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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, 2010

OR

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

Commission File Number 0-14278

MICROSOFT CORPORATION

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

ONE MICROSOFT WAY, REDMOND, WASHINGTON 98052-6399

(425) 882-8080

www.microsoft.com/investor

Securities registered pursuant to Section 12(b) of the Act:
COMMON STOCK **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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark 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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Microsoft Corporation:

We have audited the accompanying consolidated balance sheets of Microsoft Corporation and subsidiaries (the "Company") as of June 30, 2010 and 2009, and the related consolidated statements of income, cash flows, and stockholders' equity for each of the three years in the period ended June 30, 2010. 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, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2010, 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, 2010, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated July 30, 2010, expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
July 30, 2010

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Stock Options

In fiscal year 2004, we began granting employees and non-employee directors SAs rather than non-qualified and incentive stock options as part of our equity compensation plans. Since then, stock options issued to employees have been issued primarily in conjunction with business acquisitions. Options granted between 1995 and 2001 generally vest over four and one-half years and expire seven years from the date of grant, while certain options vest either over four and one-half years or over seven and one-half years and expire 10 years from the date of grant. Options granted after 2001 vest over four and one-half years and expire 10 years from the date of grant. We granted one million, one million, and 10 million stock options in conjunction with business acquisitions during fiscal years 2010, 2009, and 2008, respectively.

Employee stock options activity was as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
	(In millions)		(Years)	(In millions)
Balance, July 1, 2009	330	$ 27.99		
Granted	1	$ 3.20		
Exercised	(74)	$ 25.86		
Canceled	(69)	$ 39.00		
Forfeited	(1)	$ 12.94		
Balance, June 30, 2010	187	$ 24.68	1.46	$ 143
Exercisable, June 30, 2010	186	$ 24.68	1.43	$ 130

Options outstanding as of June 30, 2010 include approximately three million options that were granted in conjunction with business acquisitions. While these options are included in the options outstanding balance, they are excluded from the weighted average exercise price. These options have an exercise price range of $0.01 to $150.93 and a weighted average exercise price of $7.49.

During fiscal years 2010, 2009, and 2008, the following activity occurred under our stock plans:

(In millions)

	2010	2009	2008
Total intrinsic value of stock options exercised	**$ 365**	$ 48	$ 1,042
Total vest-date fair value of stock awards vested	**$ 1,358**	$ 1,137	$ 955
Total vest-date fair value of shared performance stock awards vested	**$ 227**	$ 485	$ 401

Cash received from option exercises for fiscal years 2010, 2009, and 2008, was $1.8 billion, $88 million, and $3.0 billion, respectively. The actual tax benefit realized for the tax deductions from option exercises totaled $126 million, $12 million, and $365 million for fiscal years 2010, 2009, and 2008, respectively.

Savings Plan

We have a savings plan in the United States 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 up to 50%

of their salary, but not more than statutory limits. We contribute fifty cents for each dollar a participant contributes in this plan, with a maximum contribution of 3% of a participant's earnings. Matching contributions for all plans were $275 million, $262 million, and $238 million in fiscal years 2010, 2009, and 2008, respectively, and were expensed as contributed. Matching contributions are invested proportionate to each participant's voluntary contributions in the investment options provided under the plan. Investment options in the U.S. plan include Microsoft common stock, but neither participant nor our matching contributions are required to be invested in Microsoft common stock.

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Employee Stock Purchase Plan

We have an employee stock purchase plan 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 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,	2010	2009	2008
Shares purchased	**20**	24	18
Average price per share	**$ 23.73**	$ 20.13	$ 26.78

At June 30, 2010, 64 million shares of our common stock were reserved for future issuance through the employee stock purchase plan.

Stock Plans

We have stock plans for directors and for officers, employees, consultants, and advisors. At June 30, 2010, an aggregate of 690 million shares were authorized for future grant under our stock plans, which cover stock options, stock awards, and shared performance stock awards. Awards that expire or are canceled without delivery of shares generally become available for issuance under the plans. We issue new shares to satisfy exercises and vestings of awards granted under all of our stock plans.

Stock Awards

Stock awards ("SAs") are grants that entitle the holder to shares of Microsoft common stock as the award vests. Our SAs generally vest over a five-year period.

Shared Performance Stock Awards

Shared performance stock awards ("SPSAs") are a form of SA in which the number of shares ultimately received depends on our business performance against specified performance targets.

We granted SPSAs for fiscal years 2010, 2009, and 2008 with performance periods of July 1, 2009 through June 30, 2010, July 1, 2008 through June 30, 2009, and July 1, 2007 through June 30, 2008, respectively. In September following the end of each performance period, the number of shares of stock subject to the award is determined by multiplying the target award by a percentage ranging from 0% to 150%. The percentage is based on performance metrics for the performance period, as determined by the Compensation Committee of the Board of Directors in its sole discretion. An additional number of shares, approximately 12% of the total target SPSAs, are available as additional awards to participants based on individual performance. One-quarter of the shares of stock subject to each award vest following the end of the performance period, and an additional one-quarter of the shares vest on each of the following three anniversaries of the grant date.

Executive Officer Incentive Plan

In fiscal year 2009, the Compensation Committee approved a new Executive Officer Incentive Plan ("EOIP") for executive officers of the Company. The EOIP replaced the annual cash bonus opportunity and equity award plans for executive officers. Under the EOIP, the Compensation Committee makes awards of performance-based compensation for specified performance periods. For fiscal years 2010 and 2009, executive officers were eligible to receive annual awards comprised of cash and SAs from an incentive pool equal to a percentage of the Company's operating income. For fiscal year 2010 it was 0.45% of operating income, and for fiscal year 2009 it was 0.35% of operating income. Following approval of the awards, 20% of the award is payable to the executive officers in cash, and the remaining 80% is converted into an SA for shares of Microsoft common stock. The SA portion of the award vests one-quarter immediately after the award is approved following fiscal year-end, and one-quarter on August 31 of each of the following three years.

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We grant awards from the incentive pool to the executive officers in September following the end of the fiscal year based on the officer's performance during the prior fiscal year period. Each executive officer receives a fixed percentage of the pool ranging between 0% and 150% of a target based on an assessment of the executive officer's performance during the fiscal year. The number of shares subject to the SA portion of the award is determined by dividing the value of the award by the closing price of Microsoft common stock on August 31 of each year.

Activity for All Stock Plans

The fair value of each award is estimated on the date of grant using the following assumptions:

Year Ended June 30,	2010	2009	2008
Dividends per share (quarterly amounts)	**$ 0.13**	$ 0.11 - $ 0.13	$ 0.10 - $ 0.11
Interest rates range	**2.1% - 2.9%**	1.4% - 3.6%	2.5% - 4.9%

During fiscal year 2010, the following activity occurred under our existing plans:

	Shares	Weighted Average Grant-Date Fair Value
	(In millions)	
Stock Awards		
Nonvested balance, beginning of year	**191**	**$ 25.69**
Granted	**100**	**$ 23.43**
Vested	**(52)**	**$ 25.50**
Forfeited	**(16)**	**$ 25.19**
Nonvested balance, end of year	**223**	**$ 24.76**
Shared Performance Stock Awards		
Nonvested balance, beginning of year	**28**	**$ 26.79**
Granted	**12**	**$ 24.57**
Vested	**(7)**	**$ 26.65**
Forfeited	**(3)**	**$ 25.74**
Nonvested balance, end of year	**30**	**$ 25.32**

As of June 30, 2010, there was $4.2 billion and $482 million of total unrecognized compensation costs related to SAs and SPSAs, respectively. These costs are expected to be recognized over a weighted average period of 3.4 years and 2.4 years, respectively.

During fiscal year 2009 and 2008, the following activity occurred under our stock plans:

(In millions, except fair values)	2009	2008
Stock Awards		

Awards granted	91	71
Weighted average grant-date fair value	$ 24.95	$ 27.83
Shared Performance Stock Awards		
Awards granted	10	19
Weighted average grant-date fair value	$ 25.93	$ 27.82

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Sales and Marketing

Sales and marketing expenses include payroll, employee benefits, stock-based compensation, 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 $1.6 billion, $1.4 billion, and $1.2 billion in fiscal years 2010, 2009, and 2008, respectively.

Employee Severance

We record employee severance when a specific plan has been approved by management, the plan has been communicated to employees, and it is unlikely that significant changes will be made to the plan.

Stock-Based Compensation

We measure stock-based compensation cost at the grant date based on the fair value of the award and recognize it as expense over the applicable vesting period of the stock award (generally four to five years) using the straight-line method.

Employee Stock Purchase Plan

Shares of our common stock may be purchased by employees at three-month intervals at 90% of the fair market value of the stock on the last day of each three-month period. Compensation expense for the employee stock purchase plan 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 invested 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.

Fair Value Measurements

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

- *Level 1* – inputs are based upon unadjusted quoted prices for identical instruments traded in active markets. Our Level 1 non-derivative investments primarily include U.S. treasuries, 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