845

MICROSOFT CORPORATION

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

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(425) 882-8080

www.microsoft.com/investor

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

COMMON STOCK, $0.00000625 par value per share	NASDAQ

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

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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.

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of December 31, 2016, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was $466.5 billion based on the closing sale price as reported on the NASDAQ National Market System. As of July 31, 2017, there were 7,702,243,979 shares of common stock outstanding.

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 on November 29, 2017 are incorporated by reference into Part III.

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Note About Forward-Looking Statements

This report includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including the following sections: “Business” (Part I, Item 1 of this Form 10-K), “Risk Factors” (Part I, Item 1A of this Form 10-K), and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” (Part II, Item 7 of this Form 10-K). These forward-looking statements generally are identified by the words “believe,” “project,” “expect,” “anticipate,” “estimate,” “intend,” “strategy,” “ “opportunity,” “plan,” “may,” “should,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expression Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. We describe risks and uncertainties that could cause actual results and events to differ materially in “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Quantitative and Qualitative Disclosures about Market Risk” (Part II, Item 7A of this Form 10-K). We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

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ITEM 1. BUSINESS

GENERAL

Our vision

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our strategy is to build best-in-class platforms and productivity services for an intelligent cloud and an intelligent edge infused with artificial intelligence (“AI”).

The way individuals and organizations use and interact with technology continues to evolve. A person’s experience with technology increasingly spans a multitude of devices and becomes more natural and multi-sensory with voice, ink, and gaze interactions. We believe a new technology paradigm is emerging that manifests itself through an intelligent cloud and an intelligent edge where computing is more distributed, AI drives insights and acts on the user’s behalf, and user experiences span devices with a user’s available data and information. We continue to transform our business to lead this new era of digital transformation and enable our customers and partners to thrive in this evolving world.

What we offer

Founded in 1975, we operate worldwide in over 190 countries. We develop, license, and support a wide range of software products, services, and devices that deliver new opportunities, greater convenience, and enhanced value to people’s lives. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity.

Our products include operating systems; cross-device productivity applications; server applications; business solution applications; desktop and server management tools; software development tools; video games; and training and certification of computer system integrators and developers. We also design, manufacture, and sell devices, including PCs, tablets, gaming and entertainment consoles, other intelligent devices, and related accessories, that integrate with our cloud-based offerings. We offer an array of services, including cloud-based solutions that provide customers with software, services, platforms, and content, and we provide solution support and consulting services. We also deliver relevant online advertising to a global audience.

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The ambitions that drive us

To achieve our vision, our research and development efforts focus on three interconnected ambitions:

- Reinvent productivity and business processes.
- Build the intelligent cloud platform.
- Create more personal computing.

Reinvent productivity and business processes

We believe we can significantly enhance the lives of our customers using our broad portfolio of productivity, communication, and information products and services that span platforms and devices. Productivity is our first and foremost objective, to enable people to meet and collaborate more easily, and to effectively express ideas in new ways. We invent new scenarios that in turn create opportunity for our partners and help businesses accelerate their digital transformation while respecting each person’s privacy choices.

The foundation for these efforts rests on advancing our leading productivity, collaboration, communication, and business process tools including Microsoft Office, Microsoft Dynamics, and LinkedIn. With Office 365, we provide familiar industry-leading productivity and business process tools as cloud services, enabling access from anywhere and any device. New scenarios – like those enabled by Microsoft Teams – will redefine how work gets done and help foster employee engagement and culture. This work creates an opportunity to reach new customers and expand the usage of our services by our existing customers. We see opportunity in combining our offerings in new ways that are mobile, secure, collaborative, intelligent, and trustworthy. We offer our services across platforms and devices outside our own. As people move from device to device, so does their content and the richness of their services. We engineer our applications so users can find, try, and buy them in friction-free ways.

On December 8, 2016, we completed our acquisition of LinkedIn Corporation, the world’s largest professional network on the Internet. The acquisition is expected to accelerate the growth of Office 365, Dynamics 365, and LinkedIn.

Build the intelligent cloud platform

Cloud computing is foundational to enabling any organization’s digital transformation. In deploying technology that advances business strategy, enterprises decide what solutions will make employees more productive, collaborative, and satisfied, and connect with customers in new and compelling ways. Enterprises work to unlock business insights from a world of data. To achieve these objectives, they increasingly look to leverage the benefits of the cloud. Helping businesses digitally transform and move to the cloud is one of our largest opportunities. As one of the two largest providers of cloud computing at scale, we believe we work from a position of strength. The Microsoft Cloud is a secure solution that can listen, learn, and predict; turning data into actionable insight that enhances business opportunities. It provides a scalable and complete collaboration suite that transforms the way teams work. With the cloud, high-performance computing and agility can help businesses expand their growth.

Our cloud business benefits from three economies of scale: larger datacenters that deploy computational resources at significantly lower cost per unit than smaller ones; larger datacenters that coordinate and aggregate diverse customer, geographic, and application demand patterns, improving the utilization of computing, storage, and network resources; and multi-tenancy locations that lower application maintenance labor costs.

We believe our server products and cloud services, which include Microsoft SQL Server, Windows Server, Visual Studio, System Center, and Microsoft Azure, make us the only company with a public, private, and hybrid cloud platform that can power modern business. What differentiates Azure is our hybrid consistency, developer productivity, and software-as-a-service ("SaaS") application integration. In addition, our hybrid infrastructure spans identity, data, compute, management, and security, helping to support the real-world needs and evolving regulatory requirements of commercial customers and enterprise-focused SaaS partners. We are working to enhance the customer's return on investment by enabling enterprises to combine their existing datacenters and our public cloud into a single cohesive infrastructure. Businesses can deploy applications in their own datacenter, a partner's datacenter, or in our datacenters with common security, management, and administration across all environments, providing the flexibility and scale they want. AI will be pervasive across devices, applications, and infrastructure to drive insights and act on the user's behalf. Azure is also unique in its support for emerging applications so that Internet of Things ("IoT") devices can act locally at the edge while taking advantage of the cloud for global coordination and machine learning at scale.

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We enable organizations to securely adopt SaaS applications, both our own and third-party, and integrate them with their existing security and management infrastructure. We continue to innovate with higher-level services including identity and directory services that manage employee corporate identity and manage and secure corporate information accessed and stored across a growing number of devices, rich data storage and analytics services, machine learning services, media services, web and mobile backend services, and developer productivity services. To foster a rich developer ecosystem, our platform is extensible, enabling customers and partners to further customize and enhance our solutions, achieving even more value. This strategy requires continuing investment in datacenters and other infrastructure to support our services.

Create more personal computing

We strive to make computing more personal by putting users at the core of the experience, enabling them to interact with technology in more intuitive, engaging, and dynamic ways. Windows 10 is the cornerstone of our ambition to create more personal computing, allowing us to move from an operating system that runs on a PC to a service that can power the full spectrum of devices. Windows 10 is more personal and productive with functionality such as Cortana, Windows Hello, Windows Ink, Microsoft Edge, and universal applications. Windows 10 offers a foundation for the secure, modern workplace. Windows 10 is designed to foster innovation – from us, our partners, and developers – through rich and consistent experiences across the range of existing devices and entirely new device categories.

Our ambition for Windows 10 is to broaden our economic opportunity through three key levers: an original equipment manufacturer (“OEM”) ecosystem that creates exciting new hardware designs for Windows 10; our own commitment to the health and profitability of our first-party premium device portfolio; and monetization opportunities such as services, subscriptions, gaming, and search advertising. Our OEM partners are investing in an extensive portfolio of hardware designs and configurations for Windows 10. We now have the widest range of Windows hardware ever available.

With the unified Windows operating system, developers and OEMs can contribute to a thriving Windows ecosystem. We invest heavily to make Windows the most secure, manageable, and capable operating system for the needs of a modern workforce. We are working to create a broad developer opportunity by unifying the Windows installed base on Windows 10, and by enabling universal Windows applications to run across all device targets.

As part of our strategic objectives, we are committed to designing and marketing first-party devices to help drive innovation, create new categories, and stimulate demand in the Windows ecosystem. We are developing new input and output methods within Windows 10, including speech, pen, gesture, and mixed reality capabilities to power more personal computing experiences. The experiences and tools we build will unlock the creator in everyone and enable seamless teamwork not just in the workplace, but also at school and at home across all the devices people use.

Our future opportunity

Customers are looking to Microsoft and our thriving partner ecosystem to accelerate their own digital transformations and to unlock new opportunity in this era of intelligent cloud and intelligent edge. We continue to develop complete, intelligent solutions for our customers, including offerings like the recently introduced Microsoft 365 which brings together Office 365, Windows 10, and Enterprise Mobility and Security, that empower users to be creative and work together while safeguarding businesses and simplifying IT management. Our goal is to lead the industry in several distinct areas of technology over the long-term, which we expect will translate to sustained growth. We are investing significant resources in:

- Transforming the workplace to deliver new modular business applications to improve how people communicate, collaborate, learn, work, play, and interact with one another.
- Building and running cloud-based services in ways that unleash new experiences and opportunities for businesses and individuals, including converting data into AI.
- Using Windows to develop new categories of devices – both our own and third-party – as a person's experience with technology becomes more natural, personal, and predictive with multi-sensory breakthroughs in voice, ink, gaze interactions, and augmented reality holograms.

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- Inventing new gaming experiences that bring people together around their shared love for games, using an approach that enables people to play the games they want, with the people they want, on the devices they want.
- Applying AI to drive insights and act on our customer's behalf by understanding and interpreting their needs using natural methods of communication.

Our future growth depends on our ability to transcend current product category definitions, business models, and sales motions. We have the opportunity to redefine what customers and partners can expect and are working to deliver new solutions that reflect the best of Microsoft.

OPERATING SEGMENTS

We operate our business and report our financial performance using three segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. Our segments provide management with a comprehensive financial view of our key businesses. The segments enable the alignment of strategies and objectives across the development, sales, marketing, and services organizations, and they provide a framework for timely and rational allocation of resources within businesses.

Additional information on our operating segments and geographic and product information is contained in Note 21 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

Our reportable segments are described below.

Productivity and Business Processes

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

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

Office Commercial

Office Commercial is designed to increase personal, team, and organizational productivity through a range of products and services. Growth depends on our ability to reach new users, add value to our core product set, and continue to expand our product and service offerings into new markets such as security, analytics, collaboration, unified communications, and business intelligence. Office Commercial revenue is mainly affected by a combination of the demand from commercial customers for volume licensing, including Software Assurance, and the number of information workers in an enterprise, as well as the continued shift to Office 365. CALs provide certain Office Commercial products and services with access rights to our server products and CAL revenue is reported with the associated Office products and services.

Office Consumer

Office Consumer is designed to increase personal productivity through a range of products and services. Growth depends on our ability to reach new users, add value to our core product set, and continue to expand our product and service offerings into new markets. Office Consumer revenue is mainly affected by the percentage of customers that buy Office with their new devices and the continued shift to Office 365. Office Consumer Services revenue is mainly affected by the demand for communication and storage through Skype, Outlook.com, and OneDrive, which is largely driven by subscriptions, advertising, and the sale of minutes.

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LinkedIn

LinkedIn connects the world's professionals to make them more productive and successful, and is the world's largest professional network on the Internet. LinkedIn offers services that can be used by customers to transform the way they hire, market, sell, and learn. In addition to LinkedIn’s free services, LinkedIn offers three categories of monetized solutions: Talent Solutions, Marketing Solutions, and Premium Subscriptions, which includes Sales Solutions. Talent Solutions is comprised of two elements: Hiring, and Learning and Development. Hiring provides services to recruiters that enable them to attract, recruit, and hire talent. Learning and Development provides subscriptions to enterprises and individuals to access online learning content. Marketing Solutions enables companies to advertise to LinkedIn’s member base. Premium Subscriptions enables professionals to manage their professional identity, grow their network, and connect with talent through additional services like premium search. Premium Subscriptions also includes Sales Solutions, which helps sales professionals find, qualify, and create sales opportunities and accelerate social selling capabilities. Growth will depend on our ability to increase the number of LinkedIn members and our ability to continue offering services that provide value for our members and increase their engagement. LinkedIn revenue is mainly affected by demand from enterprises and professional organizations for subscriptions to Talent Solutions and Premium Subscriptions offerings, as well as member engagement and the quality of the sponsored content delivered to those members to drive Marketing Solutions.

Dynamics

Dynamics provides on-premises and cloud-based business solutions for financial management, enterprise resource planning (“ERP”), customer relationship management (“CRM”), supply chain management, and analytics applications for small and medium businesses, large organizations, and divisions of global enterprises. Dynamics revenue is largely driven by the number of information workers licensed and the continued shift to Dynamics 365, a unified set of cloud-based intelligent business applications for enterprises.

Competition

Competitors to Office include software and global application vendors such as Adobe Systems, Apple, Cisco Systems, Facebook, Google, IBM, Oracle, SAP, and numerous web-based and mobile application competitors as well as local application developers in Asia and Europe. Cisco Systems is using its position in enterprise communications equipment to grow its unified communications business. Google provides a hosted messaging and productivity suite. Apple distributes versions of its pre-installed application software, such as email and calendar products, through its PCs, tablets, and phones. Skype for Business and Skype also compete with a variety of instant messaging, voice, and video communication providers, ranging from start-ups to established enterprises. Web-based offerings competing with individual applications have also positioned themselves as alternatives to our products. We believe our products compete effectively based on our strategy of providing powerful, flexible, secure, and easy-to-use solutions that work well with technologies our customers already have and are available on a device or via the cloud.

LinkedIn faces competition from online recruiting companies, talent management companies, and larger companies that are focusing on talent management and human resource services; job boards; traditional recruiting firms; and companies that provide learning and development products and services. Marketing Solutions competes with online and offline outlets that generate revenue from advertisers and marketers.

Dynamics competes with vendors such as Oracle and SAP in the market that provides solutions for large organizations and divisions of global enterprises. In the market that provides solutions for small and mid-sized businesses, our Dynamics products compete with vendors such as Infor, The Sage Group, and NetSuite. Salesforce.com's cloud CRM offerings compete with our Dynamics CRM on-premises and Dynamics 365 offerings.

Intelligent Cloud

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

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

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Server Products and Cloud Services

Our server products are designed to make IT professionals, developers, and their systems more productive and efficient. Server software is integrated server infrastructure and middleware designed to support software applications built on the Windows Server operating system. This includes the server platform, database, business intelligence, storage, management and operations, virtualization, service-oriented architecture platform, security, and identity software. We also license standalone and software development lifecycle tools for software architects, developers, testers, and project managers. Server products and cloud services revenue is mainly affected by purchases through volume licensing programs, licenses sold to OEMs, and retail packaged products. CALs provide access rights to certain server products, including SQL Server and Windows Server, and revenue is reported along with the associated server product.

Azure is a scalable cloud platform with computing, networking, storage, database, and management, along with advanced services such as analytics, and comprehensive solutions such as Enterprise Mobility Suite. Azure includes a flexible platform that helps developers build, deploy, and manage enterprise, mobile, web, and IoT applications, for any platform or device without having to worry about the underlying infrastructure. Azure enables customers to devote more resources to development and use of applications that benefit their organizations, rather than managing on-premises hardware and software.

Enterprise Services

Enterprise Services, including Premier Support Services and Microsoft Consulting Services, assist customers in developing, deploying, and managing Microsoft server and desktop solutions and provide training and certification to developers and IT professionals on various Microsoft products.

Competition

Our server products face competition from a wide variety of server operating systems and applications offered by companies with a range of market approaches. Vertically integrated computer manufacturers such as Hewlett-Packard, IBM, and Oracle offer their own versions of the Unix operating system preinstalled on server hardware. Nearly all computer manufacturers offer server hardware for the Linux operating system and many contribute to Linux operating system development. The competitive position of Linux has also benefited from the large number of compatible applications now produced by many commercial and non-commercial software developers. A number of companies, such as Red Hat, supply versions of Linux.

We compete to provide enterprise-wide computing solutions and point solutions with numerous commercial software vendors that offer solutions and middleware technology platforms, software applications for connectivity (both Internet and intranet), security, hosting, database, and e-business servers. IBM and Oracle lead a group of companies focused on the Java Platform Enterprise Edition that competes with our enterprise-wide computing solutions. Commercial competitors for our server applications for PC-based distributed client-server environments include CA Technologies, IBM, and Oracle. Our web application platform software competes with open source software such as Apache, Linux, MySQL, and PHP. In middleware, we compete against Java vendors.

Our database, business intelligence, and data warehousing solutions offerings compete with products from IBM, Oracle, SAP, and other companies. Our system management solutions compete with server management and server virtualization platform providers, such as BMC, CA Technologies, Hewlett-Packard, IBM, and VMware. Our products for software developers compete against offerings from Adobe, IBM, Oracle, and other companies, and also against open-source projects, including Eclipse (sponsored by CA Technologies, IBM, Oracle, and SAP), PHP, and Ruby on Rails.

We believe our server products provide customers with advantages in performance, total costs of ownership, and productivity by delivering superior applications, development tools, compatibility with a broad base of hardware and software applications, security, and manageability.

Azure faces diverse competition from companies such as Amazon, Google, IBM, Oracle, Salesforce.com, VMware, and open source offerings. Azure's competitive advantage includes enabling a hybrid cloud, allowing deployment of existing datacenters with our public cloud into a single, cohesive infrastructure, and the ability to run at a scale that meets the needs of businesses of all sizes and complexities.

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Our Enterprise Services business competes with a wide range of companies that provide strategy and business planning, application development, and infrastructure services, including multinational consulting firms and small niche businesses focused on specific technologies.

More Personal Computing

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

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

Windows

The Windows operating system is designed to deliver a more personal computing experience for users by enabling consistency of experience, applications, and information across their devices. Windows OEM revenue is impacted significantly by the number of Windows operating system licenses purchased by OEMs, which they pre-install on the devices they sell. In addition to computing device market volume, Windows OEM revenue is impacted by:

- The mix of computing devices based on form factor and screen size.
- Differences in device market demand between developed markets and emerging markets.
- Attachment of Windows to devices shipped.
- Customer mix between consumer, small and medium businesses, and large enterprises.
- Changes in inventory levels in the OEM channel.
- Pricing changes and promotions, pricing variation that occurs when the mix of devices manufactured shifts from local and regional system builders to large multinational OEMs, and different pricing of Windows versions licensed.
- Piracy.

Windows Commercial revenue, which includes volume licensing of the Windows operating system, is affected mainly by the demand from commercial customers for volume licensing and Software Assurance, often reflecting the number of information workers in a licensed enterprise, and is therefore relatively independent of the number of PCs sold in a given year. Revenue from Windows cloud services, such as Windows Defender Advanced Threat Protection, and other Windows commercial offerings, is mainly impacted by attachment of Windows to devices shipped, pricing changes and promotions, mix of computing devices, and the customer mix among large enterprises, small and medium businesses, and educational institutions.

Patent licensing includes our programs to license patents we own for use across a broad array of technology areas, including mobile devices and cloud offerings.

Windows IoT extends the power of Windows and the cloud to intelligent systems by delivering specialized operating systems, tools, and services for use in embedded devices.

Display advertising primarily includes MSN ads. In June 2015, we entered into agreements with AOL and AppNexus to outsource our display sales responsibility.

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Devices

We design, manufacture, and sell devices, including Surface, PC accessories, and other intelligent devices, such as Surface Hub and HoloLens. Our devices are designed to enable people and organizations to connect to the people and content that matter most using Windows and integrated Microsoft products and services. Surface is designed to help organizations, students, and consumers be more productive. We released the Surface Studio in December 2016 and our latest Surface devices, the Surface Laptop and Surface Pro, in June 2017.

In July 2015, we announced a plan to restructure our phone business to better focus and align resources. In May 2016, we announced plans to further streamline our smartphone hardware business. In November 2016, we completed the sale of our feature phone business.

Gaming

Our gaming platform is designed to provide a unique variety of entertainment using our devices, peripherals, applications, online services, and content. We released Xbox One and Xbox One S in November 2013 and August 2016, respectively, and announced Xbox One X in June 2017. With the launch of the Windows 10 Xbox app in July 2015, and the launch of the Mixer service in May 2017, we continue to open new opportunities for customers to engage both on- and off-console. Xbox Live enables people to connect and share online gaming experiences and is accessible on Xbox consoles, Windows-enabled devices, and other devices. Xbox Live is designed to benefit users by providing access to a network of certified applications and services and to benefit our developer and partner ecosystems by providing access to a large customer base. Xbox Live revenue is mainly affected by subscriptions and sales of Xbox Live enabled content, as well as advertising. We also design and sell gaming content to showcase our unique platform capabilities for Xbox consoles, Windows-enabled devices, and other devices. Growth of our gaming business is determined by the overall active user base through Xbox Live enabled content, availability of games, providing exclusive game content that gamers seek, the computational power and reliability of the devices used to access our content and services, and the ability to create new experiences via online services, downloadable content, and peripherals.

Search Advertising

Search advertising, including Bing and Bing Ads, is designed to deliver relevant online advertising to a global audience. We have several partnerships with other companies, including Oath (formerly Yahoo! and AOL) which is owned by Verizon, through which we provide and monetize search queries. Growth depends on our ability to attract new users, understand intent, and match intent with relevant content and advertiser offerings.

Competition

Windows faces competition from various software products and from alternative platforms and devices, mainly from Apple and Google. We believe Windows competes effectively by giving customers choice, value, flexibility, security, an easy-to-use interface, and compatibility with a broad range of hardware and software applications, including those that enable productivity.

Devices face competition from various computer, tablet, hardware, and phone manufacturers who offer a unique combination of high-quality industrial design and innovative technologies across various price points. These manufacturers, many of which are also current or potential partners and customers, include Apple and our Windows OEMs.

Our gaming platform competes with console platforms from Sony and Nintendo, both of which have a large, established base of customers. The lifecycle for gaming and entertainment consoles averages five to ten years. Nintendo released its latest generation console in March 2017 and Sony released its latest generation console in November 2013. We also compete with other providers of entertainment services through online marketplaces. We believe our gaming platform is effectively positioned against competitive products and services based on significant innovation in hardware architecture, user interface, developer tools, online gaming and entertainment services, and continued strong exclusive content from our own game franchises as well as other digital content offerings. Our video games competitors include Electronic Arts and Activision Blizzard. Xbox Live faces competition from various online marketplaces, including those operated by Amazon, Apple, and Google.

Our search advertising business competes with Google and a wide array of websites, social platforms like Facebook, and portals that provide content and online offerings to end users.

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OPERATIONS

We have operations centers that support operations in their regions, including customer contract and order processing, credit and collections, information processing, and vendor management and logistics. The regional center in Ireland supports the European, Middle Eastern, and African region; the center in Singapore supports the Japan, India, Greater China, and Asia-Pacific region; and the centers in Fargo, North Dakota, Fort Lauderdale, Florida, Puerto Rico, Redmond, Washington, and Reno, Nevada support Latin America and North America. In addition to the operations centers, we also operate datacenters throughout the Americas, Australia, Europe, and Asia.

To serve the needs of customers around the world and to improve the quality and usability of products in international markets, we localize many of our products to reflect local languages and conventions. Localizing a product may require modifying the user interface, altering dialog boxes, and translating text.

Our devices are primarily manufactured by third-party contract manufacturers. We generally have the ability to use other manufacturers if a current vendor becomes unavailable or unable to meet our requirements.

We sold our feature phone business in November 2016, which included the sale of our phone manufacturing facility in Vietnam.

RESEARCH AND DEVELOPMENT

During fiscal years 2017, 2016, and 2015, research and development expense was $13.0 billion, $12.0 billion, and $12.0 billion, respectively. These amounts represented 14%, 14%, and 13% of revenue in fiscal years 2017, 2016, and 2015, respectively. We plan to continue to make significant investments in a broad range of research and development efforts.

Product and Service Development, and Intellectual Property

We develop most of our products and services internally through the following engineering groups.

- Office Product Group, focuses on our business across productivity, communications, education, and other information applications and services.
- Artificial Intelligence and Research, focuses on our AI development and other forward-looking research and development efforts spanning infrastructure, services, applications, and search.
- Cloud and Enterprise, focuses on our cloud infrastructure, server, database, CRM, ERP, management and development tools, and other business process applications and services for enterprises.
- Windows and Devices Group, focuses on our Windows platform, applications, games, store, and devices that power the Windows ecosystem.
- LinkedIn, focuses on our services that transform the way customers hire, market, sell, and learn.

Internal development allows us to maintain competitive advantages that come from product differentiation and closer technical control over our products and services. It also gives us the freedom to decide which modifications and enhancements are most important and when they should be implemented. We strive to obtain information as early as possible about changing usage patterns and hardware advances that may affect software design. Before releasing new software platforms, we provide application vendors with a range of resources and guidelines for development, training, and testing. Generally, we also create product documentation internally.

We protect our intellectual property investments in a variety of ways. We work actively in the U.S. and internationally to ensure the enforcement of copyright, trademark, trade secret, and other protections that apply to our software and hardware products, services, business plans, and branding. We are a leader among technology companies in pursuing patents and currently have a portfolio of over 66,000 U.S. and international patents issued and over 35,000 pending. While we employ much of our internally developed intellectual property exclusively in our products and services, we also engage in outbound and inbound licensing of specific patented technologies that are incorporated into licensees' or Microsoft's products. From time to time, we enter into broader cross-license agreements with other technology companies covering entire groups of patents. We also purchase or license technology that we incorporate into our products and services. At times, we make select intellectual property broadly available at no or low cost to achieve a strategic objective, such as promoting industry standards, advancing interoperability, or attracting and enabling our external development community.

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While it may be necessary in the future to seek or renew licenses relating to various aspects of our products, services, and business methods, we believe, based upon past experience and industry practice, such licenses generally can be obtained on commercially reasonable terms. We believe our continuing research and product development are not materially dependent on any single license or other agreement with a third party relating to the development of our products.

Investing in the Future

Our success is based on our ability to create new and compelling products, services, and experiences for our users, to initiate and embrace disruptive technology trends, to enter new geographic and product markets, and to drive broad adoption of our products and services. We invest in a range of emerging technology trends and breakthroughs that we believe offer significant opportunities to deliver value to our customers and growth for the company. Based on our assessment of key technology trends, we maintain our long-term commitment to research and development across a wide spectrum of technologies, tools, and platforms spanning digital work and life experiences, cloud computing, AI, and hardware operating systems.

While our main research and development facilities are located in Redmond, Washington, we also operate research and development facilities in other parts of the U.S. and around the world, including Canada, China, India, Ireland, Israel, and the United Kingdom. This global approach helps us remain competitive in local markets and enables us to continue to attract top talent from across the world. We generally fund research at the corporate level to ensure that we are looking beyond immediate product considerations to opportunities further in the future. We also fund research and development activities at the operating segment level. Much of our segment level research and development is coordinated with other segments and leveraged across the company.

In addition to our main research and development operations, we also operate Microsoft Research. Microsoft Research is one of the world's largest computer science research organizations, and works in close collaboration with top universities around the world to advance the state-of-the-art in computer science, providing us a unique perspective on future technology trends and contributing to our innovation.

DISTRIBUTION, SALES, AND MARKETING

We market and distribute our products and services through the following channels: OEMs, direct, and distributors and resellers. Our sales force performs a variety of functions, including working directly with enterprises and public-sector organizations worldwide to identify and meet their technology requirements; managing OEM relationships; and supporting system integrators, independent software vendors, and other partners who engage directly with our customers to perform sales, consulting, and fulfillment functions for our products and services.

OEMs

We distribute our software through OEMs that pre-install our software on new devices and servers they sell. The largest component of the OEM business is the Windows operating system pre-installed on devices. OEMs also sell devices pre-installed with other Microsoft products and services, including applications such as Office and the capability to subscribe to Office 365.

There are two broad categories of OEMs. The largest category of OEMs are direct OEMs as our relationship with them is managed through a direct agreement between Microsoft and the OEM. We have distribution agreements covering one or more of our products with virtually all the multinational OEMs, including Acer, ASUS, Dell, Fujitsu, Hewlett-Packard, Lenovo, Samsung, Toshiba, and with many regional and local OEMs. The second broad category of OEMs are system builders consisting of lower-volume PC manufacturers, which source Microsoft software for pre-installation and local redistribution primarily through the Microsoft distributor channel rather than through a direct agreement or relationship with Microsoft.

Direct

Many organizations that license our products and services transact directly with us through Enterprise Agreements and Enterprise Services contracts, with sales support from system integrators, independent software vendors, web agencies, and partners that advise organizations on licensing our products and services ("Enterprise Agreement Software Advisors", or "ESA"). Microsoft offers direct sales programs targeted to reach small, medium, and corporate customers, in addition to those offered through the reseller channel. A large network of partner advisors support many of these sales.

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We also provide commercial and consumer products and services directly to customers, such as cloud services, search, and gaming, through our online portals, marketplaces, and retail stores.

Distributors and Resellers

Organizations also license our products and services indirectly, primarily through licensing solution partners ("LSP"), distributors, value-added resellers ("VAR"), OEMs, and retailers. Although each type of reselling partner may reach organizations of all sizes, LSPs are primarily engaged with large organizations, distributors resell primarily to VARs, and VARs typically reach small and medium organizations. ESAs are also typically authorized as LSPs and operate as resellers for our other volume licensing programs. Microsoft Cloud Solution Provider is our main partner program for reselling cloud services.

Our Dynamics software offerings are also licensed to enterprises through a global network of channel partners providing vertical solutions and specialized services. We distribute our retail packaged products primarily through independent non-exclusive distributors, authorized replicators, resellers, and retail outlets. Individual consumers obtain these products primarily through retail outlets. We distribute our devices through third-party retailers. We have a network of field sales representatives and field support personnel that solicit orders from distributors and resellers, and provide product training and sales support.

LICENSING OPTIONS

We offer options for organizations that want to purchase our cloud services, on-premises software, and Software Assurance. We license software to organizations under volume licensing agreements to allow the customer to acquire multiple licenses of products and services instead of having to acquire separate licenses through retail channels. We use different programs designed to provide flexibility for organizations of various sizes. While these programs may differ in various parts of the world, generally they include those discussed below.

Software Assurance conveys rights to new software and upgrades for perpetual licenses released over the contract period. It also provides support, tools, and training to help customers deploy and use software efficiently. Software Assurance is included with certain volume licensing agreements and is an optional purchase with others.

Volume Licensing Programs

Enterprise Agreement

Enterprise Agreements offer large organizations a manageable volume licensing program that gives them the flexibility to buy cloud services and software licenses under one agreement. Enterprise Agreements are designed for medium or large organizations that want to license cloud services and on-premises software organization-wide over a three-year period. Organizations can elect to purchase perpetual licenses or subscribe to licenses. Software Assurance is included.

Microsoft Product and Services Agreement

MPSAs are designed for medium and large organizations that want to license cloud services and on-premises software as needed, with no organization-wide commitment, under a single, non-expiring agreement. Organizations purchase perpetual licenses or subscribe to licenses. Software Assurance is optional for customers that purchase perpetual licenses.

Open

Open Licensing agreements are a simple, cost-effective way to acquire the latest Microsoft technology. Open Licensing agreements are designed for small and medium organizations that want to license cloud services and on-premises software over a one- to three-year period. Under the Open License program, organizations purchase perpetual licenses and Software Assurance is optional. Under Open Value programs, organizations can elect to purchase perpetual licenses or subscribe to licenses and Software Assurance is included.

Select Plus

Select Plus agreements are designed for government and academic organizations to acquire on-premises licenses at any affiliate or department level, while realizing advantages as one organization. Organizations purchase perpetual licenses and Software Assurance is optional.

In July 2014, we announced the retirement over a two-year period of Select Plus agreements for commercial organizations. Beginning July 2015, no new Select Plus agreements were signed with commercial organizations. Starting in July 2016, we no longer accept orders from commercial organizations for Select Plus after their next agreement anniversary.

Microsoft Online Subscription Agreement

Microsoft Online Subscription Agreement is designed for small and medium organizations that want to subscribe to, activate, provision, and maintain cloud services seamlessly and directly via the web, through the Microsoft Online Subscription Program. The program allows customers to acquire monthly or annual subscriptions for cloud-based services.

Partner Programs

The Microsoft Cloud Solution Provider program offers customers an easy way to license the cloud services they need in combination with the value-added services offered by their systems integrator, hosting partner, or cloud reseller partner. Partners in this program can easily package their own products and services to directly provision, manage, and support their customer subscriptions.

The Microsoft Services Provider License Agreement allows service providers and independent software vendors who want to license eligible Microsoft software products to provide software services and hosted applications to their end customers. Partners license software over a three-year period and are billed monthly based on consumption.

The Independent Software Vendor Royalty program enables partners to integrate Microsoft products into other applications and then license the unified business solution to their end users.

CUSTOMERS

Our customers include individual consumers, small and medium organizations, large global enterprises, public-sector institutions, Internet service providers, application developers, and OEMs. No sales to an individual customer accounted for more than 10% of revenue in fiscal years 2017, 2016, or 2015. Our practice is to ship our products promptly upon receipt of purchase orders from customers; consequently, backlog is not significant.

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EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers as of August 2, 2017 were as follows:

Name	Age	Position with the Company
Satya Nadella	49	Chief Executive Officer
Christopher C. Capossela	47	Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer
Jean-Philippe Courtois	56	Executive Vice President and President, Microsoft Global Sales, Marketing and Operations
Kathleen T. Hogan	51	Executive Vice President, Human Resources
Amy E. Hood	45	Executive Vice President, Chief Financial Officer
Margaret L. Johnson	55	Executive Vice President, Business Development
Bradford L. Smith	58	President and Chief Legal Officer

Mr. Nadella was appointed Chief Executive Officer in February 2014. He served as Executive Vice President, Cloud and Enterprise from July 2013 until that time. From 2011 to 2013, Mr. Nadella served as President, Server and Tools. From 2009 to 2011, he was Senior Vice President, Online Services Division. From 2008 to 2009, he was Senior Vice President, Search, Portal, and Advertising. Since joining Microsoft in 1992, Mr. Nadella's roles also included Vice President of the Business Division. Mr. Nadella also serves on the Board of Directors of Starbucks Corporation.

Mr. Capossela was appointed Executive Vice President, Marketing and Consumer Business, and Chief Marketing Officer in July 2016. He had served as Executive Vice President, Chief Marketing Officer since March 2014. Previously, he served as the worldwide leader of the Consumer Channels Group, responsible for sales and marketing activities with OEMs, operators, and retail partners. In his more than 25 years at Microsoft, Mr. Capossela has held a variety of marketing leadership roles in the Microsoft Office Division. He was responsible for marketing productivity solutions including Microsoft Office, Office 365, SharePoint, Exchange, Skype for Business, Project, and Visio.

Mr. Courtois was named Executive Vice President and President, Microsoft Global Sales, Marketing and Operations in July 2016. Before that he was President of Microsoft International since 2005. He was Chief Executive Officer, Microsoft Europe, Middle East, and Africa from 2003 to 2005.He was Senior Vice President and President, Microsoft Europe, Middle East, and Africa from 2000 to 2003. He was Corporate Vice President, Worldwide Customer Marketing from 1998 to 2000. Mr. Courtois joined Microsoft in 1984.

Ms. Hogan was appointed Executive Vice President, Human Resources in November 2014. Prior to that Ms. Hogan was Corporate Vice President of Microsoft Services. She also served as Corporate Vice President of Customer Service and Support. Ms. Hogan joined Microsoft in 2003.

Ms. Hood was appointed Executive Vice President and Chief Financial Officer in July 2013, subsequent to her appointment as Chief Financial Officer in May 2013. From 2010 to 2013, Ms. Hood was Chief Financial Officer of the Microsoft Business Division. From 2006 through 2009, Ms. Hood was General Manager, Microsoft Business

Division Strategy. Since joining Microsoft in 2002, Ms. Hood has also held finance-related positions in the Server and Tools Business and the corporate finance organization.

Ms. Johnson was appointed Executive Vice President, Business Development in September 2014. Prior to that Ms. Johnson spent 24 years at Qualcomm in various leadership positions across engineering, sales, marketing and business development. She most recently served as Executive Vice President of Qualcomm Technologies, Inc. Ms. Johnson also serves on the Board of Directors of Live Nation Entertainment, Inc.

Mr. Smith was appointed President and Chief Legal Officer in September 2015. He served as Executive Vice President, General Counsel, and Secretary from 2011 to 2015, and served as Senior Vice President, General Counsel, and Secretary from 2001 to 2011. Mr. Smith was also named Chief Compliance Officer in 2002. Since joining Microsoft in 1993, he was Deputy General Counsel for Worldwide Sales and previously was responsible for managing the European Law and Corporate Affairs Group, based in Paris. Mr. Smith also serves on the Board of Directors of Netflix, Inc.

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EMPLOYEES

As of June 30, 2017, we employed approximately 124,000 people on a full-time basis, 73,000 in the U.S. and 51,000 internationally. Of the total employed people, 39,000 were in operations, including manufacturing, distribution, product support, and consulting services; 40,000 were in product research and development; 34,000 were in sales and marketing; and 11,000 were in general and administration. The acquisition of LinkedIn Corporation resulted in the addition of approximately 11,000 people in fiscal year 2017. Certain of our employees are subject to collective bargaining agreements.

AVAILABLE INFORMATION

Our Internet address is www.microsoft.com. At our Investor Relations website, www.microsoft.com/investor, we make available free of charge a variety of information for investors. Our goal is to maintain the Investor Relations website as a portal through which investors can easily find or navigate to pertinent information about us, including:

- Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file that material with or furnish it to the Securities and Exchange Commission ("SEC").
- Information on our business strategies, financial results, and metrics for investors.
- Announcements of investor conferences, speeches, and events at which our executives talk about our product, service, and competitive strategies. Archives of these events are also available.
- Press releases on quarterly earnings, product and service announcements, legal developments, and international news.
- Corporate governance information including our articles of incorporation, bylaws, governance guidelines, committee charters, codes of conduct and ethics, global corporate social responsibility initiatives, and other governance-related policies.
- Other news and announcements that we may post from time to time that investors might find useful or interesting.
- Opportunities to sign up for email alerts and RSS feeds to have information pushed in real time.

The information found on our website is not part of this or any other report we file with, or furnish to, the SEC. In addition to these channels, we use social media to communicate to the public. It is possible that the information we post on social media could be deemed to be material to investors. We encourage investors, the media, and others interested in Microsoft to review the information we post on the social media channels listed on our Investor Relations website.

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ITEM 1A. RISK FACTORS

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

We face intense competition across all markets for our products and services, which may lead to lower revenue or operating margins.

Competition in the technology sector

Our competitors range in size from diversified global companies with significant research and development resources to small, specialized firms whose narrower product lines may let them be more effective in deploying technical, marketing, and financial resources. Barriers to entry in many of our businesses are low and many of the areas in which we compete evolve rapidly with changing and disruptive technologies, shifting user needs, and frequent introductions of new products and services. Our ability to remain competitive depends on our success in making innovative products, devices, and services that appeal to businesses and consumers.

Competition among platforms, ecosystems, and devices

An important element of our business model has been to create platform-based ecosystems on which many participants can build diverse solutions. A well-established ecosystem creates beneficial network effects among users, application developers, and the platform provider that can accelerate growth. Establishing significant scale in the marketplace is necessary to achieve and maintain attractive margins. We face significant competition from firms that provide competing platforms, applications, and services.

- A competing vertically-integrated model, in which a single firm controls the software and hardware elements of a product and related services, has succeeded with some consumer products such as personal computers, tablets, phones, gaming consoles, and wearables. Competitors pursuing this model also earn revenue from services integrated with the hardware and software platform. We also offer some vertically-integrated hardware and software products and services. To the extent we shift a portion of our business to a vertically integrated model we increase our cost of revenue and reduce our operating margins.
- We derive substantial revenue from licenses of Windows operating systems on personal computers. We face significant competition from competing platforms developed for new devices and form factors such as smartphones and tablet computers. These devices compete on multiple bases including price and the perceived utility of the device and its platform. Users are increasingly turning to these devices to perform functions that in the past were performed by personal computers. Even if many users view these devices as complementary to a personal computer, the prevalence of these devices may make it more difficult to attract application developers to our PC operating system platforms. Competing with operating systems licensed at low or no cost may decrease our PC operating system margins. In addition, some of our devices compete with products made by our OEM partners, which may affect their commitment to our platform.
- Competing platforms have content and application marketplaces with scale and significant installed bases. The variety and utility of content and applications available on a platform are important to device purchasing decisions. Users sometimes incur costs to move data and buy new content and applications when switching platforms. To compete, we must successfully enlist developers to write applications for our marketplace and ensure that these

applications have high quality, customer appeal, and value. Efforts to compete with competitors' content and application marketplaces may increase our cost of revenue and lower our operating margins.

Business model competition

Companies compete with us based on a growing variety of business models.

- Even as we transition more of our business to a services and subscription business model, the license-based proprietary software model generates most of our software revenue. We bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from licensing our products. Many of our competitors also develop and sell software to businesses and consumers under this model.

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- Other competitors develop and offer free applications, online services and content, and make money by selling third-party advertising. Advertising revenue funds development of products and services these competitors provide to users at no or little cost, competing directly with our revenue-generating products.
- Some companies compete with us using an open source business model by modifying and then distributing open source software at nominal cost to end-users, and earning revenue on advertising or complementary services and products. These firms do not bear the full costs of research and development for the software. Some open source software vendors develop software that mimics the features and functionality of our products.

The competitive pressures described above may cause decreased sales volumes, price reductions, and/or increased operating costs, such as for research and development, marketing, and sales incentives. This may lead to lower revenue, gross margins, and operating income.

Our increasing focus on services presents execution and competitive risks. A growing part of our business involves cloud-based services available across the spectrum of computing devices. Our strategic vision is to compete and grow by building best-in-class platforms and productivity services for an intelligent cloud and an intelligent edge infused with AI. At the same time, our competitors are rapidly developing and deploying cloud-based services for consumers and business customers. Pricing and delivery models are evolving. Devices and form factors influence how users access services in the cloud and sometimes the user's choice of which suite of cloud-based services to use. We are devoting significant resources to develop and deploy our cloud-based strategies. The Windows ecosystem must continue to evolve with this changing environment. We are undertaking cultural and organizational changes to drive accountability and eliminate obstacles to innovation. The Company's investment in gaining insights from data is becoming central to the value of the services we deliver to customers, to our operational efficiency and key opportunities in monetization, customer perceptions of quality, and operational efficiency. Our ability to use data in this way may be constrained by regulatory developments that impede realizing the expected return from this investment.

Besides software development costs, we are incurring costs to build and maintain infrastructure to support cloud computing services. These costs will reduce the operating margins we have previously achieved. Whether we succeed in cloud-based services depends on our execution in several areas, including:

- Continuing to bring to market compelling cloud-based experiences that generate increasing traffic and market share.
- Maintaining the utility, compatibility, and performance of our cloud-based services on the growing array of computing devices, including PCs, smartphones, tablets, gaming consoles, and other television-related devices.
- Continuing to enhance the attractiveness of our cloud platforms to third-party developers.
- Ensuring our cloud-based services meet the reliability expectations of our customers and maintain the security of their data.
- Making our suite of cloud-based services platform-agnostic, available on a wide range of devices and ecosystems, including those of our competitors.

It is uncertain whether our strategies will attract the users or generate the revenue required to succeed. If we are not effective in executing organizational and technical changes to increase efficiency and accelerate innovation, or if we fail to generate sufficient usage of our new products and services, we may not grow revenue in line with the infrastructure and development investments described above. This may negatively impact gross margins and operating income.

We make significant investments in new products and services that may not achieve expected returns. We will continue to make significant investments in research, development, and marketing for existing products, services, and technologies, including the Windows operating system, the Microsoft Office system, Bing, Windows Server, the Windows Store, the Microsoft Azure Services platform, Office 365, other cloud-based offerings, and the Xbox entertainment platform. We also invest in the development and acquisition of a variety of hardware for productivity, communication, and entertainment including PCs, tablets, gaming devices, and HoloLens. Investments in new technology are speculative. Commercial success depends on many factors, including innovativeness, developer support, and effective distribution and marketing. If customers do not perceive our latest offerings as providing significant new functionality or other value, they may reduce their purchases of new software and hardware products or upgrades, unfavorably affecting revenue. We may not achieve significant revenue from new product, service, and distribution channel investments for several years, if at all. New products and services may not be profitable, and even if they are profitable, operating margins for some new products and businesses will not be as high as the margins we have experienced historically.

We did extensive preparation and ongoing compatibility testing for applications and devices to help ensure a positive experience for our users installing Windows 10. However, negative upgrade experiences could adversely affect the reception of Windows 10 in the marketplace and could lead to litigation or regulatory actions by customers and government agencies. In addition, we anticipate that Windows 10 will enable new post-license monetization opportunities beyond initial license revenues. Our inability to realize these opportunities to the extent we expect could have an adverse impact on our revenues. Finally, our practices for data collection, use, and management in Windows 10 are subject to regulatory review, and may result in decisions directing us to change these practices and imposing fines. If so, we could face negative public reaction, degraded user experiences, and reduced flexibility in product design.

Developing new technologies is complex. It can require long development and testing periods. Significant delays in new releases or significant problems in creating new products or services could adversely affect our revenue.

Acquisitions, joint ventures, and strategic alliances may have an adverse effect on our business. We expect to continue making acquisitions and entering into joint ventures and strategic alliances as part of our long-term business strategy. In December 2016, we completed our acquisition of LinkedIn for $27.0 billion. The LinkedIn acquisition and other transactions and arrangements involve significant challenges and risks, including that they do not advance our business strategy, that we get an unsatisfactory return on our investment, that we have difficulty integrating and retaining new employees, business systems, and technology, or that they distract management from our other businesses. If an arrangement fails to adequately anticipate changing circumstances and interests of a party, it may result in early termination or renegotiation of the arrangement. The success of these transactions and arrangements will depend in part on our ability to leverage them to enhance our existing products and services or develop compelling new ones. It may take longer than expected to realize the full benefits from these transactions and arrangements, such as increased revenue, enhanced efficiencies, or increased market share, or the benefits may ultimately be smaller than we expected. These events could adversely affect our operating results or financial condition.

If our goodwill or amortizable intangible assets become impaired, we may be required to record a significant charge to earnings. We acquire other companies and intangible assets and may not realize all the economic benefit from those acquisitions, which could cause an impairment of goodwill or intangibles. We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. We test goodwill for impairment at least annually. Factors that may be a change in circumstances, indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable, include a decline in our stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in industry segments in which we participate. We may be required to record a significant charge on our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, negatively affecting our results of operations. For example, in the fourth quarter of fiscal year 2015, we recorded a $5.1 billion charge for the impairment of goodwill and a $2.2 billion charge for the impairment of intangible assets, and in the fourth quarter of fiscal year 2016 we recorded a $480 million charge for the impairment of intangible assets. The impairment charges for both periods related to our phone business. Our acquisition of LinkedIn resulted in a significant increase in our goodwill and intangible asset balances.

We may not earn the revenues we expect from our intellectual property rights.

We may not be able to adequately protect our intellectual property rights

Protecting our intellectual property rights and combating unlicensed copying and use of our software and other intellectual property on a global basis is difficult. While piracy adversely affects U.S. revenue, the impact on revenue from outside the U.S. is more significant, particularly in countries where laws are less protective of intellectual property rights. Our revenue in these markets may grow slower than the underlying device market. Similarly, the absence of harmonized patent laws makes it more difficult to ensure consistent respect for patent rights. Throughout the world, we educate users about the benefits of licensing genuine products and obtaining indemnification benefits for intellectual property risks, and we educate lawmakers about the advantages of a business climate where intellectual property rights are protected. Reductions in the legal protection for software intellectual property rights could adversely affect revenue.

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We may not receive expected royalties from our patent licenses

We expend significant resources to patent the intellectual property we create with the expectation that we will generate revenues by incorporating that intellectual property in our products or services or, in some instances, by licensing our patents to others in return for a royalty. Changes in the law may weaken our ability to prevent the use of patented technology or collect revenue for licensing our patents. These include legislative changes and regulatory actions that make it more difficult to obtain injunctions, and the increasing use of legal process to challenge issued patents. Similarly, licensees of our patents may fail to satisfy their obligations to pay us royalties, or may contest the scope and extent of their obligations. Finally, the royalties we can obtain to monetize our intellectual property may decline because of the evolution of technology, selling price changes in products using licensed patents, or the difficulty of discovering infringements.

Third parties may claim we infringe their intellectual property rights. From time to time, others claim we infringe their intellectual property rights. The number of these claims may grow because of constant technological change in the markets in which we compete, the extensive patent coverage of existing technologies, the rapid rate of issuance of new patents, and our offering of first-party devices, such as Surface and Lumia phones. To resolve these claims, we may enter into royalty and licensing agreements on terms that are less favorable than currently available, stop selling or redesign affected products or services, or pay damages to satisfy indemnification commitments with our customers. These outcomes may cause operating margins to decline. Besides money damages, in some jurisdictions plaintiffs can seek injunctive relief that may limit or prevent importing, marketing, and selling our products or services that have infringing technologies. In some countries, such as Germany, an injunction can be issued before the parties have fully litigated the validity of the underlying patents. We have paid significant amounts to settle claims related to the use of technology and intellectual property rights and to procure intellectual property rights as part of our strategy to manage this risk, and may continue to do so.

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

Cyber-attacks and security vulnerabilities could lead to reduced revenue, increased costs, liability claims, or harm to our competitive position.

Security of Microsoft’s information technology

Threats to IT security can take a variety of forms. Individual and groups of hackers and sophisticated organizations, including state-sponsored organizations or nation-states, continuously undertake attacks that pose threats to our customers and our IT. These actors may use a wide variety of methods, which may include developing and deploying malicious software to attack our products and services and gain access to our networks and datacenters, using social engineering techniques to induce our employees, users, partners, or customers to disclose passwords or other sensitive information or take other actions to gain access to our data or our users’ or customers’ data, or acting in a coordinated manner to launch distributed denial of service or other coordinated attacks. Cyber threats are constantly evolving, increasing the difficulty of detecting and successfully defending against them. Cyber threats can have cascading impacts that unfold with increasing speed across our internal networks and systems and those of our partners and customers. Breaches of our network or data security could disrupt the security of our internal systems and business applications, impair our ability to provide services to our customers and protect the privacy of their data, result in product development delays, compromise confidential or technical business information harming our reputation or competitive position, result in theft or misuse of our intellectual property or other assets, require us to allocate more resources to improved technologies, or otherwise adversely affect our business.

In addition, our internal IT environment continues to evolve. Often, we are early adopters of new devices and technologies. We embrace new ways of sharing data and communicating internally and with partners and customers using methods such as social networking and other consumer-oriented technologies. Our business policies and internal security controls may not keep pace with these changes as new threats emerge.

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Security of our products, services, devices, and customers' data

The Security of our products and services is important in our customers' decisions to purchase or use our products or services. Security threats are a challenge to companies like us whose business is technology products and services. Threats to our own IT infrastructure can also affect our customers. Customers using our cloud-based services rely on the security of our infrastructure to ensure the reliability of our services and the protection of their data. Hackers tend to focus their efforts on the most popular operating systems, programs, and services, including many of ours, and we expect that to continue. Hackers that acquire user account information at other companies can use that information to compromise our users' accounts where accounts share the same attributes like passwords.

To defend against security threats, both to our internal IT systems and those of our customers, we must continuously engineer more secure products and services, enhance security and reliability features, improve the deployment of software updates to address security vulnerabilities, develop mitigation technologies that help to secure customers from attacks even when software updates are not deployed, maintain the digital security infrastructure that protects the integrity of our network, products, and services, and provide customers security tools such as firewalls and anti-virus software.

The cost of these steps could reduce our operating margins. If we fail to do these things well, actual or perceived security vulnerabilities in our products and services could harm our reputation and lead customers to reduce or delay future purchases of products or subscriptions to services, or to use competing products or services. Customers may also spend more on protecting their existing computer systems from attack, which could delay adoption of additional products or services. Customers may fail to update their systems, continue to run software or operating systems we no longer support, or may fail timely to install security patches. Any of these actions by customers could adversely affect our revenue. Actual or perceived vulnerabilities may lead to claims against us. Although our license agreements typically contain provisions that eliminate or limit our exposure to liability, there is no assurance these provisions will withstand legal challenges. Legislative or regulatory action in these areas may increase the costs to develop, implement, or secure our products and services.

Disclosure of personal data could result in liability and harm our reputation. As we continue to grow the number and scale of our cloud-based offerings, we store and process increasingly large amounts of personally identifiable information of our customers. The continued occurrence of high-profile data breaches provides evidence of an external environment increasingly hostile to information security. Despite our efforts to improve the security controls across our business groups and geographies, it is possible our security controls over personal data, our training of employees and vendors on data security, and other practices we follow may not prevent the improper disclosure of customer data we or our vendors store and manage. Improper disclosure could harm our reputation, lead to legal exposure to customers, or subject us to liability under laws that protect personal data, resulting in increased costs or loss of revenue. Our software products and services also enable our customers to store and process personal data on-premises or, increasingly, in a cloud-based environment we host. Government authorities can sometimes require us to produce customer data in response to valid legal orders. In the U.S. and elsewhere, we advocate for transparency concerning these requests and appropriate limitations on government authority to compel disclosure. Despite our efforts to protect customer data, perceptions that the collection, use, and retention of personal information is not satisfactorily protected could inhibit sales of our products or services, and could limit adoption of our cloud-based solutions by consumers, businesses, and government entities. Additional security measures we may take to address customer concerns, or constraints on our flexibility to determine where and how to operate datacenters in response to customer expectations or governmental rules or actions, may cause higher operating expenses.

We may have outages, data losses, and disruptions of our online services if we fail to maintain an adequate operations infrastructure. Our increasing user traffic, growth in services, and the complexity of our products and services demand more computing power. We spend substantial amounts to build, purchase, or lease datacenters and equipment and to upgrade our technology and network infrastructure to handle more traffic on our websites and in our datacenters. These demands continue to increase as we introduce new products and services and support the growth of existing services such as Bing, Exchange Online, Microsoft Azure, Microsoft Account services, Office 365, OneDrive, SharePoint Online, Skype, Xbox Live, Outlook.com, and Windows Stores. We are rapidly growing our business of providing a platform and back-end hosting for services provided by third parties to their end users. Maintaining, securing, and expanding this infrastructure is expensive and complex. It requires that we maintain an Internet connectivity infrastructure that is robust and reliable within competitive and regulatory constraints that continue to evolve. Inefficiencies or operational failures, including temporary or permanent loss of customer data or insufficient Internet connectivity, could diminish the quality of our products, services, and user experience resulting in contractual liability, claims by customers and other third parties, regulatory actions, damage to our reputation, and loss of current and potential users, subscribers, and advertisers, each of which may harm our operating results and financial condition.

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Government litigation and regulatory activity relating to competition rules may limit how we design and market our products. As a leading global software and device maker, government agencies closely scrutinize us under U.S. and foreign competition laws. An increasing number of governments are regulating competition law activities and this includes increased scrutiny in potentially large markets such as the European Union ("EU"), the U.S., and China. Some jurisdictions also allow competitors or consumers to assert claims of anti-competitive conduct. U.S. federal and state antitrust authorities have previously brought enforcement actions and continue to scrutinize our business.

The European Commission ("the Commission") closely scrutinizes the design of high-volume Microsoft products and the terms on which we make certain technologies used in these products, such as file formats, programming interfaces, and protocols, available to other companies. Flagship product releases such as Windows 10 can receive significant scrutiny under competition laws. For example, in 2004, the Commission ordered us to create new versions of our Windows operating system that do not include certain multimedia technologies and to provide our competitors with specifications for how to implement certain proprietary Windows communications protocols in their own products. In 2009, the Commission accepted a set of commitments offered by Microsoft to address the Commission's concerns relating to competition in web browsing software, including an undertaking to address Commission concerns relating to interoperability. The web browsing commitments expired in 2014. The remaining obligations may limit our ability to innovate in Windows or other products in the future, diminish the developer appeal of the Windows platform, and increase our product development costs. The availability of licenses related to protocols and file formats may enable competitors to develop software products that better mimic the functionality of our products, which could hamper sales of our products.

Our portfolio of first-party devices continues to grow; at the same time our OEM partners offer a large variety of devices on our platforms. As a result, increasingly we both cooperate and compete with our OEM partners, creating a risk that we fail to do so in compliance with competition rules. Regulatory scrutiny in this area may increase. Certain foreign governments, particularly in China and other countries in Asia, have advanced arguments under their competition laws that exert downward pressure on royalties for our intellectual property. Because these jurisdictions only recently implemented competition laws, their enforcement activities are unpredictable.

Government regulatory actions and court decisions such as these may hinder our ability to provide the benefits of our software to consumers and businesses, reducing the attractiveness of our products and the revenue that come from them. New competition law actions could be initiated. The outcome of such actions, or steps taken to avoid them, could adversely affect us in a variety of ways, including:

- We may have to choose between withdrawing products from certain geographies to avoid fines or designing and developing alternative versions of those products to comply with government rulings, which may entail a delay in a product release and removing functionality that customers want or on which developers rely.
- We may be required to make available licenses to our proprietary technologies on terms that do not reflect their fair market value or do not protect our associated intellectual property.
- The rulings described above may be precedent in other competition law proceedings.
- We are subject to a variety of ongoing commitments because of court or administrative orders, consent decrees, or other voluntary actions we have taken. If we fail to comply with these commitments, we may incur litigation costs and be subject to substantial fines or other remedial actions.
- Our ability to realize anticipated Windows 10 post-sale monetization opportunities may be limited.

Our global operations subject us to potential liability under anti-corruption, trade protection, and other laws and regulations. The Foreign Corrupt Practices Act and other anti-corruption laws and regulations ("Anti-Corruption Laws") prohibit corrupt payments by our employees, vendors, or agents. From time to time, we receive inquiries from authorities in the U.S. and elsewhere and reports from employees and others about our business activities outside the U.S. and our compliance with Anti-Corruption Laws. Specifically, we have been cooperating with authorities in the U.S. in connection with reports concerning our compliance with the Foreign Corrupt Practices Act in various countries. While we devote substantial resources to our global compliance programs and have implemented policies, training, and internal controls designed to reduce the risk of corrupt payments, our employees, vendors, or agents may violate our policies. Our failure to comply with Anti-Corruption Laws could result in significant fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation. Operations outside the U.S. may be affected by changes in trade protection laws, policies, and measures, sanctions, and other regulatory requirements affecting trade and investment. We may be subject to legal liability and reputational damage if we sell goods or services in violation of U.S. trade sanctions on countries such as Iran, North Korea, Cuba, Sudan, and Syria.

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Other regulatory areas that may apply to our products and online services offerings include user privacy, telecommunications, data storage and protection, and online content. For example, regulators may take the position that our offerings such as Skype are covered by laws regulating telecommunications services. Data protection authorities may assert that our collection, use, and management of customer data is inconsistent with their laws and regulations. Applying these laws and regulations to our business is often unclear, subject to change over time, and sometimes may conflict from jurisdiction to jurisdiction. Additionally, these laws and governments' approach to their enforcement, and our products and services, are continuing to evolve. Compliance with these types of regulation may involve significant costs or require changes in products or business practices that result in reduced revenue. Noncompliance could result in the imposition of penalties or orders we stop the alleged noncompliant activity.

Laws and regulations relating to the handling of personal data may impede the adoption of our services or result in increased costs, legal claims, or fines against us. The growth of our Internet- and cloud-based services internationally relies increasingly on the movement of data across national boundaries. Legal requirements relating to the collection, storage, handling, and transfer of personal data continue to evolve. For example, the EU and the U.S. formally entered into a new framework in July 2016 that provides a mechanism for companies to transfer data from EU member states to the U.S. This new framework, called the Privacy Shield, is intended to address shortcomings identified by the European Court of Justice in a predecessor mechanism. The Privacy Shield and other mechanisms are subject to review by the European courts, which may lead to uncertainty about the legal basis for data transfers across the Atlantic. In 2016, the EU adopted a new law governing data practices and privacy called the General Data Protection Regulation ("GDPR"), which becomes effective in May 2018. The law requires firms to meet new requirements regarding the handling of personal data. Engineering efforts to build new capabilities to facilitate compliance with the law may entail substantial expense and the diversion of engineering resources from other projects. If we are unable to engineer products that meet Microsoft's legal duties or help our customers meet their obligations under the GDPR or other data regulations, we might experience reduced demand for our offerings. Non-compliance with the GDPR may result in monetary penalties of up to 4% of worldwide revenue.

Ongoing legal reviews by regulators may result in burdensome or inconsistent requirements affecting the location and movement of our customer and internal employee data as well as the management of that data. Compliance may require changes in services, business practices, or internal systems that result in increased costs, lower revenue, reduced efficiency, or greater difficulty in competing with foreign-based firms. Failure to comply with existing or new rules may result in significant penalties or orders to stop the alleged noncompliant activity.

Our business depends on our ability to attract and retain talented employees. Our business is based on successfully attracting and retaining talented employees. The market for highly skilled workers and leaders in our industry is extremely competitive. We are limited in our ability to recruit internationally by restrictive domestic immigration laws. Changes to U.S. immigration policies that restrain the flow of technical and professional talent may inhibit our ability to adequately staff our research and development efforts. If we are less successful in our recruiting efforts, or if we cannot retain key employees, our ability to develop and deliver successful products and services may be adversely affected. Effective succession planning is also important to our long-term success. Failure to ensure effective transfer of knowledge and smooth transitions involving key employees could hinder our strategic planning and execution. How employment-related laws are interpreted and applied to our workforce practices may result in increased operating costs and less flexibility in how we meet our workforce needs.

We have claims and lawsuits against us that may result in adverse outcomes. We are subject to a variety of claims and lawsuits. These claims may arise from a wide variety of business practices and initiatives, including major new product releases such as Windows 10, significant business transactions, warranty or product claims, and employment practices. Adverse outcomes in some or all of these claims may result in significant monetary damages or injunctive relief that could adversely affect our ability to conduct our business. The litigation and other claims are subject to inherent uncertainties and management’s view of these matters may change in the future. A material adverse impact on our consolidated financial statements could occur for the period in which the effect of an unfavorable outcome becomes probable and reasonably estimable.

We may have additional tax liabilities. We are subject to income taxes in the U.S. and many foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We regularly are under audit by tax authorities in different jurisdictions. Economic and political pressures to increase tax revenue in various jurisdictions may make resolving tax disputes favorably more difficult. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation in the jurisdictions where we are subject to taxation could be materially different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material effect on our consolidated financial statements in the period or periods in which that determination is made.

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We earn a significant amount of our operating income from outside the U.S., and any repatriation of funds currently held in foreign jurisdictions to the U.S. may result in higher effective tax rates for the company. In addition, there have been proposals from Congress to change U.S. tax laws that would significantly impact how U.S. multinational corporations are taxed on foreign earnings. Although we cannot predict whether or in what form any proposed legislation may pass, if enacted, it could have a material adverse impact on our tax expense and cash flows.

Our hardware and software products may experience quality or supply problems. Our vertically-integrated hardware products such as Xbox consoles, Surface devices, and other devices we design, manufacture, and market are highly complex and can have defects in design, manufacture, or associated software. We could incur significant expenses, lost revenue, and reputational harm as a result of recalls, safety alerts, or product liability claims if we fail to prevent, detect, or address such issues through design, testing, or warranty repairs. We acquire some device components from sole suppliers. Our competitors use some of the same suppliers and their demand for hardware components can affect the capacity available to us. If a component from a sole-source supplier is delayed or becomes unavailable, whether because of supplier capacity constraint or industry shortages, we may not obtain timely replacement supplies, resulting in reduced sales. Component shortages, excess or obsolete inventory, or price reductions resulting in inventory adjustments may increase our cost of revenue. Xbox consoles, Surface devices, and other hardware are assembled in Asia and other geographies that may be subject to disruptions in the supply chain, resulting in shortages that would affect our revenue and operating margins. These same risks would apply to any other vertically-integrated hardware and software products we may offer.

Our software products also may experience quality or reliability problems. The highly-sophisticated software products we develop may contain bugs and other defects that interfere with their intended operation. Any defects we do not detect and fix in pre-release testing could cause reduced sales and revenue, damage to our reputation, repair or remediation costs, delays in the release of new products or versions, or legal liability. Although our license agreements typically contain provisions that eliminate or limit our exposure to liability, there is no assurance these provisions will withstand legal challenge.

We strive to empower all people and organizations to achieve more, and accessibility of our products is an important aspect of this goal. There is increasing pressure from advocacy groups, regulators, competitors, and customers to make technology more accessible. If our products do not meet customer expectations or emerging global accessibility requirements, we could lose sales opportunities or face regulatory actions.

Our global business exposes us to operational and economic risks. Our customers are located in over 200 countries and a significant part of our revenue comes from international sales. The global nature of our business creates operational and economic risks. Emerging markets are a significant focus of our international growth strategy. The developing nature of these markets presents several risks, including deterioration of social, political, labor, or economic conditions in a country or region, and difficulties in staffing and managing foreign operations. Although we hedge a portion of our international currency exposure, significant fluctuations in foreign exchange rates between the U.S. dollar and foreign currencies may adversely affect our revenue. Competitive or regulatory pressure to make our pricing structure uniform might require that we reduce the sales price of our software in the U.S. and other countries.

Catastrophic events or geopolitical conditions may disrupt our business. A disruption or failure of our systems or operations because of a major earthquake, weather event, cyber-attack, terrorist attack, or other catastrophic event could cause delays in completing sales, providing services, or performing other critical functions. Our corporate headquarters, a significant portion of our research and development activities, and certain other essential business operations are in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are seismically active regions. A catastrophic event that results in the destruction or disruption of any of our critical business or IT systems could harm our ability to conduct normal business operations. Providing our customers with more services and solutions in the cloud puts a premium on the resilience of our systems and strength of our business continuity management plans, and magnifies the potential impact of prolonged service outages on our operating results.

Abrupt political change, terrorist activity, and armed conflict pose a risk of general economic disruption in affected countries, which may increase our operating costs. These conditions also may add uncertainty to the timing and budget for technology investment decisions by our customers, and may cause supply chain disruptions for hardware manufacturers. Geopolitical change may result in changing regulatory requirements that could impact our operating strategies, access to global markets, hiring, and profitability. Geopolitical instability may lead to sanctions and impact our ability to do business in some markets or with some public-sector customers. Emerging nationalist trends in specific countries may significantly alter the trade environment. Changes to trade policy or agreements may result in higher tariffs, local sourcing initiatives, or other developments that make it more difficult to sell our products in foreign countries. Any of these changes may negatively impact our revenues.

The long-term effects of climate change on the global economy or the IT industry in particular are unclear. Environmental regulations or changes in the supply, demand or available sources of energy or other natural resources may affect the availability or cost of goods and services, including natural resources, necessary to run our business. Changes in weather where we operate may increase the costs of powering and cooling computer hardware we use to develop software and provide cloud-based services.

Adverse economic or market conditions may harm our business. Worsening economic conditions, including inflation, recession, or other changes in economic conditions, may cause lower IT spending and adversely affect our revenue. If demand for PCs, servers, and other computing devices declines, or consumer or business spending for those products declines, our revenue will be adversely affected. Substantial revenue comes from our U.S. government contracts. An extended federal government shutdown resulting from failing to pass budget appropriations, adopt continuing funding resolutions or raise the debt ceiling, and other budgetary decisions limiting or delaying federal government spending, could reduce government IT spending on our products and services and adversely affect our revenue.

Our product distribution system relies on an extensive partner and retail network. OEMs building devices that run our software have also been a significant means of distribution. The impact of economic conditions on our partners, such as the bankruptcy of a major distributor, OEM, or retailer, could cause sales channel disruption.

Challenging economic conditions also may impair the ability of our customers to pay for products and services they have purchased. As a result, allowances for doubtful accounts and write-offs of accounts receivable may increase.

We maintain an investment portfolio of various holdings, types, and maturities. These investments are subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by unusual events that affect global financial markets. A significant part of our investment portfolio comprises U.S. government securities. If global credit and equity markets decline for long periods, or if there is a downgrade of the U.S. government credit rating due to an actual or threatened default on government debt, our investment portfolio may be adversely affected and we could determine that more of our investments have experienced an other-than-temporary decline in fair value, requiring impairment charges that could adversely affect our financial results.

Changes in our sales organization may impact revenues. In July 2017, we announced plans to reorganize our global sales organization to help enable customers' digital transformation, add greater technical ability to our sales force, and create pooled resources that can be used across countries and industries. The reorganization is the most significant change in our global sales organization in Microsoft's history, involving employees changing roles, adding additional talent, realigning teams, and onboarding new partners. Successfully executing these changes will be a significant factor in enabling future revenue growth. As we navigate through this transition, sales, profitability, and cash flow could be adversely impacted.

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Item 1B, 2, 3, 4

ITEM 1B. UNRESOLVED STAFF COMMENTS

We have received no written comments regarding our periodic or current reports from the staff of the SEC that were issued 180 days or more preceding the end of our fiscal year 2017 that remain unresolved.

ITEM 2. PROPERTIES

Our corporate headquarters are located in Redmond, Washington. We have approximately 15 million square feet of space located in King County, Washington that is used for engineering, sales, marketing, and operations, among other general and administrative purposes. These facilities include approximately 10 million square feet of owned space situated on approximately 500 acres of land we own at our corporate headquarters, and approximately five million square feet of space we lease. In addition, we own and lease space domestically that includes office, retail, and datacenter space.

We also own and lease facilities internationally. Properties that we own include: our research and development centers in China and India; our operations in Ireland; and our facilities in Singapore, the Netherlands, and the United Kingdom. The largest leased properties include space in the following locations: India, China, the United Kingdom, Canada, France, Australia, Germany, and Japan. In addition to the above locations, we have various product development facilities, both domestically and internationally, as described under Research and Development (Part I, Item 1 of this Form 10-K).

In fiscal year 2017, the acquisition of LinkedIn Corporation increased our owned and leased space both domestically and internationally. We also sold various facilities related to the divestiture of our feature phone business.

The table below shows a summary of the square footage of our facilities owned and leased domestically and internationally as of June 30, 2017:

(Square feet in millions)

Location	Owned	Leased	Total
U.S.	17	13	30
International	6	12	18
Total	23	25	48

ITEM 3. LEGAL PROCEEDINGS

While not material to the Company, the Company makes the following annual report of the general activities of the Company’s Antitrust Compliance Office as required by the Final Order and Judgment in Barovic v. Ballmer et al, United States District Court for the Western District of Washington (“Final Order”). For more information see http://aka.ms/MSLegalNotice2015. These annual reports will continue through 2020. During fiscal year 2017, the Antitrust Compliance Office (a) monitored the Company's compliance with the European Commission Decision of March 24, 2004, ("2004 Decision") and with the Company's Public Undertaking to the European Commission dated December 16, 2009 ("2009 Undertaking"); (b) monitored, in the manner required by the Final Order, employee, customer, competitor, regulator, or other third-party complaints regarding compliance with the 2004 Decision, the 2009 Undertaking, or other EU or U.S. laws or regulations governing tying, bundling, and exclusive dealing contracts; and, (c) monitored, in the manner required by the Final Order, the training of the Company's employees regarding the Company's antitrust compliance polices. In addition, the Antitrust Compliance Officer reports to the Regulatory and Public Policy Committee of the Board at each of its regularly scheduled meetings and to the full Board annually.

See Note 17 – Contingencies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for information regarding legal proceedings in which we are involved.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

MARKET AND STOCKHOLDERS

Our common stock is traded on the NASDAQ Stock Market under the symbol MSFT. On July 31, 2017, there were 101,825 registered holders of record of our common stock. The high and low common stock sales prices per share were as follows:

Quarter Ended	September 30	December 31	March 31	June 30	Fiscal Year
Fiscal Year 2017					
High	$ 58.70	$ 64.10	$ 66.19	$ 72.89	$ 72.89
Low	50.39	56.32	61.95	64.85	50.39
Fiscal Year 2016					
High	$ 48.41	$ 56.85	$ 55.64	$ 56.77	$ 56.85
Low	39.72	43.75	48.19	48.04	39.72

DIVIDENDS AND SHARE REPURCHASES

See Note 18 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion regarding dividends and share repurchases. Following are our monthly stock repurchases for the fourth quarter of fiscal year 2017:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet be Purchased under the Plans or Programs
				(in millions)

April 1, 2017 – April 30, 2017	5,241,413	$ 66.17	5,241,413	$	38,053
May 1, 2017 – May 31, 2017	9,635,700	$ 68.77	9,635,700	$	37,391
June 1, 2017 – June 30, 2017	8,369,066	$ 70.56	8,369,066	$	36,800
	23,246,179		23,246,179		

All repurchases were made using cash resources. Our stock repurchases may occur through open market purchases or pursuant to a Rule 10b5-1 trading plan. The above table excludes shares repurchased to settle statutory employee tax withholding related to the vesting of stock awards.

PART II

Item 6

ITEM 6. SELECTED FINANCIAL DATA

FINANCIAL HIGHLIGHTS

(In millions, except per share data)

Year Ended June 30,	2017 [a]	2016	2015	2014 [h]	2013
Revenue	$89,950 [b]	$85,320 [d]	$93,580	$86,833	$77,849
Gross margin	55,689 [b]	52,540 [d]	60,542	59,755	57,464
Operating income	22,326 [b][c]	20,182 [d][e]	18,161 [g]	27,759	26,764 [i]
Net income	21,204 [b][c]	16,798 [d][e]	12,193 [g]	22,074	21,863 [i]
Diluted earnings per share	2.71 [b][c]	2.10 [d][e]	1.48 [g]	2.63	2.58 [i]
Cash dividends declared per share	1.56	1.44	1.24	1.12	0.92
Cash, cash equivalents, and short-term investments	132,981	113,240	96,526	85,709	77,022
Total assets	241,086	193,468 [f]	174,303 [f]	170,569 [f]	140,890 [f]
Long-term obligations	104,165	62,114 [f]	44,574 [f]	35,285 [f]	24,531 [f]
Stockholders' equity	72,394	71,997	80,083	89,784	78,944

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

(b) Reflects the impact of the net revenue deferral from Windows 10 of $6.7 billion, which decreased operating income, net income, and diluted earnings per share ("EPS") by $6.7 billion, $4.4 billion, and $0.57, respectively.

(c) Includes $306 million of employee severance expenses primarily related to our sales and marketing restructuring plan, which decreased operating income, net income, and diluted EPS by $306 million, $243 million, and $0.03, respectively.

(d) Reflects the impact of the net revenue deferral from Windows 10 of $6.6 billion, which decreased operating income, net income, and diluted EPS by $6.6 billion, $4.6 billion, and $0.58, respectively.

(e) Includes $630 million of asset impairment charges related to our phone business, and $480 million of restructuring charges associated with our phone business restructuring plans, which together decreased operating income, net income, and diluted EPS by $1.1 billion, $895 million, and $0.11, respectively.

(f) Reflects the impact of the adoption of the new accounting standard in fiscal year 2017 related to balance sheet classification of debt issuance costs. See Note 12 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

(g) Includes $7.5 billion of goodwill and asset impairment charges related to our phone business, and $2.5 billion of integration and restructuring expenses, primarily associated with our phone business restructuring plans, which together decreased operating income, net income, and diluted EPS by $10.0 billion, $9.5 billion, and $1.15, respectively.

(h)

On April 25, 2014, we acquired substantially all of Nokia Corporation's Devices and Services business ("NDS"). NDS has been included in our consolidated results of operations starting on the acquisition date.

(i) Includes a charge related to a fine imposed by the European Commission in March 2013 which decreased operating income and net income by $733 million (€561 million) and diluted EPS by $0.09. Also includes a charge for Surface RT inventory adjustments recorded in the fourth quarter of fiscal year 2013, which decreased operating income, net income, and diluted EPS by $900 million, $596 million, and $0.07, respectively.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is intended to help the reader understand the results of operations and financial condition of Microsoft Corporation. MD&A is provided as a supplement to, and should be read in conjunction with, our financial statements and the accompanying Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

OVERVIEW

Microsoft is a technology company whose mission is to empower every person and every organization on the planet to achieve more. We strive to create local opportunity, growth, and impact in every country around the world. Our strategy is to build best-in-class platforms and productivity services for an intelligent cloud and an intelligent edge infused with artificial intelligence ("AI"). We develop, license, and support a wide range of software products, services, and devices that deliver new opportunities, greater convenience, and enhanced value to people's lives. Our platforms and tools help drive small business productivity, large business competitiveness, and public-sector efficiency. They also support new startups, improve educational and health outcomes, and empower human ingenuity.

We generate revenue by licensing and supporting an array of software products, by offering a wide range of cloud-based and other services to consumers and businesses, by designing, manufacturing, and selling devices that integrate with our cloud-based services, and by delivering relevant online advertising to a global audience. Our most significant expenses are related to compensating employees; designing, manufacturing, marketing, and selling our products and services; datacenter costs in support of our cloud-based services; and income taxes.

Highlights* from fiscal year 2017 included:

- Commercial cloud annualized revenue run rate** exceeded $18.9 billion.
- Office Commercial revenue grew 6%, driven by Office 365 commercial revenue growth of 46%.
- Office Consumer revenue grew 14%, and Office 365 consumer subscribers increased to 27.0 million.
- Microsoft Dynamics revenue grew 9%, driven by Dynamics 365 revenue growth of 78%.
- LinkedIn contributed revenue of $2.3 billion.
- Server products and cloud services revenue grew 13%, driven by Microsoft Azure revenue growth of 99%.
- Enterprise Services revenue decreased 2%, driven by a decline in revenue from custom support agreements, offset in part by higher revenue from Premier Support Services and Microsoft Consulting Services.
- Windows original equipment manufacturer licensing ("Windows OEM") revenue increased 3%.
- Windows Commercial revenue grew 5%, driven by multi-year agreement revenue.
- Microsoft Surface revenue decreased 2%, driven by a reduction in volumes sold, offset in part by a higher mix of premium devices.
- Search advertising revenue, excluding traffic acquisition costs, grew 9%.
- Gaming revenue decreased slightly, driven by lower Xbox hardware revenue, offset in part by growth in Xbox software and services.

* Highlights are presented based on segment results.
**

Commercial cloud annualized revenue run rate is calculated by multiplying revenue for the last month of the quarter by twelve for Office 365 commercial, Azure, Dynamics 365, and other cloud properties.

On December 8, 2016, we completed our acquisition of LinkedIn Corporation for a total purchase price of $27.0 billion. LinkedIn has been included in our consolidated results of operations since the date of acquisition. See Note 9 – Business Combinations in the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

In November 2016, we completed the sale of our feature phone business for $350 million.

In July 2015, we announced a plan to restructure our phone business to better focus and align resources. In May 2016, we announced plans to further streamline our smartphone hardware business. Our change in phone strategy resulted in a reduction in units sold and associated expenses in fiscal year 2016 and 2017.

Industry Trends

Our industry is dynamic and highly competitive, with frequent changes in both technologies and business models. Each industry shift is an opportunity to conceive new products, new technologies, or new ideas that can further transform the industry and our business. At Microsoft, we push the boundaries of what is possible through a broad range of research and development activities that seek to identify and address the changing demands of customers and users, industry trends, and competitive forces.

Economic Conditions, Challenges, and Risks

The markets for software, devices, and cloud-based services are dynamic and highly competitive. Our competitors are developing new software and devices, while also deploying competing cloud-based services for consumers and businesses. The devices and form factors customers prefer evolve rapidly, and influence how users access services in the cloud, and in some cases, the user's choice of which suite of cloud-based services to use. We must continue to evolve and adapt over an extended time in pace with this changing environment. The investments we are making in infrastructure and devices will continue to increase our operating costs and may decrease our operating margins.

Our success is highly dependent on our ability to attract and retain qualified employees. We hire a mix of university and industry talent worldwide. Microsoft competes for talented individuals globally by offering an exceptional working environment, broad customer reach, scale in resources, the ability to grow one's career across many different products and businesses, and competitive compensation and benefits. Aggregate demand for our software, services, and devices is correlated to global macroeconomic and geopolitical factors, which remain dynamic.

Our international operations provide a significant portion of our total revenue and expenses. Many of these revenue and expenses are denominated in currencies other than the U.S. dollar. As a result, changes in foreign exchange rates may significantly affect revenue and expenses. The strengthening of the U.S. dollar relative to certain foreign currencies throughout fiscal year 2015, 2016, and 2017, negatively impacted reported revenue and reduced reported expenses from our international operations.

See a discussion of these factors and other risks under Risk Factors (Part I, Item 1A of this Form 10-K).

Seasonality

Our revenue historically has fluctuated quarterly and has generally been highest in the second quarter of our fiscal year due to corporate calendar year-end spending trends in our major markets and holiday season spending by consumers.

Reportable Segments

We report our financial performance based on the following segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing. The segment amounts included in MD&A are presented on a basis consistent with our internal management reporting. All differences between our internal management reporting basis and accounting principles generally accepted in the United States ("U.S. GAAP"), along with certain corporate-level and other activity, are included in Corporate and Other. We have recast certain previously reported amounts to conform to the way we internally manage and monitor segment performance.

Additional information on our reportable segments is contained in Note 21 – Segment Information and Geographic Data of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).

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SUMMARY RESULTS OF OPERATIONS

(In millions, except percentages and per share amounts)	2017	2016	2015	Percentage Change 2017 Versus 2016	Percentage Change 2016 Versus 2015
Revenue	$89,950	$85,320	$93,580	5%	(9)%
Gross margin	55,689	52,540	60,542	6%	(13)%
Operating income	22,326	20,182	18,161	11%	11%
Diluted earnings per share	2.71	2.10	1.48	29%	42%

Fiscal year 2017 compared with fiscal year 2016

Revenue increased $4.6 billion or 5%, driven by growth in Productivity and Business Processes and Intelligent Cloud, offset in part by lower revenue from More Personal Computing. Productivity and Business Processes revenue increased, driven by the acquisition of LinkedIn and higher revenue from Microsoft Office. Intelligent Cloud revenue increased, primarily due to higher revenue from server products and cloud services. More Personal Computing revenue decreased, mainly due to lower revenue from Devices, offset in part by higher revenue from Windows and Search advertising. Revenue included an unfavorable foreign currency impact of 2%.

Gross margin increased $3.1 billion or 6%, due to growth across each of our segments, including the acquisition of LinkedIn, driven by higher revenue. Gross margin included an unfavorable foreign currency impact of 2%. Gross margin percentage increased slightly due to a margin percent increase in More Personal Computing and segment sales mix, offset in part by margin percent declines in Productivity and Business Processes and Intelligent Cloud. Gross margin percentage includes a 5-point improvement in commercial cloud gross margin primarily across Azure and Office 365.

Operating income increased $2.1 billion or 11%, primarily due to higher gross margin and lower impairment, integration, and restructuring expenses, offset in part by an increase in research and development and sales and marketing expenses. Operating income included an operating loss of $948 million related to the acquisition of LinkedIn, including $866 million of amortization of intangible assets. Operating income also included an unfavorable foreign currency impact of 4%. Key changes in expenses were:

- Cost of revenue increased $1.5 billion or 5%, mainly due to growth in our commercial cloud, the acquisition of LinkedIn, and higher Search advertising traffic acquisition costs, offset in part by a reduction in phone sales and Gaming cost of revenue.
- Research and development expenses increased $1.0 billion or 9%, primarily due to LinkedIn expenses and increased investments in cloud engineering, offset in part by a reduction in phone expenses.
- Sales and marketing expenses increased $842 million or 6%, primarily due to LinkedIn expenses and increased investments in sales capacity for our commercial cloud, offset in part by a reduction in phone and marketing expenses.
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Impairment, integration, and restructuring expenses decreased $804 million, driven by prior year asset impairment charges and restructuring charges related to our phone business, offset in part by current year employee severance expenses primarily related to our sales and marketing restructuring plan.

Diluted earnings per share ("EPS") was $2.71 for fiscal year 2017. Current year diluted EPS was negatively impacted by the net revenue deferral from Windows 10 and restructuring expenses, which resulted in a decrease in diluted EPS of $0.60. Diluted EPS was $2.10 for fiscal year 2016. Prior year diluted EPS was negatively impacted by the net revenue deferral from Windows 10 and impairment and restructuring expenses, which resulted in a decrease in diluted EPS of $0.69.

Fiscal year 2016 compared with fiscal year 2015

Revenue decreased $8.3 billion or 9%, primarily due to the impact of the net revenue deferral from Windows 10 of $6.6 billion and an unfavorable foreign currency impact of approximately $3.8 billion or 4%. Windows 10 revenue is primarily recognized at the time of billing in the More Personal Computing segment, and the deferral and subsequent recognition of revenue is reflected in Corporate and Other. More Personal Computing revenue decreased, mainly due to lower revenue from Devices and Windows, offset in part by higher revenue from Search advertising and Gaming. Intelligent Cloud revenue increased, primarily due to higher revenue from server products and cloud services and Enterprise Services. Productivity and Business Processes revenue increased slightly, driven by an increase in Office and Dynamics revenue.

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Operating income increased $2.0 billion or 11%, primarily due to a decrease in impairment, integration, and restructuring expenses and sales and marketing expenses, offset in part by lower gross margin. Gross margin decreased $8.0 billion or 13%, driven by the decline in revenue as discussed above, and included an unfavorable foreign currency impact of approximately $3.3 billion or 5%. Productivity and Business Processes and More Personal Computing gross margin decreased, offset in part by higher gross margin from Intelligent Cloud.

Key changes in expenses were:

- Cost of revenue decreased $258 million or 1%, mainly due to a reduction in phone sales, driven by the change in strategy for the phone business, offset in part by growth in commercial cloud and Search advertising.
- Impairment, integration, and restructuring expenses decreased $8.9 billion, primarily driven by prior year goodwill and asset impairment charges related to our phone business and restructuring charges associated with our phone business restructuring plans.
- Sales and marketing expenses decreased $1.0 billion or 6%, driven by a reduction in phone expenses and a favorable foreign currency impact of approximately 2%.

Diluted EPS was $2.10 for fiscal year 2016. Diluted EPS was negatively impacted by the net revenue deferral from Windows 10 and impairment, integration, and restructuring expenses, which resulted in a decrease to diluted EPS of $0.69. Diluted EPS was $1.48 for fiscal year 2015. Diluted EPS was negatively impacted by impairment, integration, and restructuring expenses, which resulted in a decrease to diluted EPS of $1.15.

SEGMENT RESULTS OF OPERATIONS

(In millions, except percentages)	2017	2016	2015	Percentage Change 2017 Versus 2016	Percentage Change 2016 Versus 2015
Revenue					
Productivity and Business Processes	$30,444	$26,487	$26,430	15%	0%
Intelligent Cloud	27,440	25,042	23,715	10%	6%
More Personal Computing	38,773	40,434	43,435	(4)%	(7)%
Corporate and Other	(6,707)	(6,643)	0	(1)%	*
Total	$89,950	$85,320	$93,580	5%	(9)%
Operating income (loss)					
Productivity and Business Processes	$11,913	$12,418	$13,274	(4)%	(6)%
Intelligent Cloud	9,138	9,315	9,803	(2)%	(5)%
More Personal Computing	8,288	6,202	5,095	34%	22%

Corporate and Other	(7,013)	(7,753)	(10,011)	*	*
Total	$22,326	$20,182	$18,161	11%	11%

*Not meaningful

Reportable Segments

Fiscal year 2017 compared with fiscal year 2016

Productivity and Business Processes

Revenue increased $4.0 billion or 15%, driven by the acquisition of LinkedIn and higher revenue from Office.

- LinkedIn revenue was $2.3 billion, primarily comprised of revenue from Talent Solutions.
- Office Commercial revenue increased $1.2 billion or 6%, driven by higher revenue from Office 365 commercial, mainly due to growth in subscribers, offset in part by lower revenue from products licensed on-premises, reflecting a continued shift to Office 365 commercial.

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- Office Consumer revenue increased $425 million or 14%, driven by higher revenue from Office 365 consumer, mainly due to growth in subscribers.
- Dynamics revenue increased 9%, primarily due to higher revenue from Dynamics 365.

Operating income decreased $505 million or 4%, primarily due to higher operating expenses, offset in part by higher gross margin. Operating income included an unfavorable foreign currency impact of 3%.

- Operating expenses increased $2.4 billion or 26%, mainly due to LinkedIn and cloud engineering expenses. Operating expenses included $2.3 billion related to our acquisition of LinkedIn, including $359 million of amortization of acquired intangible assets. Sales and marketing expenses increased $1.2 billion or 24%, research and development expenses increased $955 million or 35%, and general and administrative expenses increased $212 million or 14%.
- Gross margin increased $1.8 billion or 9%, primarily due to our acquisition of LinkedIn. Gross margin percentage decreased due to an increased mix of cloud offerings and amortization of acquired intangible assets related to LinkedIn. Cost of revenue included $918 million related to our acquisition of LinkedIn, including $507 million of amortization of acquired intangible assets.

Intelligent Cloud

Revenue increased $2.4 billion or 10%, primarily due to higher revenue from server products and cloud services.

- Server products and cloud services revenue grew $2.5 billion or 13%, driven by Azure revenue growth of 99% and server products licensed on-premises revenue growth of 4%.
- Enterprise Services revenue decreased 2%, driven by a decline in revenue from custom support agreements, offset in part by higher revenue from Premier Support Services and Microsoft Consulting Services.

Operating income decreased $177 million or 2%, primarily due to higher operating expenses, offset in part by higher gross margin. Operating income included an unfavorable foreign currency impact of 3%.

- Operating expenses increased $973 million or 11%, driven by investments in sales capacity, cloud engineering, and developer engagement. Sales and marketing expenses increased $547 million or 13%, research and development expenses increased $468 million or 14%, and general and administrative expenses decreased $42 million or 3%.
- Gross margin increased $796 million or 4%, driven by growth in server products and cloud services revenue and cloud services scale and efficiencies, offset in part by a decline in Enterprise Services gross margin. Gross margin included an unfavorable foreign currency impact of 2%. Gross margin percentage decreased due to an increased mix of cloud offerings and lower Enterprise Services gross margin percent, offset by improvement in Azure gross margin percent.

More Personal Computing

Revenue decreased $1.7 billion or 4%, mainly due to lower revenue from Devices, offset in part by higher revenue from Windows and Search advertising.

- Windows revenue increased $442 million or 3%, mainly due to higher revenue from Windows OEM and Windows Commercial. Windows OEM revenue increased 3%. Windows OEM Pro revenue grew 5%, outperforming the commercial PC market, primarily due to a higher mix of premium licenses sold. Windows OEM non-Pro revenue grew 1%, outperforming the consumer PC market, primarily due to a higher mix of premium devices sold. Windows Commercial revenue grew 5%, driven by multi-year agreement revenue.
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Search advertising revenue increased $791 million or 15%. Search advertising revenue, excluding traffic acquisition costs, increased 9%, primarily driven by growth in Bing, due to higher revenue per search and search volume.

- Gaming revenue decreased slightly, primarily due to lower Xbox hardware revenue, offset in part by higher revenue from Xbox software and services. Xbox hardware revenue decreased 21%, mainly due to lower prices of consoles sold and a decline in volume of consoles sold. Xbox software and services revenue increased 11%, driven by a higher volume of Xbox Live transactions and revenue per transaction.

- Surface revenue decreased $82 million or 2%, primarily due to a reduction in volumes sold, offset in part by a higher mix of premium devices.
- Phone revenue decreased $2.8 billion.

Operating income increased $2.1 billion or 34%, due to lower operating expenses and higher gross margin. Operating income included an unfavorable foreign currency impact of 4%.

- Operating expenses decreased $1.5 billion or 12%, driven by a reduction in phone expenses and Surface launch-related expenses in the prior year. Sales and marketing expenses decreased $892 million or 16%, research and development expenses decreased $374 million or 6%, and general and administrative expenses decreased $252 million or 16%.
- Gross margin increased $568 million or 3%, driven by growth in Windows, Search advertising, and Gaming, offset in part by a decline in Phone and Surface. Gross margin percentage increased due to favorable sales mix and gross margin percent improvements across Gaming, Windows, and Search advertising, offset by a gross margin percent decline in Devices. Gross margin included an unfavorable foreign currency impact of 2%.

Fiscal year 2016 compared with fiscal year 2015

Productivity and Business Processes

Productivity and Business Processes revenue increased slightly, primarily due to an increase in Office and Dynamics revenue. Revenue included an unfavorable foreign currency impact of approximately 6%.

- Office Commercial revenue increased $135 million or 1%, driven by higher revenue from Office 365 commercial, mainly due to growth in subscribers, offset by lower transactional license volume, reflecting a continued shift to Office 365 commercial and a decline in the business PC market. Revenue included an unfavorable foreign currency impact of approximately 6%.
- Office Consumer revenue decreased $69 million or 2%, driven by a decline in the consumer PC market, offset in part by higher revenue from Office 365 consumer, mainly due to growth in subscribers. Revenue included an unfavorable foreign currency impact of approximately 4%.
- Dynamics revenue increased 4%, mainly due to higher revenue from Dynamics CRM Online, driven by seat growth. Revenue included an unfavorable foreign currency impact of approximately 6%.

Productivity and Business Processes operating income decreased $856 million or 6%, driven by lower gross margin. Gross margin decreased $928 million or 4%, primarily due to higher cost of revenue. Gross margin included an unfavorable foreign currency impact of approximately 6%. Cost of revenue increased $985 million or 25%, primarily due to an increased mix of cloud offerings. Operating expenses decreased $72 million or 1%, driven by lower sales and marketing expenses. Sales and marketing expenses decreased $82 million or 2%, mainly due to a reduction in headcount-related expenses and lower fees paid to third-party enterprise software advisors.

Intelligent Cloud

Intelligent Cloud revenue increased $1.3 billion or 6%, primarily due to higher server products and cloud services revenue and Enterprise Services revenue. Revenue included an unfavorable foreign currency impact of approximately 5%.

- Server products and cloud services revenue grew $686 million or 4%, driven by revenue growth from Azure of 113%, offset in part by a decline in transactional revenue from our on-premises server products. Revenue included an unfavorable foreign currency impact of approximately 5%.

- Enterprise Services revenue grew $536 million or 11%, mainly due to growth in Premier Support Services. Revenue included an unfavorable foreign currency impact of approximately 5%.

Intelligent Cloud operating income decreased $488 million or 5%, primarily due to higher operating expenses, offset in part by higher gross margin. Operating expenses increased $989 million or 12%, mainly due to higher research and development expenses and sales and marketing expenses. Research and development expenses increased $567 million or 21% and sales and marketing expenses increased $347 million or 9%, driven by increased strategic investments and acquisitions to drive cloud sales capacity and innovation. Gross margin increased $501 million or 3%, driven by revenue growth, offset in part by higher cost of revenue. Gross margin included an unfavorable foreign currency impact of approximately 5%. Cost of revenue increased $826 million or 14%, primarily driven by an increased mix of cloud services.

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More Personal Computing

More Personal Computing revenue decreased $3.0 billion or 7%, mainly due to lower revenue from Devices and Windows, offset in part by higher revenue from Search advertising and Gaming. Revenue included an unfavorable foreign currency impact of approximately 2%.

- Devices revenue decreased $4.0 billion or 33%, mainly due to lower revenue from phones, driven by the change in strategy for the phone business, offset in part by higher Surface revenue. Phone revenue decreased $4.2 billion or 56%, as we sold 13.8 million Microsoft Lumia phones and 75.5 million other phones in fiscal year 2016, compared with 36.8 million and 126.8 million sold, respectively, in fiscal year 2015. Surface revenue increased $207 million or 5%, primarily driven by the release of Surface Pro 4 and Surface Book in the second quarter of fiscal year 2016, as well as the release of Surface 3 in the fourth quarter of fiscal year 2015, offset in part by a decline in revenue from Surface Pro 3. Devices revenue included an unfavorable foreign currency impact of approximately 3%.
- Windows revenue decreased $958 million or 5%, mainly due to lower revenue from patent licensing, Windows OEM, and Windows Phone licensing. Patent licensing revenue decreased 27%, due to a decline in license revenue per unit and licensed units. Windows OEM revenue decreased 1%. Windows OEM Pro revenue declined 6%, driven by a decline in the business PC market. Windows OEM non-Pro revenue increased 7%, outperforming the consumer PC market, driven by a higher mix of premium licenses sold. Windows Phone licensing revenue decreased 64%, driven by the recognition of deferred revenue in fiscal year 2015 from Windows Phone 8. Windows revenue included an unfavorable foreign currency impact of approximately 2%.
- Search advertising revenue increased $1.7 billion or 46%. Search advertising revenue, excluding traffic acquisition costs, increased 17%, primarily driven by growth in Bing, due to higher revenue per search and search volume. Search advertising revenue included an unfavorable foreign currency impact of approximately 2%.
- Gaming revenue increased $75 million or 1%, primarily due to higher revenue from Xbox Live and video games, offset in part by lower Xbox hardware revenue. Xbox Live revenue increased 17%, driven by higher revenue per transaction and volume of transactions. Video games revenue grew 28%, driven by the launch of Halo 5 and sales of Minecraft. We acquired Mojang AB, the Swedish video game developer of the Minecraft gaming franchise, in November 2014. Xbox hardware revenue decreased 16%, mainly due to lower prices of Xbox One consoles sold and a decline in Xbox 360 console volume, offset in part by higher Xbox One console volume. Gaming revenue included an unfavorable foreign currency impact of approximately 4%.

More Personal Computing operating income increased $1.1 billion or 22%, primarily due to lower operating expenses, offset in part by lower gross margin. Operating expenses decreased $2.0 billion or 13%, mainly due to lower sales and marketing expenses and research and development expenses. Sales and marketing expenses decreased $1.3 billion or 19% and research and development expenses decreased $676 million or 10%, driven by a reduction in phone expenses. Gross margin decreased $932 million or 5%, reflecting lower revenue, offset in part by a reduction in cost of revenue. Gross margin included an unfavorable foreign currency impact of approximately 5%. Cost of revenue decreased $2.1 billion or 9%, primarily driven by a reduction in phone sales, offset in part by higher search advertising cost of revenue.

Corporate and Other

Corporate and Other revenue is comprised of revenue deferrals related to Windows 10. Corporate and Other operating income (loss) is comprised of revenue deferrals related to Windows 10 and corporate-level activity not specifically allocated to a segment, including impairment, integration, and restructuring expenses.

Fiscal year 2017 compared with fiscal year 2016

Revenue decreased $64 million, due to an increase in the net revenue deferral from Windows 10. During fiscal year 2017 and 2016, we deferred net revenue from Windows 10 of $6.7 billion and $6.6 billion, respectively.

Corporate and Other operating loss decreased $740 million, primarily due to an $804 million reduction in impairment, integration, and restructuring expenses, driven by prior year goodwill and asset impairment charges and restructuring charges related to our phone business, offset in part by current year employee severance expenses primarily related to our sales and marketing restructuring plan.

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Fiscal year 2016 compared with fiscal year 2015

Corporate and Other revenue decreased $6.6 billion, due to the net revenue deferral from Windows 10.

Corporate and Other operating loss decreased $2.3 billion, primarily due to an $8.9 billion reduction in impairment, integration, and restructuring expenses, driven by prior year goodwill and asset impairment charges related to our phone business, offset in part by lower revenue.

OPERATING EXPENSES

Research and Development

(In millions, except percentages)	2017	2016	2015	Percentage Change 2017 Versus 2016	Percentage Change 2016 Versus 2015
Research and development	$13,037	$11,988	$12,046	9%	0%
As a percent of revenue	14%	14%	13%	0ppt	1ppt

Research and development expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content.

Fiscal year 2017 compared with fiscal year 2016

Research and development expenses increased $1.0 billion or 9%, primarily due to LinkedIn expenses and increased investments in cloud engineering, offset in part by a reduction in phone expenses. Expenses included $745 million related to our acquisition of LinkedIn.

Fiscal year 2016 compared with fiscal year 2015

Research and development expenses decreased $58 million, primarily due to a reduction in phone expenses, driven by the change in strategy for the phone business, offset in part by increased strategic investments and acquisitions to drive cloud innovation.

Sales and Marketing

(In millions, except percentages)	2017	2016	2015	Percentage Change 2017	Percentage Change 2016

				Versus 2016	Versus 2015
Sales and marketing	$15,539	$14,697	$15,713	6%	(6)%
As a percent of revenue	17%	17%	17%	0ppt	0ppt

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs.

Fiscal year 2017 compared with fiscal year 2016

Sales and marketing expenses increased $842 million or 6%, primarily due to LinkedIn expenses and increased investments in sales capacity for our commercial cloud, offset in part by a reduction in phone expenses and prior year marketing expenses primarily related to Surface, commercial, and Windows 10. Expenses included $1.3 billion related to our acquisition of LinkedIn, including $359 million of amortization of acquired intangible assets.

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Fiscal year 2016 compared with fiscal year 2015

Sales and marketing expenses decreased $1.0 billion or 6%, primarily due to a reduction in phone expenses, driven by the change in strategy for the phone business. Expenses included a favorable foreign currency impact of approximately 2%.

General and Administrative

(In millions, except percentages)	2017	2016	2015	Percentage Change 2017 Versus 2016	Percentage Change 2016 Versus 2015
General and administrative	$4,481	$4,563	$4,611	(2)%	(1)%
As a percent of revenue	5%	5%	5%	0ppt	0ppt

General and administrative expenses include payroll, employee benefits, stock-based compensation expense, severance expense, and other headcount-related expenses associated with finance, legal, facilities, certain human resources and other administrative personnel, certain taxes, and legal and other administrative fees.

Fiscal year 2017 compared with fiscal year 2016

General and administrative expenses decreased $82 million or 2%, primarily due to prior year investments in infrastructure supporting our business transformation, a reduction in phone expenses, and lower employee-related expenses, offset in part by LinkedIn expenses. Expenses included $294 million related to our acquisition of LinkedIn.

Fiscal year 2016 compared with fiscal year 2015

General and administrative expenses decreased $48 million or 1%, primarily due to a reduction in employee-related expenses, offset in part by increased investments in infrastructure supporting our business transformation. Expenses included a favorable foreign currency impact of approximately 2%.

IMPAIRMENT, INTEGRATION, AND RESTRUCTURING EXPENSES

Impairment, integration, and restructuring expenses include costs associated with the impairment of goodwill and intangible assets related to our phone business, employee severance expenses and costs associated with the consolidation of facilities and manufacturing operations related to restructuring activities, and systems consolidation and other business integration expenses associated with our acquisition of Nokia Corporation’s Devices and Services business (“NDS”).

Fiscal year 2017 compared with fiscal year 2016

Impairment, integration, and restructuring expenses were $306 million for fiscal year 2017, compared to $1.1 billion for fiscal year 2016.

During fiscal year 2017, we recorded $306 million of employee severance expenses primarily related to our sales and marketing restructuring plan. During fiscal year 2016, we recorded $630 million of asset impairment charges related to our phone business. We also recorded $480 million of restructuring charges, including employee severance expenses and contract termination costs, primarily related to our previously announced phone business restructuring plans.

Fiscal year 2016 compared with fiscal year 2015

Impairment, integration, and restructuring expenses were $1.1 billion for fiscal year 2016, compared to $10.0 billion for fiscal year 2015.

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During fiscal year 2015, we recognized impairment charges of $7.5 billion related to our phone business. Our annual goodwill impairment test as of May 1, 2015 indicated that the carrying value of our previous Phone Hardware reporting unit goodwill exceeded its estimated fair value. Accordingly, we recorded a goodwill impairment charge of $5.1 billion, reducing our Phone Hardware reporting unit goodwill from $5.4 billion to $116 million, net of foreign currency remeasurements, as well as an impairment charge of $2.2 billion related to the write-down of our Phone Hardware reporting unit intangible assets. All remaining goodwill and intangible assets are included in our Devices reporting unit, within More Personal Computing under our current segment structure. Restructuring charges were $2.1 billion, including employee severance expenses and the write-down of certain assets in connection with our restructuring activities. Integration expenses associated with the acquisition of NDS were $435 million in fiscal year 2015.

OTHER INCOME (EXPENSE), NET

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

(In millions)

Year Ended June 30,	2017	2016	2015
Dividends and interest income	$1,387	$903	$766
Interest expense	(2,222)	(1,243)	(781)
Net recognized gains on investments	2,583	668	716
Net losses on derivatives	(510)	(443)	(423)
Net gains (losses) on foreign currency remeasurements	(164)	(121)	335
Other	(251)	(195)	(267)
Total	$823	$(431)	$346

We use derivative instruments to: manage risks related to foreign currencies, equity prices, interest rates, and credit; enhance investment returns; and facilitate portfolio diversification. Gains and losses from changes in fair values of derivatives that are not designated as hedges are primarily recognized in other income (expense), net. Other than those derivatives entered into for investment purposes, such as commodity contracts, the gains (losses) are generally economically offset by unrealized gains (losses) in the underlying available-for-sale securities and gains (losses) on certain balance sheet amounts from foreign exchange rate changes.

Fiscal year 2017 compared with fiscal year 2016

Dividends and interest income increased primarily due to higher portfolio balances and yields on fixed-income securities. Interest expense increased primarily due to higher outstanding long-term debt. Net recognized gains on investments increased primarily due to higher gains on sales of equity securities. Net losses on derivatives increased due to higher losses on equity derivatives, offset in part by lower losses on commodity and foreign currency derivatives. Other, net reflects recognized losses from certain joint ventures and divestitures.

Fiscal year 2016 compared with fiscal year 2015

Dividends and interest income increased due to higher portfolio balances and slightly higher yields on fixed-income securities. Interest expense increased due to higher outstanding long-term debt. Net recognized gains on investments decreased primarily due to higher other-than-temporary impairments and lower gains on sales of fixed-income securities, offset in part by higher gains on sales of equity securities. Net losses on derivatives increased due to higher losses on currency and equity contracts and lower gains on interest rate contracts in the current period as compared to the prior period, offset in part by lower losses on commodity contracts. For fiscal year 2016, other reflects recognized losses from divestitures and certain joint ventures.

INCOME TAXES

Fiscal year 2017 compared with fiscal year 2016

Our effective tax rate for fiscal years 2017 and 2016 was 8% and 15%, respectively. The decrease in our effective tax rate for fiscal year 2017 compared to fiscal year 2016 was primarily due to the realization of tax benefits attributable to previous phone business losses, offset in part by changes in the mix of our income before income taxes between the U.S. and foreign countries. The fiscal year 2016 effective tax rate included the impact of nondeductible phone charges and valuation allowances. Our effective tax rate was lower than the U.S. federal statutory rate primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland, Singapore, and Puerto Rico. Additionally, our effective tax rate in fiscal year 2017 reflects the realization of tax benefits attributable to previous phone business losses.

The mix of income before income taxes between the U.S. and foreign countries impacted our effective tax rate as a result of the geographic distribution of, and customer demand for, our products and services. We supply our Windows PC operating system to customers through our U.S. regional operating center, while we supply the Microsoft Office system and our server products and tools to customers through our foreign regional operations centers. In fiscal year 2017, our U.S. income before income taxes was $453 million and our foreign income before income taxes was $22.7 billion. Net revenue deferrals related to sales of Windows 10 negatively impacted our fiscal year 2017 U.S. income before income taxes by $6.4 billion and foreign income before income taxes by $317 million. In fiscal year 2016, our U.S. loss before income taxes was $325 million and our foreign income before income taxes was $20.1 billion. Net revenue deferrals related to sales of Windows 10 negatively impacted our fiscal year 2016 U.S. loss by $6.0 billion and foreign income before income taxes by $588 million.

Tax contingencies and other income tax liabilities were $13.5 billion and $11.8 billion as of June 30, 2017 and 2016, respectively, and are included in other long-term liabilities. This increase relates primarily to current period intercompany transfer pricing and tax credits.

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

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

Fiscal year 2016 compared with fiscal year 2015

Our effective tax rate for fiscal years 2016 and 2015 was 15% and 34%, respectively. Our effective tax rate was lower than the U.S. federal statutory rate primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland, Singapore, and Puerto Rico.

The decrease in our effective tax rate for fiscal year 2016 compared to fiscal year 2015 was primarily due to changes in the mix of our income before income taxes between the U.S. and foreign countries including the impact of net revenue deferrals related to sales of Windows 10, tax benefits from the adoption of the new accounting guidance relating to stock-based compensation, and distributions from foreign affiliates. The fiscal year 2015 effective tax rate included the tax impact of losses in foreign jurisdictions for which we may not realize a tax benefit, primarily as a result of impairment and restructuring charges.

The mix of income before income taxes between the U.S. and foreign countries impacted our effective tax rate as a result of the geographic distribution of, and customer demand for, our products and services. We supply our Windows PC operating system to customers through our U.S. regional operating center, while we supply the Microsoft Office system and our server products and tools to customers through our foreign regional operations centers. In fiscal year 2016, our U.S. loss before income taxes was $325 million and our foreign income before income taxes was $20.1 billion. Net revenue deferrals related to sales of Windows 10 negatively impacted our fiscal year 2016 U.S. loss before income taxes by $6.0 billion and foreign income before income taxes by $588 million. In fiscal year 2015, our U.S. income before income taxes was $7.4 billion and our foreign income before income taxes was $11.1 billion. Impairment, integration, and restructuring expense relating to our phone business decreased our fiscal year 2015 U.S income before income taxes by $1.1 billion and foreign income before income taxes by $8.9 billion.

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FINANCIAL CONDITION

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and short-term investments totaled $133.0 billion as of June 30, 2017, compared with $113.2 billion as of June 30, 2016. Equity and other investments were $6.0 billion as of June 30, 2017, compared with $10.4 billion as of June 30, 2016. Our short-term investments are primarily intended to facilitate liquidity and for capital preservation. They consist predominantly of highly liquid investment-grade fixed-income securities, diversified among industries and individual issuers. The investments are predominantly U.S. dollar-denominated securities, but also include foreign currency-denominated securities to diversify risk. Our fixed-income investments are exposed to interest rate risk and credit risk. The credit risk and average maturity of our fixed-income portfolio are managed to achieve economic returns that correlate to certain fixed-income indices. The settlement risk related to these investments is insignificant given that the short-term investments held are primarily highly liquid investment-grade fixed-income securities.

Of the cash, cash equivalents, and short-term investments as of June 30, 2017, $127.9 billion was held by our foreign subsidiaries and would be subject to material repatriation tax effects. The amount of cash, cash equivalents, and short-term investments held by foreign subsidiaries subject to other restrictions on the free flow of funds (primarily currency and other local regulatory) was $2.4 billion. As of June 30, 2017, approximately 87% of the cash equivalents and short-term investments held by our foreign subsidiaries were invested in U.S. government and agency securities, approximately 3% were invested in U.S. mortgage- and asset-backed securities, and approximately 2% were invested in corporate notes and bonds of U.S. companies, all of which are denominated in U.S. dollars. The remaining cash equivalents and short-term investments held by our foreign subsidiaries were primarily invested in foreign securities.

Securities lending

We lend certain fixed-income and equity securities to increase investment returns. The loaned securities continue to be carried as investments on our consolidated balance sheets. Cash and/or security interests are received as collateral for the loaned securities with the amount determined based upon the underlying security lent and the creditworthiness of the borrower. Cash collateral received is recorded as an asset with a corresponding liability. Our securities lending payable balance was $97 million as of June 30, 2017. Our average and maximum securities lending payable balances for fiscal year 2017 were $484 million and $1.5 billion, respectively. Intra-year variances in the amount of securities loaned are mainly due to fluctuations in the demand for the securities.

Valuation

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

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

Cash Flows

Fiscal year 2017 compared with fiscal year 2016

Cash from operations increased $6.2 billion to $39.5 billion during the fiscal year, mainly due to an increase in cash received from customers and an income tax refund for overpayment of estimated taxes, offset in part by an increase in cash paid to employees. Cash from financing increased $16.8 billion to $8.4 billion, mainly due to a $13.2 billion increase in proceeds from issuances of debt, net of repayments, and a $4.2 billion decrease in cash used for common stock repurchases, offset in part by an $839 million increase in dividends paid. Cash used in investing increased $22.8 billion to $46.8 billion, mainly due to a $24.6 billion increase in cash used for acquisitions of companies, net of cash acquired, and purchases of intangibles and other assets, offset in part by a $1.9 billion decrease in cash used for net investment purchases, sales, and maturities.

Fiscal year 2016 compared with fiscal year 2015

Cash from operations increased $3.7 billion to $33.3 billion during the fiscal year, mainly due to lower operating expenditures and a reduction in materials and production costs, offset in part by a decrease in cash received from customers. Cash used in financing decreased $1.3 billion to $8.4 billion, mainly due to a $4.6 billion increase in proceeds from issuances of debt, net of repayments, offset in part by a $1.5 billion increase in cash used for common stock repurchases and a $1.1 billion increase in dividends paid. Cash used in investing increased $949 million to $24.0 billion, mainly due to a $2.4 billion increase in cash used for additions to property and equipment and a $1.5 billion increase in cash used for net investment purchases, sales, and maturities, offset in part by a $2.3 billion decrease in cash used for acquisitions of companies, net of cash acquired, and purchases of intangibles and other assets.

Debt

We issued debt to take advantage of favorable pricing and liquidity in the debt markets, reflecting our credit rating and the low interest rate environment. The proceeds of these issuances were or will be used for general corporate purposes, which may include, among other things, funding for working capital, capital expenditures, repurchases of capital stock, acquisitions, and repayment of existing debt. See Note 12 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Unearned Revenue

Unearned revenue as of June 30, 2017 was comprised mainly of unearned revenue from volume licensing programs. Unearned revenue from volume licensing programs represents customer billings for multi-year licensing arrangements paid for either at inception of the agreement or annually at the beginning of each coverage period and accounted for as subscriptions with revenue recognized ratably over the coverage period. Unearned revenue as of June 30, 2017 also included payments for: Windows 10 licenses; post-delivery support and consulting services to be performed in the future; Office 365 subscriptions; LinkedIn; Xbox Live subscriptions; Dynamics business solutions products; Skype prepaid credits and subscriptions; and other offerings for which we have been paid in advance and earn the revenue when we provide the service or software, or otherwise meet the revenue recognition criteria.

The following table outlines the expected future recognition of unearned revenue as of June 30, 2017:

(In millions)

Three Months Ending,	
September 30, 2017	$12,544
December 31, 2017	9,993
March 31, 2018	7,307
June 30, 2018	4,258
Thereafter	10,377
Total	$44,479

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If our customers choose to license cloud-based versions of our products and services rather than licensing transaction-based products and services, the associated revenue will shift from being recognized at the time of the transaction to being recognized over the subscription period or upon consumption, as applicable.

Share Repurchases

During fiscal year 2017, 2016, and 2015, we repurchased 170 million shares, 294 million shares, and 295 million shares of our common stock for $10.3 billion, $14.8 billion, and $13.2 billion, respectively, through our share repurchase programs. All repurchases were made using cash resources. See Note 18 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Dividends

See Note 18 – Stockholders' Equity of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Off-Balance Sheet Arrangements

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

Contractual Obligations

The following table summarizes the payments due by fiscal year for our outstanding contractual obligations as of June 30, 2017:

(In millions)	2018	2019-2020	2021-2022	Thereafter	Total
Long-term debt: [a]					
Principal payments	$1,050	$ 9,518	$ 11,746	$ 55,523	$77,837
Interest payments	2,402	4,672	4,301	33,179	44,554
Construction commitments [b]	1,067	0	0	0	1,067
Operating leases [b]	1,292	2,335	1,657	2,588	7,872
Capital leases, including imputed interest [b]	334	835	866	4,612	6,647
Purchase commitments [c]	16,002	628	176	397	17,203
Other long-term liabilities [d]	0	120	26	319	465

Total contractual obligations	$22,147	$ 18,108	$ 18,772	$ 96,618	$155,645

(a) See Note 12 – Debt of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).
(b) See Note 16 – Commitments of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K).
(c) Amounts represent purchase commitments, including open purchase orders and take-or-pay contracts that are not presented as construction commitments above.
(d) We have excluded long-term tax contingencies, other tax liabilities, deferred income taxes, and long-term pension liabilities of $14.4 billion from the amounts presented as the timing of these obligations is uncertain. We have also excluded unearned revenue and non-cash items.

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Other Planned Uses of Capital

We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology, as well as continue making acquisitions that align with our business strategy. Additions to property and equipment will continue, including new facilities, datacenters, and computer systems for research and development, sales and marketing, support, and administrative staff. We expect capital expenditures to increase in coming years to support growth in our cloud offerings. We have operating leases for most U.S. and international sales and support offices and certain equipment. We have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of capital resources.

Liquidity

We earn a significant amount of our operating income outside the U.S., which is deemed to be permanently reinvested in foreign jurisdictions. As a result, as discussed above under Cash, Cash Equivalents, and Investments, the majority of our cash, cash equivalents, and short-term investments are held by foreign subsidiaries. We currently do not intend nor foresee a need to repatriate these funds. We expect existing domestic cash, cash equivalents, short-term investments, cash flows from operations, and access to capital markets to continue to be sufficient to fund our domestic operating activities and cash commitments for investing and financing activities, such as regular quarterly dividends, debt maturities, and material capital expenditures, for at least the next 12 months and thereafter for the foreseeable future. In addition, we expect existing foreign cash, cash equivalents, short-term investments, and cash flows from operations to continue to be sufficient to fund our foreign operating activities and cash commitments for investing activities, such as material capital expenditures, for at least the next 12 months and thereafter for the foreseeable future.

Should we require more capital in the U.S. than is generated by our operations domestically, for example to fund significant discretionary activities, such as business acquisitions and share repurchases, we could elect to repatriate future earnings from foreign jurisdictions or raise capital in the U.S. through debt or equity issuances. These alternatives could result in higher effective tax rates, increased interest expense, or dilution of our earnings. We have borrowed funds domestically and continue to believe we have the ability to do so at reasonable interest rates.

RECENT ACCOUNTING GUIDANCE

See Note 1 – Accounting Policies of the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

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

Revenue Recognition

Revenue recognition for multiple-element arrangements requires judgment to determine if multiple elements exist, whether elements can be accounted for as separate units of accounting, and if so, the fair value for each of the elements.

Judgment is also required to assess whether future releases of certain software represent new products or upgrades and enhancements to existing products. Certain volume licensing arrangements include a perpetual license for current products combined with rights to receive unspecified future versions of software products and are accounted for as subscriptions, with billings recorded as unearned revenue and recognized as revenue ratably over the coverage period.

Software updates are evaluated on a case-by-case basis to determine whether they meet the definition of an upgrade, which may require revenue to be deferred and recognized when the upgrade is delivered. If it is determined that implied post-contract customer support ("PCS") is being provided, revenue from the arrangement is deferred and recognized over the implied PCS term. If updates are determined to not meet the definition of an upgrade, revenue is generally recognized as products are shipped or made available.

Microsoft enters into arrangements that can include various combinations of software, services, and hardware. Where elements are delivered over different periods of time, and when allowed under U.S. GAAP, revenue is allocated to the respective elements based on their relative selling prices at the inception of the arrangement, and revenue is recognized as each element is delivered. We use a hierarchy to determine the fair value to be used for allocating revenue to elements: (i) vendor-specific objective evidence of fair value ("VSOE"), (ii) third-party evidence, and (iii) best estimate of selling price ("ESP"). For software elements, we follow the industry-specific software guidance which only allows for the use of VSOE in establishing fair value. Generally, VSOE is the price charged when the deliverable is sold separately or the price established by management for a product that is not yet sold if it is probable that the price will not change before introduction into the marketplace. ESPs are established as best estimates of what the selling prices would be if the deliverables were sold regularly on a stand-alone basis. Our process for determining ESPs requires judgment and considers multiple factors that may vary over time depending upon the unique facts and circumstances related to each deliverable.

Customers purchasing a Windows 10 license will receive unspecified updates and upgrades over the life of their Windows 10 device at no additional cost. As these updates and upgrades will not be sold on a stand-alone basis, we are unable to establish VSOE. Accordingly, revenue from licenses of Windows 10 is recognized ratably over the estimated life of the related device, which ranges between two to four years.

The new standard related to revenue recognition will have a material impact on our consolidated financial statements. See Note 1 – Accounting Policies in the Notes to Financial Statements (Part II, Item 8 of this Form 10-K) for further discussion.

Impairment of Investment Securities

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

Goodwill

We allocate goodwill to reporting units based on the reporting unit expected to benefit from the business combination. We evaluate our reporting units on an annual basis and, if necessary, reassign goodwill using a relative fair value allocation approach. Goodwill is tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (May 1 for us) and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the business climate, legal factors, operating performance indicators, competition, or sale or disposition of a significant portion of a reporting unit.

Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated primarily through the use of a discounted cash flow methodology. This analysis requires significant judgments, including estimation of future cash flows, which is dependent on internal forecasts, estimation of the long-term rate of growth for our business, estimation of the useful life over which cash flows will occur, and determination of our weighted average cost of capital.

The estimates used to calculate the fair value of a reporting unit change from year to year based on operating results, market conditions, and other factors. Changes in these estimates and assumptions could materially affect the determination of fair value and goodwill impairment for each reporting unit.

Research and Development Costs

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

Legal and Other Contingencies

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

Income Taxes

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

Inventories

Inventories are stated at average cost, subject to the lower of cost or market. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. We regularly review inventory quantities on hand, future purchase commitments with our suppliers, and the estimated utility of our inventory. These reviews include analysis of demand forecasts, product life cycle status, product development plans, current sales levels, pricing strategy, and component cost trends. If our review indicates a reduction in utility below carrying value, we reduce our inventory to a new cost basis through a charge to cost of revenue.

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

Management is responsible for the preparation of the consolidated financial statements and related information that are presented in this report. The consolidated financial statements, which include amounts based on management's estimates and judgments, have been prepared in conformity with accounting principles generally accepted in the United States of America.

The Company designs and maintains accounting and internal control systems to provide reasonable assurance at reasonable cost that assets are safeguarded against loss from unauthorized use or disposition, and that the financial records are reliable for preparing consolidated financial statements and maintaining accountability for assets. These systems are augmented by written policies, an organizational structure providing division of responsibilities, careful selection and training of qualified personnel, and a program of internal audits.

The Company engaged Deloitte & Touche LLP, an independent registered public accounting firm, to audit and render an opinion on the consolidated financial statements and internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States).

The Board of Directors, through its Audit Committee, consisting solely of independent directors of the Company, meets periodically with management, internal auditors, and our independent registered public accounting firm to ensure that each is meeting its responsibilities and to discuss matters concerning internal controls and financial reporting. Deloitte & Touche LLP and the internal auditors each have full and free access to the Audit Committee.

Satya Nadella
Chief Executive Officer

Amy E. Hood
Executive Vice President and Chief Financial Officer

Frank H. Brod
Corporate Vice President, Finance and Administration;
Chief Accounting Officer

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

RISKS

We are exposed to economic risk from foreign exchange rates, interest rates, credit risk, equity prices, and commodity prices. A portion of these risks is hedged, but they may impact our consolidated financial statements.

Foreign Currency

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

Interest Rate

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

Equity

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

Commodity

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

VALUE-AT-RISK

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

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

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The following table sets forth the one-day VaR for substantially all of our positions as of June 30, 2017 and 2016 and for the year ended June 30, 2017:

(In millions)					
	June 30, 2017	June 30, 2016	Year Ended June 30, 2017		
Risk Categories			Average	High	Low
Foreign currency	$ 114	$92	$ 169	$ 303	$ 88
Interest rate	152	58	113	155	57
Equity	54	157	121	165	54
Commodity	0	12	8	12	0

Total one-day VaR for the combined risk categories was $207 million and $225 million as of June 30, 2017 and 2016. The total VaR is 35% and 29% less as of June 30, 2017 and 2016, respectively, than the sum of the separate risk categories in the table above due to the diversification benefit of the combination of risks.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INCOME STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	2017	2016	2015
Revenue:			
Product	$57,190	$61,502	$75,956
Service and other	32,760	23,818	17,624
Total revenue	89,950	85,320	93,580
Cost of revenue:			
Product	15,175	17,880	21,410
Service and other	19,086	14,900	11,628
Total cost of revenue	34,261	32,780	33,038
Gross margin	55,689	52,540	60,542
Research and development	13,037	11,988	12,046
Sales and marketing	15,539	14,697	15,713
General and administrative	4,481	4,563	4,611
Impairment, integration, and restructuring	306	1,110	10,011
Operating income	22,326	20,182	18,161
Other income (expense), net	823	(431)	346
Income before income taxes	23,149	19,751	18,507
Provision for income taxes	1,945	2,953	6,314
Net income	$ 21,204	$ 16,798	$12,193

Earnings per share:			
Basic	$2.74	$2.12	$1.49
Diluted	$2.71	$2.10	$1.48
Weighted average shares outstanding:			
Basic	7,746	7,925	8,177
Diluted	7,832	8,013	8,254
Cash dividends declared per common share	$1.56	$1.44	$1.24

See accompanying notes.

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COMPREHENSIVE INCOME STATEMENTS

(In millions)

Year Ended June 30,	2017	2016	2015
Net income	$ 21,204	$ 16,798	$ 12,193
Other comprehensive income (loss):			
Net unrealized gains (losses) on derivatives (net of tax effects of $(5), $(12), and $20)	(218)	(238)	559
Net unrealized losses on investments (net of tax effects of $(613), $(121), and $(197))	(1,116)	(228)	(362)
Translation adjustments and other (net of tax effects of $9, $(33), and $16)	228	(519)	(1,383)
Other comprehensive loss	(1,106)	(985)	(1,186)
Comprehensive income	$20,098	$15,813	$ 11,007

See accompanying notes. Refer to Note 19 — Accumulated Other Comprehensive Income for further information.

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BALANCE SHEETS

(In millions)

June 30,	2017	2016
Assets		
Current assets:		
Cash and cash equivalents	$7,663	$6,510
Short-term investments (including securities loaned of $3,694 and $204)	125,318	106,730
Total cash, cash equivalents, and short-term investments	132,981	113,240
Accounts receivable, net of allowance for doubtful accounts of $405 and $426	19,792	18,277
Inventories	2,181	2,251
Other	4,897	5,892
Total current assets	159,851	139,660
Property and equipment, net of accumulated depreciation of $24,179 and $19,800	23,734	18,356
Equity and other investments	6,023	10,431
Goodwill	35,122	17,872
Intangible assets, net	10,106	3,733
Other long-term assets	6,250	3,416
Total assets	$241,086	$193,468
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$7,390	$6,898
Short-term debt	9,072	12,904
Current portion of long-term debt	1,049	0
Accrued compensation	5,819	5,264
Income taxes	718	580
Short-term unearned revenue	34,102	27,468
Securities lending payable	97	294
Other	6,280	5,949
Total current liabilities	64,527	59,357

Long-term debt	76,073	40,557
Long-term unearned revenue	10,377	6,441
Deferred income taxes	531	1,476
Other long-term liabilities	17,184	13,640
Total liabilities	168,692	121,471
Commitments and contingencies		
Stockholders’ equity:		
Common stock and paid-in capital – shares authorized 24,000; outstanding 7,708 and 7,808	69,315	68,178
Retained earnings	2,648	2,282
Accumulated other comprehensive income	431	1,537
Total stockholders’ equity	72,394	71,997
Total liabilities and stockholders’ equity	$ 241,086	$ 193,468

See accompanying notes.

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CASH FLOWS STATEMENTS

(In millions)

Year Ended June 30,	2017	2016	2015
Operations			
Net income	$21,204	$16,798	$12,193
Adjustments to reconcile net income to net cash from operations:			
Goodwill and asset impairments	0	630	7,498
Depreciation, amortization, and other	8,778	6,622	5,957
Stock-based compensation expense	3,266	2,668	2,574
Net recognized gains on investments and derivatives	(2,073)	(223)	(443)
Deferred income taxes	(3,296)	332	224
Deferral of unearned revenue	67,711	57,072	45,072
Recognition of unearned revenue	(57,735)	(48,498)	(44,920)
Changes in operating assets and liabilities:			
Accounts receivable	(925)	(530)	1,456
Inventories	50	600	(272)
Other current assets	1,066	(1,167)	62
Other long-term assets	(539)	(41)	346
Accounts payable	81	88	(1,054)
Other current liabilities	386	(260)	(624)
Other long-term liabilities	1,533	(766)	1,599
Net cash from operations	39,507	33,325	29,668
Financing			
Proceeds from issuance (repayments) of short-term debt, maturities of 90 days or less, net	(4,963)	7,195	4,481
Proceeds from issuance of debt	44,344	13,884	10,680
Repayments of debt	(7,922)	(2,796)	(1,500)
Common stock issued	772	668	634
Common stock repurchased	(11,788)	(15,969)	(14,443)
Common stock cash dividends paid	(11,845)	(11,006)	(9,882)
Other, net	(190)	(369)	362
Net cash from (used in) financing	8,408	(8,393)	(9,668)

Investing			
Additions to property and equipment	(8,129)	(8,343)	(5,944)
Acquisition of companies, net of cash acquired, and purchases of intangible and other assets	(25,944)	(1,393)	(3,723)
Purchases of investments	(176,905)	(129,758)	(98,729)
Maturities of investments	28,044	22,054	15,013
Sales of investments	136,350	93,287	70,848
Securities lending payable	(197)	203	(466)
Net cash used in investing	(46,781)	(23,950)	(23,001)
Effect of foreign exchange rates on cash and cash equivalents	19	(67)	(73)
Net change in cash and cash equivalents	1,153	915	(3,074)
Cash and cash equivalents, beginning of period	6,510	5,595	8,669
Cash and cash equivalents, end of period	$7,663	$6,510	$5,595

See accompanying notes.

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STOCKHOLDERS' EQUITY STATEMENTS

(In millions)

Year Ended June 30,	2017	2016	2015
Common stock and paid-in capital			
Balance, beginning of period	$68,178	$68,465	$68,366
Common stock issued	772	668	634
Common stock repurchased	(2,987)	(3,689)	(3,700)
Stock-based compensation expense	3,266	2,668	2,574
Stock-based compensation income tax benefits	0	0	588
Other, net	86	66	3
Balance, end of period	69,315	68,178	68,465
Retained earnings			
Balance, beginning of period	2,282	9,096	17,710
Net income	21,204	16,798	12,193
Common stock cash dividends	(12,040)	(11,329)	(10,063)
Common stock repurchased	(8,798)	(12,283)	(10,744)
Balance, end of period	2,648	2,282	9,096
Accumulated other comprehensive income			
Balance, beginning of period	1,537	2,522	3,708
Other comprehensive loss	(1,106)	(985)	(1,186)
Balance, end of period	431	1,537	2,522
Total stockholders' equity	$ 72,394	$ 71,997	$ 80,083

See accompanying notes.

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NOTES TO FINANCIAL STATEMENTS

NOTE 1 — ACCOUNTING POLICIES

Accounting Principles

The consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

We have recast certain prior period amounts to conform to the current period presentation, with no impact on consolidated net income or cash flows.

Principles of Consolidation

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

Estimates and Assumptions

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates include: loss contingencies; product warranties; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; allowances for product returns; the market value of, and demand for, our inventory; and stock-based compensation forfeiture rates. Examples of assumptions include: the elements comprising a software arrangement, including the distinction between upgrades or enhancements and new products; when technological feasibility is achieved for our products; the potential outcome of future tax consequences of events that have been recognized on our consolidated financial statements or tax returns; and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from management’s estimates and assumptions.

Foreign Currencies

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

Product Revenue and Service and Other Revenue

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

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

Revenue Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable. Revenue generally is recognized net of allowances for returns and any taxes collected from customers and subsequently remitted to governmental authorities.

Revenue recognition for multiple-element arrangements requires judgment to determine if multiple elements exist, whether elements can be accounted for as separate units of accounting, and if so, the fair value for each of the elements.

Microsoft enters into arrangements that can include various combinations of software, services, and hardware. Where elements are delivered over different periods of time, and when allowed under U.S. GAAP, revenue is allocated to the respective elements based on their relative selling prices at the inception of the arrangement, and revenue is recognized as each element is delivered. We use a hierarchy to determine the fair value to be used for allocating revenue to elements: (i) vendor-specific objective evidence of fair value ("VSOE"), (ii) third-party evidence, and (iii) best estimate of selling price ("ESP"). For software elements, we follow the industry specific software guidance which only allows for the use of VSOE in establishing fair value. Generally, VSOE is the price charged when the deliverable is sold separately or the price established by management for a product that is not yet sold if it is probable that the price will not change before introduction into the marketplace. ESPs are established as best estimates of what the selling prices would be if the deliverables were sold regularly on a stand-alone basis. Our process for determining ESPs requires judgment and considers multiple factors that may vary over time depending upon the unique facts and circumstances related to each deliverable.

Revenue for retail packaged products, products licensed to original equipment manufacturers ("OEMs"), and perpetual licenses under certain volume licensing programs generally is recognized as products are shipped or made available.

Technology guarantee programs are accounted for as multiple-element arrangements as customers receive free or significantly discounted rights to use upcoming new versions of a software product if they license existing versions of the product during the eligibility period. Revenue is allocated between the existing product and the new product, and revenue allocated to the new product is deferred until that version is delivered. The revenue allocation is based on the VSOE of fair value of the products. The VSOE of fair value for upcoming new products are based on the price determined by management having the relevant authority when the element is not yet sold separately, but is expected to be sold in the near future at the price set by management.

Software updates that will be provided free of charge are evaluated on a case-by-case basis to determine whether they meet the definition of an upgrade and create a multiple-element arrangement, which may require revenue to be deferred and recognized when the upgrade is delivered, or if it is determined that implied post-contract customer support ("PCS") is being provided, the arrangement is accounted for as a multiple-element arrangement and all revenue from the arrangement is deferred and recognized over the implied PCS term when the VSOE of fair value does not exist. If updates are determined to not meet the definition of an upgrade, revenue is generally recognized as products are shipped or made available.

Customers purchasing a Windows 10 license will receive unspecified updates and upgrades over the life of their Windows 10 device at no additional cost. As these updates and upgrades will not be sold on a stand-alone basis, we are unable to establish VSOE of fair value. Accordingly, revenue from licenses of Windows 10 is recognized ratably over the estimated life of the related device, which ranges between two to four years.

Certain volume licensing arrangements include a perpetual license for current products combined with rights to receive unspecified future versions of software products, which we have determined are additional software products and are therefore accounted for as subscriptions, with billings recorded as unearned revenue and recognized as revenue ratably over the coverage period. Arrangements that include term-based licenses for current products with the right to use unspecified future versions of the software during the coverage period, are also accounted for as subscriptions, with revenue recognized ratably over the coverage period. Revenue from cloud-based services arrangements that allow for the use of a hosted software product or service over a contractually determined period of time without taking possession of software are accounted for as subscriptions with billings recorded as unearned revenue and recognized as revenue ratably over the coverage period beginning on the date the service is made available to customers. Revenue from cloud-based services arrangements that are provided on a consumption basis (for example, the amount of storage used in a particular period) is recognized commensurate with the customer utilization of such resources.

Some volume licensing arrangements include time-based subscriptions for cloud-based services and software offerings that are accounted for as subscriptions. These arrangements are considered multiple-element arrangements. However, because all elements are accounted for as subscriptions and have the same coverage period and delivery pattern, they have the same revenue recognition timing.

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Revenue related to Surface devices, Xbox consoles, games published by us, phones, and other hardware components is generally recognized when ownership is transferred to the resellers or to end customers when selling directly through Microsoft retail stores and online marketplaces. A portion of revenue may be deferred when these products are combined with software elements, and/or services. Revenue related to licensing for games published by third parties for use on the Xbox consoles is recognized when games are manufactured by the game publishers.

Display advertising revenue is recognized as advertisements are displayed. Search advertising revenue is recognized when the ad appears in the search results or when the action necessary to earn the revenue has been completed. Consulting services revenue is recognized as services are rendered, generally based on the negotiated hourly rate in the consulting arrangement and the number of hours worked during the period. Consulting revenue for fixed-price services arrangements is recognized as services are provided.

Cost of Revenue

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

Product Warranty

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

Research and Development

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

Sales and Marketing

Sales and marketing expenses include payroll, employee benefits, stock-based compensation expense, and other headcount-related expenses associated with sales and marketing personnel, and the costs of advertising, promotions, trade shows, seminars, and other programs. Advertising costs are expensed as incurred. Advertising expense was $1.5 billion, $1.6 billion, and $1.9 billion in fiscal years 2017, 2016, and 2015, respectively.

Stock-Based Compensation

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

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

Income Taxes

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

Fair Value Measurements

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

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

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

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

Financial Instruments

Investments

We consider all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. The fair values of these investments approximate their carrying values. In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Investments with maturities beyond one year may be classified as short-term

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based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. All cash equivalents and short-term investments are classified as available-for-sale and realized gains and losses are recorded using the specific identification method. Changes in market value, excluding other-than-temporary impairments, are reflected in OCI.

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

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

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

Derivatives

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

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

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

For derivative instruments that are not designated as hedges, gains (losses) from changes in fair values are primarily recognized in other income (expense), net. Other than those derivatives entered into for investment purposes, such as commodity contracts, the gains (losses) are generally economically offset by unrealized gains (losses) in the underlying available-for-sale securities, which are recorded as a component of OCI until the securities are sold or other-than-temporarily impaired, at which time the amounts are reclassified from accumulated other comprehensive income ("AOCI") into other income (expense), net.

Allowance for Doubtful Accounts

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

(In millions)

Year Ended June 30,	2017	2016	2015
Balance, beginning of period	$426	$335	$301
Charged to costs and other	85	146	77
Write-offs	(106)	(55)	(43)
Balance, end of period	$ 405	$ 426	$ 335

Inventories

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

Property and Equipment

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

Goodwill

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

Intangible Assets

All of our intangible assets are subject to amortization and are amortized using the straight-line method over their estimated period of benefit, ranging from one to 15 years. We evaluate the recoverability of intangible assets periodically by taking into account events or circumstances that may warrant revised estimates of useful lives or that indicate the asset may be impaired.

Recent Accounting Guidance

Accounting for Income Taxes – Intra-Entity Asset Transfers

In October 2016, the Financial Accounting Standards Board ("FASB") issued new guidance requiring an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs, rather than when the asset has been sold to an outside party. This guidance is effective for us beginning July 1, 2018, with early adoption permitted beginning July 1, 2017. We plan to adopt the guidance effective July 1, 2018. Adoption of the guidance will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. A cumulative-effect adjustment will capture the write-off of income tax consequences deferred from past intra-entity transfers involving assets other than inventory and new deferred tax assets for amounts not recognized under current U.S. GAAP. We anticipate this guidance will have a material impact on our consolidated balance sheets upon adoption, and continue to evaluate any impacts to our accounting policies, processes, and systems.

Financial Instruments – Credit Losses

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

Leases

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

The standard will be effective for us beginning July 1, 2019, with early adoption permitted. We elected to early adopt the standard effective July 1, 2017 concurrent with our adoption of the new standard related to revenue recognition. We elected the available practical expedients on adoption. In preparation for adoption of the standard, we have implemented internal controls and key system functionality to enable the preparation of financial information.

The standard will have a material impact on our consolidated balance sheets, but will not have a material impact on our consolidated income statements. The most significant impact will be the recognition of ROU assets and lease liabilities for operating leases, while our accounting for capital leases remains substantially unchanged.

Adoption of the standard will result in the recognition of additional ROU assets and lease liabilities for operating leases of $6.6 billion and $5.2 billion as of June 30, 2017 and 2016, respectively. See Expected Impacts to Reported Results below for the impact of adoption of the standard on our consolidated financial statements.

Financial Instruments – Recognition, Measurement, Presentation, and Disclosure

In January 2016, the FASB issued a new standard related to certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most prominent among the changes in the standard is the requirement for changes in the fair value of our equity investments, with certain exceptions, to be recognized through net income rather than OCI. The standard will be effective for us beginning July 1, 2018. Adoption of the standard will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the effective date. We are currently evaluating the impact of this standard on our consolidated financial statements, including accounting policies, processes, and systems.

Revenue from Contracts with Customers

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

The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). We will adopt the standard using the full retrospective method to restate each prior reporting period presented.

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The standard will be effective for us beginning July 1, 2018, with early adoption permitted. We elected to early adopt the standard effective July 1, 2017. In preparation for adoption of the standard, we have implemented internal controls and key system functionality to enable the preparation of financial information and have reached conclusions on key accounting assessments related to the standard, including our assessment that the impact of accounting for costs incurred to obtain a contract is immaterial.

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

Adoption of the standard will result in the recognition of additional revenue of $6.6 billion and $5.8 billion for fiscal year 2017 and 2016, respectively, and an increase in the provision for income taxes of $2.5 billion and $2.1 billion, respectively, primarily due to the net change in Windows 10 revenue recognition. In addition, adoption of the standard will result in an increase in accounts receivable and other current and long-term assets of $2.7 billion and $4.2 billion, as of June 30, 2017 and 2016, respectively, driven by unbilled receivables from upfront recognition of revenue for certain multi-year commercial software subscriptions that include both distinct software licenses and Software Assurance; a reduction of unearned revenue of $17.8 billion and $11.7 billion as of June 30, 2017 and 2016, respectively, driven by the upfront recognition of license revenue from Windows 10 and certain multi-year commercial software subscriptions; and an increase in deferred income taxes of $5.2 billion and $4.8 billion as of June 30, 2017 and 2016, respectively, driven by the upfront recognition of revenue. See Expected Impacts to Reported Results below for the impact of adoption of the standard on our consolidated financial statements.

Expected Impacts to Reported Results

Adoption of the standards related to revenue recognition and leases is expected to impact our reported results as follows:

(In millions, except earnings per share)			Year Ended June 30, 2017	
	As Reported	New Revenue	New Lease	As Adjusted

		Standard Adjustment	Standard Adjustment	
Income statements:				
Revenue	$89,950	$ 6,621	$0	$96,571
Provision for income taxes	1,945	2,467	0	4,412
Net income	21,204	4,285	0	25,489
Diluted earnings per share	2.71	0.54	0	3.25

(In millions, except earnings per share)			Year Ended June 30, 2016	
	As Reported	New Revenue Standard Adjustment	New Lease Standard Adjustment	As Adjusted
Income statements:				
Revenue	$85,320	$ 5,834	$0	$91,154
Provision for income taxes	2,953	2,147	0	5,100
Net income	16,798	3,741	0	20,539
Diluted earnings per share	2.10	0.46	0	2.56

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

(In millions)			June 30, 2016	
	As Reported	New Revenue Standard Adjustment	New Lease Standard Adjustment	As Adjusted
Balance sheets:				
Accounts receivable, net	$18,277	$ 2,359	$0	$20,636
Operating lease right-of-use assets	0	0	5,198	5,198
Other current and long-term assets	9,308	1,872	0	11,180
Unearned revenue	33,909	(11,716)	0	22,193
Deferred income taxes	1,476	4,837	0	6,313
Operating lease liabilities	0	0	4,257	4,257
Other current and long-term liabilities	19,589	17	941	20,547
Stockholders' equity	71,997	11,093	0	83,090

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

NOTE 2 — EARNINGS PER SHARE

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

The components of basic and diluted EPS were as follows:

(In millions, except earnings per share)

Year Ended June 30,	2017	2016	2015
Net income available for common shareholders (A)	$ 21,204	$ 16,798	$ 12,193
Weighted average outstanding shares of common stock (B)	7,746	7,925	8,177
Dilutive effect of stock-based awards	86	88	77
Common stock and common stock equivalents (C)	7,832	8,013	8,254
Earnings Per Share			
Basic (A/B)	$2.74	$2.12	$1.49
Diluted (A/C)	$2.71	$2.10	$1.48

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

NOTE 3 — OTHER INCOME (EXPENSE), NET

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

(In millions)			
Year Ended June 30,	2017	2016	2015
Dividends and interest income	$1,387	$903	$766
Interest expense	(2,222)	(1,243)	(781)
Net recognized gains on investments	2,583	668	716
Net losses on derivatives	(510)	(443)	(423)
Net gains (losses) on foreign currency remeasurements	(164)	(121)	335
Other, net	(251)	(195)	(267)
Total	$823	$(431)	$ 346

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

(In millions)			
Year Ended June 30,	2017	2016	2015
Other-than-temporary impairments of investments	$(55)	$(322)	$(183)
Realized gains from sales of available-for-sale securities	3,064	1,376	1,176
Realized losses from sales of available-for-sale securities	(426)	(386)	(277)
Total	$ 2,583	$ 668	$ 716

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NOTE 4 — INVESTMENTS

Investment Components

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

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

(In millions)	Cost Basis	Unrealized Gains	Unrealized Losses	Recorded Basis	Cash and Cash Equivalents	Short-term Investments	Equity and Other Investments
June 30, 2016							

Cash	$3,501	$0	$0	$3,501	$3,501	$0	$0
Mutual funds	1,012	0	0	1,012	1,012	0	0
Commercial paper	298	0	0	298	298	0	0
Certificates of deposit	1,000	0	0	1,000	868	132	0
U.S. government and agency securities	89,970	245	(11)	90,204	100	90,104	0
Foreign government bonds	5,502	10	(18)	5,494	731	4,763	0
Mortgage- and asset-backed securities	4,789	21	(2)	4,808	0	4,808	0
Corporate notes and bonds	6,509	110	(35)	6,584	0	6,584	0
Municipal securities	285	57	0	342	0	342	0
Common and preferred stock	5,597	4,452	(236)	9,813	0	0	9,813
Other investments	615	0	0	615	0	(3)	618
Total	$ 119,078	$ 4,895	$ (302)	$123,671	$ 6,510	$ 106,730	$ 10,431

As of June 30, 2017 and 2016, the recorded bases of common and preferred stock that are restricted for more than one year or are not publicly traded were $1.1 billion and $767 million, respectively. These investments are carried at cost and are reviewed quarterly for indicators of other-than-temporary impairment. It is not practicable for us to reliably estimate the fair value of these investments.

As of June 30, 2017, collateral received under agreements for loaned securities was $3.7 billion, which was primarily comprised of U.S. government and agency securities. As of June 30, 2016, collateral received under agreements for loaned securities was $294 million, which was primarily comprised of cash.

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Unrealized Losses on Investments

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

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

	Less than 12 Months		12 Months or Greater			
(In millions)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Total Fair Value	Total Unrealized Losses
June 30, 2016						
U.S. government and agency securities	$5,816	$ (3)	$432	$ (8)	$6,248	$ (11)
Foreign government bonds	3,452	(3)	35	(15)	3,487	(18)
Mortgage- and asset-backed securities	844	(1)	322	(1)	1,166	(2)
Corporate notes and bonds	1,180	(11)	788	(24)	1,968	(35)
Common and preferred stock	896	(147)	390	(89)	1,286	(236)
Total	$ 12,188	$ (165)	$ 1,967	$ (137)	$ 14,155	$ (302)

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

Debt Investment Maturities

(In millions)	Cost Basis	Estimated Fair Value
June 30, 2017		
Due in one year or less	$ 18,212	$ 18,188
Due after one year through five years	102,374	102,168
Due after five years through 10 years	6,478	6,504
Due after 10 years	999	1,019
Total	$ 128,063	$ 127,879

NOTE 5 — DERIVATIVES

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

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

Foreign Currency

Certain forecasted transactions, assets, and liabilities are exposed to foreign currency risk. We monitor our foreign currency exposures daily to maximize the economic effectiveness of our foreign currency hedge positions. Option and forward contracts are used to hedge a portion of forecasted international revenue for up to three years in the future and are designated as cash flow hedging instruments. Principal currencies hedged include the euro, Japanese yen, British pound, Canadian dollar, and Australian dollar. As of June 30, 2017 and 2016, the total notional amounts of these foreign exchange contracts sold were $8.9 billion and $8.4 billion, respectively.

Foreign currency risks related to certain non-U.S. dollar denominated securities are hedged using foreign exchange forward contracts that are designated as fair value hedging instruments. As of June 30, 2017 and 2016, the total notional amounts of these foreign exchange contracts sold were $5.1 billion and $5.3 billion, respectively.

Certain options and forwards not designated as hedging instruments are also used to manage the variability in foreign exchange rates on certain balance sheet amounts and to manage other foreign currency exposures. As of June 30, 2017, the total notional amounts of these foreign exchange contracts purchased and sold were $8.8 billion and $10.6 billion, respectively. As of June 30, 2016, the total notional amounts of these foreign exchange contracts purchased and sold were $12.0 billion and $11.7 billion, respectively.

Equity

Securities held in our equity and other investments portfolio are subject to market price risk. Market price risk is managed relative to broad-based global and domestic equity indices using certain convertible preferred investments, options, futures, and swap contracts not designated as hedging instruments. From time to time, to hedge our price risk, we may use and designate equity derivatives as hedging instruments, including puts, calls, swaps, and forwards. As of June 30, 2017, the total notional amounts of equity contracts purchased and sold for managing market price risk were $1.9 billion and $2.4 billion, respectively, of which $1.6 billion and $1.8 billion, respectively, were designated as hedging instruments. As of June 30, 2016, the total notional amounts of equity contracts purchased and sold for managing market price risk were $1.3 billion and $2.2 billion, respectively, of which $737 million and $986 million, respectively, were designated as hedging instruments.

Interest Rate

Securities held in our fixed-income portfolio are subject to different interest rate risks based on their maturities. We manage the average maturity of our fixed-income portfolio to achieve economic returns that correlate to certain broad-based fixed-income indices using exchange-traded option and futures contracts, and over-the-counter swap and option contracts, none of which are designated as hedging instruments. As of June 30, 2017, the total notional amounts of fixed-interest rate contracts purchased and sold were $233 million and $352 million, respectively. As of June 30, 2016, the total notional amounts of fixed-interest rate contracts purchased and sold were $328 million and $2.4 billion, respectively.

In addition, we use "To Be Announced" forward purchase commitments of mortgage-backed assets to gain exposure to agency mortgage-backed securities. These meet the definition of a derivative instrument in cases where physical delivery of the assets is not taken at the earliest available delivery date. As of June 30, 2017 and 2016, the total notional derivative amounts of mortgage contracts purchased were $567 million and $548 million, respectively.

Credit

Our fixed-income portfolio is diversified and consists primarily of investment-grade securities. We use credit default swap contracts, not designated as hedging instruments, to manage credit exposures relative to broad-based indices and to facilitate portfolio diversification. We use credit default swaps as they are a low-cost method of managing exposure to individual credit risks or groups of credit risks. As of June 30, 2017, the total notional amounts of credit contracts purchased and sold were $267 million and $63 million, respectively. As of June 30, 2016, the total notional amounts of credit contracts purchased and sold were $440 million and $273 million, respectively.

Commodity

We use broad-based commodity exposures to enhance portfolio returns and to facilitate portfolio diversification. We use swaps, futures, and option contracts, not designated as hedging instruments, to generate and manage exposures to broad-based commodity indices. We use derivatives on commodities as they can be low-cost alternatives to the purchase and storage of a variety of commodities, including, but not limited to, precious metals, energy, and grain. As of June 30, 2017, the total notional amounts of commodity contracts purchased were $19 million. As of June 30, 2016, the total notional amounts of commodity contracts purchased and sold were $631 million and $162 million, respectively.

Credit-Risk-Related Contingent Features

Certain of our counterparty agreements for derivative instruments contain provisions that require our issued and outstanding long-term unsecured debt to maintain an investment grade credit rating and require us to maintain minimum liquidity of $1.0 billion. To the extent we fail to meet these requirements, we will be required to post collateral, similar to the standard convention related to over-the-counter derivatives. As of June 30, 2017, our long-term unsecured debt rating was AAA, and cash investments were in excess of $1.0 billion. As a result, no collateral was required to be posted.

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Fair Values of Derivative Instruments

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

	June 30, 2017						June 30, 2016			
	Assets				Liabilities		Assets			Liabilities
(In millions)	Short-term Investments	Other Current Assets	Equity and Other Investments	Other Long-term Assets	Other Current Liabilities	Other Long-term Liabilities	Short-term Investments	Other Current Assets	Equity and Other Investments	Other Current Liabilities
Non-designated Hedge Derivatives										
Foreign exchange contracts	$9	$203	$0	$6	$(134)	$(8)	$33	$156	$0	$(296)
Equity contracts	3	0	0	0	(6)	0	23	0	0	(16)
Interest rate contracts	3	0	0	0	(7)	0	10	0	0	(25)
Credit contracts	5	0	0	0	(1)	0	6	0	0	(5)
Total	$20	$203	$0	$6	$(148)	$(8)	$72	$156	$0	$(342)
Designated Hedge Derivatives										
Foreign exchange contracts	$80	$133	$0	$0	$(3)	$0	$1	$392	$0	$(263)
Equity contracts	0	0	67	0	(186)	0	0	0	18	(25)
Total	$80	$133	$67	$0	$(189)	$0	$1	$392	$18	$(288)

Total gross amounts of derivatives	$100	$336	$67	$6	$(337)	$(8)	$73	$548	$18	$(630)
Gross derivatives either offset or subject to an enforceable master netting agreement	$100	$336	$67	$6	$(334)	$(8)	$69	$548	$18	$(630)
Gross amounts of derivatives offset on the balance sheet	(20)	(132)	(67)	(8)	221	7	(74)	(302)	(25)	398
Net amounts presented on the balance sheet	80	204	0	(2)	(113)	(1)	(5)	246	(7)	(232)
Gross amounts of derivatives not offset on the balance sheet	0	0	0	0	0	0	0	0	0	0
Cash collateral received	0	0	0	0	(228)	0	0	0	0	(250)
Net amount	$80	$204	$0	$(2)	$(341)	$(1)	$(5)	$246	$(7)	$(482)

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

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Fair Value Hedge Gains (Losses)

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

(In millions)			
Year Ended June 30,	2017	2016	2015
Foreign Exchange Contracts			
Derivatives	$ 441	$ (797)	$ 741
Hedged items	(386)	838	(725)
Total amount of ineffectiveness	$ 55	$ 41	$ 16
Equity Contracts			
Derivatives	$ (74)	$ (76)	$ (107)
Hedged items	74	76	107
Total amount of ineffectiveness	$ 0	$ 0	$ 0
Amount of equity contracts excluded from effectiveness assessment	$ (80)	$ (10)	$ 0

Cash Flow Hedge Gains (Losses)

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

(In millions)			
Year Ended June 30,	2017	2016	2015

Effective Portion

Gains recognized in other comprehensive income (net of tax effects of $4, $24 and $35)	$328	$351	$ 1,152
Gains reclassified from accumulated other comprehensive income into revenue	555	625	608

Amount Excluded from Effectiveness Assessment and Ineffective Portion

Losses recognized in other income (expense), net	(389)	(354)	(346)

We estimate that $130 million of net derivative gains included in AOCI as of June 30, 2017 will be reclassified into earnings within the following 12 months. No significant amounts of gains (losses) were reclassified from AOCI into earnings as a result of forecasted transactions that failed to occur during fiscal year 2017.

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Non-Designated Derivative Gains (Losses)

Gains (losses) from changes in fair values of derivatives that are not designated as hedges are primarily recognized in other income (expense), net. These amounts are shown in the table below, with the exception of gains (losses) on derivatives presented in income statement line items other than other income (expense), net, which were immaterial for the periods presented. Other than those derivatives entered into for investment purposes, such as commodity contracts, the gains (losses) below are generally economically offset by unrealized gains (losses) in the underlying available-for-sale securities and gains (losses) from foreign exchange rate changes on certain balance sheet amounts.

(In millions)

Year Ended June 30,	2017	2016	2015
Foreign exchange contracts	$(117)	$(55)	$(483)
Equity contracts	(114)	(21)	(19)
Interest-rate contracts	14	10	23
Credit contracts	5	(1)	(1)
Commodity contracts	(22)	(87)	(223)
Total	$ (234)	$ (154)	$ (703)

NOTE 6 — FAIR VALUE MEASUREMENTS

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

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

(In millions)	Level 1	Level 2	Level 3	Gross Fair Value	Netting (a)	Net Fair Value

June 30, 2017

Assets

Mutual funds	$1,478	$0	$0	$1,478	$0	$1,478
Commercial paper	0	319	0	319	0	319
Certificates of deposit	0	1,358	0	1,358	0	1,358
U.S. government and agency securities	109,228	2,616	0	111,844	0	111,844
Foreign government bonds	0	5,187	0	5,187	0	5,187
Mortgage- and asset-backed securities	0	3,934	0	3,934	0	3,934
Corporate notes and bonds	0	4,829	1	4,830	0	4,830
Municipal securities	0	327	0	327	0	327
Common and preferred stock	2,414	1,994	18	4,426	0	4,426
Derivatives	1	508	0	509	(227)	282
Total	$ 113,121	$ 21,072	$19	$ 134,212	$ (227)	$ 133,985

Liabilities

Derivatives and other	$0	$345	$39	$384	$(228)	$156

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(In millions)	Level 1	Level 2	Level 3	Gross Fair Value	Netting (a)	Net Fair Value
June 30, 2016						
Assets						
Mutual funds	$1,012	$0	$0	$1,012	$0	$1,012
Commercial paper	0	298	0	298	0	298
Certificates of deposit	0	1,000	0	1,000	0	1,000
U.S. government and agency securities	86,492	3,707	0	90,199	0	90,199
Foreign government bonds	10	5,705	0	5,715	0	5,715
Mortgage- and asset-backed securities	0	4,803	0	4,803	0	4,803
Corporate notes and bonds	0	6,361	1	6,362	0	6,362
Municipal securities	0	342	0	342	0	342
Common and preferred stock	6,918	2,114	18	9,050	0	9,050
Derivatives	6	633	0	639	(401)	238
Total	$ 94,438	$ 24,963	$ 19	$ 119,420	$ (401)	$ 119,019
Liabilities						
Derivatives and other	$17	$613	$0	$630	$(398)	$232

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

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

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

(In millions)

June 30,	2017	2016
Net fair value of assets measured at fair value on a recurring basis	$133,985	$119,019
Cash	3,624	3,501
Common and preferred stock measured at fair value on a nonrecurring basis	1,073	767
Other investments measured at fair value on a nonrecurring basis	523	618
Less derivative net assets classified as other current and long-term assets	(202)	(246)
Other	1	12
Recorded basis of investment components	$ 139,004	$ 123,671

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

During fiscal year 2017 and 2016, we did not record any material other-than-temporary impairments on financial assets required to be measured at fair value on a nonrecurring basis.

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NOTE 7 — INVENTORIES

The components of inventories were as follows:

(In millions)		
June 30,	2017	2016
Raw materials	$797	$612
Work in process	145	158
Finished goods	1,239	1,481
Total	$ 2,181	$ 2,251

NOTE 8 — PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

(In millions)		
June 30,	2017	2016
Land	$1,107	$824
Buildings and improvements	16,284	12,393
Leasehold improvements	5,064	3,659
Computer equipment and software	21,414	17,391
Furniture and equipment	4,044	3,889
Total, at cost	47,913	38,156
Accumulated depreciation	(24,179)	(19,800)
Total, net	$ 23,734	$ 18,356

As of June 30, 2017 and 2016, assets recorded under capital leases were $2.7 billion and $865 million, respectively, and accumulated depreciation associated with capital leases was $161 million and $57 million, respectively. During fiscal years 2017 and 2016, property and equipment acquired under capital leases was $1.8 billion and $413 million, respectively.

During fiscal years 2017, 2016, and 2015, depreciation expense was $6.1 billion, $4.9 billion, and $4.1 billion, respectively.

NOTE 9 — BUSINESS COMBINATIONS

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

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

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

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

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

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

(In millions)	Amount	Weighted Average Life
Customer-related	$ 3,607	7 years
Marketing-related (trade names)	2,148	20 years
Technology-based	2,109	3 years
Contract-based	23	5 years

Fair value of intangible assets acquired	$7,887	9 years

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

(In millions)	
Year Ended June 30,	2017
Revenue	$ 2,268
Operating loss	$(948)

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

(In millions, except earnings per share)		
Year Ended June 30,	2017	2016
Revenue	$ 91,668	$ 88,652
Net income	20,894	15,383
Diluted earnings per share	2.67	1.92

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

NOTE 10 — GOODWILL

Changes in the carrying amount of goodwill were as follows:

(In millions)	June 30, 2015	Acquisitions	Other	June 30, 2016	Acquisitions	Other	June 30, 2017
Productivity and Business Processes	$6,309	$ 443	$(74)	$6,678	$ 17,072 (a)	$(11)	$23,739
Intelligent Cloud	4,917	549	1	5,467	49	39	5,555
More Personal Computing	5,713	100	(86)	5,727	115	(14)	5,828
Total	$ 16,939	$ 1,092	$ (159)	$ 17,872	$ 17,236	$ 14	$ 35,122

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

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

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

Our accumulated goodwill impairment as of both June 30, 2017 and 2016 was $11.3 billion.

Goodwill Impairment

We test goodwill for impairment annually on May 1 at the reporting unit level, primarily using a discounted cash flow methodology with a peer-based, risk-adjusted weighted average cost of capital. We believe use of a discounted cash flow approach is the most reliable indicator of the fair values of the businesses. Effective May 1, 2017, we prospectively adopted accounting guidance that simplifies our goodwill impairment testing by eliminating the requirement to calculate the implied fair value of goodwill (formerly “Step 2”) in the event that an impairment is identified. Instead, an impairment charge is recorded based on the excess of the reporting unit’s carrying amount over its fair value.

No instances of impairment were identified in our May 1, 2017 or May 1, 2016 test. During fiscal year 2015, we recorded impairment charges of $5.1 billion related to goodwill in our previous Phone Hardware reporting unit. Phone Hardware goodwill is included in the Devices reporting unit within More Personal Computing under our current segment structure.

Upon completion of the annual testing as of May 1, 2015, our previous Phone Hardware reporting unit goodwill was determined to be impaired. In the second half of fiscal year 2015, Phone Hardware did not meet its sales volume and revenue goals, and the mix of units sold had lower margins than planned. These results, along with changes in the competitive marketplace and an evaluation of business priorities, led to a shift in strategic direction and reduced future revenue and profitability expectations for the business. As a result of these changes in strategy and expectations, we forecasted reductions in unit volume growth rates and lower future cash flows used to estimate the fair value of the Phone Hardware reporting unit, which resulted in the determination that an impairment adjustment was required.

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Because our annual test indicated that Phone Hardware's carrying value exceeded its estimated fair value, Step 2 of the goodwill impairment test was performed specific to Phone Hardware. Under Step 2, the fair value of all Phone Hardware assets and liabilities were estimated, including tangible assets, existing technology, patent agreements, and contractual arrangements, for the purpose of deriving an estimate of the implied fair value of goodwill. The implied fair value of the goodwill was then compared to the recorded goodwill to determine the amount of the impairment. Assumptions used in measuring the value of these assets and liabilities included the discount rates and royalty rates used in valuing the intangible assets, and consideration of the market environment in valuing the tangible assets.

NOTE 11 — INTANGIBLE ASSETS

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

(In millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
June 30,			2017			2016
Technology-based [(a)]	$7,765	$ (4,318)	$ 3,447	$5,970	$ (3,648)	$ 2,322
Marketing-related	4,016	(829)	3,187	1,869	(616)	1,253
Contract-based	841	(722)	119	796	(718)	78
Customer-related	4,045	(692)	3,353	465	(385)	80
Total	$ 16,667 [(b)]	$ (6,561)	$ 10,106	$ 9,100	$ (5,367)	$ 3,733

(a) Technology-based intangible assets included $59 million and $115 million of net carrying amount of software to be sold, leased, or otherwise marketed as of June 30, 2017 and 2016, respectively.
(b) Includes intangible assets related to LinkedIn and other additions. See Note 9 – Business Combinations for further information.

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

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

During fiscal year 2015, we recorded impairment charges of $2.2 billion related to intangible assets in our previous Phone Hardware reporting unit. Phone Hardware intangible assets are included in the Devices reporting unit under our current segment structure. In the fourth quarter of fiscal year 2015, we tested these intangible assets for recoverability due to changes in facts and circumstances associated with the shift in strategic direction and reduced profitability expectations for Phone Hardware. Based on the results of our testing, we determined that the carrying value of the intangible assets was not recoverable, and an impairment charge was recorded to the extent that estimated fair value exceeded carrying value. We primarily used a relief from royalty income approach to determine the fair value of the intangible assets and determine the amount of impairment.

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

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

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

(In millions)	Amount	Weighted Average Life	Amount	Weighted Average Life
Year Ended June 30,	2017		2016	
Customer-related	$3,607	7 years	$ 30	3 years
Technology-based	2,265	2 years	361	4 years
Marketing-related	2,148	19 years	2	1 year
Contract-based	63	6 years	0	n/a
Total	$ 8,083	9 years	$ 393	4 years

Intangible assets amortization expense was $1.7 billion, $978 million, and $1.3 billion for fiscal years 2017, 2016, and 2015, respectively. Amortization of capitalized software was $55 million, $69 million, and $79 million for fiscal years 2017, 2016, and 2015, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held as of June 30, 2017:

(In millions)	
Year Ending June 30,	
2018	$2,190
2019	1,698
2020	1,180
2021	1,006
2022	932
Thereafter	3,100
Total	$ 10,106

NOTE 12 — DEBT

Short-term Debt

As of June 30, 2017, we had $9.1 billion of commercial paper issued and outstanding, with a weighted-average interest rate of 1.01% and maturities ranging from 25 days to 264 days. As of June 30, 2016, we had $12.9 billion of commercial paper issued and outstanding, with a weighted-average interest rate of 0.43% and maturities ranging from 1 day to 99 days. The estimated fair value of this commercial paper approximates its carrying value.

We have two $5.0 billion credit facilities that expire on October 31, 2017 and November 14, 2018, respectively. These credit facilities serve as a back-up for our commercial paper program. As of June 30, 2017, we were in compliance with the only financial covenant in both credit agreements, which requires us to maintain a coverage ratio of at least three times earnings before interest, taxes, depreciation, and amortization to interest expense, as defined in the credit agreements. No amounts were drawn against these credit facilities during any of the periods presented.

Long-term Debt

As of June 30, 2017, the total carrying value and estimated fair value of our long-term debt, including the current portion, were $77.1 billion and $80.3 billion, respectively. As of June 30, 2016, the total carrying value and estimated fair value of our long-term debt were $40.6 billion and $44.0 billion, respectively. These estimated fair values are based on Level 2 inputs.

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

(In millions, except interest rates)	Face Value	Face Value	Stated Interest Rate	Effective Interest Rate
June 30,	2017	2016		
Notes				
November 15, 2017	$ 600	$ 600	0.875%	1.084%
May 1, 2018	450	450	1.000%	1.106%
November 3, 2018	1,750	1,750	1.300%	1.396%
December 6, 2018	1,250	1,250	1.625%	1.824%
June 1, 2019	1,000	1,000	4.200%	4.379%
August 8, 2019 (a)	2,500	*	1.100%	1.203%
November 1, 2019 (b)	18	*	0.500%	0.500%
February 6, 2020 (c)	1,500	*	1.850%	1.952%
February 12, 2020	1,500	1,500	1.850%	1.935%
October 1, 2020	1,000	1,000	3.000%	3.137%
November 3, 2020	2,250	2,250	2.000%	2.093%
February 8, 2021	500	500	4.000%	4.082%
August 8, 2021 (a)	2,750	*	1.550%	1.642%
December 6, 2021 (d)	1,996	1,944	2.125%	2.233%
February 6, 2022 (c)	1,750	*	2.400%	2.520%
February 12, 2022	1,500	1,500	2.375%	2.466%
November 3, 2022	1,000	1,000	2.650%	2.717%
November 15, 2022	750	750	2.125%	2.239%
May 1, 2023	1,000	1,000	2.375%	2.465%
August 8, 2023 (a)	1,500	*	2.000%	2.101%
December 15, 2023	1,500	1,500	3.625%	3.726%
February 6, 2024 (c)	2,250	*	2.875%	3.041%
February 12, 2025	2,250	2,250	2.700%	2.772%
November 3, 2025	3,000	3,000	3.125%	3.176%
August 8, 2026 (a)	4,000	*	2.400%	2.464%
February 6, 2027 (c)	4,000	*	3.300%	3.383%
December 6, 2028 (d)	1,996	1,944	3.125%	3.218%
May 2, 2033 (d)	627	611	2.625%	2.690%
February 12, 2035	1,500	1,500	3.500%	3.604%
November 3, 2035	1,000	1,000	4.200%	4.260%

August 8, 2036 (a)	2,250	*	3.450%	3.510%
February 6, 2037 (c)	2,500	*	4.100%	4.152%
June 1, 2039	750	750	5.200%	5.240%
October 1, 2040	1,000	1,000	4.500%	4.567%
February 8, 2041	1,000	1,000	5.300%	5.361%
November 15, 2042	900	900	3.500%	3.571%
May 1, 2043	500	500	3.750%	3.829%
December 15, 2043	500	500	4.875%	4.918%
February 12, 2045	1,750	1,750	3.750%	3.800%
November 3, 2045	3,000	3,000	4.450%	4.492%
August 8, 2046 (a)	4,500	*	3.700%	3.743%
February 6, 2047 (c)	3,000	*	4.250%	4.287%
February 12, 2055	2,250	2,250	4.000%	4.063%
November 3, 2055	1,000	1,000	4.750%	4.782%
August 8, 2056 (a)	2,250	*	3.950%	4.033%
February 6, 2057 (c)	2,000	*	4.500%	4.528%
Total	$ 77,837	$ 40,949		

(a) In August 2016, we issued $19.8 billion of debt securities.

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(b) Remaining notes that were acquired as part of the LinkedIn acquisition. See Note 9 – Business Combinations for further information.
(c) In February 2017, we issued $17.0 billion of debt securities.
(d) Euro-denominated debt securities.
* Not applicable.

The notes in the table above are senior unsecured obligations and rank equally with our other senior unsecured debt outstanding. Interest on these notes is paid semi-annually, except for the euro-denominated debt securities on which interest is paid annually. Cash paid for interest on our debt for fiscal years 2017, 2016, and 2015 was $1.6 billion, $1.1 billion, and $620 million, respectively. Effective July 1, 2016, we retrospectively adopted accounting guidance that requires debt issuance costs to be recorded as a deduction from the carrying amount of the debt liability, consistent with debt discounts. As of June 30, 2017 and 2016, the aggregate unamortized discount and debt issuance costs associated with our long-term debt, including the current portion, were $715 million and $392 million, respectively.

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

(In millions)	
Year Ending June 30,	
2018	$ 1,050
2019	4,000
2020	5,518
2021	3,750
2022	7,996
Thereafter	55,523
Total	$ 77,837

NOTE 13 — INCOME TAXES

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

(In millions)			
Year Ended June 30,	2017	2016	2015

Current Taxes			
U.S. federal	$2,739	$545	$3,661
U.S. state and local	30	136	364
Foreign	2,472	1,940	2,065
Current taxes	5,241	2,621	6,090
Deferred Taxes			
Deferred taxes	(3,296)	332	224
Provision for income taxes	$ 1,945	$ 2,953	$ 6,314

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In fiscal year 2017, deferred taxes included U.S. and foreign deferred tax benefit of $2.7 billion and $617 million, respectively.

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

(In millions)

Year Ended June 30,	2017	2016	2015
U.S.	$453	$(325)	$7,363
Foreign	22,696	20,076	11,144
Income before income taxes	$ 23,149	$ 19,751	$ 18,507

In fiscal year 2017, income before income taxes included the net impact of U.S. and foreign revenue deferrals related to the sales of Windows 10 of $6.4 billion and $317 million, respectively. In fiscal year 2016, income before income taxes included the net impact of U.S. and foreign revenue deferrals related to the sales of Windows 10 of $6.0 billion and $588 million, respectively. In fiscal year 2015, income before income taxes included the net impact of U.S. and foreign impairment, integration, and restructuring expenses relating to our phone business of $1.1 billion and $8.9 billion, respectively.

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

Year Ended June 30,	2017	2016	2015
Federal statutory rate	35.0%	35.0%	35.0%
Effect of:			
Foreign earnings taxed at lower rates	(15.7)%	(19.4)%	(20.9)%
Phone business losses	(7.3)%	1.3%	19.1%
Excess tax benefits relating to stock-based compensation	(2.7)%	(2.0)%	0%
Domestic production activities deduction	(1.4)%	(0.6)%	(2.4)%
Interest, net	1.8%	1.2%	1.5%

Other reconciling items, net	(1.3)%	(0.5)%	1.8%
Effective rate	8.4%	15.0%	34.1%

The reduction from the federal statutory rate is primarily due to earnings taxed at lower rates in foreign jurisdictions resulting from producing and distributing our products and services through our foreign regional operations centers in Ireland, Singapore, and Puerto Rico. Our foreign regional operating centers, which are taxed at rates lower than the U.S. rate, generated 64%, 69%, and 73% of our foreign income before tax in fiscal years 2017, 2016, and 2015, respectively. Additionally, our effective tax rate in fiscal year 2017 reflects the realization of tax benefits attributable to previous phone business losses. In general, other reconciling items consist primarily of U.S. state income taxes, permanent items, and credits. In fiscal years 2017, 2016, and 2015, there were no individually significant other reconciling items.

The decrease in our effective tax rate for fiscal year 2017 compared to fiscal year 2016 was primarily due to the realization of tax benefits attributable to previous phone business losses, offset in part by changes in the mix of our income before income taxes between the U.S. and foreign countries. The fiscal year 2016 effective tax rate included the impact of nondeductible phone charges and valuation allowances.

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

(In millions)

June 30,	2017	2016
Deferred Income Tax Assets		
Stock-based compensation expense	$777	$809
Other expense items	1,550	1,609
Restructuring charges	66	284
Unearned revenue	1,889	494
Impaired investments	59	226
Loss carryforwards	4,809	4,252
Depreciation and amortization	53	115
Other revenue items	130	89
Deferred income tax assets	9,333	7,878
Less valuation allowance	(3,310)	(4,729)
Deferred income tax assets, net of valuation allowance	$6,023	$3,149
Deferred Income Tax Liabilities		
Foreign earnings	$(1,107)	$(1,242)
Unrealized gain on investments and debt	(1,384)	(2,102)
Depreciation and amortization	(1,630)	(1,008)
Other	(21)	(54)
Deferred income tax liabilities	(4,142)	(4,406)
Net deferred income tax assets (liabilities)	$1,881	$(1,257)
Reported As		
Other long-term assets	$2,412	$219

Long-term deferred income tax liabilities	(531)	(1,476)
Net deferred income tax assets (liabilities)	$1,881	$(1,257)

In fiscal year 2017, we corrected the table above to include a $2.5 billion loss carryforward and valuation allowance as of June 30, 2016. We do not consider this correction to be material, and there was no impact to our consolidated financial statements.

As of June 30, 2017, we had net operating loss carryforwards of $13.7 billion, including $11.1 billion of foreign net operating loss carryforwards. The valuation allowance disclosed in the table above relates to the foreign net operating loss carryforwards and other net deferred tax assets that may not be realized.

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

As of June 30, 2017, we have not provided deferred U.S. income taxes or foreign withholding taxes on temporary differences of approximately $142 billion resulting from earnings for certain non-U.S. subsidiaries which are permanently reinvested outside the U.S. The unrecognized deferred tax liability associated with these temporary differences was approximately $45 billion as of June 30, 2017.

Income taxes paid, net of refunds, were $2.4 billion, $3.9 billion, and $4.4 billion in fiscal years 2017, 2016, and 2015, respectively.

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Tax contingencies and other income tax liabilities were $13.5 billion and $11.8 billion as of June 30, 2017 and 2016, respectively, and are included in other long-term liabilities. This increase relates primarily to current period intercompany transfer pricing and tax credits.

Uncertain Tax Positions

Unrecognized tax benefits as of June 30, 2017, 2016, and 2015, were $11.7 billion, $10.2 billion, and $9.6 billion, respectively. If recognized, these tax benefits would affect our effective tax rates for fiscal years 2017, 2016, and 2015, by $10.2 billion, $8.8 billion, and $7.9 billion, respectively.

As of June 30, 2017, 2016, and 2015, we had accrued interest expense related to uncertain tax positions of $2.3 billion, $1.9 billion, and $1.7 billion, respectively, net of federal income tax benefits. Interest expense on unrecognized tax benefits was $399 million, $163 million, and $237 million in fiscal years 2017, 2016, and 2015, respectively, and was included in provision for income taxes.

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

(In millions)

Year Ended June 30,	2017	2016	2015
Balance, beginning of year	$10,164	$9,599	$ 8,714
Decreases related to settlements	(4)	(201)	(50)
Increases for tax positions related to the current year	1,277	1,086	1,091
Increases for tax positions related to prior years	397	115	94
Decreases for tax positions related to prior years	(49)	(317)	(144)
Decreases due to lapsed statutes of limitations	(48)	(118)	(106)
Balance, end of year	$11,737	$ 10,164	$ 9,599

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

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

NOTE 14 — RESTRUCTURING CHARGES

Phone Hardware Restructuring

In June 2015, management approved a plan to restructure our phone business to better focus and align resources (the "Phone Hardware Restructuring Plan"), under which we eliminated approximately 7,400 positions in fiscal year 2016. In fiscal year 2015, we incurred restructuring charges of $780 million under the Phone Hardware Restructuring Plan, including severance expenses and other reorganization costs. In fiscal year 2016, we reversed $21 million of previously estimated restructuring charges related to contract termination costs. The actions associated with the Phone Hardware Restructuring Plan were completed as of June 30, 2017.

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2016 Restructuring

In the fourth quarter of fiscal year 2016, management approved restructuring plans that resulted in approximately 4,700 job eliminations in fiscal year 2017, primarily across our smartphone hardware business and global sales.

In fiscal year 2016, we incurred restructuring charges of $501 million in connection with the 2016 restructuring plans, including severance expenses and other reorganization costs. The actions associated with these restructuring plans were completed as of June 30, 2017.

2017 Restructuring

In June 2017, management approved a sales and marketing restructuring plan. In fiscal year 2017, we recorded employee severance expenses of $306 million primarily related to this sales and marketing restructuring plan. We do not expect to incur additional charges for this restructuring plan in subsequent years. The actions associated with this restructuring plan are expected to be completed by the end of fiscal year 2018.

Restructuring Summary

Restructuring charges associated with each of these plans were included in impairment, integration, and restructuring expenses on our consolidated income statements, and were reflected in Corporate and Other in our table of operating income (loss) by segment.

Changes in the restructuring liability were as follows:

(In millions)	Severance	Other [(a)]	Total
Balance, as of June 30, 2016	$ 470	$ 239	$ 709
Restructuring charges	306	0	306
Cash paid	(367)	(101)	(468)
Other	(36)	(79)	(115)
Balance, as of June 30, 2017	$ 373	$ 59	$ 432

(a) Primarily reflects activities associated with the consolidation of our facilities and manufacturing operations, including contract termination costs and asset write-downs.

NOTE 15 — UNEARNED REVENUE

Unearned revenue by segment was as follows:

(In millions)

June 30,	2017	2016
Productivity and Business Processes	$14,291	$12,497
Intelligent Cloud	13,464	11,472
More Personal Computing	3,420	3,334
Corporate and Other	13,304	6,606
Total	$ 44,479	$ 33,909

Corporate and Other consists of the net revenue deferral from Windows 10. Revenue from Windows 10 is primarily recognized at the time of billing in the More Personal Computing segment, and the deferral and subsequent recognition of revenue is reflected in Corporate and Other.

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NOTE 16 — COMMITMENTS

Construction and Operating Leases

We have committed $1.1 billion for constructing new buildings, building improvements, and leasehold improvements as of June 30, 2017.

We have operating leases for most U.S. and international sales and support offices, datacenters, research and development facilities, manufacturing facilities, retail stores, and certain equipment. Rental expense for facilities operating leases was $1.3 billion, $1.0 billion, and $989 million, in fiscal years 2017, 2016, and 2015, respectively.

Future minimum rental commitments under non-cancellable facilities operating leases in place as of June 30, 2017 are as follows:

(In millions)	
Year Ending June 30,	
2018	$1,292
2019	1,220
2020	1,115
2021	908
2022	749
Thereafter	2,588
Total	$ 7,872

Capital Leases

We have capital leases for datacenters and corporate offices. As of June 30, 2017 and 2016, capital lease obligations included in other current liabilities were $113 million and $25 million, respectively, and capital lease obligations included in other long-term liabilities were $2.4 billion and $761 million, respectively.

Future minimum lease payments under non-cancellable capital leases as of June 30, 2017 were as follows:

(In millions)

Year Ending June 30,	
2018	$ 209
2019	217
2020	222
2021	227
2022	232
Thereafter	2,353
Total [(a)]	$ 3,460

(a) Includes imputed interest of $922 million.

As of June 30, 2017, we had additional purchase obligations for capital leases executed but not yet recorded of $3.2 billion.

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NOTE 17 — CONTINGENCIES

Patent and Intellectual Property Claims

IPCom patent litigation

IPCom GmbH & Co. (“IPCom”) is a German company that holds a large portfolio of mobile technology-related patents spanning about 170 patent families and addressing a broad range of cellular technologies. IPCom has asserted 19 of these patents in litigation against Nokia Corporation (“Nokia”) and many of the leading cell phone companies and operators. In November 2014, Microsoft and IPCom entered into a standstill agreement staying all of the pending litigation against Microsoft to permit the parties to pursue settlement discussions, which continue.

InterDigital patent litigation

InterDigital Technology Corporation and InterDigital Communications Corporation (collectively, “IDT”) filed four patent infringement cases against Nokia in the International Trade Commission (“ITC”) and in U.S. District Court for the District of Delaware between 2007 and 2013. We were added to these cases as a defendant after we acquired the Nokia phone business. Each of the ITC matters was resolved in our favor. In September 2015, in an inter partes review the United States Patent Trial and Appeal Board issued a final written decision that deemed unpatentable all asserted claims of the patent remaining at issue in the Delaware case. IDT’s appeal of this decision was heard by the U.S. Court of Appeals for the Federal Circuit on April 7, 2017 and the Delaware case was stayed pending final completion of the inter partes review (including appeals and any subsequent proceedings in the Patent Office). We filed an antitrust complaint against IDT in the District of Delaware in August 2015 asserting violations of Section 2 of the Sherman Act, alleging unlawful exploitation of standard essential patents. Microsoft and IDT settled these cases in May 2017 and they have been dismissed.

European copyright levies

We assumed from Nokia all potential liability due to Nokia’s alleged failure to pay “private copyright levies” in various European countries based upon sale of memory cards and mobile phones that incorporate blank memory. The levies are based upon a 2001 European Union (“EU”) Directive establishing a right for end users to make copies of copyrighted works for personal or private use, but also allowing the collection of levies based upon sales of blank media or recording devices to compensate copyright holders for private copying. Various collecting societies in EU countries initiated litigation against Nokia, stating it must pay levies not only based upon sales of blank memory cards, but also phones that include blank memory for data storage on the phones, regardless of actual usage of that memory. The most significant cases against Nokia were pending in Germany and Austria, due to both the high volume of sales and high levy amounts sought in these countries. We reached a settlement of the Austrian case in August 2016. In Germany, the only period for which settlement has not been reached is 2004 through 2007. In July 2016, the German Supreme Court heard our appeal contesting the legality of the levy assessed on phones with music players and over five megabytes of memory. The Supreme Court issued a ruling in December 2016, finding that the levy may not be appropriate for phones that have the ability to receive music files only via Bluetooth or infrared inputs, and remanded for further proceedings. A new case schedule has not been set, and we have reached a tentative settlement.

Other patent and intellectual property claims

In addition to the IPCom cases, there were 41 other patent infringement cases pending against Microsoft as of June 30, 2017.

Antitrust, Unfair Competition, and Overcharge Class Actions

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

The trial of the British Columbia action commenced in May 2016. The plaintiffs filed their case in chief in August 2016, setting out claims made, authorities, and evidence in support of their claims. A six-month oral hearing is scheduled to commence in September 2017, consisting of cross examination on witness affidavits. The Ontario and Quebec cases are inactive.

Other Antitrust Litigation and Claims

China State Administration for Industry and Commerce investigation

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

Product-Related Litigation

U.S. cell phone litigation

Nokia, along with other handset manufacturers and network operators, is a defendant in 19 lawsuits filed in the Superior Court for the District of Columbia by individual plaintiffs who allege that radio emissions from cellular handsets caused their brain tumors and other adverse health effects. We assumed responsibility for these claims as part of our acquisition of Nokia's Devices and Services business and have been substituted for the Nokia defendants. Nine of these cases were filed in 2002 and are consolidated for certain pre-trial proceedings; the remaining 10 cases are stayed. In a separate 2009 decision, the Court of Appeals for the District of Columbia held that adverse health effect claims arising from the use of cellular handsets that operate within the U.S. Federal Communications Commission radio frequency emission guidelines ("FCC Guidelines") are pre-empted by federal law. The plaintiffs allege that their handsets either operated outside the FCC Guidelines or were manufactured before the FCC Guidelines went into effect. The lawsuits also allege an industry-wide conspiracy to manipulate the science and testing around emission guidelines.

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

Canadian cell phone class action

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

Other Contingencies

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

As of June 30, 2017, we accrued aggregate legal liabilities of $352 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $1.0 billion in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact on our consolidated financial statements for the period in which the effects become reasonably estimable.

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Indemnifications

We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products and certain other matters. Additionally, we have agreed to cover damages resulting from breaches of certain security and privacy commitments in our cloud business. We evaluate estimated losses for these indemnifications, and we consider such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. To date, we have not encountered significant costs as a result of these obligations and have not accrued any liabilities related to these indemnifications on our consolidated financial statements.

NOTE 18 — STOCKHOLDERS' EQUITY

Shares Outstanding

Shares of common stock outstanding were as follows:

(In millions)

Year Ended June 30,	2017	2016	2015
Balance, beginning of year	7,808	8,027	8,239
Issued	70	75	83
Repurchased	(170)	(294)	(295)
Balance, end of year	7,708	7,808	8,027

Share Repurchases

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

On September 20, 2016, our Board of Directors approved a share repurchase program authorizing up to an additional $40.0 billion in share repurchases. This share repurchase program commenced on December 22, 2016 following completion of the prior program approved on September 16, 2013, has no expiration date, and may be suspended or discontinued at any time without notice. As of June 30, 2017, $36.8 billion remained of this $40.0 billion share repurchase program.

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

(In millions)	Shares	Amount	Shares	Amount	Shares	Amount
Year Ended June 30,	2017		2016		2015	
First Quarter	63	$3,550	89	$4,000	43	$2,000
Second Quarter	59	3,533	66	3,600	43	2,000
Third Quarter	25	1,600	69	3,600	116	5,000
Fourth Quarter	23	1,600	70	3,600	93	4,209
Total	170	$ 10,283	294	$ 14,800	295	$ 13,209

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

Dividends

In fiscal year 2017, our Board of Directors declared the following dividends:

Declaration Date	Dividend Per Share	Record Date	Total Amount (In millions)	Payment Date
September 20, 2016	$ 0.39	November 17, 2016	$ 3,024	December 8, 2016
November 30, 2016	0.39	February 16, 2017	3,012	March 9, 2017
March 14, 2017	0.39	May 18, 2017	3,009	June 8, 2017
June 13, 2017	0.39	August 17, 2017	3,006	September 14, 2017

The dividend declared on June 13, 2017 will be paid after the filing date of the 2017 Form 10-K and was included in other current liabilities as of June 30, 2017.

In fiscal year 2016, our Board of Directors declared the following dividends:

Declaration Date	Dividend Per Share	Record Date	Total Amount (In millions)	Payment Date
September 15, 2015	$ 0.36	November 19, 2015	$ 2,868	December 10, 2015
December 2, 2015	0.36	February 18, 2016	2,842	March 10, 2016
March 15, 2016	0.36	May 19, 2016	2,821	June 9, 2016
June 14, 2016	0.36	August 18, 2016	2,800	September 8, 2016

The dividend declared on June 14, 2016 was included in other current liabilities as of June 30, 2016.

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NOTE 19 — ACCUMULATED OTHER COMPREHENSIVE INCOME

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

(In millions)

Year Ended June 30,	2017	2016	2015
Derivatives			
Balance, beginning of period	$352	$590	$31
Unrealized gains, net of tax effects of $4, $24 and $35	328	351	1,152
Reclassification adjustments for gains included in revenue	(555)	(625)	(608)
Tax expense included in provision for income taxes	9	36	15
Amounts reclassified from accumulated other comprehensive income	(546)	(589)	(593)
Net current period other comprehensive income (loss)	(218)	(238)	559
Balance, end of period	$134	$352	$590
Investments			
Balance, beginning of period	$2,941	$3,169	$3,531
Unrealized gains, net of tax effects of $267, $120 and $59	517	219	110
Reclassification adjustments for gains included in other income (expense), net	(2,513)	(688)	(728)
Tax expense included in provision for income taxes	880	241	256
Amounts reclassified from accumulated other comprehensive income	(1,633)	(447)	(472)
Net current period other comprehensive loss	(1,116)	(228)	(362)
Balance, end of period	$1,825	$2,941	$3,169

Translation Adjustments and Other

Balance, beginning of period	$ (1,756)	$ (1,237)	$146
Translation adjustments and other, net of tax effects of $9, $(33) and $16	228	(519)	(1,383)
Balance, end of period	$(1,528)	$(1,756)	$(1,237)
Accumulated other comprehensive income, end of period	$431	$1,537	$ 2,522

NOTE 20 — EMPLOYEE STOCK AND SAVINGS PLANS

We grant stock-based compensation to employees and directors. As of June 30, 2017, an aggregate of 127 million shares were authorized for future grant under our stock plans. Awards that expire or are canceled without delivery of shares generally become available for issuance under the plans. We issue new shares of Microsoft common stock to satisfy vesting of awards granted under our stock plans. We also have an ESPP for all eligible employees.

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

(In millions)

Year Ended June 30,	2017	2016	2015
Stock-based compensation expense	$ 3,266	$ 2,668	$ 2,574
Income tax benefits related to stock-based compensation	1,066	882	868

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Stock Plans

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

Executive Incentive Plan

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

Activity for all stock plans

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

Year Ended June 30,	2017	2016	2015
Dividends per share (quarterly amounts)	$ 0.36 - $ 0.39	$ 0.31 - $ 0.36	$ 0.28 - $ 0.31
Interest rates	1.2% - 2.2%	1.1% - 1.8%	1.2% - 1.9%

During fiscal year 2017, the following activity occurred under our stock plans:

	Shares	Weighted Average Grant-Date Fair Value
(In millions)		
Stock Awards		
Nonvested balance, beginning of year	194	$ 36.92
Granted [a]	84	55.64
Assumed in acquisitions [b]	23	59.09

Vested	(80)	37.36
Forfeited	(20)	43.71
Nonvested balance, end of year	201	46.32

(a) Includes 2 million PSUs granted during fiscal year 2017. During both fiscal year 2016 and 2015 we granted 1 million PSUs.

(b) Substantially all awards assumed were related to LinkedIn. See Note 9 – Business Combinations for further information.

As of June 30, 2017, there was approximately $6.5 billion of total unrecognized compensation costs related to stock awards. These costs are expected to be recognized over a weighted average period of 3 years. The weighted average grant-date fair value of stock awards granted was $55.64, $41.51, and $42.36 for fiscal years 2017, 2016, and 2015, respectively. The fair value of stock awards vested was $4.8 billion, $3.9 billion, and $4.2 billion, for fiscal years 2017, 2016, and 2015, respectively.

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Employee Stock Purchase Plan

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

(Shares in millions)

Year Ended June 30,	2017	2016	2015
Shares purchased	13	15	16
Average price per share	$ 56.36	$ 44.83	$ 39.87

As of June 30, 2017, 129 million shares of our common stock were reserved for future issuance through the ESPP.

Savings Plan

We have a savings plan in the U.S. that qualifies under Section 401(k) of the Internal Revenue Code, and a number of savings plans in international locations. Participating U.S. employees may contribute a portion of their salary, subject to certain limitations. Beginning January 2016, we contribute fifty cents for each dollar a participant contributes in this plan, with a maximum employer contribution of 50% of the IRS contribution limit for the calendar year. Prior to January 2016, we contributed fifty cents for each dollar of the first 6% a participant contributed in this plan, with a maximum contribution of the lesser of 3% of a participant’s earnings or 3% of the IRS compensation limit for the calendar year. Matching contributions for all plans were $734 million, $549 million, and $454 million in fiscal years 2017, 2016, and 2015, respectively, and were expensed as contributed.

NOTE 21 — SEGMENT INFORMATION AND GEOGRAPHIC DATA

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

In December 2016, we completed our acquisition of LinkedIn Corporation. LinkedIn is reported as part of our Productivity and Business Processes segment.

Our reportable segments are described below.

Productivity and Business Processes

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

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

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Intelligent Cloud

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

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

More Personal Computing

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

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

Corporate and Other includes adjustments to conform our internal accounting policies to U.S. GAAP, and impairment, integration, and restructuring expenses. Significant internal accounting policies that differ from U.S. GAAP relate to Windows 10 revenue recognition.

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

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

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

(In millions)

Year Ended June 30,	2017	2016	2015
Revenue			
Productivity and Business Processes	$30,444	$26,487	$26,430
Intelligent Cloud	27,440	25,042	23,715
More Personal Computing	38,773	40,434	43,435
Corporate and Other	(6,707)	(6,643)	0
Total	$ 89,950	$ 85,320	$ 93,580

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(In millions)

Year Ended June 30,	2017	2016	2015
Operating income (loss)			
Productivity and Business Processes	$11,913	$12,418	$13,274
Intelligent Cloud	9,138	9,315	9,803
More Personal Computing	8,288	6,202	5,095
Corporate and Other	(7,013)	(7,753)	(10,011)
Total	$ 22,326	$ 20,182	$ 18,161

Corporate and Other operating loss activity was as follows during the periods presented:

(In millions)

Year Ended June 30,	2017	2016	2015
Net revenue deferral from Windows 10	$(6,707)	$(6,643)	$0
Impairment, integration, and restructuring expenses	(306)	(1,110)	(10,011)
Total Corporate and Other	$ (7,013)	$ (7,753)	$ (10,011)

No sales to an individual customer or country other than the United States accounted for more than 10% of fiscal year 2017, 2016, or 2015 revenue. Revenue, classified by the major geographic areas in which our customers are located, was as follows:

(In millions)

Year Ended June 30,	2017	2016	2015
United States [(a)]	$45,248	$40,578	$42,941
Other countries	44,702	44,742	50,639
Total	$ 89,950	$ 85,320	$ 93,580

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

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

(In millions)			
Year Ended June 30,	2017	2016	2015
Microsoft Office system	$25,389	$23,588	$23,538
Server products and tools	21,758	19,177	18,612
Xbox	9,256	9,395	9,121
Windows PC operating system	8,625 (a)	8,104 (a)	14,826
Advertising	6,971	6,098	4,557
Consulting and product support services	5,588	5,641	5,090
Devices	4,557	7,466	11,602
LinkedIn	2,268 (b)	0	0
Other	5,538	5,851	6,234
Total	$ 89,950	$ 85,320	$ 93,580

(a) Includes the net revenue deferral from Windows 10.

(b) Includes advertising revenue.

Our total commercial cloud revenue, which primarily comprises Office 365 commercial, Azure, Dynamics 365, and other cloud properties, was $14.9 billion, $9.5 billion, and $5.8 billion in fiscal years 2017, 2016, and 2015, respectively. These amounts are included in their respective product categories in the table above.

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

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

(In millions)

June 30,	2017	2016	2015
United States	$39,118	$22,819	$19,562
Ireland	12,876	2,078	1,595
Luxembourg	6,845	6,854	6,879
Other countries	10,123	8,210	8,469
Total	$ 68,962	$ 39,961	$36,505

NOTE 22 — QUARTERLY INFORMATION (UNAUDITED)

(In millions, except per share amounts)

Quarter Ended	September 30	December 31	March 31	June 30	Total
Fiscal Year 2017 [a]					
Revenue [b]	$ 20,453	$ 24,090	$ 22,090	$ 23,317	$ 89,950
Gross margin	12,609	14,189	14,030	14,861	55,689
Operating income	5,225	6,177	5,594	5,330	22,326
Net income	4,690	5,200	4,801	6,513 [c]	21,204 [c]
Basic earnings per share	0.60	0.67	0.62	0.84	2.74
Diluted earnings per share	0.60	0.66	0.61	0.83 [c]	2.71 [c]

Fiscal Year 2016

Revenue [d]	$ 20,379	$ 23,796	$ 20,531	$ 20,614		$ 85,320	
Gross margin	13,172	13,924	12,809	12,635		52,540	
Operating income	5,793	6,026	5,283	3,080		20,182	
Net income	4,902	5,018	3,756	3,122	(e)	16,798	(e)
Basic earnings per share	0.61	0.63	0.48	0.40		2.12	
Diluted earnings per share	0.61	0.62	0.47	0.39	(e)	2.10	(e)

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

(b) Reflects the impact of the net revenue deferral from Windows 10 of $1.9 billion, $2.0 billion, $1.5 billion, and $1.4 billion, for the first, second, third, and fourth quarter of fiscal year 2017, respectively, and $6.7 billion for fiscal year 2017.

(c) Includes $306 million of employee severance expenses primarily related to our sales and marketing restructuring plan, which decreased operating income, net income, and diluted EPS by $306 million, $243 million, and $0.03, respectively.

(d) Reflects the impact of the net revenue deferral from Windows 10 of $1.3 billion, $1.7 billion, $1.6 billion, and $2.0 billion, for the first, second, third, and fourth quarter of fiscal year 2016, respectively, and $6.6 billion for fiscal year 2016.

(e) Includes $630 million of asset impairment charges related to our phone business, and $480 million of restructuring charges associated with our 2016 restructuring plans, which together decreased operating income, net income, and diluted EPS by $1.1 billion, $895 million, and $0.11, respectively.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Microsoft Corporation

Redmond, Washington

We have audited the accompanying consolidated balance sheets of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2017 and 2016, and the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity for each of the three years in the period ended June 30, 2017. 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 the standards of the Public Company Accounting Oversight Board (United States). 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, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2017, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of June 30, 2017, based on the criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 2, 2017 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington

August 2, 2017

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

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective.

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the company. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements; providing reasonable assurance that receipts and expenditures of company assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use, or disposition of company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that the company’s internal control over financial reporting was effective as of June 30, 2017. Deloitte & Touche LLP has audited our internal control over financial reporting as of June 30, 2017; their report is included in Item 9A.

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. During fiscal year 2017, we implemented internal controls to ensure we have adequately evaluated our contracts and properly assessed the impact of the new accounting standards related to revenue recognition and leases on our financial statements to facilitate the adoption on July 1, 2017. We do not expect significant changes to our internal control over financial reporting due to the adoption of the new standards.

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Item 9A

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Microsoft Corporation

Redmond, Washington

We have audited the internal control over financial reporting of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2017, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2017, based on the criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended June 30, 2017 of the Company and our report dated August 2, 2017 expressed an unqualified opinion on those financial statements.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington

August 2, 2017

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

A list of our executive officers and biographical information appears in Part I, Item 1 of this Form 10-K. Information about our directors may be found under the caption "Our director nominees" in our Proxy Statement for the Annual Meeting of Shareholders to be held November 29, 2017 (the "Proxy Statement"). Information about our Audit Committee may be found under the caption "Board committees" in the Proxy Statement. That information is incorporated herein by reference.

The information in the Proxy Statement set forth under the caption "Section 16(a) beneficial ownership reporting compliance" is incorporated herein by reference.

We have adopted the Microsoft Finance Code of Professional Conduct (the "finance code of ethics"), a code of ethics that applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer and Corporate Controller, and other finance organization employees. The finance code of ethics is publicly available on our website at www.microsoft.com/investor/MSFinanceCode. If we make any substantive amendments to the finance code of ethics or grant any waiver, including any implicit waiver, from a provision of the code to our Chief Executive Officer, Chief Financial Officer, or Chief Accounting Officer and Corporate Controller, we will disclose the nature of the amendment or waiver on that website or in a report on Form 8-K.

ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions "Director compensation," "Named executive officer compensation," "Compensation Committee interlocks and insider participation," and "Compensation Committee report" is incorporated herein by reference.

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

The information in the Proxy Statement set forth under the captions "Stock ownership information" and "Equity compensation plan information" is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information set forth in the Proxy Statement under the captions "Director independence" and "Certain relationships and related transactions" is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

Information concerning principal accountant fees and services appears in the Proxy Statement under the headings "Fees billed by Deloitte & Touche" and "Policy on Audit Committee pre-approval of audit and permissible non-audit services of independent auditor" and is incorporated herein by reference.

PART IV

Item 15

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements and Schedules

The financial statements are set forth under Item 8 of this Form 10-K, as indexed below. Financial statement schedules have been omitted since they either are not required, not applicable, or the information is otherwise included.

(b) Exhibit Listing

			Incorporated by Reference			
Exhibit Number	Exhibit Description	Filed Herewith	Form	Period Ending	Exhibit	Filing Date
2.1	Agreement and Plan of Merger, dated as of June 11, 2016, by and among Microsoft Corporation, Liberty Merger Sub Inc., and LinkedIn Corporation		8-K***		2.1	6/13/16
3.1	Amended and Restated Articles of Incorporation of Microsoft Corporation		8-K		3.1	12/1/16
3.2	Bylaws of Microsoft Corporation		8-K		3.2	6/14/17

4.1	Form of Indenture between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee (“Base Indenture”)	S-3ASR	4.1	11/20/08
4.2	Form of First Supplemental Indenture for 2.95% Notes due 2014, 4.20% Notes due 2019, and 5.20% Notes due 2039, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Base Indenture	8-K	4.2	5/15/09
4.5	Form of Second Supplemental Indenture for 0.875% Notes due 2013, 1.625% Notes due 2015, 3.00% Notes due 2020, and 4.50% Notes due 2040, dated as of September 27, 2010, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee	8-K	4.2	9/27/10

PART IV

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.6	Third Supplemental Indenture for 2.500% Notes due 2016, 4.000% Notes due 2021, and 5.300% Notes due 2041, dated as of February 8, 2011, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	2/8/11
4.7	Fourth Supplemental Indenture for 0.875% Notes due 2017, 2.125% Notes due 2022, and 3.500% Notes due 2042, dated as of November 7, 2012, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	11/7/12
4.8	Fifth Supplemental Indenture for 2.625% Notes due 2033, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	5/1/13
4.9	Sixth Supplemental Indenture for 1.000% Notes due 2018, 2.375% Notes due 2023, and 3.750% Notes due 2043, dated as of May 2, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	5/1/13
4.10	Seventh Supplemental Indenture for 2.125% Notes due 2021 and 3.125% Notes due 2028, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	12/6/13

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Item 15

Exhibit Number	Exhibit Description	Filed Herewith	Form	Period Ending	Exhibit	Filing Date
			Incorporated by Reference			
4.11	Eighth Supplemental Indenture for 1.625% Notes due 2018, 3.625% Notes due 2023, and 4.875% Notes due 2043, dated as of December 6, 2013, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.2	12/6/13
4.12	Ninth Supplemental Indenture for 1.850% Notes due 2020, 2.375% Notes due 2022, 2.700% Notes due 2025, 3.500% Notes due 2035, 3.750% Notes due 2045, and 4.000% Notes due 2055, dated as of February 12, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	2/12/15
4.13	Tenth Supplemental Indenture for 1.300% Notes due 2018, 2.000% Notes due 2020, 2.650% Notes due 2022, 3.125% Notes due 2025, 4.200% Notes due 2035, 4.450% Notes due 2045, and 4.750% Notes due 2055, dated as of November 3, 2015, between Microsoft Corporation and U.S. Bank National Association, as Trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	11/3/15
4.14	Eleventh Supplemental Indenture for 1.100% Notes due 2019, 1.550% Notes due 2021, 2.000% Notes due 2023, 2.400% Notes due 2026, 3.450% Notes due 2036, 3.700% Notes due 2046, and 3.950% Notes due 2056, dated as of August 8, 2016, between Microsoft Corporation and U.S. Bank, National Association, as trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as Trustee		8-K		4.1	8/5/16

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
4.15	Twelfth Supplemental Indenture for 1.850% Notes due 2020, 2.400% Notes due 2022, 2.875% Notes due 2024, 3.300% Notes due 2027, 4.100% Notes due 2037, 4.250% Notes due 2047, and 4.500% Notes due 2057, dated as of February 6, 2017, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee, to the Indenture, dated as of May 18, 2009, between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		8-K		4.1	2/3/17
10.1*	Microsoft Corporation 2001 Stock Plan		10-K	6/30/16	10.1	7/28/16
10.3*	Microsoft Corporation 1999 Stock Plan for Non-Employee Directors	X				
10.4*	Microsoft Corporation Employee Stock Purchase Plan		10-K	6/30/12	10.4	7/26/12
10.5*	Microsoft Corporation Deferred Compensation Plan		10-Q	3/31/12	10.5	4/19/12
10.7*	Form of Stock Award Agreement for Non-Employee Directors under the Microsoft Corporation 1999 Stock Plan for Non-Employee Directors		10-K	6/30/04	10.9	9/1/04
10.10*	Form of Stock Option Agreement under the Microsoft Corporation 2001 Stock Plan		10-K	6/30/04	10.12	9/1/04
10.11*	Form of Stock Option Agreement for Non-Employee Directors under the 1999 Stock Plan for Non-Employee Directors		10-K	6/30/04	10.13	9/1/04
10.12	Amended and Restated Officers' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		10-Q	9/30/16	10.12	10/20/16
10.13	Amended and Restated Directors' Indemnification Trust Agreement between Microsoft Corporation and The Bank of New York Mellon Trust Company, N.A., as trustee		10-Q	9/30/16	10.13	10/20/16

10.14*	Microsoft Corporation Deferred Compensation Plan for Non-Employee Directors	10-K	6/30/15	10.14	7/31/15
10.17*	Executive Officer Incentive Plan	10-Q	9/30/15	10.17	10/22/15
10.18*	Form of Executive Officer Incentive Plan Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan	10-Q	9/30/15	10.18	10/22/15

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
10.21*	Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan (Service-Based)		10-Q	9/30/15	10.21	10/22/15
10.22*	Senior Executive Severance Benefit Plan		10-Q	9/30/15	10.22	10/22/15
10.23*	Offer Letter, dated February 3, 2014, between Microsoft Corporation and Satya Nadella		8-K		10.1	2/4/14
10.24*	Long-Term Performance Stock Award Agreement between Microsoft Corporation and Satya Nadella		10-Q	12/31/14	10.24	1/26/15
10.25*	Form of Executive Officer Incentive Plan Performance Stock Award Agreement under the Microsoft Corporation 2001 Stock Plan		10-Q	9/30/15	10.25	10/22/15
12	Computation of Ratios of Earnings to Fixed Charges	X				
21	Subsidiaries of Registrant	X				
23.1	Consent of Independent Registered Public Accounting Firm	X				
31.1	Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2	Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
32.1**	Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				
32.2**	Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ending	Exhibit	Filing Date
101.INS	XBRL Instance Document	X				
101.SCH	XBRL Taxonomy Extension Schema	X				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase	X				
101.DEF	XBRL Taxonomy Extension Definition Linkbase	X				
101.LAB	XBRL Taxonomy Extension Label Linkbase	X				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	X				

*Indicates a management contract or compensatory plan or arrangement
**Furnished, not filed
***Form 8-K of LinkedIn Corporation

ITEM 16. FORM 10-K SUMMARY

None.

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 August 2, 2017.

MICROSOFT CORPORATION

/S/ FRANK H. BROD
Frank H. Brod
Corporate Vice President, Finance and Administration;

Chief Accounting Officer (Principal Accounting 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 August 2, 2017.

Signature	Title
/s/ JOHN W. THOMPSON	Chairman
John W. Thompson	
/s/ SATYA NADELLA	Director and Chief Executive Officer
Satya Nadella	
/s/ WILLIAM H. GATES III	Director
William H. Gates III	
/s/ REID HOFFMAN	Director
Reid Hoffman	
/s/ Teri L. List-Stoll	Director

Teri L. List-Stoll

/s/ G. MASON MORFIT	Director
G. Mason Morfit	
/s/ CHARLES H. NOSKI	Director
Charles H. Noski	
/s/ HELMUT PANKE	Director
Helmut Panke	
/s/ Sandra E. Peterson	Director
Sandra E. Peterson	
/s/ Charles W. Scharf	Director
Charles W. Scharf	
/s/ John W. Stanton	Director
John W. Stanton	
/s/ Padmasree Warrior	Director
Padmasree Warrior	
/s/ AMY E. HOOD	Executive Vice President and Chief Financial Officer (Principal Financial Officer)
Amy E. Hood	

/s/ FRANK H. BROD	Corporate Vice President, Finance and Administration;
	Chief Accounting Officer
Frank H. Brod	(Principal Accounting Officer)