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March 21, 2005

Mr. Jonathan G. Katz  
Secretary, Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609

Re: File Reference No. 4-497

Dear Mr. Katz:

Microsoft appreciates the opportunity to comment on the internal control provisions of the Sarbanes Oxley Act of 2002 (the "Act") and applauds the Commission for seeking feedback from registrants to better understand the impact that complying with Section 404 of the Act is having on companies listed on U.S. exchanges.

We believe that the internal control provisions of the Act, when combined with integrity in financial reporting, will help to restore investor confidence in the financial information reported by registrants by reducing the likelihood of significant errors or misstatements. We also feel that the internal control provisions will help U.S. companies strengthen their systems of internal control and add a level of rigor that did not exist previously. An important issue is whether the existing interpretations of the Act and the SEC Final Rules by the PCAOB and the large auditing firms are resulting in registrants expending significantly more resources to achieve these goals than was intended by Congress and the Commission.

As a direct result of our evaluation of our system of internal control, we have made a number of improvements to our accounting processes and systems. We have also identified a number of control deficiencies that we either have remediated or are in the process of remediating. We have standardized our control sets for accounting processes such as the subsidiary accounting close processes, accounts payable, and payroll, enabling our managers to more efficiently monitor the controls being performed by our subsidiaries. We have also made improvements to our information technology systems and applications that have enabled us to automate a greater portion of our controls and move to a more preventative/detective model.

While Microsoft has realized benefits from this process, it is not clear that the benefits outweigh the costs. Our year-end is June 30, so we are still in the process of preparing for our first attestation on our internal controls over financial reporting. To date, we have spent over \$15 million on external consultants and significant internal time documenting and evaluating our system of internal control over financial reporting and still have a substantial amount of work remaining over the next four months. Much of this effort was spent to establish a program management office and build the compliance program to be in conformity with the guidelines that were ever-changing as implementation practices developed over the last two years. Additionally, a portion of this time and cost reflects our own learning curve and that of our external consultants and independent auditor. We expect our recurring costs to be somewhat lower as we can leverage these learnings and our documentation in future years. This amount is significantly greater than the estimated cost of compliance of \$91,000 per company that was included in the Commission's Final Rule. We think it is important that the causes for actual compliance costs being so much greater than the initial estimate be identified so that a determination may be made as to whether the unanticipated level of effort being expended is truly consistent with intention of the Act and the Final Rules.

We believe there are certain elements of the interpretations made by the PCAOB and large accounting firms that have contributed significantly to a dramatic increase in the costs of complying with the requirements of Section 404 without providing commensurate benefits. These are summarized below:

**Unnecessary focus on controls over routine processes.** Currently, there is not sufficient differentiation in the level and frequency of testing that should be performed between areas with a high level of estimation, judgment and subjectivity that are more likely to result in a material misstatement versus routine transactions and processes. Just as financial auditing has evolved to focus the audit process on areas that pose a higher risk of a material misstatement, in our view, an evaluation of internal control should also focus on these areas. For example, due to PCAOB Audit Standard No. 2 (AS #2) coverage requirements, we have spent significantly more time documenting and testing controls over payroll processing than we have on topside journal entries and management override of controls. As a large multinational business with offices in over 100 countries, the framework outlined in PCAOB Audit Standard No. 2 requires us to visit a substantial number of locations to get adequate coverage over our worldwide payroll activity regardless of the risk of a misstatement associated with the activity being tested.

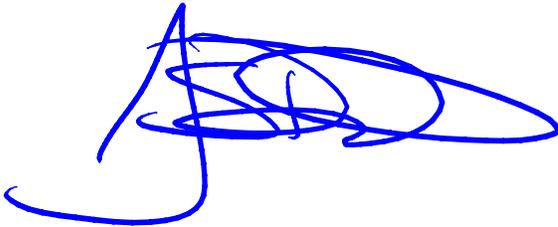
**Definition of a significant deficiency.** The current definition of a significant deficiency included in the PCAOB standard sets a very low threshold. Yet, the standard also acknowledges that management's approach to its assessment of internal controls is at the level of reasonable assurance. Identifying all control deficiencies or combination of deficiencies that create more than a remote likelihood that more than an inconsequential error or misstatement would not be prevented or detected seems to be significantly different than providing a reasonable assurance that a material misstatements would be prevented or detected. This difference causes a tremendous amount of work that must be performed by both management and the independent auditor solely for the purpose of

communicating these types of deficiencies to the Audit Committee. The time required to do this work and communicate it to the Audit Committee risks distracting management and the Audit Committee from the areas that are truly significant and may be closer to becoming material weaknesses.

**State of uncertainty under which auditing firms currently operate.** At the same time the PCAOB is publicly stating that “Some auditors and issuers have been interpreting the standard as being more prescriptive and demanding more work than was intended”, the audit firms are operating in an environment where, after the fact, the PCAOB may criticize them for deficiencies in their audit methodology, documentation or conclusions. As such, the safest course for the firms is to adopt a “worst case scenario” approach in applying the guidance in PCAOB AS #2. If the PCAOB believes that some auditors are being too demanding, we would encourage the PCAOB provide improved and clearer guidance in its standards.

In conclusion, we do not believe it is necessary to modify the provisions of Section 404 of the Sarbanes Oxley Act or the SEC’s rules. However, continuing refinement of the PCAOB’s regulations, guidance and areas of focus will help all companies regain the proper balance of costs and benefits of the internal control provisions of the Sarbanes Oxley Act.

Sincerely,



Scott Di Valerio  
Corporate Vice President, Corporate Controller  
Microsoft Corporation

cc:

William H. Donaldson, Chairman  
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