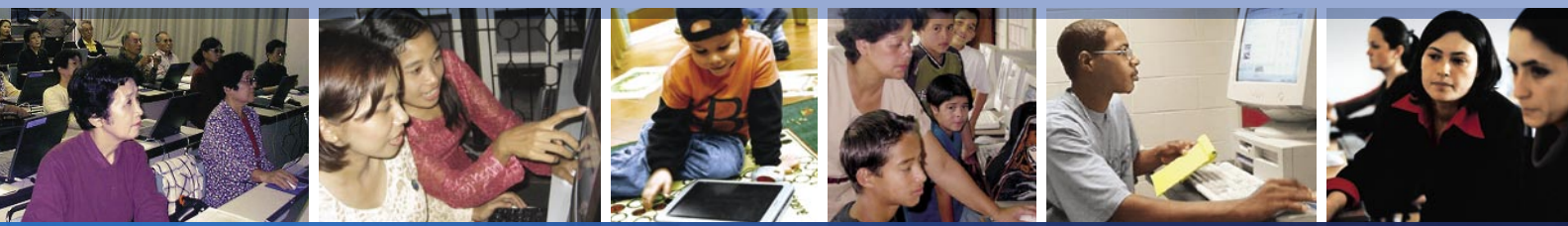


Microsoft®



2004 Global Citizenship Report

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Although Microsoft is well known as one of the world's leading software companies, our business is really about people. It's about our employees, who create innovative software that empowers millions of people around the world. It's about our customers, who do amazing things with the tools we provide, and our partners, who use our products and platforms to build their own successful businesses. And it's about our investors, who continue to put their faith in our company.

We value all of our stakeholder relationships and strive to honor and enhance them through our ongoing commitment to global citizenship.

We have worked hard to make Microsoft a values-driven company that maintains the highest standards of professional conduct, meets or exceeds the ethical and legal expectations of countries where we do business, and seeks to enable people throughout the world to realize their full potential.

Some of these efforts are focused on our internal corporate governance, and ensuring integrity and transparency in our business processes and practices. Others are about being open, honest, and respectful with other people and businesses, which is one of the core values of our company.

We have learned a lot over the years about our role and responsibility as a global corporate citizen. We have learned that security and privacy threats can accompany technology benefits, and that we must help consumers and business identify and neutralize those threats. We have learned that extending the benefits of information and communications technology to more people and communities worldwide requires not only access to technology, but also skills training that can unlock individual potential. And we have learned that

strengthening local economies requires not only good software, but also forward-looking public policy and incentives to encourage new business investment and economic development.

At Microsoft, we are focused on delivering unparalleled customer and partner experiences. Across the company, we have created new listening, feedback, and response systems to help us get closer to stakeholders, and to respond more quickly and with greater precision.

During the past several years, for example, we have been exploring new ways to share more information about our software with partners and customers, to enable them to get more value from our products. Through our Shared Source Initiative (SSI), which began in 2001, we make the source code for all versions of Windows® 2000, Windows XP, Windows Server™ 2003, and other key products available to customers, partners, and governments worldwide. In fiscal year 2004, the period covered by this report, we welcomed the one millionth participant into the SSI community.

We are continuing to build positive relationships with governments worldwide and with others in our industry, including our competitors. We are also working across our industry to help make technology safer and easier to use. We work with law enforcement officials to

help protect people's privacy online, to help prevent consumer fraud and identity theft, and to help protect the safety of children online.

We are also helping to bring the benefits of technology to communities and classrooms around the world. Through our Unlimited Potential and Partners in Learning initiatives, we are working with governments and communities in many different countries to promote workforce development and lifelong learning and digital literacy.

Everywhere we do business, we work to help strengthen local economies — through products that help to increase customer productivity and competitiveness, and our business model that creates opportunities for nearly 700,000 partners worldwide.

We are proud of the progress we made in each of these areas in fiscal year 2004, but the work doesn't stop when each year's report goes to the printer. For example, in the first few months of fiscal year 2005, we established Windows Marketplace, an online site that offers consumers easy access to more than 93,000 Windows-compatible products ranging from digital cameras to games to language courses. This is not only great for consumers, who now have an easy way to find, acquire, and download products, but also offers small

merchants from around the world the opportunity to sell their products to thousands of new customers.

We clearly don't have all of the answers, but we're working in close collaboration with governments, NGOs, and industry partners to expand our understanding and approach to global citizenship, and to address many of the most serious challenges facing our industry and the communities where we conduct our business. Together, we can make a difference.

Sincerely,



Bill Gates

Bill Gates
Chairman and
Chief Software Architect



Steven A. Ballmer

Steven A. Ballmer
Chief Executive Officer

Microsoft as a Global Citizen

At Microsoft, corporate citizenship is a global initiative, but it is felt most deeply by local communities. Here, our regional vice presidents discuss how our citizenship efforts touch people's lives in the regions they serve.



Eugenio Beaufrand
Regional Vice President,
Latin America

“In Latin America, where the World Economic Forum reports that only 10 percent of the population owns a personal computer, Microsoft donated \$8.8 million in cash and software through our Unlimited Potential program to support more than 650 community technology learning centers in 17 countries. Those centers are providing information and communications technology (ICT) training to more than 463,000 people, who are gaining the skills they need to participate in the digital economy. We also invested \$9 million through our Partners in Learning program to provide ICT education in 17 countries, which will reach millions of students and teachers throughout the region.”

Eugenio Beaufrand
Regional Vice President, Latin America



Tim Chen
CEO,
Greater China

“As regional vice presidents for Microsoft, we have the privilege of leading dynamic organizations that serve people from many different cultures and more than 90 countries around the world.

We are proud of the thousands of Microsoft employees, in every region, who do so much to act responsibly, promote Internet safety, advance digital inclusion, and strengthen local economies. We are excited about the work we have done in these areas across Greater China. This includes our collaboration with local computer scientists and other technology specialists engaged in research and development of innovative new solutions that will benefit computer users in the region and have a positive impact on the broader economy. And we salute our partners, whose businesses are such an important and integral part of our success.”

Tim Chen
CEO, Greater China



Jean-Philippe Courtois
CEO, Europe, Middle
East and Africa

“As this report will show, we take a broad view of global citizenship at Microsoft, and concentrate our efforts on several carefully chosen priorities that address significant business and societal issues, as well as key challenges for stakeholders and the communities where we conduct our business. Our commitment to responsible citizenship involves thinking about how our business activities can help grow local economies, how we can partner with local and national governments, and how we can expand IT skills training and educational and employment opportunities for more people.

Microsoft in Europe has developed the EU Grants Advisor program to increase small and mid-sized businesses' awareness and understanding of EU funds, and facilitate the application process. Through this initiative, Microsoft in partnership with other leading IT and financial services companies, as well as community partners, such as Chambers of Commerce and local associations, offers broad information and resources on available funds, provides streamlined

application processes to reduce paperwork, and offers ICT guidance for productivity enhancement programs. The goal is to make it easier for European entrepreneurs to gain informed access to the funds they need to grow their businesses.”

Jean-Philippe Courtois
CEO, Europe, Middle East and Africa

“Our employees are the heart, mind, and soul of Microsoft. As the people who design, develop, and market all of our products, they are clearly our most valuable asset. After all, they create the intellectual property that gives Microsoft its value as a company. They also do most of the work and make most of the decisions that support our corporate commitment to global citizenship.

Global citizenship at Microsoft includes practicing ethical business behavior — something our employees do routinely — and working with governments and law enforcement officials to protect consumer privacy and promote Internet safety and security.”

Michael Rawding
Corporate Vice President, Japan Region

“Asia Pacific is diverse and we’ve continued to introduce innovative programs to meet the region’s unique needs. The Windows XP Starter Edition pilot programs offer an affordable, easy-to-use version of the Windows XP operating system that is tailored to specific markets, in local languages in Thailand, India, Indonesia, and Malaysia. Our effort to provide these affordable PCs to first-time users in underserved communities is part of our larger local digital inclusion efforts, with Unlimited Potential providing disadvantaged communities with access to technology tools and skills to facilitate greater technology literacy and Partners in Learning delivering ground-breaking educational outcomes.”

Eduardo Rosini
Regional Vice President, Asia Pacific Region

“Microsoft employees and our partners make important contributions to our efforts to strengthen local economies. Nearly 700,000 technology companies worldwide create applications, provide computer services, and, in many other ways, build their businesses on our platform. According to studies by IDC, a leading industry analyst firm, Microsoft partners earn an average of \$7 or \$8 in revenue for every \$1 Microsoft earns, and every Microsoft job creates many more jobs in local economies around the world.”

Bill Veghte
Corporate Vice President, United States and Canada



Michael Rawding
Corporate Vice President,
Japan Region



Eduardo Rosini
Regional Vice President,
Asia Pacific Region



Bill Veghte
Corporate Vice President,
United States and Canada

Global Citizenship at Microsoft

Microsoft is committed to being a responsible industry partner, working with businesses, communities, and governments to help advance social and economic well-being and to enable people around the world to realize their full potential. Over the past three decades, we have expanded our business from the United States into more than 90 other countries, and we now employ more than 57,000 people globally. While Microsoft, by many measures, could be considered the world's most successful software company, it is also a local company and a neighbor in every country and community where Microsoft employees live, work, and do business.

As a successful global corporation, we have a responsibility to use our resources and influence to make a positive impact on the world and its people. At Microsoft, our passion to do well is matched by our desire to do good. We believe the best way to achieve those parallel goals is to align our business and global citizenship strategies. To achieve that goal, we consulted with our employees, and with people in government and industry from many parts of the world, because we wanted to create a citizenship framework that would both reflect and enhance the other aspects of our business.

Organized for Global Citizenship

At Microsoft, our Global Citizenship Initiative is organized around four pillars, which form the foundation of our citizenship activities worldwide:

- Responsible Business Practices — to ensure integrity and transparency in all of our business practices, and to provide a healthy, safe work environment for our employees.
- Internet Safety and Policy Leadership — to work with governments, industry leaders, and others to address the key societal challenges of information technology, such as spam, security, privacy, and children's online safety.

- Digital Inclusion and Education — to help people, communities, and nations gain access to the technology tools, skills, and innovation they need to realize their full potential.
- Economic Opportunity — to work with governments and communities worldwide to help strengthen local economies.

Each of these four pillars is fundamental to our business. We organize our Global Citizenship Initiative this way to help ensure our business strategies fully support our commitment to corporate governance, business ethics, and global citizenship.

Citizenship Inventory and Assessment

In fiscal year 2004, we engaged PricewaterhouseCoopers (PwC), a global consulting firm, to conduct an inventory and assessment of our

business practices and reporting from a corporate citizenship perspective. We wanted to understand more clearly the impact that our policies, processes, and metrics were having on our ability to achieve the goals of our Global Citizenship Initiative.

PwC highlighted areas of global citizenship where Microsoft was particularly strong, and other areas where we could do better. Our strengths included having a citizenship initiative with a focused strategy, several ongoing programs that support our corporate citizenship goals worldwide, and a number of leading citizenship practices such as our employee benefits, research and development, and accessibility work.

Among the areas where we needed improvement, PwC called out too little awareness and understanding of our citizenship initiative among Microsoft employees, the challenge of implementing citizenship programs consistently in all of our subsidiaries and the countries where we do business, and insufficient focus on key performance indicators, metrics, and external reporting.

We already have begun to address some of these gaps. For example, PwC pointed out that the Microsoft Board of Directors had no explicit charter or committee with a focus on global corporate citizenship. Since then, the Board has voted to expand the responsibilities of the Governance and Nominating committee to include oversight of global corporate citizenship issues.

CITIZENSHIP PERFORMANCE MEASUREMENT

At Microsoft, we recognize the importance of monitoring and measuring the performance of our business across the four pillars of our citizenship efforts. During fiscal year 2005, we will begin working with key experts in performance measurement to develop metrics that will help us achieve this goal. Work is already under way in our United Kingdom (U.K.) subsidiary to develop a framework we can use to assess performance and impact, and the results of this work will inform a wider global framework for measurement.

Stakeholder Engagement

In fiscal year 2004, Microsoft asked Sustainability, a leading business consultancy on corporate responsibility and sustainable development, to help us review and develop our approach to non-governmental organization (NGO) strategy and engagement in a number of EMEA markets, namely the U.K., France, Italy, Germany, Poland, and South Africa. Within the U.K. market, the research was widened to include all stakeholders to serve as the pilot for a broader approach to stakeholder engagement throughout EMEA.

At Microsoft, we believe that constructive stakeholder engagement improves our business decision-making processes and helps us anticipate and address the changing expectations of society. We understand that our reputation outside the company is a direct reflection of how we demonstrate our corporate values. Engagement with customers, partners, shareholders, NGOs, governments, and other stakeholders will be essential in helping us to identify and manage key issues that will test how successfully we live our values.

Feedback on Microsoft Global Citizenship Report

Following publication of the *2003 Microsoft Global Citizenship Report*, we asked a number of stakeholders to provide feedback about the 2003 report. Our goal in seeking feedback was to ensure future reports would provide additional value to readers.

This year, we submitted an advance draft of the *2004 Microsoft Global Citizenship Report* to three external organizations that are recognized leaders in promoting corporate social responsibility and global citizenship:

F&C Asset Management plc, London, United Kingdom, a socially responsible investment firm.

Business for Social Responsibility (BSR), San Francisco, California, a global organization that helps member companies achieve success in ways that respect ethical values, people, communities, and the environment.

International Business Leaders Forum, London, United Kingdom, an international educational charity, which promotes responsible business practices internationally that benefit both business and society while helping to achieve social, economic, and environmentally sustainable development, particularly in new and emerging market economies.

All three organizations provided us with a critical review of the report while it was still being revised, which allowed us to incorporate many of their suggestions. We are grateful for their feedback, which enabled us to improve and strengthen the fiscal year 2004 report.

An Invitation to Our Readers

At Microsoft, we appreciate frank and honest stakeholder feedback, both positive and negative, because it helps us to improve. We invite you to offer your observations and suggestions about this report as well as Microsoft's global citizenship activities. Please send your comments to citizenship@microsoft.com.

About This Report

Scope

In the *2004 Microsoft Global Citizenship Report*, we discuss our major citizenship initiatives and activities worldwide, highlight some of our more significant 2004 accomplishments, and share our goals for 2005.

Reporting period

This report focuses on Microsoft's fiscal year 2004 (which began July 1, 2003, and ended June 30, 2004). All data are for that period unless otherwise noted.

Report structure

This report is organized the same way we organize our Global Citizenship Initiative and related activities (see page 06) because we want our stakeholders — employees, customers, partners, shareholders, and others — to be able to compare our program goals and objectives with our results.

Currency

All money figures in this report are in U.S. dollars unless otherwise noted.

Terminology

The terms “Global Citizenship” and “Corporate Citizenship,” which are used throughout this report, are interchangeable with similar terms such as “Corporate Social Responsibility” and “Corporate Sustainability.”

Joint ventures

Joint venture company data are not included in this report.

Global Reporting Initiative (GRI)

The function of the GRI performance indicators is to provide information about the economic, environmental, and social impacts of organizations in a manner that enhances comparability between reports and organizations. In the Table of Contents of this report, we have included references to applicable GRI indicators to assist stakeholders in their review and assessment of our Global Citizenship Initiative. (More information about the GRI performance indicators is available at <http://www.globalreporting.org/>.)

Microsoft citizenship resources. Our 2003 *Microsoft Citizenship Report*, as well as other information about our Global Citizenship Initiative, is available at <http://www.microsoft.com/mscorp/citizenship/>.

NEXT STEPS FOR FISCAL YEAR 2005

- Demonstrate and communicate that Microsoft is a values-driven company, motivated by its mission to help people and businesses realize their potential
- Address the challenges created by our technology and its impact on society, and ensure the benefits of our technology are more broadly available
- Continue to make our business practices more open and transparent
- Develop citizenship-related performance measurements

About Microsoft

Microsoft provides software and services that help people communicate, do their work, be entertained, and manage their personal lives. Over the past 30 years, innovative technology has transformed how we access and share information, changed the way businesses and institutions operate, and made the world smaller by giving us instant access to people and resources everywhere.

Overview

Founded in 1975, Microsoft has been a leader in the wave of innovation that has created so much new opportunity, convenience, and value over the past three decades. During that time, we have created many new products, added new lines of business, and expanded our operations worldwide. Along the way, we were guided by our corporate mission and the six core values it reflects — and they will continue to guide us in the future.

Our Mission and Core Values

Microsoft's corporate mission is *to enable people and businesses throughout the world to realize their full potential*. Our mission reflects our six core values, which embody our ethical approach to business and our role as a committed corporate citizen in each of the countries and communities where we operate. Our ability

to deliver on our mission depends on intelligent, creative people who share these values:

- We act with integrity and honesty.
- We are passionate about our customers and partners, and about technology.
- We are open and respectful with others and dedicated to making them better.
- We are willing to take on big challenges and see them through.
- We are self-critical, questioning, and committed to personal excellence and self-improvement.
- We are accountable for commitments, results, and quality to customers, shareholders, partners, and employees.

Business Operations

Microsoft does business almost everywhere in the world. We have offices in more than 90



Microsoft Canada, Mississauga, Canada

countries, which are grouped into six corporate regions: North America (the United States and Canada); Latin America (LATAM); Europe, the Middle East and Africa (EMEA); Japan; Asia Pacific (APAC); and Greater China. We also have operational centers in Dublin, Ireland; Humacao, Puerto Rico; Reno, Nevada, USA; and Singapore. The operational centers are responsible for licensing, manufacturing, and operations and logistics, although not every center performs all of these functions.

We generate revenue by developing, manufacturing, licensing, and supporting a wide range of software products for many computing devices. Our software products include operating systems for servers, personal computers (PCs), and intelligent devices; server applications for distributed computing environments; information worker productivity applications; business solutions; and software development tools. We provide consulting and product support services, and we train and certify system integrators and developers. We sell the Xbox® video game console and games, PC games, and peripherals. Online communication services and information services are delivered through our MSN® portals and channels around the world.

We also research and develop advanced technologies for future software products. Delivering breakthrough innovation and high-value solutions through our integrated platform is the key to meeting customer needs and to our future growth.

We believe that over the past few years we have laid the foundation for long-term growth by making global citizenship an integral part of our business, delivering innovative new products, creating opportunity for partners, improving customer satisfaction, putting some of our most significant legal challenges behind us, and improving our internal processes.

Our focus in fiscal year 2005 is to build on this foundation by executing well in several key areas, such as strengthening every aspect of global citizenship at Microsoft; continuing to innovate on our integrated software platform; delivering compelling value propositions to customers; responding effectively to customer and partner needs; and continuing to focus internally on product excellence, business efficacy, and accountability across the company.

Business Groups

Microsoft's operational structure includes seven business groups, research and development, and corporate functions. As of June 30, 2004, the end of our fiscal year and the period covered by this report, Microsoft's business groups are:

- Windows Client
- Information Worker
- Microsoft Business Solutions
- Server and Tools
- Mobile and Embedded Devices
- MSN
- Home and Entertainment

Additional information about our business groups is available in our 2004 Microsoft Annual Report at <http://www.microsoft.com/msft/ar.mspx>.

Windows Client (includes the Microsoft Windows XP desktop operating system, Windows 2000, and Windows Embedded operating system). Today, there are 600 million personal computers around the world; by 2010, we estimate the number will grow to 1 billion. Much of this growth will come from new generations of PCs with enhanced capabilities, such as the Media Center and Tablet PCs that Microsoft has pioneered. The next generation of Windows, currently code-named "Longhorn", will lead to exciting new innovations in software applications, digital media, and entertainment products, which are expected to broaden PC adoption.

Information Worker (includes Microsoft Office, Microsoft Publisher, Microsoft Visio®, Microsoft Project, and other standalone desktop applications). Our Information Worker business continues to grow, with a 17 percent increase in revenue during fiscal year 2004. Established programs such as Word, Excel, Outlook®, and other Office 2003 applications continue to help people work more effectively. Meanwhile, Microsoft has introduced many new technologies and services that enhance communication, collaboration, and productivity. We are also providing our partners with new tools through the Office Solution Accelerator program, so that we can work together to deliver new productivity solutions to customers.

Microsoft Business Solutions (includes Great Plains® and Navision® business process applications, and bCentral™ business services). Microsoft Business Solutions is responsible for developing and marketing integrated applications and services that are designed to enable small and mid-sized businesses to automate business processes, make better decisions, accelerate growth, and achieve success by becoming more connected with customers, employees, partners, and suppliers. Specifically, our applications provide end-to-end automation for financial reporting, distribution, project accounting, electronic commerce, human resources and payroll, manufacturing, supply chain management, business intelligence, sales

and marketing management, customer relationship management, and customer service and support.

Server and Tools (includes the Microsoft Windows Server System™ integrated server software, software developer tools, and MSDN®). More businesses are migrating their computer networks from UNIX servers to less expensive ones running on the PC platform. Partly because of this trend, revenue from our Server and Tools business increased 19 percent in fiscal year 2004. Although Linux and other open source software continue to be our biggest challenge in this area, we have succeeded in demonstrating to our customers the unique value of the Windows platform. Several independent analysts have reported that Windows offers lower total cost of ownership, stronger security features, and more comprehensive indemnification. In fiscal year 2005, Microsoft will release SQL Server™ 2005 — a more reliable, secure, scalable, and manageable database platform — and Visual Studio® 2005 will provide developers with new tools that aim to further reduce complexity and cost.

Mobile and Embedded Devices (includes mobile devices such as the Windows Powered Pocket PC, the Mobile Explorer microbrowser, and the Windows Powered Smartphone software platform). The market for devices that combine wireless connectivity with a handheld PC is expected to grow rapidly over the next several years. At Microsoft, we are making strategic investments to ensure our mobile offerings provide the greatest benefit to consumers and device manufacturers. In addition, our Windows Mobile™ software is the foundation for the new Portable Media Center devices coming from leading consumer electronics companies.

MSN (includes the MSN network, MSN TV, and other Web-based services). Our MSN business achieved its first full year of profitable operations in fiscal year 2004, as annual advertising revenue rose 43 percent, exceeding \$1 billion for the first time. We are investing in many new online services, including search, communication, and music technologies that

will deliver outstanding consumer benefits and increased revenue opportunities.

Home and Entertainment (includes Microsoft Xbox, consumer hardware and software, online games, and the Microsoft TV platform). Xbox continues to show strong momentum in the video games market. Approximately 15.5 million consoles have shipped since launch and more than 425 Xbox games have been published. Xbox now ranks second in units sold among game consoles in the North American and European markets, and is gaining on the market leader. Xbox Live™, our interactive service with more than 1 million subscribers in 24 countries, has revolutionized the online gaming business. Looking ahead, we see many new opportunities to create more digital entertainment on the Xbox, Microsoft TV, and Windows XP Media Center platforms.

Financial Report

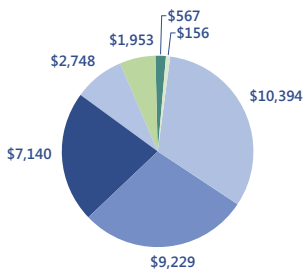
All of our businesses grew in fiscal year 2004, increasing total revenue by \$4.65 billion, or 14 percent, to \$36.84 billion.

During the year, our Board of Directors approved a plan to return as much as \$75 billion to shareholders over the next four years, beginning in fiscal year 2005, by increasing the regular dividend and expanding our stock buyback program. The Board also declared a special one-time dividend of \$3.00 per share for fiscal year 2005.

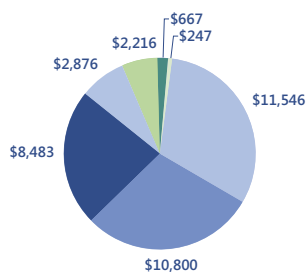
To maintain the value of employee equity compensation awards following the dividend, it was necessary to make adjustments to the company's stock plan. These amendments were approved by shareholders at our annual meeting in November 2004.

For additional details, see the *Microsoft 2004 Annual Report* at <http://www.microsoft.com/msft/ar.mspx>.

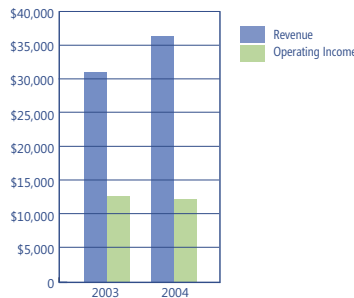
2003 Revenue by Segment
as reported in 2004 annual report



2004 Revenue by Segment
as reported in 2004 annual report



Revenue and Operating Income
as reported in 2004 annual report



(Dollars in millions)	FY 2003		FY 2004	
	Revenue	Operating Income	Revenue	Operating Income
Client	\$10,394	\$8,017	\$11,546	\$8,015
Server and Tools	\$7,140	\$1,121	\$8,483	\$96
Information Worker	\$9,229	\$6,486	\$10,800	\$7,151
Microsoft Business Solutions	\$567	-\$309	\$667	-\$255
MSN	\$1,953	-\$567	\$2,216	\$121
Mobile and Embedded Devices	\$156	-\$277	\$247	-\$224
Home and Entertainment	\$2,748	-\$1,191	\$2,876	-\$1,215
Total	\$32,187	\$13,280	\$36,835	\$13,689



Microsoft Corporate Headquarters, Redmond, Washington

A detailed explanation of Microsoft legal issues in fiscal year 2004 is available in the Notes section of the 2004 Microsoft Annual Report at <http://www.microsoft.com/msft/ar.msp>.

Legal Disputes

During fiscal year 2004, we resolved a number of legal disputes. Some of those involved legal issues such as the antitrust lawsuit brought by the U.S. Department of Justice, a number of consumer class-action antitrust suits filed in various states, and private antitrust lawsuits brought by other companies.

Resolving these legal issues clears the way for new collaboration with leading companies that were litigants. At the same time, a few new issues emerged in fiscal year 2004, most notably the European Commission's decision that Microsoft had infringed European competition law, and the lawsuit filed by RealNetworks, Inc.

Update on the U.S. Federal Antitrust Suit

Since U.S. District Court Judge Jackson issued his conclusions of law in the antitrust suit filed against Microsoft in 1998 by the U.S. Department of Justice, 20 states and the District of Columbia, a number of private lawsuits have been filed related to the findings in that case.

Over the course of the past two years, Microsoft has made a concerted effort to resolve these legal issues through settlement or through dismissals by the Court. While we continue to face legal challenges, we have made considerable progress in resolving these conflicts and in building a more constructive relationship with government and industry.

Update on U.S. Federal Class-Action Suits

The federal consumer class-action suits, also known as multi-district litigation (MDL), were a consolidation of more than 100 class-action cases that originally included potentially hundreds of millions of licensees. These cases were consolidated before Judge Motz of the U.S. District Court for the District of Maryland in Baltimore, where through the pre-trial process, he narrowed the claims significantly — throwing out the federal law claims of indirect purchasers and foreign purchasers, and refusing to certify a class of volume license customers. These rulings are subject to appeals.

With the September 2003 settlement of the remaining narrow class of end-user direct purchasers, all federal damages claims on behalf of consumers have been addressed, subject to various appeals.

Update on the European Commission Competition Case

On March 25, 2004, the European Commission announced a decision in its competition law investigation of Microsoft. The Commission concluded that Microsoft infringed European competition law by refusing to provide our competitors with licenses to certain protocol technology in the Windows server operating systems and by including streaming media playback functionality in Windows desktop operating systems.

The Commission ordered Microsoft to make available to our competitors licenses to relevant technology and to develop and make available a version of the Windows desktop operating system that does not include specified software relating to media playback. The decision also imposed a fine of €497 million, which resulted in a charge of €497 million (\$605 million).

We contest the conclusion that European competition law was infringed and will defend our position.

Other Investigations

In other ongoing investigations, various foreign governments and several state attorneys general have requested information from us concerning competition, privacy, and security issues. Microsoft also faces competition reviews from other regulatory bodies. The Japanese Fair Trade Commission is reviewing a narrow patent provision in Microsoft's contracts with computer makers (which has been removed going forward). The Korea Fair Trade Commission is reviewing the integration of Instant Messenger and media technology into the operating system. Microsoft is fully cooperating with these investigations and all other inquiries from regulatory bodies around the world.

Corporate Governance

Corporate governance at Microsoft serves several purposes:

- to appropriately distribute rights and responsibilities among our Board members, managers, and shareholders in order to establish and preserve management accountability to Microsoft's owners;
- to provide a structure through which our company objectives are set and attained, and our performance is monitored;
- to strengthen and safeguard our culture of business integrity and responsible business practices; and
- to encourage the efficient use of resources and to require accountability for our stewardship of those resources.

Board of Directors

At Microsoft, we understand that strong corporate governance is a fundamental component of our business success. Our Board of Directors establishes the standards and policies for corporate governance, ethics, and compliance throughout Microsoft. The Board's role is to oversee the work of management in conducting Microsoft's business and to serve the

The Corporate Governance Guidelines, as well as the charters for all five Board committees, are available at <http://www.microsoft.com/msft/corpinfo.mspix>.



Company Meeting 2004

BOARD OF DIRECTORS

(as of June 30, 2004)

Steven A. Ballmer, Chief Executive Officer, Microsoft Corporation**James I. Cash Jr., Ph.D.**, Former James E. Robison Professor, Harvard Business School**William H. Gates III**, Chairman, Chief Software Architect, Microsoft Corporation**Raymond V. Gilmartin**, Chairman, President and Chief Executive Officer, Merck & Co., Inc.**Ann McLaughlin Korologos**, Chairman, RAND Corporation; Chairman Emeritus, The Aspen Institute; Senior Advisor, Benedetto, Gartland & Co. Inc.**David F. Marquardt**, General Partner, August Capital**Charles H. Noski**, Corporate Vice President and Chief Financial Officer, Northrop Grumman Corporation**Helmut Panke**, Chairman of the Board of Management, BMW AG**William G. Reed**, Former Chairman, Simpson Investment Company**Jon A. Shirley**, Former President and Chief Operating Officer, Microsoft CorporationFor more information, visit <http://www.microsoft.com/presspass/bod/default>.

long-term interests of shareholders. The Board believes that taking account of the interests of other stakeholders such as employees, customers, partners, suppliers, and the many communities around the world where we do business is an important component of achieving shareholders' long-term interests.

At the end of fiscal year 2004, Microsoft's Board of Directors had 10 members. The Board is chaired by Bill Gates, Microsoft co-founder and chief software architect, and holds regularly scheduled quarterly meetings.

Typically, in addition to the quarterly meetings, there are two other regularly scheduled meetings and several special meetings each year. At each quarterly Board meeting, time is set aside for the non-management directors to meet without management present.

The Board has five committees, each led by one of the non-management directors, that are responsible for review and oversight of company activities in their areas. The committees are:

- Audit Committee;
- Compensation Committee;
- Finance Committee;
- Governance and Nominating Committee; and
- Antitrust Compliance Committee.

The Corporate Governance Guidelines were most recently modified by the Board effective July 1, 2004. Among other things, those modifications were intended to ensure our compliance with corporate governance requirements contained in both the Nasdaq Stock Market and New York Stock Exchange listing standards and to enhance our corporate governance policies, including creating the role of lead independent director.

In fiscal year 2004, the Board voted to expand the responsibilities of the Governance and Nominating Committee to include corporate citizenship issues. As a result of that change, the Committee's responsibilities now include monitoring compliance with and recommending changes to the Corporate Governance Guidelines; and reviewing the policies and programs that relate to matters of corporate responsibility, including public issues of significance to Microsoft and its stakeholders.

The chair of the Governance and Nominating Committee serves as the lead independent director and is responsible for coordinating the activities of the non-management directors, coordinating with the chairman to set the agenda for Board meetings, chairing meetings of the non-management directors, and leading the Board's review of the chief executive officer.

In June 2004, we established procedures for shareholders to contact via mail or e-mail (askboard@microsoft.com), an individual director, the lead independent director, the Board as a group, or a specified Board committee or group, including the non-employee directors as a group.

Each communication should specify the person or people for whom it is intended, as well as the general topic of the communication.

Stakeholders who have concerns about accounting or auditing matters or possible violations of the Microsoft Standards of Business Conduct are encouraged to report these by following the procedures outlined in the Standards of Business Conduct, which are available on our Web site at <http://www.microsoft.com/mscorp/legal/buscond/>. Confidential concerns can be directed to buscond@microsoft.com, or anonymous reports may be submitted directly to msft.buscond@alertline.com.

Executive Team

Microsoft's executive team is made up of 16 company officers, including the Chairman and Chief Software Architect; Chief Executive Officer; General Counsel and Secretary; Chief Financial Officer; senior and group vice presidents from our business units; the CEO of our Europe, Middle East and Africa region; and the heads of Worldwide Sales, Marketing and Services; Human Resources; and Corporate Marketing. In addition to other duties, the executive team is responsible for ensuring all Microsoft employees understand and support the company's culture of business integrity and compliance.

Corporate Staff Council

The Corporate Staff Council represents all major staff functions of the company, with senior executive representation from the Law and Corporate Affairs, Finance, Human Resources, Corporate Marketing, and Advanced Strategy and Policy groups at Microsoft. Microsoft established the Corporate Staff Council in fiscal year 2004 as the centralized management function charged with enhancing coordination among corporate functions. One of the specific roles of the Corporate Staff Council is to oversee, review, and approve corporate policies.

BUSINESS COMMITMENTS FOR FISCAL YEAR 2005

- Provide breakthrough, high-quality integrated innovation
- Deliver best-in-class customer responsiveness
- Make our platform best for developers
- Deliver simple, high-value experiences and services
- Reignite customer enthusiasm and tell the Microsoft story
- Build our talent pool and increase productivity

Responsible Business Practices

At Microsoft, we know that how we conduct ourselves and our business is as important as delivering outstanding products and services. How we work with customers, partners, governments, vendors, and communities worldwide is fundamental to our success as a company.

Overview

Our commitment to responsible business practices is absolute — in our core values and in our daily work. That means being open about our business operations, transparent in all of our dealings with stakeholders, and compliant with all laws and regulations that apply to our business. It also means having the honesty to acknowledge when we fall short of those goals, and the integrity to set things right. As Microsoft continues to grow, we will continually strive to exceed expectations regarding the responsible manner in which we conduct our business.

Microsoft's Business Conduct

Public demand for greater corporate responsibility and more rigorous corporate governance rose dramatically in the wake of high-profile business scandals that left shareholders reeling. Regulators and lawmakers around the world responded with new requirements such as the Sarbanes-Oxley Act of 2002 in the United States, new regulations from the China Securi-

ties Regulatory Commission, and the proposed Corporate Governance Directive being considered by the European Commission. The global environment adds further complexity by offering a range of privacy regulations, employment laws that vary from country to country, and differing anti-competition laws.

While emerging legislation may have influenced the types of internal controls Microsoft has developed, it is our internal drive for integrity and accountability that has fueled our motivation to build a compliance and ethics infrastructure that does more than meet the minimum standards set by external regulators. For us, compliance means more than complying with laws and regulations that impact our day-to-day business activities. Compliance also means living our values and being accountable to Microsoft's codes of conduct, which govern our business practices around the world.

To deliver on these responsibilities we must demonstrate, more than ever before, that Microsoft is a business that behaves with integrity in all interactions with customers,

partners, shareholders, consumers, and governments — all the many different stakeholders whose trust we must continue to earn and honor. Beginning with our Board of Directors, we are committed to building a culture of accountability throughout our global operations.

As part of that commitment, we've taken practical steps to meet or exceed all of our legal obligations, from creating an Office of Legal Compliance and adopting new Standards of Business Conduct to guiding our employees in all of their professional decisions and interactions.

Microsoft Codes of Conduct

Microsoft's Standards of Business Conduct (SBC) apply to all Microsoft employees, and set clear guidelines for them to follow when conducting business on behalf of the company. The SBC are an extension of Microsoft's values and the foundation of our business practices. They reflect our collective commitment to ethical business behavior, and legal and regulatory compliance. At a high level, they summarize and are supported by the principles and policies that govern Microsoft's global business practices in several important areas:

- regulatory compliance;
- trust and respect of consumers, partners, and shareholders;
- asset protection and stewardship;

- creation of a cooperative, diverse, safe, and productive work environment; and
- commitment to the global environment.

Standards of Business Conduct

In fiscal year 2004, we completed our worldwide distribution of the SBC, customizing and localizing the messages for global audiences in 15 languages in 30 countries. The SBC have now been distributed to every employee in hard copy, with online training completed and certified by the majority of employees. Microsoft updates the SBC as required to reflect changes in legal obligations or reporting requirements.

Microsoft also produced and released an online Standards of Business Conduct training program to all employees worldwide in fiscal year 2004. Every new employee receives a copy of the Standards of Business Conduct at New Employee Orientation, along with information and resources to acquaint them with the company's expectations relative to the SBC and to ensure they understand the requirement that they complete SBC training.

Supplemental Codes of Conduct

As supplements to our overarching Standards of Business Conduct, Microsoft also has developed complementary codes of professional conduct that apply specifically to employees who are engaged in certain types of business activities. These supplemental codes include:

More information about Microsoft's Standards of Business Conduct is available at <http://www.microsoft.com/mscorp/legal/buscond/#standards>.

- Microsoft Finance Code of Professional Conduct (CEO, CFO, Finance Department)
- Microsoft Procurement Code of Professional Conduct (Microsoft Procurement Group)
- Microsoft Vendor Code of Conduct (Microsoft Vendors)
- Microsoft Policy for Compliance with SEC Attorney Conduct Standards (U.S. Attorneys)

IN FISCAL YEAR 2004:

- Completed the worldwide distribution of the Standards of Business Conduct, which are localized in 15 languages and in 30 countries
- Hired a dedicated Compliance Training Manager to help develop a comprehensive training infrastructure to enhance the effectiveness of our worldwide compliance training
- Hired a Compliance Communications Manager to concentrate on expanding Microsoft's global compliance and ethics communications efforts

Legal Compliance

U.S. Federal Trade Commission Passport Consent Order Compliance

This 20-year Consent Order imposes specific obligations relating to (1) marketing representations, (2) document retention, and (3) information security for Passport, MSN Wallet, Kids Passport, any other similar product or service, and any multi-site authentication service ("Covered Services"). Microsoft remains fully committed to meeting its obligations under the Order and has begun applying best practices that resulted from this process across the company. Examples of milestones to date:

- In 2003, we underwent an independent third-party audit of our Information Security

Program ("ISP") for the Covered Services. The external auditor determined that our ISP was reasonably designed to protect the security, confidentiality, and integrity of consumers' personal information collected by the Covered Services, and further, that we were in compliance with our program. In 2004, the Federal Trade Commission agreed with our auditor's opinion of the ISP.

- The MSN Security team has used its ISP efforts under the Order to implement training, document standard operating procedures, and conduct risk assessments across all MSN properties that handle personally identifiable information.
- We developed a centralized tool within our legal department for submission and storage of documents subject to the Order's five-year retention obligation.

We must continue our dedicated efforts to comply with the Order to help ensure our customer information is protected. Product teams have begun preparation for the next independent third-party audit, which will take place in late 2005 and every year thereafter during the life of the Order. We will continually evaluate and revise the ISP to help ensure it meets the changing environment of information security.

Antitrust Compliance

We are nearly two years into the five-year consent decree with the U.S. Department of Justice (DOJ) and nine states, which resulted from the antitrust lawsuit those and other parties filed against Microsoft in 1998. We remain completely committed to fulfilling all of our obligations under the settlement, working cooperatively with the DOJ and other government authorities, and building stronger ties with customers, partners, and government.

The settlement imposes a wide variety of tough obligations on our company, and we are committed to living up to those obligations.

We devote substantial resources to all of our compliance efforts under the consent decree, and have been responsive, flexible, and innovative in working with the DOJ and the states to proactively address as well as resolve issues as they arise. We recognize that Microsoft will continue to undergo a high level of scrutiny, and we will continue to commit the time, energy, and other resources necessary to meet this high standard.

Milestones

Among our antitrust compliance efforts, we:

- Created standardized Windows license and uniform royalty rates for all PC manufacturers
- Provided developers in 2003 with more than 4,000 Windows application programming interfaces (APIs), which are the building blocks developers need to create applications for the Windows platform
- Put forth extensive and significant efforts to simplify and communicate

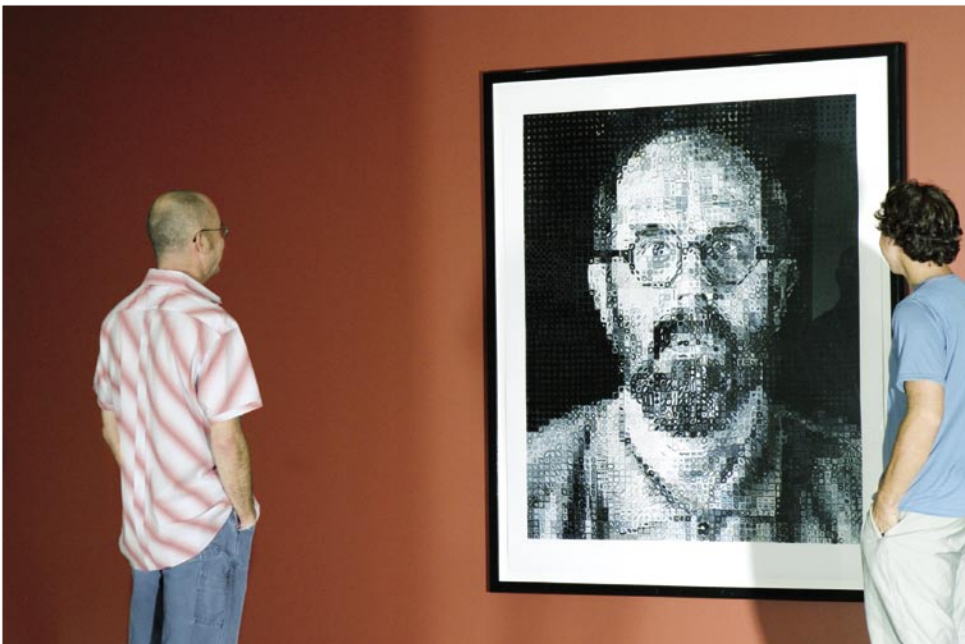
our protocol licensing program (see <http://www.microsoft.com/mscorp/ip/protocols/>)

- Conducted training programs in more than 60 countries to ensure employees understand our legal obligations and our commitment to full compliance

General Counsel's Office of Legal Compliance

The mission of the office is to provide supervision and oversight in the establishment, implementation, and maintenance of effective and collaborative compliance and governance programs. The General Counsel serves as the company's Chief Compliance Officer and reports directly to the Chief Executive Officer and, for this purpose, to the Audit Committee of the Board of Directors.

Day-to-day responsibility for the operations of the office is vested with the Director of Com-



Chuck Close, *Self-Portrait*, 1995, 80 color silkscreen, 68 x 58 inches, Microsoft Art Collection, © Adam L. Weintraub

HOW TO REPORT COMPLIANCE VIOLATIONS OR CONCERNS

Partners, customers, or others outside the company who have concerns about compliance or Microsoft business practices may report their concerns to the Office of Legal Compliance by calling the Business Conduct Line at (877) 320-6738, e-mailing msft.buscond@alertline.com or buscond@microsoft.com, or sending a confidential fax to the Director of Compliance at (425) 705-2985. For more information, please visit <http://www.microsoft.com/mscorp/legal/buscond/>.

Employees who need guidance about a business practice or compliance issue, or who wish to report a compliance concern, can call the Business Conduct Line or contact the Director of Compliance. Employees outside the United States can call the Business Conduct Line by accessing an international operator and asking to place a collect call.

pliance. The Director of Compliance reports to both the Chief Compliance Officer and the Audit Committee of the Board of Directors. This responsibility includes, but is not limited to, the administration of the Standards of Business Conduct to specific situations and questions that may arise. In administering the program, the Director works closely with colleagues across the company who are accountable for ensuring compliance with a wide range of legal and regulatory obligations in specific areas, including human resources, internal audit, security, environmental stewardship, and others.

To promote their independence and facilitate the escalation of matters that require it, both the Chief Compliance Officer and the Director of Compliance are permitted to report outside their respective chains of command and are protected from dismissal without Board approval.

Worldwide Compliance Network

During fiscal year 2004, the Office of Legal Compliance expanded its worldwide network, adding additional corporate compliance staff members. In addition, privacy compliance managers were added in the EMEA and APAC regions.

Some regions and subsidiaries such as EMEA, Japan, Mexico, and Brazil have formed compliance committees that are designed to assist Microsoft with oversight and compliance with

laws and regulations that are specific to their nations. These committees also implement proactive compliance and ethics programs that are customized to local laws and cultures while remaining aligned with Microsoft corporate requirements.

Compliance Scorecards

In fiscal year 2004, the EMEA region developed a "compliance scorecard" to measure compliance activities for all of the larger EMEA subsidiaries. The scorecards help the EMEA Governance Cabinet measure compliance progress and address deficiencies. EMEA also created customized compliance scorecards for the Eastern Europe and Middle East/Africa subsidiaries, to help them meet their unique compliance needs. In addition, EMEA established a framework for reporting compliance activities and concerns to the EMEA Governance Cabinet.

MSPolicy

MSPolicy (an internal portal) is a centralized repository for all corporate policies. This resource provides a standardized process for creating and managing policy as well as a centralized location to house policy, guidelines, and other related content.

MSPolicy has begun the process of categorizing policies for the purpose of streamlining processes for policy development, approvals, communications and implementation efforts, and clarifying consequences for non-compliance.

THE CHALLENGE OF RESPONSIBLE SUPPLY CHAIN MANAGEMENT

Achieving our supply chain management goals is sometimes challenging. A current issue that demonstrates the complexity of that challenge is the presence of Coltan in some of our products. Coltan is an exceptionally temperature-resistant conductor that is widely used in products such as printed circuit boards, mobile phones, and computer game equipment. No one objects to the use of Coltan on environmental grounds; the problem is the effect of Coltan mining on human rights.

Experts believe that 80 percent of the world's Coltan reserves are located in Africa, with a large concentration in the war-torn Democratic Republic of Congo. A 2001

report commissioned by the United Nations Security Council concluded that the lucrative Coltan trade in the Congo was contributing to the war that is still raging in the region, by helping to finance armies from Rwanda and Uganda.

Not all Coltan is mined in the Congo — some comes from places like Canada, Australia, and Brazil — and it is almost impossible to determine the origin of the Coltan in a particular product given the number of steps between the mine and the manufacturer.

Microsoft is concerned about the human rights issues related to the mining of Coltan in the Republic of Congo. We will continue to work with our suppliers to monitor the situation and urge them to find alternative sources of Coltan.

IN FISCAL YEAR 2004:

- Expanded Office of Legal Compliance
- Added privacy compliance managers in EMEA and APAC
- Developed a "compliance scorecard" to measure concrete compliance activities in EMEA
- Established MSPolicy, a centralized internal online repository for all corporate policies

Responsible Industry Leadership

As an ICT industry leader whose technology products are used by millions of consumers, businesses, and organizations worldwide, we have a responsibility to develop technology that is based on commonly used standards and to make sure our products work well with those of other companies — including our competitors. To help promote innovation, enable greater security throughout the industry, and foster new economic opportunities we also have a responsibility to share the source code of our leading products.

Shared Source Initiative

Microsoft is sharing source code with customers, partners, and governments worldwide through the Shared Source Initiative (SSI). Launched in May 2001, the SSI enables us to make source code for Windows 2000, Windows XP, Windows Server 2003, Office 2003, and other leading Microsoft products more broadly

available while retaining the intellectual property (IP) rights that are vital to sustain innovation within the software industry.

The SSI is an evolving framework that supports a variety of licensing programs, each tailored to meet the source code access needs of a specific constituent community such as customers, partners, independent developers, researchers, students, and other interested parties. At the end of fiscal year 2004, the SSI included 17 different programs that provided source code to 1.5 million developers in more than 60 countries. The SSI programs focus on four key areas:

- Supporting governments and other customers;
- Working with developers;
- Providing source code and development tools to university students, faculty, and researchers; and
- Creating joint economic opportunities with partners.

The SSI uses broad-based licensing to foster the growth of global communities of software developers who, equipped with Microsoft product source code, are free to devise new solutions and implement their own innovations. Also, by placing source code in the hands of universities throughout the world as a research and teaching tool, the SSI nurtures the vibrant software industry of the future.

At the same time, the SSI rewards innovators for their research and development efforts by

Details about each of the 17 Shared Source Initiative (SSI) programs are available at <http://www.microsoft.com/resources/sharesource/default.aspx>.

A list of countries in which the various SSI programs are available is at <http://www.microsoft.com/resources/sharesource/Licensing/Availability.mspix>.

SUPPLY CHAIN MANAGEMENT: A PILOT PROGRAM

In 2004, the Hardware Manufacturing and Procurement Management team in our Home and Entertainment (H&E) Division sponsored a citizenship project to demonstrate Microsoft's industry leadership in product, environmental, and social responsibility. The program objective was: *To create and implement a comprehensive and transparent set of product, social, and environmental responsibility policies and practices that is integrated into the business requirements and operations supporting decision making processes within H&E Hardware.*

The H&E Hardware business model is to outsource development and manufacturing of Microsoft hardware

consumer electronic products. The hardware supply chain comprises contract primary assembly suppliers who procure, final-assemble, and ship PC hardware and Xbox finished products. Microsoft also contracts directly with secondary suppliers for some critical components that are assembled in the hardware products at the primary assembly suppliers. The major products are mice, keyboards, and Xbox consoles and peripheral devices.

In the second quarter of fiscal year 2004, our program team developed the citizenship requirements for primary assembly suppliers, and program assessments were conducted at every primary assembly site. Eighty-six percent of the suppliers assessed were found to be in compliance

protecting their valuable IP rights in the source code they produce. By preserving this free-market incentive, programs like the SSI ensure that the software industry can sustain its unparalleled level of innovation and continue to fuel the global economy, while providing users access to source code.

Government Security Program

The Government Security Program (GSP), one of the SSI programs, is a global initiative from Microsoft that helps national governments address their critical security needs by providing access to the source code for key Microsoft products, technical information, and Microsoft development staff. GSP enables governments to better evaluate their existing ICT systems and create computing infrastructures that are more secure. (For information about other Microsoft government programs, see page 66.)

By participating in the GSP, national governments can provide recommendations for more secure private-sector and public-sector systems. Through GSP, governments can also help Microsoft improve the security of their home and business operating systems by collaborating with us on threat modeling and conducting reviews of our products. By collaborating with Microsoft through GSP, governments will be able to implement the latest innovations and security features from Microsoft in less time and with fewer resources, because our products will be more precisely tailored to their needs.

In fiscal year 2004, GSP grew to include the governments of 33 countries, including the United States, United Kingdom, China, Russia, and Australia, and two international organizations (NATO and EUROPOL). Government delegations from around the world visit Microsoft headquarters frequently for executive briefings and technical training. Meanwhile, we have expanded the number of Microsoft technologies covered by the program. In addition to giving participating governments access to the Windows source code, we have added Office source code, Office file formats, and Windows communications protocol specifications.

IN FISCAL YEAR 2004:

- Expanded the Government Security Program to include the governments of 33 countries and two international organizations

Microsoft's Commitment to Interoperability

At Microsoft, we consider interoperability (the ability of ICT components, systems, and services to communicate and exchange information), the openness of our technology, and the widespread licensing of our intellectual property to be responsible business practices.

Our customers, and the customers of other companies in our industry, are increasingly concerned with making the most of their ICT

with local laws and to have a high level of citizenship awareness; 14 percent were found to be deficient due to a general lack of understanding of local law and global citizenship principles.

The assessments were provided to the suppliers, and in the third quarter the Microsoft team met with each supplier to review the results and request corrective action where needed. All of the corrective actions we identified were completed by the spring of 2004.

From the findings, we concluded that our specific focus in fiscal year 2005 should be on improving supplier compliance in the areas of environment, occupational health and safety, and labor standards. In parallel with the citizenship

assessment, our team also developed an H&E Social and Environmental specification, which is now attached to each supplier contract. Another key part of the project is to ensure products produced in 2004 and beyond are lead-free and meet all additional RoHS (European Union legislated requirements) standards for 2006.

investments, staff skills, and the diverse technology solutions available in the marketplace. We believe that interoperability makes it possible for customers to more efficiently manage heterogeneous ICT environments, increase productivity, create business advantage, and maximize their return on ICT investments.

Moreover, interoperability encourages competition and innovation, and generally helps foster a healthy ICT industry. There are several ways to accomplish interoperability, such as IP licensing — the publication and commercial licensing of technology innovations — and standards implementation (including common standards that are widely used throughout the industry). As an industry leader, Microsoft is committed and active in all of these areas. In fact, in the last year Microsoft entered into landmark agreements that promote interoperability with several key competitors and partners, including Sun Microsystems, Oracle, Siebel, Yahoo!, AOL, palmOne, and Vodafone.

A 2004 Jupiter Research study that surveyed 800 ICT professionals ranked Microsoft as the interoperability leader over other industry vendors. Specifically, the study showed that 72 percent of the ICT professionals surveyed believe Microsoft is the best in supporting interoperability.

Intellectual Property Licensing That Enables Interoperability and Industry Standards

Proactive, voluntary efforts to address government and industry requests for greater trans-

parency and improved access to Microsoft innovations and intellectual property include the December 2003 launch of our Intellectual Property Licensing Program. This program is continuously evolving to provide the industry with increased offerings, contribute to a healthy ICT ecosystem, and improve interoperability among ICT products and services (hardware and software).

Over the last several years, we have granted many companies licenses to portions of our IP portfolio, which enabled them to implement Microsoft innovations in their own products and also served our goal of spurring innovation more broadly throughout the ICT sector. Microsoft also benefits from similar programs with third-party companies when we license their IP and technology and incorporate it into Microsoft products.

Because we recognize that IP licensing fosters interoperability and benefits the ICT industry as a whole, we have deployed a comprehensive, multifaceted IP licensing program that includes programs for licensing source code for Microsoft Windows and other software (Shared Source Programs), communications protocols, and our popular Office file formats and XML reference schemas. The IP licensing program also includes our application programming interfaces (APIs), the building blocks developers need to create highly interoperable applications for the Windows platform, and the rest of our diverse IP portfolio.



Charles Goldman, *Distance Painting 48', 80', 96', 64'*; 2002, ink on aluminum, Microsoft Art Collection, © Adam L. Weintraub

For details about all aspects of our IP licensing program, see <http://www.microsoft.com/mscorp/ip>.

Our protocol licensing programs, part of our Intellectual Property Licensing Program, are good examples of how we are sharing our intellectual property. We have licensing programs for many of the protocols that we have developed to support communications among our software products. Communications protocols provide the rules for information exchange to accomplish specific, predefined tasks across a network connection. Microsoft's protocol licensing programs provide licensees with technical documentation for the covered protocols and the related intellectual property rights needed to develop and distribute implementations of Microsoft protocol technology on reasonable and non-discriminatory terms.

The Microsoft Communications Protocol Program (MCP), for example, makes available more than 100 communications protocols that Microsoft implements in its client and server operating system products. The MCP license allows third parties to develop and distribute

server software that interoperates with Windows desktop operating systems and other compatible software using protocols that Microsoft built into Windows. Microsoft Windows Media protocols — including media streaming protocols, audio and video codecs, and the Windows Media file container — are licensed under the umbrella of the Windows Media Licensing Program for client-side development and distribution. This program enables device manufacturers and software developers to build high-quality digital media capabilities into a broader range of products. Since the launch of the Intellectual Property Licensing Program in December 2003, Microsoft has entered into IP cross-licensing agreements with several leading companies, including Time Warner, Sun Microsystems, Siemens AG, and SAP, and many smaller companies. Moreover, Microsoft is currently discussing similar agreements with many other companies throughout the world.

In addition, we also have a long history of licensing portions of our own intellectual property, including technology, copyrights, and patents, which are necessary to implement many different industry standards through standards-setting bodies in which Microsoft participates, such as the International Telecommunications Union (ITU), Internet Engineering Task Force (IETF), World Wide Web Consortium (W3C), Organization for the Advancement of Structured Information Standards (OASIS), International Committee for Information Technology Standards (INCITS), European Computer Manufacturers Association (ECMA), Open Mobile Alliance (OMA), and many others.

Open Standards

Standards (all standards, including open standards, de jure, de facto, product, and proprietary) are an important element in our products and we believe that standards help facilitate interoperability, data exchange, and portability across the widest range of products and services, bringing great benefits to our customers. Microsoft's standards implementation is focused on customer needs and includes implementation of open standards, de facto standards, product standards, and proprietary standards. A 2003 study by Lawrence Associates/Forbes found that Windows provides a 102-percent improvement over competing open source products for standards compliance.

Open standards are technical specifications developed and maintained, or affirmed and ratified, by consensus in a market-driven process, in which the technical specification is (a) publicly available to all interested in implementing, (b) vendor and product neutral (not tied to the services of any particular vendor and implementation is not limited to particular products), and (c) whose patent rights are available to all implementers on at least reasonable and non-discriminatory (RAND) terms (either with payment of a reasonable royalty or without). We believe they provide a highly effective way to develop platform-neutral, market-based standards that effectively promote interoperability. Microsoft has been actively working with customers,

partners, competitors, and governments to develop standards for several critical technology areas. Those efforts include but are not limited to our work on:

- E-commerce and Web-based standards for Web services in organizations such as W3C, OASIS, and the Web Services Interoperability Forum
- Hardware standards in the PCI Special Interest Group, the Personal Computer Memory Card International Association, and the Infrared Data Association
- Industry-specific business standards in the School Interoperability Forum and Health Level 7
- Internet protocol standards in the IETF
- Language and runtime environment standards in the ECMA

Supply Chain Management

Our supply chain management philosophy is simple. We believe in working proactively with the most responsible, strongest, and most productive suppliers available to deliver value to our customers, and we expect them to share our corporate values and operating philosophy.

We expect our suppliers to operate with the same honesty, integrity, and commitment to service and quality that we demand from our employees. We also expect them to behave responsibly toward the environment, ensure workforce diversity in their own supply chains, and provide fair and safe working conditions for their employees.

To ensure our suppliers understand the depth of our commitment to citizenship and social responsibility, we ask them to read and sign our Vendor Code of Conduct, and we monitor code compliance among our top suppliers.

We also foster a strong supplier diversity program. Our spending with diverse firms in the U.S. has grown more than 200 percent over the past three years. In addition, we have increased the number and amount of deposits made in

For information on our procurement practices and policies, see <http://www.microsoft.com/mscorp/procurement/process/contracting.asp>.

For more information on our supplier diversity program, visit our Web site at <http://www.microsoft.com/procurement/diversity>.

minority banks in the U.S. We were honored to be recognized as “National Corporation of the Year” by the Northwest Chapter of the National Minority Supplier Development Council this past year. We also received “Corporation of the Year” honors from Astra, the Northwest Chapter of the Women’s Business Enterprise National Council.

Partners, customers, or others outside the company who have concerns about Microsoft’s procurement practices should contact the Director of Compliance as explained on page 21.

Environmental Impact

At Microsoft, we work actively to protect our natural resources. We have corporate policies and procedures that conserve environmental resources at our facilities and in our products, packaging, and supplier operations. We follow strict policies to ensure that we remain in full compliance with international environmental regulations as well as the specific environmental requirements of each country where we do business.

Recycling and Conservation at Our Corporate Headquarters Facilities

We reduce waste and conserve resources at our facilities, recycling a daily average of 24 tons of material, including glass, plastic, aluminum, cardboard, paper, organic waste, wood pallets, and copper wire cabling. We also work with a contractor to recycle our old PCs, monitors, servers, and other surplus technology, ensuring that our surplus equipment is recovered or recycled at an environmentally compliant facility. In addition, we participate in programs throughout the world that refurbish thousands of PCs every year and donate them to schools and NGOs. (For more information about the Microsoft Authorized Refurbisher donation program, see page 55.)

An advanced irrigation management system at our corporate headquarters campus automatically senses weather conditions and replenishes the right amount of water, which saves approximately 11 million gallons of water

annually. Microsoft also makes energy conservation a priority, both in new construction and in renovations of existing buildings, investing in construction methods that provide long-term energy savings.

While Microsoft is not a member of the U.S. Green Building Council (USGBC), we support their agenda in general and have certified operations of existing facilities at our U.S. headquarters under the USGBC Leadership in Energy and Environmental Design (LEED) program for existing buildings. We have also followed the LEED program in the design of new facilities.

Improving Air Quality

At our corporate headquarters in the United States, we have organized internal campaigns to encourage employees to use non-Single Occupant Vehicle (SOV) commuting. We provide employee subsidies and education to promote the use of car pools and van pools, offer a public transportation pass to employees, and provide shuttle services to employees who need to move around our corporate campus during their workday. To encourage commuting, we also offer a guaranteed ride home program to employees who may have to stay late and miss their usual ride or who experience some kind of emergency.

Products and Packaging

We design our software and hardware products to comply with worldwide environmental regulations. We use no heavy metals, such as lead and cadmium, in packaging or plastics for any Microsoft products, and we restrict the use of toxic substances in our manufacturing operations. Microsoft contracts for manufacturing throughout the world, and we require our vendors not only to abide by the applicable environmental laws but also to follow good environmental practices that reflect the spirit of those laws.

We design our hardware and software packaging to reduce environmental impact. We don’t use standard plastic shrink-wrap on our product packages and manuals. We promote the

use of compact discs (CDs) and Web-based downloads for computer programs, and whenever possible we use online instructions in place of paper manuals. We also forbid the use of old-growth trees in our packaging.

Responsible Employer

Microsoft is consistently recognized as one of the best places to work in the world. (See Awards and Recognition on page 70 for more details.) We seek to hire and promote employees who not only have a passion for technology and an ability to develop great products, but who also have the skills necessary to elevate the performance of their team members and reflect the diversity of the communities where we do business. As part of our effort to foster an environment where we help make others great, we have focused part of our recruiting efforts on identifying experienced professionals who demonstrate the management and collaborative skills that we need to achieve this goal.

Microsoft continues to grow, and we are adding jobs in the United States and globally while keeping in mind our roles and responsibilities as a global industry leader. While we are committed to expanding markets, such as India and China, in a thoughtful and deliberate manner, the majority of our core development will remain in the United States at our headquarters in Washington state.

As of June 2004, we had approximately 57,000 employees in more than 90 countries, with more than 37,000 based in the United States. We expect to hire 6,000 to 7,000 new employees in fiscal year 2005; 3,000 of those new hires will be for Microsoft facilities in Washington state. This number accounts for all new hires, whether we hire them to fill new positions or because of attrition in existing positions.

Promoting Diversity and Inclusion at Microsoft and in the ICT Sector

At Microsoft, we believe that diversity and inclusion enriches our performance and prod-

ucts, the communities where we live and work, and the lives of our employees. As we continue to develop our workforce to better reflect the growing diversity of our communities and the global marketplace, our efforts to understand, value, and incorporate differences become increasingly important.

By fully pursuing the company's mission in all parts of the world, and in keeping with what we value and what the citizens in each country value, Microsoft has established a comprehensive and specific plan to promote and integrate diversity at every level within our organization and in everything we do. In the United States and elsewhere, the plan includes:

- Establishing diversity teams in a number of our business groups, regions, and subsidiaries — such as the EMEA Diversity Council that was formed in fiscal year 2004 — to strengthen our diversity efforts in different parts of the business and the world
- Creating a corporate steering committee, the Diversity Executive Workgroup, to lead integration of diversity principles into every facet of our people and business system.
- Established our first employee affinity group in 1989 and today, support over 30 such groups including Blacks at Microsoft, Visually Impaired Persons at Microsoft, Women at Microsoft, and Gay, Lesbian, Bisexual, and Transgender Employees. These groups provide social networks and strategic input to our executive staff.
- Partnering with premier national organizations to increase career opportunities for women and minorities in technical fields and to increase their representation in the ICT industry
- Partnering with traditionally female and minority schools to build relationships and work with the faculty in those schools to develop a strong curriculum
- Offering scholarships each year to young women and minorities to encourage careers in the ICT industry

For information about employment opportunities at Microsoft, see <http://www.microsoft.com/careers/default.mspx>.

- Including sexual orientation in our corporate non-discrimination policy, and offering employee benefits to same-sex domestic partners

Despite these efforts, we sometimes fall short of living our diversity and inclusion values. We pledge to continue working to embrace the diversity of our workforce as a key element of our business strategy and to better connect with our global partners and customers.

Employing People with Disabilities

At Microsoft, we have made accessibility a companywide priority. We have been honored repeatedly for recruiting, hiring, and accommodating people with a wide range of disabilities. Our Accessible Technology Group (ATG) has been working with our product teams for more than 15 years to help ensure that every new version of Microsoft software is more accessible than the last.

ATG also works closely with companies around the world that develop and produce assistive technology (AT), such as screen readers for people who are blind and a wide range of other devices that enable people with disabilities to use computers as easily and efficiently as any of their coworkers.

We also support many different programs that help people with disabilities gain access to technology, acquire the skills they need to be successful, and get real-world work experience. For example, in fiscal years 2003 and 2004, Microsoft and the American Association of People with Disabilities co-sponsored a program that places students with disabilities as summer interns at federal agencies in Washington, D.C. Microsoft has renewed its funding commitment for this program in fiscal year 2005.

Typically, a few of the interns have been offered full-time jobs as federal employees when their internship is over, while others have parlayed their summer work experience into jobs in the private sector. These young people

are examples of how people with disabilities, given the right tools and a chance to show what they can do, will prove themselves to be outstanding employees.

To help illustrate the global nature of our work on accessibility, Microsoft supports the European Union's accessibility programs and initiatives, and we participated as a Corporate Partner in the European Year for People with Disabilities (EYPD) in 2003. The EYPD was an attempt to raise public and business awareness about the needs — including information technology needs — of people with disabilities. This yearlong effort was followed by an EU Disability Strategy, which seeks to:

- incorporate disability issues in all policy areas;
- coordinate Member State initiatives; and
- involve people with disabilities in policy development, implementation, and evaluation.

Microsoft is a member of "Business & Disability: A European Network," which ensures the continuation of the EYPD Corporate Partners group.

Career and Leadership Development

Developing leaders and helping our employees advance in their careers is a top priority for Microsoft and critical to our future success. As we grow as a company, so does our responsibility and commitment to ensuring our employees are well-rounded and have a diverse set of experiences so that they can remain the very best-in-class in our industry.

While the number of training hours per employee is difficult to capture at Microsoft due to the size and structure of the company, employees work with their managers to address training and development strategies during their annual performance review and also during their mid-year discussions. Hundreds of courses are available to all employees either in a classroom setting or as online training — during fiscal year 2004, we offered 5,270 courses

More information about assistive technology and Microsoft's work with AT companies is available at <http://www.microsoft.com/enable/at/>.

— and the training resources are explained to every employee during New Employee Orientation and on our internal Web site. The broad range of courses available include technical certifications on Microsoft products and development of skills such as communications, public speaking, management, and strategic leadership.

Compensation Philosophy and Practice

Microsoft's compensation philosophy is to provide all employees with a competitive and distinctive compensation package, and the opportunity to earn recognition and additional rewards for outstanding performance through a pay-for-performance approach. Our broad-based compensation program includes:

- competitive base salaries — we pay better than two-thirds of the companies in the industry;
- a broad-based stock awards plan;
- a retirement plan for U.S. employees that combines employee contributions with a partial match from Microsoft (not all of our employee retirement plans in other countries include the partial match); and
- an Employee Stock Purchase Plan (ESPP) that enables employees to purchase Microsoft stock at a substantial discount.

In July 2003, we announced our decision to award stock grants to all employees, in place of stock options, beginning in September 2003. The Stock Award program offers the company's employees the opportunity to earn actual shares of Microsoft stock over time, rather than options that give employees the right to purchase stock at a set price.

Also in fiscal year 2004, Microsoft instituted the Shared Performance Stock Award (SPSA) program, a long-term incentive program for executives and other senior leaders that makes a significant portion of their stock-based compensation dependent upon the company's growth and customer satisfaction over a three-year period. The size of an employee's SPSA grant depends on competitive long-term com-

penetration data, the person's job, and his or her anticipated contribution to Microsoft's long-term performance.

In December 2003, we launched an innovative Option Transfer program to enable employees to realize some value on portions of their stock options that had not increased in value. Microsoft will make payouts of approximately \$382 million over three years under this program.

Employee Benefits

We offer employees one of the most comprehensive benefits packages in the high-tech industry, which helps us attract and retain the best talent. The benefits discussed in this section are a partial list of the benefits package for U.S. employees. Because benefits for Microsoft employees outside the U.S. often vary, and are based on local norms and must be customized to address legal and cultural differences in other countries and regions, some of the benefits described here apply only to Microsoft's employees based in the U.S.

Health benefits include medical, dental, prescription drugs, vision, disability, life insurance, flexible spending accounts, a group legal network, a health club membership subsidy, paid vacation and sick leave, and various leaves of absence programs. Employees are able to customize their health benefits package to meet their individual needs — there are a variety of medical plans and two dental plans — and healthcare coverage is also offered to same-sex domestic partners.

Microsoft offers an adoption assistance plan; matching charitable contributions; tuition assistance; generous maternity and paternity leave policies; flexible work schedules; an extensive resource and referral service, including Microsoft CARES, an employee assistance program that offers counseling for family members during personal crises; and discounted software.

For more information about compensation at Microsoft, see the Microsoft 2004 Proxy Statement at <http://www.microsoft.com/msft/SEC/FY04/proxy2004.msp>.

IN FISCAL YEAR 2004:

- Revised equity compensation program as Microsoft began granting stock awards instead of stock options to employees
- Instituted Shared Performance Stock Award program, a long-term incentive program for executives and other senior leaders under which a portion of stock-based compensation depends on the growth in the number and satisfaction of our customers

Listening to Our Customers and Partners

At Microsoft, we are always working to improve our relationships with customers and partners, and to use their feedback to guide us in improving our products, services, and business processes. This requires us not only to listen and hear, but to respond and take action as part of our ongoing dialogue with customers and partners.

When a customer or partner has a specific need, we aim to respond in a timely manner to proactively improve our products and services. We established a number of product feedback processes, which include product-based technologies that act as in-the-moment feedback mechanisms and response management systems to enable Microsoft to make systemic changes and to prevent or mitigate similar issues in the future. These feedback mechanisms allow Microsoft and its partners to understand product performance in real-life scenarios, resolve bugs, prioritize the contents of service packs, and identify new features for future releases.

We empowered our account teams to send feedback from customers and partners directly to our corporate headquarters through a response management system that enables Microsoft to respond quickly. And we launched the Quick Assistance program, which enables our 57,000 employees around the world to

resolve technical problems more quickly for customers they meet outside of work.

Every year, we conduct a comprehensive survey called the Microsoft Worldwide Customer and Partner Satisfaction Study. The most recent study resulted in more than 40,000 completed customer and partner interviews in 70 locations worldwide. The survey data is not public, but we can confirm that the high-priority issues among our customers and partners are product quality and values, security, licensing, technical support, and the ease of doing business with Microsoft.

During fiscal year 2004, we touched more than 500,000 people through additional training for ICT professionals on the best ways to manage the security of their environments. With over 50 million interactions every year, our services and support group collects, analyzes, and delivers a wealth of customer and partner feedback to our product groups for incorporation into product development.

Accountability measurements for customer and partner satisfaction have been established throughout the company for every Microsoft employee. Employee performance evaluations include specific criteria that encourage a strong customer and partner focus in everything we do. For our senior employees and account management teams, customer and partner satisfaction is linked to compensation.

IN FISCAL YEAR 2004:

- Entered into IP licensing agreements with numerous companies including Time Warner, Sun Microsystems, Siemens AG, and SAP
- Launched the Quick Assistance program, enabling employees around the world to resolve technical problems more quickly for customers they meet outside of work
- Trained over 500,000 ICT professionals on the best ways to manage the security in their environments

NEXT STEPS FOR FISCAL YEAR 2005**Compliance**

- Expand New Employee Orientation compliance training
- Develop specific training programs tailored for each business group
- Launch an internal Web-based allegations submission tool
- Audit reporting of third-party vendors
- Develop and launch a campaign to increase employee awareness of our Business Conduct Line
- Ensure that all employees are aware of Microsoft's non-retaliation policies
- Expand the current Microsoft Global Compliance Network
- Develop a framework for establishing more formalized compliance committees within subsidiaries
- Establish specific benchmarks to measure progress in fiscal year 2006 and beyond

Responsible Industry Leadership

- Expand Shared Source program offerings based on what we learn from our ongoing engagement with governments, independent developers, other technology companies, and academia

Supply Chain Management

- Reinforce the importance of compliance across the supply base
- Continue training of the supply base
- Ensure that first-tier suppliers see our commitment as a joint responsibility to be implemented across their supply base
- Enforce zero tolerance
- Produce lead-free products
- Host a supplier compliance summit for first-tier suppliers

Environmental Impact

- Develop and implement a comprehensive, corporate-wide environmental policy
- Improve cross-group coordination and issue management
- Eliminate PVC in packaging by the end of calendar year 2005

Responsible Employer

- Implement a corporate diversity and inclusion scorecard

Internet Safety and Policy Leadership

As an industry leader, Microsoft recognizes its responsibility to help make the Internet safer. Our ultimate goal is to help create an environment in which adults, children, and organizations are more secure and can enjoy the full benefits of the Internet.

Overview

While information and communications technology (ICT) has created previously unimagined opportunities for millions of people worldwide, it has also provided new tools for criminals. As a leader in the industry that is creating so many benefits, Microsoft also shares responsibility for stopping technology abuses that enable crimes against consumers and businesses. We will continue to collaborate with governments, law enforcement officials, and other industry leaders to develop solutions to these problems.

Public policy is also critical to shaping the Internet's future. We will continue to work with government officials and other stakeholders to advance public policies that improve economic and social well-being, deter criminal activity, and enable people to realize their full potential.

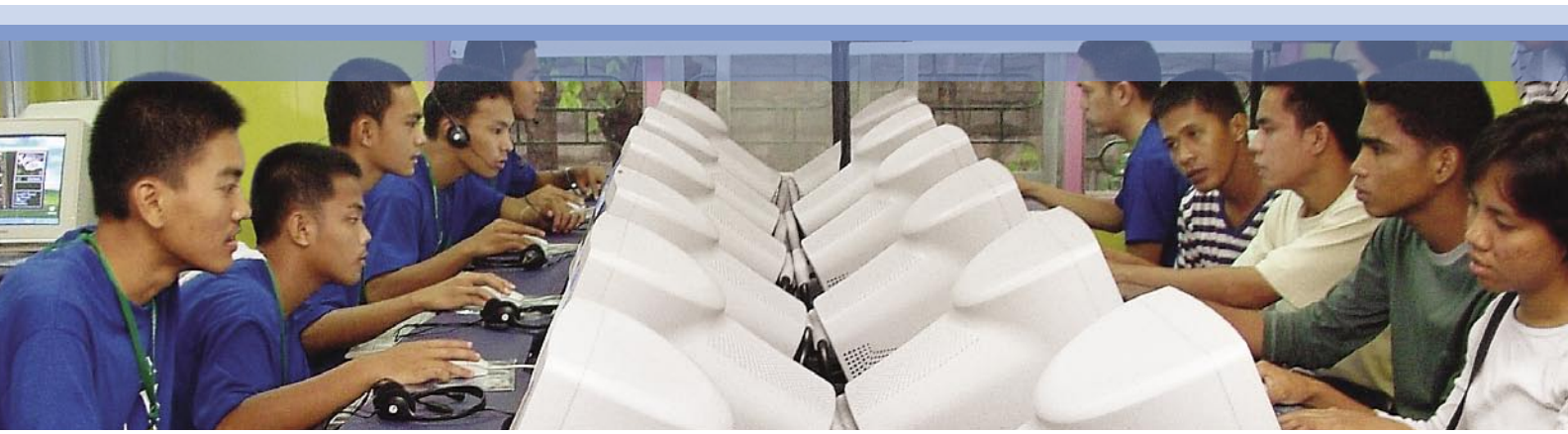
The Internet is fostering some of the fastest technological, social, and economic changes in history. Since coming into widespread use in the mid-1990s, it has evolved rapidly into a

global network, connecting many of the world's personal computers and an increasing number of cell phones and other devices.

Today, more than 800 million people routinely use the Internet, more than twice the number of people who were online four years ago and nearly 50 times the number that were online in 1995. Reliable data on global e-commerce is difficult to come by, but some experts estimate that online trade will grow to nearly \$13 trillion by 2006. Government institutions, businesses large and small, and non-governmental organizations all depend on the Internet to some degree.

That reliance will only grow with time. As a developer of leading Internet technologies and a producer of mass-market software programs, Microsoft has helped, and will continue to help, drive the Internet revolution. Given this role, we understand that we have a corresponding obligation to help address the challenges of this new information-based society.

As in other periods of rapid, technology-driven change, safety issues have arisen quickly. Junk



Pag-Asa: An Unlimited Potential program, Pampanga and Olongapo, Philippines

e-mail, more commonly known as spam, has become pervasive. Criminals impersonate legitimate companies to perpetrate identity theft. Child predators prey upon unsuspecting minors and remain undetected by adults. Viruses and malicious software are becoming increasingly potent and sophisticated. And the global nature of the Internet means that harm can be inflicted across international borders and on a massive scale.

No open system as interconnected as the Internet can be made perfectly secure. However, Microsoft believes that substantial progress can be made through persistence and a combination of reinforcing tactics:

- Continuing improvements in technology, aimed both at frustrating criminals and at making it simpler for consumers to protect themselves;
- Targeted laws and strong law enforcement, ensuring that criminals are singled out and prosecuted for their crimes;
- Partnerships across the technology industry, so that the collective efforts of those who are driving the Internet revolution have their maximum effect; and
- Consumer education, so that people grow comfortable deploying the safety technologies that industry creates, and become more knowledgeable about how to avoid harm.

In January 2002, Microsoft launched its Trustworthy Computing Initiative. Microsoft was already a leader in promoting security and

online safety in a variety of ways, but the launch of Trustworthy Computing was an inflection point for the company. Security and safety became top priorities across all business groups, and for developers and non-technical staff alike. We also began to pursue the four-pronged strategy (outlined above) more deliberately across a variety of security- and safety-related topics.

In fiscal year 2004, the company made significant progress in each of these areas. As the following paragraphs will show, we aim to do more. In particular, we need to work harder to improve our consumer-education efforts, and we must always strive to simplify technology.

Creating and Using Secure Technology

Software programs represent a unique combination of human authorship and technology. Made up of millions of lines of code, software programs tell increasingly powerful computers and smart devices what to do. The complexity of modern computing is compounded on the Internet as programs interact with a broadening diversity of other programs and devices. This complexity has become the target of hackers and writers of viruses and worms. Malicious coders have become increasingly sophisticated in probing for and exploiting vulnerabilities in order to inflict senseless harm or worse.

The launch of the Trustworthy Computing Initiative was about fundamentally changing the

way we design and develop software in order to more holistically address this reality. Back in 2002, some 8,500 Microsoft developers halted their work and dedicated their efforts to building security directly into our software. While this initiative delayed the release of Windows Server™ 2003 and postponed work on other key products, we believe that the initial Trustworthy Computing push created a quantum leap in our ability to help protect computing systems from online attacks.

The benefits of that transition continue to flow. Across the company, our developers have maintained their focus on improving the security of our products, and employees around the world helped customers, partners, and other key audiences understand how, collectively, we can improve the security of the Internet. The previous table contains highlights indicative of our broader efforts.

If there is a general theme running through many of our security-related activities, it is that



Community technology learning center for the Ngöbe-Buglé people of western Panama

FISCAL YEAR 2004 UPDATE ON SECURITY

Technology

Development and release of Windows XP Service Pack 2

This is a major security upgrade offered free to customers using the Windows XP operating systems. It increases control over add-on programs, enhances Windows' firewall, blocks pop-ups, and has other features designed to prevent harmful downloads.

MSN Premium and MSN 9 Internet access

In January 2004, MSN launched these new services, which include desktop antivirus, firewall, and anti-spyware protection powered by McAfee Security; multiple levels of junk e-mail filtering; smart pop-up management; and rich parental controls.

Software update process

Microsoft made a number of improvements to its broader security update process to help reduce downtime and improve manageability. Through this process, Microsoft has made available free removal tools for malicious code attacks including Blaster, Sasser, and MyDoom.

Ongoing strong performance of Windows Server 2003

Quality improvements through engineering excellence resulted in a 69 percent reduction in critical and important bulletins issued for Windows Server 2003 relative to Windows 2000 Server in the initial year following their respective releases. This reflects the benefits of our Trustworthy Computing Initiative.

Development tools

Microsoft continues to create tools that help automate software development and testing processes by reviewing and finding bugs before code is checked in.

Ongoing investment in Active Protection Technologies

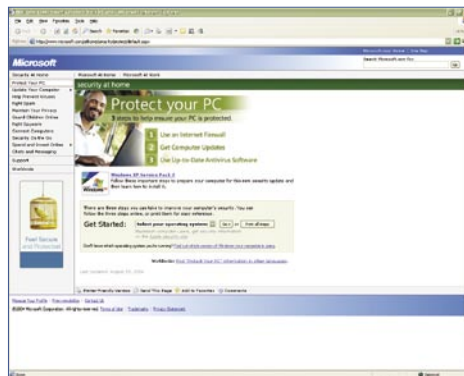
In response to increasingly sophisticated viruses and worms, we also are working on technologies that block suspicious behavior and quarantine PCs before they are allowed to attach to a network.

FISCAL YEAR 2004 UPDATE ON SECURITY (CONTINUED)

Government Partnerships	
Anti-Virus Reward Program	In November 2003, Microsoft established a \$5 million fund to help authorities identify, prosecute, and convict people who break the law by unleashing malicious viruses and worms. The fund was announced in partnership with Interpol, the FBI, and U.S. Secret Service. The program led to the charging of the person responsible for a variant of the Sasser virus. This person was responsible for 70 percent of all virus activity in the first six months of 2004.
Training of law enforcers	In addition to training law enforcers on how to pursue child predators (see table on Children's Safety), Microsoft provides training on basic computer forensics and investigation of other computer crimes. In fiscal year 2004, we conducted 22 such training sessions, reaching law enforcers from the U.S., Canada, U.K., Taiwan, Indonesia, Singapore, Australia, and other markets.
National Police Agency	Working with the National Police Agency (NPA) in Japan, Microsoft established a national hotline that NPA and other law enforcement authorities can use to consult Microsoft on any ICT topics related to crime prevention or investigation. Microsoft and NPA also joined forces to conduct law enforcement training seminars on Internet safety and cybercrime.
Cooperation Agreements	More than 30 countries have now joined our Government Security Program. We also have entered into other security-related partnerships with China, Korea, Japan, and India.
Endorsement of the Council of Europe Convention on Cybercrime	The Convention is the first international treaty to address criminal behavior directed at computer systems. Microsoft supports its ratification and advocates opening it to the largest possible number of countries.
Chief Security Advisors	Microsoft now employs 17 Chief Security Advisors in locations around the world. Their role is neither sales nor marketing, but is aimed at providing strategic advice to government and other customers on critical security issues.
National Cyber-Forensics and Training Alliance (NCFTA)	Microsoft has assigned a full-time analyst and provided over \$46,000 in software to the NCFTA to track and investigate emerging cybercrimes. The alliance was founded as a partnership between the FBI, the National White Collar Crime Center, Carnegie Mellon University, and West Virginia University.
New Industry Partnerships	
Virus Information Alliance (VIA)	Since its founding in May 2003, the VIA has grown to include 10 industry-leading antivirus vendors as well as Microsoft. VIA members exchange critical technical information about newly discovered viruses and worms to communicate to customers in a timely manner.
Global Infrastructure Alliance for Internet Safety (GIAIS)	In February 2004, Microsoft announced the formation of GIAIS, a working group of Internet service providers from around the world that are committed to educating their 150 million customers on Internet safety and helping protect them against malicious code and other threats.
Asia CyberCrime Summit	In November 2003, representatives of government, academia, and the private sector from Asia, Europe, and the U.S. convened in Hong Kong for a major cybercrime summit, to discuss the latest threats to cyber security and how to improve global coordination to address them. Microsoft was a key organizer and sponsor of the event; other industry sponsors included eBay, MasterCard, MPA, and IFPI.
Finnish National Security Day	In February 2004, Microsoft and other industry leaders co-sponsored Finnish National Security Day. The purpose of the event was to educate the nation on online security. In conjunction with it, 1.5 million safety guides were distributed, and Microsoft delivered 250,000 security-upgrade CDs through retail stores and other distributors. Additional Security Days are planned in other parts of the world during fiscal year 2005.

FISCAL YEAR 2004 UPDATE ON SECURITY (CONTINUED)

Education	
Protect Your PC campaign	Using our Web sites and print advertising, we have engaged in a worldwide campaign to create broader awareness of best practices in PC “hygiene.” The campaign focuses on three key steps: using a firewall; enabling the Automatic Update feature in Windows; and installing antivirus software.
Improved guidance within Windows XP SP2	In Windows XP SP2 we have created a new Windows Security Center on the Control Panel that enables consumers at a glance to check the status of and seek guidance on essential security functions.
U.S. National Cyber Security Alliance and U.K. Project Endurance	In late fiscal year 2004, Microsoft and a number of companies joined the U.S. Departments of Homeland Security and Justice in forming this partnership. Its goal is to promote cyber security via its staysafeonline.info Web site and other outreach efforts. Microsoft is supporting a similar effort in the United Kingdom, Project Endurance, which is set to launch in mid-2005.
Security training for up-and-coming software engineers	Microsoft UK and the University of Leeds are co-sponsoring a teaching fellowship aimed at training undergraduates on how to write secure software. In early fiscal year 2005, Microsoft Research announced that it would be making \$500,000 available in grants to colleges and universities willing to develop curricula in the basics of trustworthy computing.



Protect Your PC site
<http://www.microsoft.com/athome/security/protect/default.aspx>

the threats of harm are constantly evolving and, consequently, it is imperative that the software running computer systems, whether large- or small-scale, is kept current.

In this regard, our development of Windows XP Service Pack 2 (SP2) — a free upgrade to the Windows XP operating system — was the most significant step of the past year. Windows XP SP2 contains a number of new security technologies. During the setup process, consumers also are strongly urged to activate the Windows Automatic Update feature. Computer trespass laws restrict Microsoft’s ability to update software on consumers’ machines without their consent. By consenting

to and “turning on” Automatic Updates, consumers permit Microsoft to send them updates when they connect to the Internet. During the setup of Windows XP SP2, consumers are presented with a screen that educates them in consumer-friendly terms on the importance of enabling this feature.

We recognize that making this upgrade available is only one piece of the puzzle. Many consumers, especially home users, have yet to appreciate the significance of keeping up-to-date on software security technologies. Other consumers likely are intimidated by the prospect, or feel they do not have the time to update their software.

That said, we feel our strategies for broad-based consumer education are improving. The company aimed to have 100 million downloads of Windows XP SP2 within the first 60 days of the software’s availability. That goal was achieved in early fiscal year 2005.

Moreover, we have designed the new Windows XP Starter Edition to meet what we believe to be the security technology needs of first-time users in developing technology markets who will be participating in that pilot program. The Starter Edition operating system contains the security features of Windows XP

SP2; it has the Internet firewall locked on, so that there is a persistent level of security features in place; and it contains the same request to enable Automatic Updates. The software also detects each customer's connection speed. If this is slow, as will be the case for many Starter Edition users, the software updates are staged and deployed incrementally. (For more information about Windows XP Starter Edition, see page 54.)

Microsoft also provides training for law enforcement officials to help them capture perpetrators of high-tech crime, whether it is aimed at consumers or businesses. For example, in fiscal year 2004 Microsoft was a key organizer and sponsor of a major cyber-crime summit in Hong Kong, which focused on a wide range of Internet safety threats, from network security attacks to "phishing" and other fraud schemes that harm consumers and undermine e-commerce. The event brought together senior justice and law enforcement officials from across the Asia Pacific region, and also included representatives from Interpol, the United Nations, the Council of Europe, the U.S. Department of Justice, and the Federal Bureau of Investigation. As another example, law enforcement officials from the U.S., Canada, the United Kingdom, Taiwan, Korea, Japan, Hong Kong, Indonesia, Singapore, and Australia attended BotNET training at our Redmond headquarters to learn how to shut down "robotic networks," which are capable of conducting various types of computer-related crimes on entire networks of computers.

Helping to Safeguard Online Privacy

Our work in the security arena is focused on preventing and limiting the impact of what might be considered physical assaults on computer systems. Safeguarding consumers' privacy — protecting consumers' interest in being left alone — is a complementary goal.

Here, too, our most significant strides over the course of the past year were in improving the technology tools.

Our work to reduce spam is the most noteworthy. Microsoft e-mail customers report spam as their number one concern. This is not surprising, since spam accounts for two-thirds of all e-mail traffic worldwide: a staggering 15 billion spam messages are sent and received every day.

In early 2003, Microsoft formed the Safety Technology and Strategy Group to focus on creating spam solutions. One research project led to the development of Microsoft SmartScreen™ Technology, which helps filter out spam for customers of MSN Mail, Hotmail®, Microsoft Outlook®, and Microsoft Exchange Server. In the first six months after Hotmail introduced SmartScreen in fiscal year 2004, the new technology succeeded in blocking an average of nearly 3 billion messages daily.

Consistent with our belief that online safety issues are best addressed via comprehensive, multi-pronged strategies, Microsoft embarked on a broad campaign to frustrate spammers. In the table below, we provide more detail on our support for anti-spam legislation, our cooperation with law enforcement officials in pursuing spammers, our collaboration with industry partners on e-mail best practices, and our educational activities. Through these combined efforts, we feel we are making good headway toward reducing the impact of spam on customer privacy. Much more needs to be done, but we are committed to achieving significant further decreases in the volumes of spam worldwide.

In an e-mail message to Microsoft customers in fiscal year 2004, Microsoft Chairman and Chief Software Architect Bill Gates said:

"I believe that the lessons we're learning in this fight against junk e-mail will lead to many other benefits. As we work to help isolate and block spammers, we're also helping to build an infrastructure that will enhance the reliability, efficiency, and safety of e-mail, of the Internet, and of computing in general. Microsoft is committed to continuing these efforts until spam is no longer a major problem — a goal I'm confident will be achieved."

More information about Microsoft's efforts to eliminate junk e-mail is available at <http://www.microsoft.com/mscorp/twc/privacy/spam.mspx>.

Our anti-spam activities are in addition to ongoing efforts to block or disrupt other techniques that compromise customer privacy. Since early 2004, MSN has offered technology to block pop-up ads, and similar capabilities

are part of Windows XP SP2. Our e-mail offerings that target spam, by default, also do not display pictures embedded in e-mails. Consumers must affirmatively click on a picture or graphic to see it.

FISCAL YEAR 2004 UPDATE ON PRIVACY

Technology	
Filtering spam	We have integrated our SmartScreen Technology into Hotmail, MSN Mail, Office 2003, and Exchange Server 2003 to filter spam. We also are working with industry to develop a standard, Sender ID, to enable legitimate senders to more clearly distinguish themselves from spammers.
Detecting spyware	The new security features in Windows XP SP2 and MSN also help frustrate spyware. Customers are given more robust control over the pop-ups and downloads that often are used as delivery vehicles for spyware.
Frustrating phishing	The Sender ID technology mentioned above will frustrate spam, but is particularly well suited to helping deter phishing attempts.
Windows Error Reporting	To improve product reliability, we continue to rely on advanced error-reporting technology in Windows XP and Office XP. The tools detect product failures and offer customers the opportunity to report these details to Microsoft. This reporting is subject to clear and conspicuous notice, customer choice, and customer access to the information before transmission.
Radio Frequency Identification (RFID)	Through our internal Microsoft RFID Council and ongoing engagement with RFID standards body EPCglobal, we are actively committed to supporting the development of RFID standards and solutions that also address privacy considerations around the use of this technology.
Government Partnerships	
Supporting anti-spam legislation	Throughout fiscal year 2004, we worked with industry partners and legislators in developing laws that prohibit fraudulent and deceptive e-mail practices, not only in the U.S., where new anti-spam legislation garnered significant attention, but also within the EU and in Australia, New Zealand, China, Hong Kong, Japan, Korea, India, Malaysia, and Singapore. More broadly, Microsoft remains engaged with government officials — both bilaterally and in the context of multilateral groups such as APEC — to help create the appropriate legislative infrastructure for privacy protection.
Prosecuting spammers	Microsoft devotes substantial resources to support civil and criminal enforcement against the most harmful spammers. By the end of fiscal year 2004, we had filed over 90 enforcement actions in 14 countries. Through lawsuits, we have been awarded \$79 million in damages. We refer the most egregious cases to law enforcement officials in those countries where strong anti-spam statutes exist or where spammers can be pursued under other laws or regulations. We have pursued lawsuits in the U.S., Europe, and Asia. In fiscal year 2004, we also sent almost 200 cease-and-desist letters to spammers as an initial warning.
Spyware	Throughout fiscal year 2004, Microsoft worked closely with legislators in various jurisdictions as they contemplated, and in the case of California, passed, anti-spyware legislation. We testified before the U.S. Congress and Federal Trade Commission on the topic, and we have been working with law enforcement officials. In fiscal year 2004, we sent 30 notifications to ISPs, indicating that they appeared to be hosting spyware distributors.
Phishing	Our internal Internet Safety team is working on prosecutions, both civil and criminal, to combat phishing as well. In fiscal year 2004, we sent over 350 notifications to ISPs, indicating that they appeared to be hosting phishing sites.

FISCAL YEAR 2004 UPDATE ON PRIVACY (CONTINUED)

Industry Partnerships	
Anti-Spam Technical Alliance (ASTA)	Microsoft and ASTA members (AOL, British Telecommunications plc, Comcast Corporation, EarthLink, and Yahoo!) continue to work together to drive technical standards and promote collaboration in the development of industry guidelines to address the spam problem. ASTA has taken the lead in promoting the aforementioned Sender ID standard, but the organization also has published a host of recommendations for the industry on best e-mail practices.
Other anti-spam coalitions	As part of our global effort to marginalize spam, we also have co-founded industry anti-spam coalitions around the world. For example, Microsoft helped to spearhead the formation of a new coalition devoted to addressing the spam problem in Hong Kong and elsewhere in Asia, through public policy leadership, training, and other activities. Other coalition members include Time Warner, the Hong Kong Internet Service Provider Association, the Asia Digital Marketing Association, MessageLabs, and Global Orient. Microsoft has helped to form similar coalitions in Israel and Japan.
2004 China Internet Conference and International Anti-Spam Summit	In September 2004, Microsoft, eBay, Yahoo!, AOL, and the Internet Society of China co-sponsored a multinational summit in Beijing on how to improve coordination in reducing spam. The event culminated in the signing of a memorandum of understanding among the co-sponsors that calls for ongoing collaboration in combating spam in China.
Anti-Phishing Working Group (APWG)	As a member of APWG, Microsoft is actively engaged with other industry leaders to help reduce the threat of phishing attacks by developing and sharing information about the problem and promoting the visibility and adoption of industry-wide solutions.
Center for Information Policy Leadership	Microsoft has been participating in the Center's "Short Notices Program." The program's goal is to develop consumer-friendly privacy summaries, so that consumers can quickly grasp key privacy disclosures. We are piloting these notices in Europe and Hong Kong in fiscal year 2005.
Education	
Re-launching of consumer information on Microsoft.com and MSN.com	In fiscal year 2004, the company significantly revised and re-launched its two primary consumer-education portals, http://www.microsoft.com/athome/security and http://security.msn.com . Both sites have been translated into 19 languages and are available in almost 40 countries. The sites contain information on spam, phishing, ID theft, spyware, and helping protect your privacy. They also address child safety and other security concerns.
MSN's spambuster site in the EU	MSN's European offices collaborated in developing a site exclusively dedicated to informing consumers about how to help protect themselves from spam. It is available in 15 markets and 10 languages. See http://www.msn.co.uk/gen/antispsites.asp .

Our latest initiative is to reduce the threat of spyware — software programs that are deceptively downloaded onto your computer. They can launch a barrage of ads, track your surfing habits, or consume computing cycles without your knowledge. Windows XP SP2 includes capabilities aimed at making it easier to detect spyware.

The previous table summarizes these activities as well as other highlights from fiscal year 2004.

We recognize that there is still more work to do. Privacy is not only about preventing intrusive conduct. It is also about enabling customers to control the collection, use, and distribution of their personal data. Microsoft has long been committed to providing customers with that degree of control. Microsoft's own privacy policy is to never sell, rent, or lease customer lists to other companies.

Improving the transparency of data management practices has been a challenge, not only

at Microsoft but throughout the industry. Privacy policies are notorious for their length and complexity. We are not there yet, but we have simplification clearly in our sights. Windows Media® Player 9 might be considered an industry best practice in this regard. It offers consumers, in plain language, the ability to make privacy choices before running online video and audio files.

While we work to simplify the privacy choices our services make available, we simultaneously are working on a more all-encompassing, industry-wide answer. In fiscal year 2005, we hope to join industry partners in announcing a standard for “short notices” — privacy notices that would condense lengthy privacy statements to their key terms and display them in consumer-friendly language.

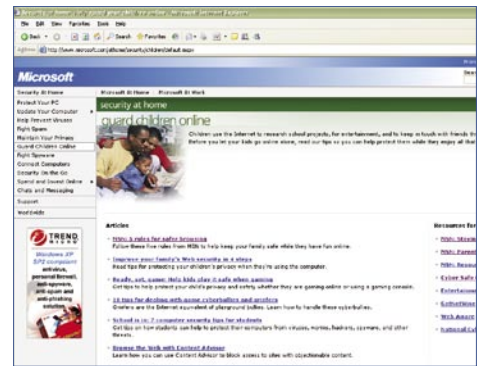
Protecting Children Online

Protecting children online is a particularly challenging issue because predators use both technical and social engineering to mask their intent. Compounding the problem, parents and other caregivers are often unfamiliar with the child-safety software tools available to them. Microsoft is committed to doing its part to contribute to the safety toolbox. As we look at gaps to be filled, we see a continuation of the themes described above. Technology providers such as Microsoft need to continue to simplify and improve upon the tools they offer. At the same time, there has to be more widespread understanding of how to use those tools.

Microsoft does not specialize in the creation of child-protection tools. But we do our part. The spam filters, pop-up blockers, and picture blockers mentioned previously also help provide a layer of protection for children. The controls we have had in Xbox since its launch enable parents to limit children’s access to inappropriate games. Most recently, since Windows XP enables consumers to set up separate user accounts, parents can establish unique accounts for their children and invoke



MSN Stay Safe Online site
<http://www.staysafeonline.com/>



Security at Home: Child Safety Online site
<http://www.microsoft.com/athome/security/children/default.msp>

Windows Content Advisor capabilities to limit children’s access only to sites they approve.

Early in 2004, MSN released Microsoft’s most sophisticated parental controls to date. Those tools, available via MSN Premium Service and MSN Internet Access, enable parents to choose categories of content they do not want their children to view, including pornography, weapons, alcohol, hate speech, drugs, and violence. A weekly activity report sent to parents shows a record of each child’s Web site visits, the sites they attempted to visit before being blocked, the people to whom they sent e-mail or instant messages, the total amount of time spent online, and any files they downloaded or attempted to download to their MSN e-mail account.

We also work closely with law enforcement officials worldwide in the investigation, pursuit and prosecution of child predators, and com-

FISCAL YEAR 2004 UPDATE ON CHILDREN'S SAFETY

Technology	
MSN Premium and MSN 9 Internet access parental controls	The parental controls launched in January 2004 as part of MSN's subscription services are some of the most sophisticated available. They enable parents to choose categories of content they do not want their children to view and to supervise their online activities.
Xbox Parental Controls	Xbox has long supported parental controls that limit access based on game and DVD movie ratings. It also supports reporting and privacy features. In December 2003, WiredSafety.org bestowed its inaugural 2003 Safe Gaming Award to Xbox.
Child Exploitation Tracking System	Over the course of fiscal year 2004, Microsoft Canada has been developing an online tracking and database solution to help any law enforcer across Canada keep tabs on child pornographers and alleged abusers who use the Internet to prey on children. A beta trial of the program is expected in early 2005.
Closure of MSN chat rooms in 28 countries	In an effort to reduce abusive behavior online, in September 2003, MSN closed its free chat rooms in much of Asia, Latin America, and Europe. Chat rooms remain open as part of subscription services in the U.S., Canada, Brazil, and Japan, where MSN has billing relationships that enable it to track abusers if need be.
Government Partnerships	
Law Enforcement and ISP Alliances	We have partnerships with law enforcement agencies and Internet service providers (ISPs) in 15 countries to develop initiatives designed to stop child exploitation over the Internet.
International Training Conference Series	Microsoft sponsors an International Training Conference Series that focuses on investigating and bringing to justice people who use the Internet to disseminate child pornography and prey upon children.
Investigating spam	Microsoft has worked closely with the Royal Thai Police on several investigations involving pornographic spam directed at MSN Hotmail customers in that country.
Training of law enforcers who focus on crimes against children	In cooperation with the International Centre for Missing & Exploited Children and Interpol, Microsoft sponsors training for law enforcement around the world. As of November 2004, nearly 500 law enforcement officers from over 90 countries have been trained. The sessions have been held in France, Costa Rica, Brazil, South Africa, Croatia, and Hong Kong. Future sessions are planned for other countries.
Policy and law enforcement	When MSN receives a report of inappropriate content or behavior on any MSN Web site or service, the report is investigated and appropriate action is taken in a timely manner. Appropriate action can include closing down a Web site, closing a chat room or a group, terminating a subscription account, or involving law enforcement. Reports are reviewed on a 24-hour basis.
Australia's "Operation Auxin"	In Australia, Microsoft helped provide law enforcement with information to assist "Operation Auxin," which ultimately led to 150 people being charged with more than 2,000 offences, including child sex tourism, child abuse, and downloading, possession, and distribution of child pornographic images.
Industry Partnerships	
Internet Watch Foundation	MSN UK has been a sponsor of this industry partnership since its inception in 1996. The organization offers citizens a single point of contact for handling allegations of unlawful Internet content, especially child pornography. In fiscal year 2004, Microsoft supplemented its annual dues with funds used to upgrade the organization's computer systems.

FISCAL YEAR 2004 UPDATE ON CHILDREN'S SAFETY (CONTINUED)

Education	
WebSafeCrackerz.com	In May 2004, MSN UK along with several U.K.-based NGOs helped launch this new online safety site designed by teens and for teens to help them understand the importance of safe surfing.
BeWebAware.org	Microsoft Canada joined industry and government partners in launching this online education site. Web hits are averaging 40,000 per month.
GetNetWise.org	Originally launched in 1999, Microsoft and industry partners sponsored the updating and re-launch of this U.S.-based safety site in July 2003.
Hector's World	Microsoft New Zealand is collaborating with an NGO, NetSafe, to develop an online safety site and a range of additional materials for children in New Zealand. Launch is expected in fiscal year 2005.

puter-facilitated crimes against children. For example, in Canada we are working with several police agencies to develop a database tool that will enable them to rapidly share information on child predation incidents and suspects. Microsoft supports law enforcement officials worldwide in the investigation and prosecution of computer-facilitated crimes against children.

Microsoft is also looking at novel ways in which to partner with law enforcement and other members of our industry to help teach children how to recognize and address Internet safety issues. In New Zealand, for example, Microsoft is working with the Internet Safety Group to develop a cartoon dolphin named Hector, which children can click on when they encounter something online that makes them uncomfortable. By clicking on the icon, a transparent Hector screen saver is layered over the screen with instructions for the child to get an adult.

The previous table summarizes the highlights of our fiscal year 2004 activities in this area.

Ultimately, consumer education is probably the most important aspect of this issue and the one in which Microsoft aims to do more during fiscal year 2005. Just as adults need to educate children to avoid strangers and dangerous places, adults need to be concerned and conscientious about overseeing children's Internet behavior. They need to stay engaged until they are comfortable that children can take care of themselves on the Internet.

Preventing Other Types of Harm

Unfortunately, criminals are very creative in finding new ways to use the Internet to deceive and harm consumers. The proliferation of spam, for example, has sparked the latest trend called "phishing." Phishing scams are spread through spam e-mail messages that provide recipients with a link to a phony Web site designed to resemble the site of a legitimate and usually well-known company. Consumers are instructed to enter personal information such as credit card, bank account, or PIN numbers. Equipped with such information, criminals can easily perpetrate fraud.

Here, too, Microsoft is pursuing a multi-pronged approach. We are working with local banking authorities, the financial services industry, and law enforcement officials worldwide to track down and prosecute perpetrators. In early fiscal year 2005, we joined Amazon.com in filing multiple lawsuits against alleged phishers who had used the two companies' brands and trademarks to defraud consumers. We provide consumers tips on how to manage the threat of phishing on our consumer safety sites on Microsoft.com and MSN.com. We are sponsors of the Anti-Phishing Working Group, an industry association that promotes consumer education and industry-driven solutions to the phishing problem. And most significantly, we have been leading the development of an Internet Engineering Task Force standard called Sender

ID, which if widely adopted could significantly reduce the effectiveness of phishing.

Sender ID is an e-mail authentication technology that helps address the problem of domain name spoofing — a common phishing tactic — by verifying the domain name from which the mail is sent. While it does not explicitly prevent spam or phishing scams from being initiated, it does make them much easier to detect because it provides a more reliable answer to the question, “Who actually sent this message?”

Our investment in the technology is significant for an additional reason. As is widely known, Microsoft has made patent claims in some of the underlying Sender ID technology. Not wanting those claims to impair deployment, however, Microsoft is making the technology available on a royalty-free basis. In early fiscal year 2005, we sat down with those who had continuing concerns about the standard and, in response, revised the proposed specification to offer adopters a range of implementation choices. If the industry widely adopts the standard, as we hope, we may see a significant decrease in the impact of phishing in the coming year.

Public Policy Leadership

The policy issues spawned by the rapid uptake of the Internet are of global interest. As a corporate leader in the global community, we see it as our responsibility to engage in national and regional dialogues on the issues of the day. Over the course of the past several years, we have been increasing the size of our government relations teams to meet this need. To provide some sense of how responsive we have been to the growing need for public policy engagement, consider this: Microsoft did not open a government affairs office in Washington, D.C., until 1995; less than 10 years later, we have government affairs representatives in almost 40 countries.

Our work with governments around the world on joint efforts to reduce spam and other Internet abuses has led to significant improve-

ments in Internet safety and security for consumers and businesses alike. For example, we supported the CAN-SPAM Act in the United States, which was enacted in January 2004. This law significantly expands the tools available for curbing fraudulent and deceptive spam, targets the practices of spammers that most invade consumers’ privacy, and extends protection to consumers nationwide with strong civil and criminal penalties.

We also consulted with the European Union (EU) and its member states to draft and implement anti-spam laws that prohibit fraudulent and deceptive behavior within the EU. In addition, Microsoft has been actively involved in shaping anti-spam legislation across the Asia Pacific region. Microsoft has worked closely with government and industry bodies in Australia, New Zealand, China, Hong Kong,



Information security class at Kaetsu Girls High School, Tokyo, Japan

Japan, Korea, India, Malaysia, and Singapore to promote effective legislation to stop spammers and prevent spam-related crimes.

Like many large, multinational corporations, Microsoft works on public policy matters in conjunction with industry partners and NGOs. We are active participants in information and

communications technology (ICT) trade associations around the world. And we seek increasingly deep relationships with officials at



IT Caravan — Bilisim Kervani Roadshow, Ankara, Turkey

international organizations such as the United Nations; global and regional development banks such as the World Bank and the Asian Development Bank; the Organisation for Economic Co-operation and Development (OECD); the Organization of American States (OAS); and the Asia-Pacific Economic Cooperation (APEC). In December 2003, Microsoft participated in the United Nations World Summit on the Information Society (WSIS) in Geneva, showcasing a "Partners in Potential" panel that featured global and regional NGO partners across five continents.

For several years, Microsoft also has sponsored global and regional Government Leaders Forums. These are efforts to bring together information technology leaders from business and government to discuss how technology can improve government services, as well as how government and the business sector can collaborate in addressing other social needs.

We are gratified that government leaders in many nations periodically seek Microsoft's views on important public policy issues. Our

business leaders and technologists have a measure of expertise in describing the path of innovations and how policy judgments can impact the course of technology development. This is especially true with respect to the security- and safety-related matters described above, which can be both technologically complex and rapidly evolving.

While the company tries to be helpful to lawmakers who raise any technology-related matter, aside from safety issues we pursue policies that promote continued innovation in information technology and the benefits that flow from it. More specifically, as a company whose products would not exist but for the protections they are afforded by intellectual property laws, we support the adoption and enforcement of such laws. Like most innovative companies, Microsoft maintains a diverse portfolio of intellectual property, including copyrights, trademarks, trade secrets, and patents. Strong intellectual property laws assure that innovators can continue to invest in new technologies, fostering broader benefits for the general population.

Access to international markets also fuels innovation. We therefore support both bilateral and multilateral trade agreements that open private and government markets, and that improve the level of intellectual property protection. Agreements recently concluded between the United States and Singapore, Chile, Australia, Bahrain, and U.S. trading partners in Central America are positive steps in this regard.

We oppose government-imposed preferences for any particular software development or licensing model. We believe governments should maintain neutral procurement practices and select software on its merits. Similarly, governments should not freeze innovation by mandating use of specific technology standards. Competition and interoperability are enhanced when standards-setting processes are open, industry-led, and consensus-based.

Not least of all, we are very conscious of the competitive concerns some government officials have about the popularity of the Windows operating system. Our commitment to comply with competition laws is discussed

more fully in the Responsible Business Practices section of this report. As mentioned there, this is part of our broader commitment to work productively with our customers, partners, and government officials worldwide.

NEXT STEPS FOR FISCAL YEAR 2005

- Work with our partners to increase consumer awareness of how they can help protect themselves online
- Continue to improve the security features of our products
- Enhance our internal security practices
- Simplify the consumer experience
- Expand our collaboration and partnerships with law enforcement authorities to pursue online criminals

Digital Inclusion and Education

Microsoft was founded on the belief that technology — if made accessible, affordable, and easy to use — can empower people, communities, and even entire nations to pursue their dreams and realize their full potential. But we recognize that for millions of people, the promise of technology is still unrealized. We've therefore made a comprehensive commitment to promote digital inclusion, and to help address inequities in access to technology tools, skills, and innovation.

Overview

Microsoft knows that access to technology is only part of the answer. It is equally critical to provide ICT skills training, tools, and guidance to help people discover what technology can do for them, and what they can do *with* technology. Our global digital inclusion efforts seek to:

- Make software more available and accessible
- Promote digital literacy
- Create economic opportunity through our products and services

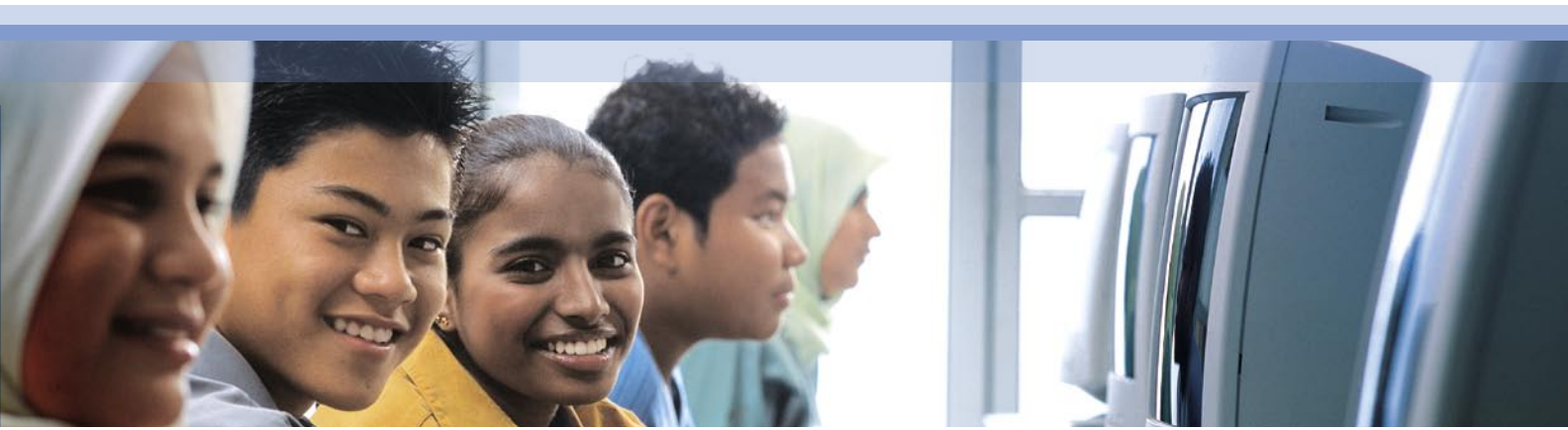
To address this set of needs, Microsoft has created two programs — Partners in Learning and Unlimited Potential — that are dedicated to providing technology resources and training in schools and through community technology learning centers (CTLCs) or telecenters.

Partners in Learning

Microsoft's Partners in Learning program aims to increase access to and build capacity for the use of information and communications technologies by educators and students (see the India case study on page 50). Partners in Learning consists of three programs: Partners in Learning grants, Fresh Start for Donated Computers, and School Agreement Subscription Licensing Program.

Partners in Learning Grants

Through Partners in Learning grants, Microsoft is investing \$253 million, from 2003 through 2008, aimed at delivering technology skills training to students and teachers. Partners in Learning funding also supports the establishment of local ICT Academy Centers through joint partnerships with local advisory boards, education institutions, and training providers.



Computer Training, Malaysia

In addition to the \$253 million, Microsoft is also making a curriculum available for schools that are seeking to integrate technology and technology skills instruction into the classroom. The Partners in Learning curriculum provides lesson plans and materials for five courses totaling 200 hours of instruction. It can be adopted in its entirety or customized by ministries of education, school administrators, or teachers to meet local education priorities. Courseware includes instruction guides and grading rubrics for teachers, as well as classroom materials for students.

In August 2004, 72 people from 13 countries in Asia received training on how to customize the curriculum to meet local education needs and how to prepare teachers to successfully use the courses in the classroom. Attendees included representatives from ministries of education, training organizations, and curriculum development agencies. The curriculum is already being piloted in Malaysia and Indonesia; by early 2005, training participants are expected to conduct additional pilots in Australia, India, Korea, the Philippines, Singapore, Sri Lanka, Thailand, and Vietnam. Similar training sessions will also take place in Latin America, Europe, the Middle East, Africa, the United States, and Canada.

Fresh Start for Donated Computers

Donated computers are an economic necessity for educational programs around the world. Microsoft's Fresh Start program helps schools make the most of donated computers by pro-

viding a licensed copy of the Windows 98 and/or Windows 2000 operating systems for donated PCs (Pentium II or older) at no charge. (Older PCs are not capable of running the Windows XP operating system.)

School Agreement Subscription Licensing Program

Participating primary and secondary schools receive free upgrades to Windows XP Professional for both new computers and computers already in the classroom as well as dramatically reduced pricing for the professional version of the Office productivity software suite. This program is not currently offered in the United States.

IN FISCAL YEAR 2004:

- Entered into Partners in Learning agreements with governments in 64 countries
- Published a five-volume Partners in Learning curriculum, and began localization efforts
- Provided licensed copies of Microsoft Windows for approximately 2.8 million PCs at 15,676 schools through the Fresh Start for Donated Computers program

Unlimited Potential

Microsoft Unlimited Potential (UP) aids global workforce development by providing technology skills training through community technology learning centers (case study on page 54).

PARTNERS IN LEARNING: BRINGING TECHNOLOGY INTO THE CLASSROOM

The Government Inter College (GIC) Dakpathar is on the banks of the river Tons in the district of Dehradun, the capital of Uttaranchal state in India. The school was started in 1972 to help educate economically disadvantaged students, and now serves 1,500 students with 31 teachers and 11 official staff. Classes are taught in Hindi.

The computer lab at GIC Dakpathar was established in 2002 after the Indian government introduced computer education in schools. While the computer lab gave GIC Dakpathar teachers and students access to technology, the school still faced the challenge of helping the

faculty integrate information and communications technology (ICT) into their teaching and transfer ICT skills to their students.

When the first Microsoft IT Academy was launched in December 2003 as part of Project Shiksha, a Microsoft Partners in Learning initiative in India, two teachers from GIC Dakpathar attended the accelerated training program, an in-depth 15-day course that focuses on project-based learning and training teachers to use technology effectively in the classroom.

The task-based Project Shiksha training uses the *I Do, We Do, You Do* method: *I Do* is when the trainer teaches; *We Do* is when the trainer and trainees work together; and

Unlimited Potential promotes digital literacy through four critical components: Unlimited Potential Grants, Software Donations, Unlimited Potential Curricula, and Community Technology Support Network.

Unlimited Potential Grants

UP grants are made to NGOs that support CTLCs and are used to enhance and enrich technology access and training opportunities. For example, Microsoft teamed with the United Nations Development Programme (UNDP) to equip ten CTLCs in Morocco as part of an agreement the two organizations entered into in January 2004. The agreement followed a successful pilot project that is now helping to

build a pool of skilled ICT professionals in war-torn Afghanistan, providing technology access and skills training to 12,000 Afghan citizens annually at 16 regional centers.

By offering skills training and other resources to students, entrepreneurs, and adult men and women at CTLCs in developing countries, the collaboration between Microsoft and the UNDP will benefit the world's poor by helping communities cultivate the skills required for success in today's information society, and encourage the exploration of creative, technology-based solutions to many of the world's most pressing development challenges. For example, Microsoft and the UNDP also agreed to work together in support of UNDP's Southern Africa Capacity Initiative (SACI), which is exploring the innovative use of technology to build capacity, facilitate e-government initiatives, and improve the delivery of basic services in countries most adversely affected by the HIV/AIDS pandemic.

Another example of how the Unlimited Potential program is helping people worldwide is Microsoft's work with the Korean Agency for Digital Opportunity and Promotion (KADO) to reduce the national information gap by putting the benefits of ICT at everyone's fingertips. The objectives of the Silvers UP program with KADO are to bridge the digital divide between the generations in Korea by providing information technology training for seniors, and to create digital opportunities for renewed participation in Korean society. The program is



Vivian Tsamadou, Public Relations Manager, Microsoft Greece, at Organization of Youth and Sports CTLC, Athens, Greece

You Do is when the trainee works independently on assigned exercises. As a result of the training, teachers at GIC Dakpathar are using PowerPoint® presentations and other information technology in their classes, the school is creating a Cyber Library of educational CDs, and students are doing assignments by searching the Internet and resources such as Microsoft Encarta®.

The results are remarkable. Students' test scores have increased as their subject matter comprehension and retention have improved, and the entire learning process has become more vibrant. Instead of depending solely on their teachers for learning material, students now gather information independently, analyze it, and draw conclusions. In

addition, enrollment has increased while absenteeism and drop-out rates have declined.

The school also reports that the benefits of widespread computer use have extended beyond the classroom to help automate and streamline many administrative tasks, which has increased staff efficiency by reducing the time and effort required for administration.

expected to reach 100,000 seniors in five years by increasing KADO's current Silvers program to 20 additional CTLCs. In addition, the grant will support several teams of KADO's ICT volunteers, who will be deployed to assist CTLCs in developing countries.

Software Donations

Our worldwide software donations program provides community-based technology and learning centers access to the most current productivity applications necessary to compete in the global economy.

Unlimited Potential Curricula

UP Community Learning Curricula provide quality content for the community (non-matriculating) learner that focuses on skill development in the areas of beginning information, technology and computer literacy, and preliminary technical certification preparation. The training emphasizes real-world applications and may be modified and/or reproduced by CTLCs, their instructors, and students to enhance local learning programs.

Through partnering with an IT Volunteer Program for Battered Women in Japan, for example, Microsoft has worked to provide basic ICT skills training to women living in shelters around Tokyo and to aid them in finding employment opportunities. During the first two years, more than 600 people participated in basic ICT skills training courses, nearly 40 people successfully got jobs, and five people earned Microsoft Office Specialist certification. Initial

support from Microsoft Japan included cash, hardware devices, and software. Our most recent grant to this organization supports enhanced goals and a new NPO partner — Wing 21 — whose expertise is providing ICT skills training to increase job opportunities as well as consulting on how to find a job. Over two years, the project will reach approximately 400 underserved women, including many victims of domestic violence.

Community Technology Support Network

Microsoft works with other interested parties — such as Canada's International Development Research Centre (IDRC), one of the world's leading institutions in generating and applying new knowledge to meet the challenges facing developing countries — to create a community-based technology support network to deliver curricula, research results, tools, and services to local technology and learning centers worldwide.

Digital Inclusion: More information about Partners in Learning, Unlimited Potential, and other programs related to Digital Inclusion and Education at Microsoft is available at <http://www.microsoft.com/mscorp/citizenship/>.

IN FISCAL YEAR 2004:

- 177 Unlimited Potential grants distributed — totaling \$56.8 million in cash, software, and technical assistance — to CTLCs and organizations supporting CTLCs
- Unlimited Potential curriculum released in English, German, French, and Spanish
- Unlimited Potential expanded to 78 countries since the program began in late fiscal year 2003

For more information about Microsoft Learning, see <http://www.microsoft.com/learning/default.asp>.

Microsoft Innovative Teachers

To help educators further their professional development as well as learn from and inspire one another, the Microsoft Innovative Teachers program promotes the creation of exemplary practices, awards software grants, and gives educators access to online learning communities.

IN FISCAL YEAR 2004:

- More than 20,000 educators participated in the Innovative Teachers program. The program is now available in 26 countries.

Microsoft Learning

Microsoft offers training designed to build consumers' skills on Microsoft products and technologies. Training is offered in a variety of formats, including traditional classes as well as online courses. Additionally, consumers can learn about Microsoft certifications, take practice tests, and register for exams.

Software Availability and Accessibility

Despite incredible advances in innovation and the proliferation of personal computers over the past decade, 90 percent of the world's population still lacks access to the technology tools they need to compete in today's "knowledge economy." To address this issue,

UNLIMITED POTENTIAL AND PARTNERS IN LEARNING

Shaded areas represent countries where Unlimited Potential and/or Partners in Learning is being implemented in one or more locations. (as of June 30, 2004)

- Unlimited Potential
- Partners in Learning
- Unlimited Potential and Partners in Learning



Microsoft is actively partnering with NGOs, governments, and others to find innovative product and/or community investment strategies that can increase technology access and software availability for individuals and communities around the world.

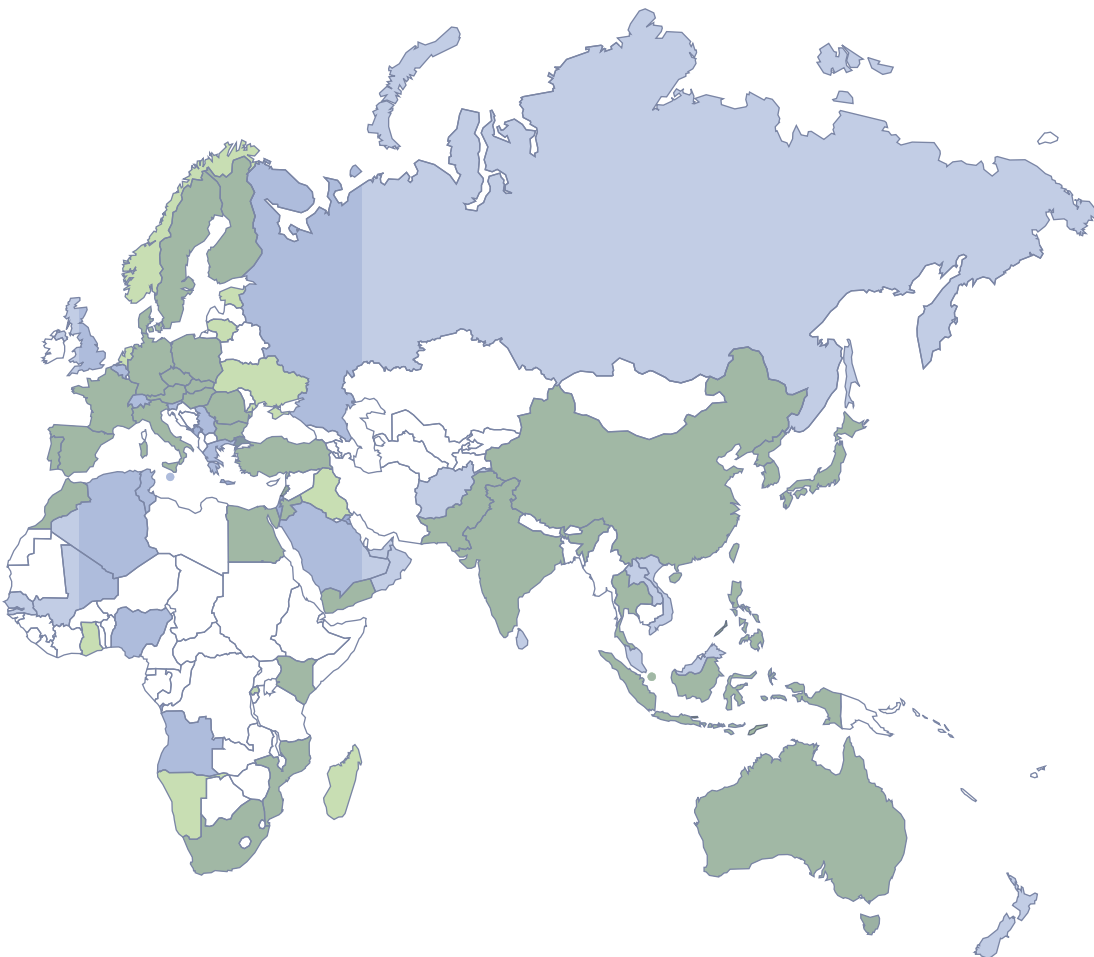
Local Language Program

Launched in March 2004, the Local Language Program is a global Microsoft initiative to build partnerships with governments, universities, and local language authorities to develop language localization resources for Windows XP Home, Windows XP Professional, and Office 2003 Standard Edition. (See the case study about the origin and execution of the Local Language Program on page 56.)

Using Web tools provided by Microsoft, sponsoring groups and volunteer translators can develop community glossaries of standardized technical terminology. These glossaries in turn provide the foundation for Language Interface Packs (LIPs), which provide computer users the ability to adapt their copies of Windows and Office to display many commonly used features in their local language.

When complete, each new Language Interface Pack is available as a free download from the Microsoft Download Center and may also be distributed by participating third parties such as governments, local language authorities, and universities. Through this collaboration,

Microsoft Language Interface Packs may be downloaded free of charge at <http://www.microsoft.com/resources/government/LocalLanguage.aspx>.



UNLIMITED POTENTIAL: A LIFE RECLAIMED

Marcos Antônio Nascimento da Silva had a hard life growing up in Brazil. His father was arrested for robbing a motel when Marcos was eight years old, and his mother was a drug addict. When his father was sent to prison, his mother abandoned Marcos and his brother and sister, so their grandmother took them in.

Marcos was only 17 when he learned that he was about to become a father. He stole a car to raise some money, but was arrested and sent to FEBEM, an institution for young offenders. That's when his life started to change for the better.

At FEBEM, Marcos enrolled in a course on information technology, sponsored by the Committee for Democracy in Information Technology (CDI), a non-governmental organization that aims to foster the social inclusion of people from less privileged social groups by using information and communications technology to encourage active citizenship. The class was taught by volunteers who were employees of PricewaterhouseCoopers (PwC), and Marcos made such a good impression that PwC had a job waiting for him when he was released.

Today, Marcos is doing well in his job at PwC and he adores Fernanda, his three-year-old daughter, who was born when he was at FEBEM. He says Fernanda is the

many people around the world will be able to work with PCs — some for the first time — in their native languages.

Besides making technology and its benefits more readily available to people in many different languages, the Local Language Program is also helping to preserve many native and indigenous languages and cultures by making it easier for people to continue working and learning in their native languages.

IN FISCAL YEAR 2004:

- Increased the number of Language Interface Packs available to more than 20:
 - Windows XP (Home and Professional Editions) — Basque, Bulgarian, Catalan, Croatian, Estonian, Hindi, Indonesian, Latvian, Lithuanian, Malay, Persian, Romanian, Serbian (Cyrillic/Latin), Slovak, Slovenian, Spanish on Tablet PC, Thai, Ukrainian, and Vietnamese
 - Office 2003 — Catalan, Hindi, Nynorsk, Serbian

Windows XP Starter Edition: Extra Help for First-Time Users in Developing Markets

Unchalee, an 18-year-old student in Bangkok, Thailand, attends a school that has only one personal computer for every 30 students. Like many students in her school, Unchalee and her family could not afford to have a PC at home. The one hour she was able to spend on the computer at school each week was enough to

help her learn basic computing skills, but she wanted more. Unfortunately, once she passed the final test for the course, she had to give up even her weekly hour of computer access and instruction so that other students could take the class.

Thanks to a pilot program sponsored by Microsoft in collaboration with the government of Thailand, Unchalee now has a Windows XP Starter Edition computer at home and is able to spend several hours each day learning new skills and exploring the Internet, which has introduced her to a new world of information. Her older brother, who had never touched a computer keyboard before, is also learning to use the machine.

Microsoft Windows XP Starter Edition is designed for first-time PC users in developing technology markets, offering them an affordable, easy-to-use version of the Windows operating system that is localized in their native language. The Windows XP Starter Edition pilot program began in 2004 with three markets — Thailand, Malaysia, and Indonesia. Microsoft will extend the program to Russia and India in early 2005.

The software will be available in the Thai, Malaysian, Indonesian, Russian, and Hindi languages and will ship on new low-cost desktop PCs. A supplemental CD includes local language instructional videos for first-time PC users. To assist those consumers even more, a redesigned Help system, called My Support,

reason he wants to go farther, both professionally and personally. He wants her to be proud of her father.

Founded in 1995, the CDI believes that learning new technologies not only creates job opportunities, but also expands access to knowledge and encourages social interchange. Currently, there are 833 autonomous and self-sustaining Information Technology and Citizens Rights Schools (ITCRS) using CDI methods in 11 countries: Brazil, Colombia, Uruguay, Chile, Mexico, Guatemala, Honduras, Japan, Angola, South Africa, and Argentina.

CDI headquarters is in Brazil and is responsible for helping each CDI regional office replicate the CDI model — and ensuring this is done to a high standard.

Microsoft has been deeply involved with CDI since 1999, and has donated almost \$6 million in cash and software — including a recent Unlimited Potential grant of \$300,000 — to help CDI build its infrastructure, expand its operations, and improve its services in Latin America. As a result of the organization's work, more than 536,900 people have been trained in information technology. In a recent evaluation, 86 percent of current and former students said that CDI schools had a positive effect on their lives.

includes a detailed Getting Started guide. The software also features country-specific images and screensavers with familiar landscapes, flags, and designs.

The settings for Windows XP Starter Edition are preconfigured, saving people time and trouble in setting up their computers. The Windows firewall is turned on by default to help make computing safer. The software also includes configurations that make it easier for novice users to organize their information and prevent accidental data loss.

PC Refurbishment

The Microsoft Authorized Refurbisher (MAR) donation program is designed to facilitate community ICT access and learning, and to lower the environmental impact of ICT hardware by enabling authorized PC refurbishers to reinstall Microsoft operating systems into donated pre-used PCs destined for schools, NGOs, and community centers. Through MAR programs in countries from Australia to Austria, Microsoft helps to facilitate the refurbishing and recycling of thousands of PCs every year by donating software licenses through NGO refurbishers, enabling schools and charities to take full advantage of personal computers they receive from donors.

In April 2004, we launched the Microsoft Authorized Refurbisher (MAR) program in EMEA, a new initiative implemented in 133 countries across Europe, the Middle East and Africa. The EMEA roll-out of the MAR program follows

successful pilots in Norway, the Netherlands, and the U.K., where through a four-year initiative 20 PC refurbishers provided more than 12,000 computers to community groups. In the final year of the U.K. pilot, more than 1,000 schools, colleges, and charities received refurbished PCs with authorized reinstallation of Microsoft software.

Software Donations and Discounts

The company also participates in a number of programs that enable NGOs to acquire Microsoft software at no charge, or at significantly discounted prices. For example, Microsoft is a founding partner of TechSoup, which is operated by CompuMentor, one of the oldest and largest NGO technology assis-

U.S.- and Canada-based NGOs that are interested in learning more about free and discounted software available through TechSoup can find more information at <http://www.techsoup.org>.



Guru school in Tarakan, Kalimantan, is one of our PIL program participants.

LOCAL LANGUAGE PROGRAM: PROBLEM NOTED, PROBLEM SOLVED

Over the years, Microsoft has localized its Windows and Office products into more than 40 languages and dialects, but there are hundreds of other languages for which Microsoft has not localized its products. Some of these languages are spoken by only a small number of people, so creating a complete localized edition of Windows or Office in those languages is not economically feasible. Others are spoken by millions of people, but in emerging markets that are just now looking to expand their IT infrastructure.

In late 2000, Bjorn Rettig, a Windows program manager, and Katya Lajintseva, a member of the Windows team based in Moscow, began discussing how localized versions

of Windows could be made available for various minority languages in eastern Europe. They envisioned a program that could be installed over the English operating system, yet could make many of the Windows commands and functions available in the local language. Teaming with a member of Microsoft's localization group in Ireland, they began work on the first Language Interface Packs (LIPs) for Windows and released the first languages — Romanian, Estonian, Latvian, and Lithuanian — in January 2002.

As the initial languages were released, the team began receiving requests from other regions. Customers were not only interested in LIPs for other languages, they also wanted similar localization for Microsoft Office. In response to these requests, an expanded team of representatives from

tance agencies in the United States. TechSoup.org is a Web site that offers NGOs a one-stop shop for their technology needs by providing free information, resources, and support. TechSoup Stock provides NGOs access to donated and discounted technology products, which have been provided by TechSoup partners.

IN FISCAL YEAR 2004:

- 40,000 software licenses valued at more than \$8.4 million donated to 180 organizations through the Microsoft Authorized Refurbisher program
- \$363.2 million in software donated to 11,000 qualifying NGOs

Accessibility

Microsoft strives to build products that are accessible and easy to learn and use. We are continually working to demystify technology and make it more accessible to people, regardless of their physical abilities, or their economic, cultural, or educational backgrounds.

Among the other innovations we continue to build into our products are a wide range of accessibility features that make it easier for people with physical or cognitive difficulties, impairments, or disabilities to use a computer and customize their work environment. We also work closely with companies that design and build assistive technology devices — such as screen readers that convert text to speech

for people who are blind or visually impaired — which run on the Windows platform and enable people with disabilities to perform a wide range of tasks and access information more easily. Accessible and assistive technologies are designed to help people with disabilities unlock their potential and optimize their abilities.

When Mumtaz Lakhani emigrated from East Africa to Canada in the 1970s, for example, she had a college degree in business administration and a severe visual impairment that made it difficult for her to find a job in her field because she was unable to use the computer systems at the companies where she applied. With the help of the Canadian Institute for the Blind, she found a job with RBC Financial Group, where her first assistive device was a handheld magnifying glass. Today, she uses a standard PC running Microsoft Windows XP and screen magnification software from Ai Squared, which gives her the same access to materials as her colleagues.

When Satoshi Fukushima was born in Kobe, Japan, in 1962, his world was like that of other children, filled with bright colors and the sounds of laughter and loving voices. But by age nine he had lost his sight, and by age 18 he had lost his hearing as well.

"When I describe my world, I use television as an example," Fukushima says. "A television that has no picture is in a state similar to that of being blind. A muted television is similar to the

For more information about the Microsoft Accessible Technology Group, see <http://www.microsoft.com/enable/aging>.

Windows and Office began discussions with customers, partners, and governments to better understand their unique localization needs.

During one such visit to the Ministry of Communications and Transport in Vietnam, Office team member Andy Abbar noticed that a receptionist had covered her PC with Post-it notes, each one bearing a handwritten message in Vietnamese. When Andy asked a colleague to translate, he discovered the receptionist's secret.

The note in the lower left corner of her computer screen translated as the word *Start*. In the upper left, there were notes bearing the Vietnamese words for *File*, *Edit*, and so on. When that receptionist left the office, another could benefit from the same notes. Andy realized these recep-

tionists had found a way to work around the language barrier and it reinforced the need for the Office team to participate with their own Office 2003 Standard Edition LIPs.

From the start Microsoft has recognized that the interfaces really belong to the individual linguistic communities, and we've made sure they are very involved in developing them.

These interfaces are in the public domain so that anyone, may use them to create additional software that will benefit linguistic communities. We believe the Local Language Program will help stimulate the growth of local software enterprises, help communities keep their languages alive, and extend the benefits of technology to more people.



Unlimited Potential Launch,
Tokushima, Japan

condition of being deaf. In my world, both the screen and sound are off."

Today, Fukushima is an associate professor in the Research Center for Advanced Science and Technology at the University of Tokyo, and a project director in the Barrier-Free Department. He relies on assistive technology to communicate with students and colleagues and to do his job.

Accessibility and the Aging Workforce

In fiscal year 2004, Microsoft's Accessible Technology Group launched an initiative to help aging workers, employers, and government officials understand how accessible and assistive technology could be used to help older workers and businesses keep their competitive edge.

People today are living and working longer, and lower birth rates in developed nations over the past few decades mean that there are fewer younger workers in those countries to replace those who do retire. For example, Japan's population is aging faster than that of any other country in the world; by 2050 an estimated 60 percent of the working-age population in the European Union will be over age 60; and by 2020, one in five U.S. workers will be older than 55 — an increase of more than 50 percent over 2000 when that age group accounted for only 13 percent of the U.S. labor force. Accessible and assistive technology can help businesses recruit and retain experienced employees, and help older workers

remain at peak productivity for as long as they choose to work.

Complex Humanitarian Emergency Response

Microsoft recognizes that the use of technology is becoming increasingly important in a broad array of relief and development efforts, and we are committed to providing assistance that can improve the efficiency and effectiveness of organizations involved in disaster relief and humanitarian assistance.

Helping countries quickly and effectively respond to disasters helps to promote economic, social, and political stability and reduce the impact on a community's vulnerable citizens. Microsoft funds projects that not only address immediate problems, but also demonstrate technology's role in long-term systemic improvements to disaster management. In fiscal year 2004, contributions to relief efforts totaled nearly \$400,000.

One example of our ongoing work in this area is our long-term partnership with the United Nations High Commissioner for Refugees (UNHCR), which started in 1999 when refugees began streaming out of Kosovo. Microsoft mobilized 100 employee volunteers and developed a mobile refugee registration kit that used technology to help half a million Kosovo refugees without papers establish their identities, a necessary first step to reuniting families, proving citizenship and property rights, and gaining access to health care and other vital

SPECIAL NOTE: Microsoft employees worldwide wish to express their deepest sympathy to the millions of people affected by the Indian Ocean tsunami.

As this report was going to press, the full extent of the devastation and destruction caused by this tragic event were still unfolding. In response to this horrific tragedy, the company committed an initial \$3.5 million in financial support for relief and recovery efforts. The donation included \$2 million in immediate corporate contributions to local and international relief agencies, and another \$1.5 million to be used to match employee donations around the world.

"The outpouring of concern and commitment from our employees has been phenomenal. Our people all around the world want to help," said Microsoft Chief Executive Officer Steve Ballmer. "If our employees contribute more than we are projecting, then our corporate donation would go up as well."

The corporate contribution is an extension of efforts already under way by local Microsoft subsidiaries in the affected region and around the world. Immediately following the disaster, local Microsoft offices began working in concert with local NGOs and other local efforts on the ground to provide financial donations, technical resources, and volunteer support.

Microsoft is committed to helping governments and relief organizations respond to the immediate needs associated with this crisis and explore ways to support the recovery and rebuilding of this region in the future.



Bill Gates in Beijing Experimental High School in China

services. Since then, Microsoft volunteers have improved and refined the registration kits and used them to help UNHCR register refugees in many other parts of the world.

In 2004, Microsoft employee volunteers worked with the UNHCR team in remote locations of Uganda, Sierra Leone, Kenya, Rwanda, Guinea, Sudan, and Tanzania. The company also agreed to establish community technology learning centers in Kenya and Russia, where refugees can learn technology skills that can help them succeed in their adopted homes.

IN FISCAL YEAR 2004:

- Contributions to relief efforts totaled nearly \$400,000. Grant recipients included the National Agency for Disaster Relief in the Democratic People's Republic of Korea, NetHope, UNHCR, UNICEF, the Chinese Red Cross, United Way International, the Mexican Red Cross, and Save the Children.

Employee Giving and Volunteering

Microsoft places a high premium on employee contributions and volunteerism. We encourage our employees to volunteer in their communities and to provide help and hope for those in

need, and they have responded by generously donating their time and money.

In April 2004, we launched the Employee Involvement Policy & Program (EIP) in EMEA, which offers our employees in Europe, the Middle East and Africa the opportunity to dedicate up to three workdays annually to a local community project. The program is entirely voluntary.

In the United States, Microsoft Giving is a tradition that goes back more than 20 years. Microsoft encourages its U.S.-based employees to contribute to one or more causes they care about, and then matches their donations dollar-for-dollar up to \$12,000 annually per employee. Employee donations qualify for the corporate match whether they are made during the annual Microsoft Giving Campaign, held every fall in the United States, or at other times during the year. The generosity of our employees has made Microsoft #1 in per capita employee giving among major companies in the United States.

IN FISCAL YEAR 2004:

- Microsoft U.S.-based employee donations, combined with the corporate match, totaled more than \$32.7 million in cash for NGOs.

More information about Microsoft Giving is available at <http://www.microsoft.com/mscorp/citizenship/giving>.

WORLDWIDE COMMUNITY INVESTMENTS FISCAL YEAR 2004 BY PROGRAM (PARTIAL LIST)

Program	Cash	Product	Total
Unlimited Potential	\$21,285,000	\$ 35,539,000	\$ 56,824,000
Partners in Learning	\$32,246,000		\$ 32,246,000
Corporate Headquarters, Washington State, U.S.	\$ 3,257,000	\$ 6,000,000	\$ 9,257,000
Corporate Match for Employee Giving	\$24,200,000	\$ 18,400,000	\$ 42,600,000
IT Support for NGOs	\$ 1,113,000	\$303,309,000	\$304,422,000
TOTAL	\$82,101,000	\$363,248,000	\$445,349,000

NEXT STEPS FOR FISCAL YEAR 2005

Partners in Learning

- Provide development opportunities for 500,00 teachers
- Provide technology or technology training opportunities to 5 million students
- Localize the Partners in Learning curriculum in 20 additional languages
- Expand Fresh Start for Donated Computers program to cover 500,000 desktops

Unlimited Potential

- Make substantial progress toward our goal of providing technology access and skills training resources to 250 million people worldwide by calendar year 2008
- Localize the UP curriculum into additional languages including Simplified Chinese, Russian, Arabic, and Brazilian Portuguese
- Launch the global support network in three regions

Local Language Program

- Release Windows XP and Office 2003 Language Interface Packs in approximately 34 additional languages

Economic Opportunity

Our commitment to corporate citizenship includes helping countries improve their global competitiveness and promote local economic growth and development. We help governments, communities, and businesses succeed by developing innovative products that meet customer needs, encouraging a partner-driven business model that creates opportunities for local companies, and investing in initiatives to improve technology access and skills development for people of all ages.

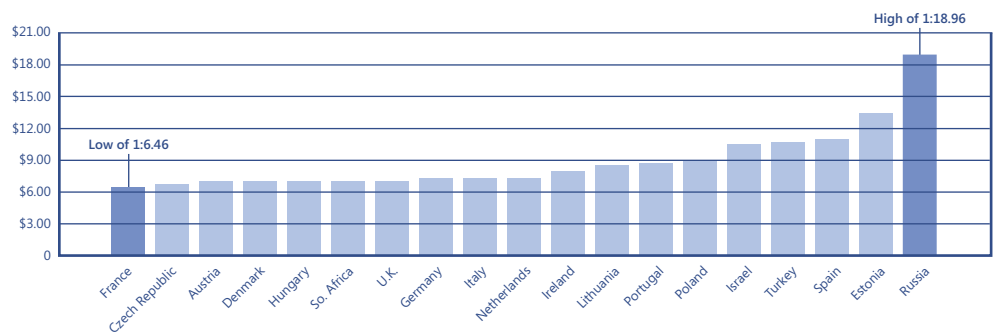
Overview

Microsoft works to help countries around the world put information and communications technology and software to use in ways that improve the social and economic well-being of local populations. Whether the goal is improving teaching and learning through technology, helping to create jobs, extending digital access to minority linguistic groups and people with disabilities, or increasing productivity levels and competitiveness, Microsoft works closely with governments, local partners, and NGOs to help countries reap the full benefits of ICT.

Microsoft Partnerships Around the World

At Microsoft, we focus on creating great software, and then work with an array of different partners around the world to accomplish most other tasks that are vital to our business. We know that our success depends in large part on our relationships with nearly 700,000 independent software vendors, system integrators, resellers, and other partners worldwide.

Microsoft-Related IT Spending per Dollar of Microsoft Revenue, 2004 (Calendar Year 2004)





Community technology learning center opening in St. Petersburg, Russia

In fiscal year 2004, approximately 96 percent of our revenue was generated by Microsoft partners. Our research shows that customers accept partner recommendations during 81 percent of all sales transactions. Partners also develop applications and create solutions for Microsoft products. At the same time, our partners also benefit from their relationships with Microsoft, and together we contribute significantly to local economic development.

A global study of 22,000 technology companies in 2001 found that Microsoft’s partners worldwide earn an average of \$8 in revenue for every dollar that Microsoft earns. That figure is consistent with a more recent study in 2004, which found that our partners in 19 countries throughout Europe, the Middle East, and Africa earn an average of \$7.50 for every dollar of Microsoft revenue. That ratio is lowest in France, where partner companies earn \$6.46 for every dollar of Microsoft revenue, and highest in Russia, where each dollar of Microsoft revenue generates \$18.96 for our partners.

According to an economic impact study by IDC, a global technology analyst firm, Microsoft-related employment accounted for 3.1 million jobs in 19 countries throughout Europe, the Middle East, and Africa in 2004. Overall, approximately 8.9 million people in those same 19 countries work in jobs related to information technology and software, a figure that is expected to grow to 11 million by 2008, an increase of 2.1 million jobs in just four years. During the same period, the packaged software industry in the region will grow from €61.3 billion (approximately \$82 billion) at the end of 2003 to €86.8 billion (approximately \$116 billion) in 2008.

Microsoft Partner Program

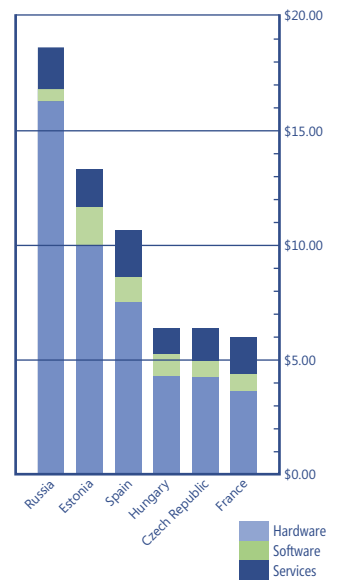
In fiscal year 2004, we launched the Microsoft Partner Program, which consolidated all of our existing partner programs into one new program and increased the tools and resources we provide to help our partners develop their businesses, increase their expertise, market their services, and retain customers.

The Microsoft Partner Program includes more than 36,500 member companies around the world. In fiscal year 2004, these firms attributed almost a third of their revenue growth to their affiliation with Microsoft. The success of Microsoft partners enables them to expand their businesses, create more jobs, and further stimulate their local economies.

In fiscal year 2004, Microsoft invested \$1.5 billion in training, support, and other resources for our partners. In fiscal year 2005, we will increase our investment in partners to \$1.7 billion. In addition, each of our global subsidiaries in fiscal year 2005 will allocate 35 percent of their global marketing funds to develop “through-partner marketing,” which will be done jointly by Microsoft and its partners.

In fiscal year 2004, we also launched Channel Builder, a combination of an online tool and offline events that enables Microsoft partners to collaborate and promote their offerings to other Microsoft partners. The main benefits of Channel Builder is that it helps our independent software vendor (ISV) partners build their sales channels; drive additional revenue through working with other Microsoft partners; extend their sales reach into new geographies; and make connections with system builders, system integrators, distributors, resellers, or other ISVs.

Microsoft-Related IT Spending by Sector of Microsoft Revenue, 2004 (Calendar Year 2004)



In fiscal year 2005, we will launch Microsoft Services Partner Advantage, a new global support offering for partners that is designed to meet the unique service needs of the Microsoft partner community. The new program provides our partners with direct access to Microsoft tools and internal resources to increase the efficiency with which they develop applications on Microsoft platforms, and deploy and support Microsoft products and technologies.

IN FISCAL YEAR 2004:

- 96 percent of Microsoft revenue was generated by Microsoft partners
- Microsoft-related employment accounted for 3.1 million jobs in 19 countries in EMEA
- Launched the Microsoft Partner Program, consolidating all existing partner programs
- Invested \$1.5 billion in training, support, and other resources for partners
- Launched Channel Builder, a tool enabling partners to collaborate and promote their offerings to other Microsoft partners

Our Products

Microsoft develops software products that are powerful yet easy to use. This enables millions of workers and entrepreneurs worldwide — not just technical experts — to harness the benefits of technology, take advantage of opportunities in the digital economy, and contribute to economic and social progress in their communities.

Interoperability

Besides making individual products easier for workers to use, Microsoft is committed to ensuring our software works well with many other platforms, applications, and systems, so that our customers won't have to spend a lot of money on systems integration. For many local businesses, governments, and NGOs, our commitment to interoperability improves information sharing, reduces the costs of

computing, and extends the benefits of their previous technology investments. (For more information on the interoperability of Microsoft technology, see page 24.)

Helping Our Customers Manage Complex Systems

Manageability is another priority for Microsoft. We are committed to reducing the complexity and cost of managing computer systems so that our customers can invest more of their resources into being more productive, improving service to *their* customers, growing their businesses, and competing globally.

Customers tell us that they would like to be spending no more than 55 percent of their ICT budgets on maintaining their existing infrastructure, with 45 percent earmarked for new projects. However, our research shows that most customers are spending as much as 70 percent to 80 percent of their ICT budgets to maintain their existing systems, which doesn't leave much money for new projects that could help them improve and grow their businesses. One reason for the difference between our customers' dreams and reality is that 60 percent to 70 percent of all management tasks today are either completely manual, or some combination of manual and home-grown processes.

In fiscal year 2004, in partnership with other technology leaders, Microsoft started making significant investments in the Dynamic Systems Initiative. The goal is to build a comprehensive set of solutions that helps to automate the design and management of increasingly complex and distributed computing systems. Doing this will free valuable resources, and make computing simpler and more cost-effective for organizations of every size.

Committed to Innovation

Finally, we invest heavily in research and development (R&D), because research is the key to integrated innovation, which helps our customers achieve maximum efficiency from all of their Microsoft software and get more from their ICT investments while lowering their total

cost of ownership. In fiscal year 2004, Microsoft spent more than \$7.7 billion on research and development.

Software is a small portion of the total cost of computing systems for most organizations. Microsoft's investment in software innovation frees customers from the need to rely on expensive computer consultants and services to keep their systems running smoothly. Several studies have shown that Microsoft software offers significant cost advantages over many competing products, which enables our customers to invest their resources in ways that will help their businesses grow. This is particularly important in developing economies, where working capital is often limited and businesses operate on thin margins.

IN FISCAL YEAR 2004:

- Began making significant investments in the Dynamic Systems Initiative in partnership with other technology leaders
- Invested more than \$7.7 billion in R&D

Our Business Model

At Microsoft, we employ a *low-cost, high-volume* business model that supports local economic development. From the beginning, we have built our business by creating inexpensive software that millions of customers can use without extensive training, services, and support. This approach enables local economies to harness technology sooner and compete globally. Our easy-to-use software also makes it possible for non-technical workers to start employing a wide range of technology productively without specialized training.

Protecting Intellectual Property

The Microsoft business model also embodies respect for the rights of innovative companies and individuals worldwide. To survive and grow, local ICT industries must be able to protect their innovations and reap the benefits from widespread use of the technology they

create. Protecting intellectual property rights and building local ICT industries and economies also enables governments to benefit from their ongoing support of education, research, and technology development. The tax revenue governments derive from a growing economy can then be reinvested to provide more community services.

At Microsoft, we have seen how the development opportunities for local ICT industries can be diminished by software licensing schemes that do not provide economic incentives for innovation, or that create disincentives by requiring innovators to give up all rights to their work. Conversely, commerce in intellectual property within a legal framework can stimulate innovation and local economic development. We work closely with governments and law enforcement agencies around the world to help them develop or strengthen laws that protect intellectual property and promote economic development.

Microsoft has paid hundreds of millions of dollars in licensing fees to companies around the world for the right to incorporate some of their technologies into its own products. In fiscal year 2004, we also announced a program to license Microsoft's intellectual property more broadly, on fair and reasonable terms, as a way to assist innovators and companies around the world.

Research and Innovation

Microsoft was built on innovation, and our future depends on it. We deliver great value to customers through diverse technologies designed to complement each other and many third-party products and services. This *integrated innovation* is a fundamental component of our business strategy.

To help drive innovation, Microsoft has made a long-term commitment to research and development. Our R&D investment since 1986 totals nearly \$40 billion and has led directly to many of the successful products our customers value. Further, it has created an increasingly

XML TECHNOLOGY CENTERS IN BRAZIL

The XML Technology Centers that Microsoft sponsors in Brazil illustrate our commitment to supporting local ICT industries and disseminating new technologies that can help them grow. This initiative brings together research institutions, universities, government agencies, and technology companies. The objectives are to accelerate the adoption of Microsoft .NET technology and the use of XML, to support Brazil's workforce development, and to help build Brazil's ICT industry.

Each center, which includes training rooms, laboratories, auditoriums, and meeting rooms, is hosted by a university campus and staffed by volunteer students and professors, scholarship students, employees from participating companies, and external consultants. The centers offer workshops and other training, and provide a place where government agencies and companies in various industries can work on "proof of concept" projects that can then be applied more broadly.

In 2004, for example, the centers in Brasília and São Paulo focused on health care technologies. One of these projects



Unlimited Potential Launch in Australia; Australian Prime Minister John Howard and Bill Gates meet David Bennett from the Australian Seniors Computer Clubs Association. Seniors from another Computer Club in Sydney "attended" the launch via Web cam.

valuable repository of intellectual property. In fiscal year 2004, we applied for more than 2,000 patents on some of our most recent innovations. In fiscal year 2005, we expect to file for another 3,000 patents. Microsoft currently holds 3,876 patents in the United States, and has 7,929 U.S. patents pending. The number of international patents issued to Microsoft totals 1,292, with 7,193 pending.

Microsoft Research

Microsoft Research (MSR) has more than 700 employees worldwide, including some of the world's leading computer scientists, sociologists, psychologists, mathematicians, physicists, and engineers. MSR has expanded globally to

ensure it can attract the richest pool of talent, and as of the end of fiscal year 2004 operated five laboratories in China, the United Kingdom, and at three U.S. locations.

In addition to working on some of the most challenging and complex computer science problems, MSR is often involved in projects that use Microsoft technology to advance science and have the potential to directly benefit humanity. At our Cambridge lab in the United Kingdom, MSR researchers are engaged in a biodiversity research project to identify and build new tools to help scientists understand and protect the life support system of planet Earth.

Other MSR researchers are working with leading scientists at the University of Washington and the Fred Hutchinson Cancer Research Center in the United States, and the Immunology Lab in Perth, Australia, on "machine learning" and other computational approaches that may help scientists design a vaccine for HIV.

Researchers have been working on finding an HIV vaccine for many years without success, partly due to the genetic diversity of HIV itself. Since each person with HIV may have a genetic variant of the virus, researchers must create a vaccine that is flexible enough to protect everyone. This requires scientists to collect massive amounts of data related to each HIV variant, which must be managed and analyzed to build a vaccine. To accomplish this, scientists need the power of machine learning, and

was a new online medical service, which was created in just six weeks. According to the CEO of the company responsible for the new service, without the XML Technology Center the project would have taken at least six months.

These centers are engaging thousands of university students, promoting collaboration among government agencies, technology companies, and universities, and having a profound and positive effect on the growth and vitality of the ICT industry in Brazil.

Microsoft Research has the expertise that may help them reach their goals.

Microsoft Research University Relations Program

By its very nature, the software industry depends on individual talent, creative ideas, and continuous innovation. The global academic community plays an essential role in cultivating the talent and advancing the science that make innovation possible. The University Relations program at Microsoft Research (MSR) was created to nurture strong collaboration between MSR and the academic community, and to be a catalyst for innovation in research and curriculum at leading academic institutions worldwide.

MSR engagement with universities includes a wide variety of activities such as an annual faculty summit at Microsoft headquarters, numerous funding awards that support research and curriculum development, training and technical support for researchers who receive funding through our grant programs, and sponsorship of more than a dozen important academic conferences and professional organizations each year.

Through MSR University Relations, we focus our work with colleges and universities on a limited number of initiatives with specific regional or global interest. We believe that is how our contributions will add the greatest value. As we solicit and respond to proposals from faculty, we strive to keep the process

open and consistent by emphasizing public requests for proposals, and to ensure the diversity of our funding recipients by encouraging women and minority applicants. We also actively engage with funding recipients in a collaborative effort to help ensure the success of projects we support. In fiscal years 2004 and 2005, our initiatives fall into three broad categories:

- **The Emerging Computing Environment**
Computing is rapidly transcending the computer to become more pervasive in our lives and a feature of almost every activity in which we engage. With the proliferation of new computing devices, ubiquitous network connectivity, and rapid advances in interoperability, a new horizon of research and curriculum challenges is emerging.
- **Transformation of Science by Computing**
Perhaps no area of computing offers greater potential for expanded impact on society, industry, and scientific inquiry than the merger of scientific research and computing. Across the sciences, computation has become a critical tool in the discovery process, enabling deeper collection and analysis of data while making access to data increasingly democratic. The result is an emerging transformation of scientific research in which data mining is as important as data gathering and computer-based simulations are the experimental apparatus of choice. At the same time, where this transformation is most advanced, computing itself is being

STRENGTHENING LOCAL EUROPEAN ECONOMIES

In March 2000, the European Council met in Lisbon and set an ambitious goal to make Europe the world's most competitive and dynamic knowledge-based economy by 2010. The purpose of this strategy, known as the Lisbon Agenda, is to build a stronger European economy that will drive job creation alongside social and environmental policies, and ensure sustainable development and social inclusion.

To help achieve the goal of the Lisbon Agenda, the European Union (EU) has made structural funding available to small and mid-sized businesses, to help them increase productivity through the use of technology. Microsoft developed the EU Grants Advisor Program to build consortiums with other technology companies, telecom-

munications companies, banks, and chambers of commerce to increase awareness of the grants and to facilitate the application process for interested businesses.

From 2002 to 2004, Microsoft successfully piloted the program in Spain, Hungary, and Poland. In fiscal year 2005, Microsoft will formally launch the program, adding the United Kingdom, France, Germany, Italy, the Netherlands, Greece, the Czech Republic, and Slovakia to the three pilot countries.

In Spain, the pilot program began with Caryma, a small family-run jewelry business based in Cordoba that has about 10 employees. Microsoft teamed with HP, Intel®, and Telefónica to help Caryma accomplish a complete technology overhaul.

transformed by the emergence of new scientific disciplines.

- **Advancing Computer Science Curriculum**

Given rapid and continuous innovation, industry requirements sometimes outpace computer science curriculum. MSR University Relations works with educators to identify emerging trends in the industry that create opportunities for improving both the content and teaching methods of academic computing programs.

We reassess our initiatives annually, and it is inevitable that they will change over time to keep pace with changes in computer science,

various scientific disciplines, the software industry, and academia.

Local Employer and Economic Engine

Every Microsoft job generates many other jobs throughout the local economy. For example, in France, 50,000 jobs are directly linked to Microsoft technologies, which means that every Microsoft job accounts for 50 other jobs. In some other countries, Microsoft's effect as an economic engine is even more dramatic. In South Africa, for example, every job at Microsoft leads to the creation of 99 other jobs.

If we include retailers that offer secondary installation services, the number of Microsoft-related jobs in many countries is much higher. To illustrate, using that formula would increase the number of Microsoft-related jobs in France from 50,000 to 160,000.

Like any successful global company, Microsoft seeks to attract the best possible candidates for every job. While that sometimes means hiring a person in one country or community to fill a job in another, the majority of our employees are local people who have strong ties to the communities where they work.

Government Partnerships

Governments have many social and economic responsibilities related to the welfare of their citizens. Microsoft works with governments in many different parts of the world to help them



TechnoBus Project, Costa Rica

Two months after Caryma began its ICT deployment, the company reported that it was more profitable and productive. Caryma went from the limitations of paper index cards to the flexibility of wireless computers. The results are better decision making; streamlined communications, business processes, and employee collaboration; and a Web site where it can display its wares to customers worldwide.

By implementing technology solutions, Caryma achieved a 40 percent reduction in the time allocated to administrative tasks, between 15 percent and 20 percent fewer unpaid orders, and the ability to handle 30 percent more customer orders with no additional staff. The company expects to achieve full return on its investment in less than five months.

According to the Spanish Institute of Statistics (Instituto Nacional de Estadística), there are about 398,000 small and mid-sized businesses in Andalusia, roughly 90 percent of the region's business community. Businesses in the region invest only 3 percent of their income in technology (lower than the European average), despite the benefits they stand to gain by investing more. Caryma serves as an example of how technology can provide cost-effective solutions to help small and mid-sized businesses improve their operations and become more profitable.

meet their specific challenges and achieve their objectives. Through our products, business model, and commitment to good corporate citizenship, we help governments:

- Improve economic efficiency so their countries can better compete globally
- Raise productivity and living standards
- Develop workforce skills and reduce unemployment
- Reduce poverty and economic inequality
- Develop local software industries
- Develop export industries and increase exports
- Reduce the cost and increase the efficiency of government information technology
- Reduce barriers for people with disabilities
- Increase the security of critical national infrastructure systems that rely on ICT, such as power, banking, transportation, and communications
- Protect citizens' privacy
- Prevent spying on privileged communications
- Shield national or global businesses that rely on ICT from hackers or other criminals who are intent on disabling systems, stealing sensitive information, or falsifying data

Partners in Innovation

Our economic development work with governments takes many forms. These range from our Government Security Program (described in detail on page 24), which provides govern-

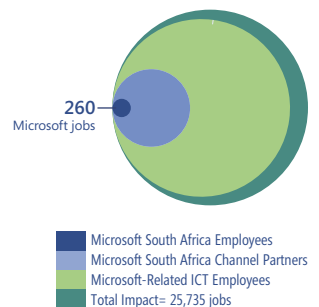
ments access to the source code for many Microsoft products so that they can develop more secure systems, to incubation programs that help governments address some of their own critical needs while developing their local ICT industries. For example, in some countries, such as Australia, New Zealand, and Germany, we have partnered with governments to create Innovation Centers. The centers work with national and local government agencies to identify innovative uses of ICT that address some of their most significant challenges, and to pool limited research and development funds to ensure a better return on their investments.

Microsoft manages the projects and provides Microsoft services, as well as resources and expertise from the local ICT industry, at no charge to the agencies. The centers limit their scope to solution prototypes or "proof of concept" projects. Once a project is complete, industry partners can offer strategies to help the agencies deploy the solution.

Japan has declared economic revitalization centered on the ICT industry a national priority. Microsoft Japan responded by working with local governments and the local ICT industry to set up incubation programs aimed at helping the next generation of ICT start-up companies in Japan develop innovative products and services.

Microsoft Japan provides software, training, conference participation, technical support, and other services free of charge to participating

Ratio of Microsoft South Africa Employment to Microsoft-Induced Employment
(at Partner Companies and IS-Departments, 2003) —
Calendar Year 2004



start-ups. So far, Microsoft Japan has provided support for joint incubation programs with Gifu Prefecture, Hokkaido, and the Japan Personal Computer Software Association, a trade association with about 500 software and technology companies as members.

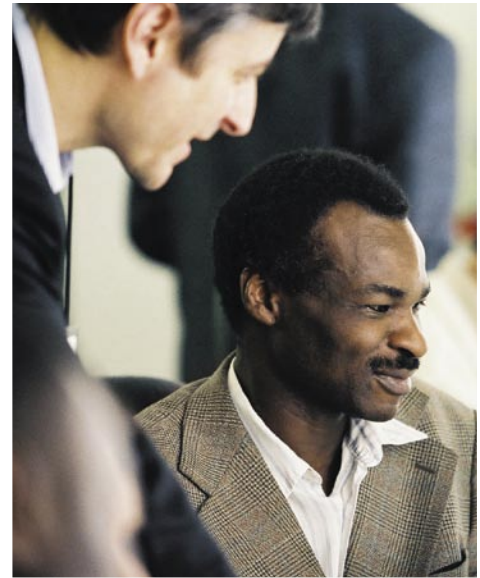
Shared Solutions Network

Microsoft established the Shared Solutions Network (SSN) to provide a collaborative Web-based environment where participating governments, organizations, and agencies can share technical information and work together to improve their software applications and technology solutions.

SSN is an online community of peers and experts whose members have the ability to view, modify, and redistribute the source code of applications submitted by other members. This helps governments and organizations lower costs by enabling them to share information, provide mutual help and support, and reduce redundant efforts. Members can contribute, and take existing solutions and knowledge from the SSN, at no charge. Academic institutions can use the SSN as well, to aid education and research related to application development.

E-government: Improving Citizen Access to Government

E-government is an increasingly important use of ICT for digital inclusion, as more and more governments worldwide look for ways to increase citizen engagement and improve citizen access to information and services.



St. Petersburg, Russia. CTLC opening with UNHCR

The Egyptian Ministry of State for Administrative Development (MSAD) and the Ministry of Communications and Information Technology (MCIT) share responsibility for leading Egypt's e-government program to have most services for citizens and businesses online by June 2007. Microsoft worked with the MCIT and three local ICT partners to deliver a unified gateway and portal that offers multiple services.

By eliminating red tape and paper-based systems for many services, the solution is expected to save up to 900,000 working hours annually. And citizens will spend less time standing in line for such things as driving license renewals, birth certificates, and utility bill payments.

The Rotherham Metropolitan Borough Council (RMBC) in the U.K. is under pressure to meet stringent government targets, in particular the Implementing Electronic Government (IEG) initiative, which includes the goal of 100 percent electronic service delivery by 2005. One barrier to achieving that goal was the number of different ICT systems the RMBC was using, which made it almost impossible to develop a coherent ICT policy or overall strategy across its lines of business.

Microsoft was able to help the RMBC create a common desktop environment and unite its disparate departmental systems, a solution that will save an estimated £400,000 (approximately \$777,000) annually in ICT support costs. With the new system in place, the Council has improved productivity through greater collaboration between departments and is on course to meet the government's 2005 IEG targets.

NEXT STEPS FOR FISCAL YEAR 2005

- Demonstrate Microsoft's commitment to local economic growth and development by continuing to build a robust and diverse partner network that supports local jobs
- Encourage the growth of the local ICT industry through investments in local innovation centers, investments in R&D, and the availability of localized tools that extend the accessibility of software and ICT to marginalized populations

Awards and Recognition

Awards Presented

Each year, Microsoft recognizes individuals and organizations for their efforts to improve IT skills, promote digital education, and spur innovation among software developers worldwide by encouraging and rewarding creative uses of technology. The students, professional developers, and independent software vendors who participate in these competitions have the chance to gain recognition for their technical skills and to take home cash prizes worth thousands of dollars. The following were among the Microsoft awards programs in fiscal year 2004:

Imagine Cup

More than 10,000 students from 90 countries were vying for Imagine Cup 2004, competing in a variety of regional, national, and online competitions to earn positions in the worldwide finals and a chance to take home one of the cash prizes that totaled \$87,000. Thirteen teams from countries in the Americas, Europe, and Asia took the top three places across four invitationals:

- software design (smart technology that makes life easier)
- short film (digital video)
- rendering (three-dimensional animation and graphics)
- algorithm (complex puzzle solving)

Windows ChallengeE

Windows ChallengeE, a competition co-sponsored by Microsoft and the Institute of Electri-

cal and Electronics Engineers (IEEE) Computer Society, is designed to empower students to work together on projects that foster excellence in computer science and computer engineering. The fiscal year 2004 competition asked competing students to address the theme of "Making the World a Safer Place," using Microsoft Windows CE .NET, an embedded operating system designed for compact computing devices. The five winning teams received prizes ranging from \$1,200 to \$4,000, and went on to compete in the Computer Society International Design Competition, sponsored by the Institute of Electrical and Electronics Engineers Inc.

Innovative Teachers Leadership Awards

This program is designed to honor and reward exceptional primary and secondary educators who have developed innovative ways of integrating technology into classroom teaching and learning, and to advance education technology as a means to improve the performance of students, enhance the effectiveness of educators, and strengthen the engagement of parents and the community. The program also seeks to provide networking opportunities among outstanding educators, promote the sharing of best practices, and focus public attention on the importance of technology innovation in education. The first Innovative Teachers Leadership Awards were presented to teachers from eastern and western Europe at the Innovative Teachers Forum held in London in April 2004, one of several regional forums Microsoft is hosting worldwide.

Awards Received

Over the course of fiscal year 2004, Microsoft has been recognized for its citizenship activities around the world. This recognition has included awards for business ethics, labor practices, diversity, accessibility, innovation, corporate citizenship, and Internet safety. A partial list includes:

Argentina

Great Place to Work Institute, Top 10 Workplaces

Australia

Australian Financial Review Magazine, Corporate Partnership Awards (finalist)

Prime Minister's Business Community Partnership Award (finalist)

Austria

Great Place to Work Institute, Number 7 Best Workplace

Belgium

Great Place to Work Institute, Number 1 Best Workplace

Brazil

Carta Capita Magazine, 10 Most Admired Companies

Exame Magazine and *Voce S/A* Magazine, 100 Best Companies to Work For

Valor, Best Executive in the IT Industry

Great Place to Work Institute, Top 10 Workplaces

Hewitt Associates and *AméricaEconomía*, Number 10 Best Employer

Info Exame Magazine, CEO of the Year

Canada

Branham Group Inc., Number 3, Top 25 Canadian IT Multinational Companies

Canadian National Institute for the Blind, Dr. Dayton Foreman Award

KPMG/Ipsos-Reid, Number 4, Most Respected in Innovation and Product/Service Development

Chile

Great Place to Work Institute, Top 10 Workplaces

Denmark

Oxford Research and *Berlingske Nyhedsmagasin*, Great Places to Work Diversity Award

Great Place to Work Institute, Number 5 Best Workplace

Finland

Great Place to Work Institute, Number 2 Best Workplace

France

Great Place to Work Institute, Number 2 Best Workplace

Germany

D21 and *Behoerderspiegel*, PPP (Public-Private Partnership) Award

Great Place to Work Institute, Number 1 Best Workplace

Initiative D21 and *Behoerderspiegel*

Greece

Dreamworks, Leader of the Year Award for Business and Society

Hong Kong

Hong Kong Institute of Social Services, Caring Company Award

International

Communicator, Crystal Award of Excellence (for the Microsoft online Standards of Business Conduct training program)

Financial Times/PricewaterhouseCoopers, World's Most Respected Companies, Number 2 overall, Number 1 company that best demonstrates commitment to corporate social responsibility, Number 4 most effective corporate governance

WorldFest, Platinum Award (for the Microsoft online Standards of Business Conduct training program)

Ireland

Great Place to Work Institute, Top 10 Workplaces

Israel

President of Israel, President's Award for Volunteering

Italy

Great Place to Work Institute, Number 2 Best Workplace

Japan

Nikkei Business Press Consulting Firm, Brand Japan 2004, Number 2 Best Company

Nikkei Research, Corporate Brand Awareness Study, Number 2 Best Company

Tokyo Metropolitan Government Council on Social Welfare, Award for IT Volunteer Program for Victims of Domestic Violence

Korea

Job Link, Most Desirable Employer for Job Seekers (Foreign Company Category)

New Industry Management Academy and *New Media Magazine*, 16th New Media Award

Mexico

Great Place to Work Institute, Top 10 Workplaces

Netherlands

Great Place to Work Institute, Number 7 Best Workplace

New Zealand

Unlimited Magazine, Best Places to Work in New Zealand (Number 1 Workplace in Medium Category)

Norway

Great Place to Work Institute, Number 2 Best Workplace

Panama

CoSPAÉ (Council for Education Assistance from the Private Sector), Social Responsibility and Investment Award

Peru

Great Place to Work Institute, Number 2 Best Workplace

Portugal

Great Place to Work Institute, Number 5 Best Workplace

Romania

IDG, Excellence Award

Russia

Junior Achievement Russia, Recognition Award

Singapore

Community Chest, Special Events Gold Award for organizing President's Challenge

Infocomm Development Authority of Singapore, e-Inclusion Corporate Sponsorship Program (eClasp) Ambassador

Ministry of Community Development, Youth and Sports, Singapore Family Friendly Employer Award

Ministry of Defence, Certificate of Appreciation

Ministry of Information and the Arts, Patron of the Arts

President, Republic of Singapore, Certificate of Appreciation for contribution to President's Challenge

Spain

Great Place to Work Institute, Diversity Award

Sweden

Great Place to Work Institute, Number 3 Best Workplace

Turkey

PLATIN Magazine, Social Responsibility Award of the Year

U.K.

Business in the Community, Opportunity Now Award (for MSN UK)

Financial Times, Respect Award

Great Place to Work Institute, Number 7 Best Workplace

U.S.

Aurora Gold Award (for the Microsoft online Standards of Business Conduct training program)

The Black Collegian Magazine and *Universum Communications*, Number 1 Top Diversity Employer

CAREERS and the disABLED, Top 50 Companies

Department of Health and Human Services, Disability Employment Awareness Award

DiversityBusiness.com, Top 50 Corporations for Multicultural Business Opportunities

Fortune Magazine, 100 Best Companies to Work for in America

Hispanic Magazine, Hispanic Corporate 100

Hispanic Magazine, Top 25 Vendor Programs for Latinos

Information Technology Association of America, IT Works Ability Awards for Accommodations

National Minority Supplier Development Council (Northwest Chapter), National Corporation of the Year Award

National Society of Black Engineers (NSBE), NSBE 50

Northwest Minority Business Council, National Corporation of the Year Award

Telly Award (for the Microsoft online Standards of Business Conduct training program)

Texas Governor's Committee on People with Disabilities, Employment Award — Employer: Large Business Employing and Empowering Texans with Disabilities

Universum Communications, Annual Survey of Undergraduates, Number 1 Ideal Employer

Urban League of Metropolitan Seattle, Edwin T. Pratt Award

WiredSafety.org, first Safe Gaming Award (for Xbox Live)

Astra Women's Business Alliance, a West Coast partner of the Women's Business Enterprise National Council, Corporation of the Year Award

Working Mother, Best Places to Work

Uruguay

Great Place to Work Institute, Top 10 Workplaces

Memberships

Microsoft belongs to a number of organizations that focus on issues related to global citizenship and corporate social responsibility. Among these are:

Argentina

Foro EcuMénico Social

Australia

The Centre for Corporate Affairs

Brazil

Instituto Ethos de Empresas e Responsabilidade Social

Canada

Canadian Business for Social Responsibility

Canadian Centre for Philanthropy

Canadian Chamber of Commerce

Canadian Public Policy Forum (PPF)

CEO Council of Canada

Conference Board of Canada

Information Technology Association of Canada (ITAC)

Media Awareness Network

Volunteer Canada (Corporate Partner)

Europe

European Academy of Business in Society (EABIS)

The European Business Network for Corporate Social Responsibility (CSR Europe)

Guatemala

CENTRARSE (Centro de Responsabilidad Social Empresarial)

Hong Kong

American Chamber of Commerce Hong Kong

Hong Kong General Chamber of Commerce

International

AIESEC

ENGAGE Online

Global Reporting Initiative

World Economic Forum

Ireland

Business in the Community Ireland

Israel

MAALA — Business for Social Responsibility in Israel

Japan

Keidanran (Japan Federation of Economic Organizations) — CSR Committee

Keizai Doyukai (Japan Association of Corporate Executives) — CSR Committee

Keizai Doyu Kai (Japan Association of Corporate Executives) — CSR Committee

Korea

The Federation of Korean Industries (FKI)

One Percent Club

Singapore

Family Life Ambassador

Institute of Policy Studies

National Internet Advisory Committee

Parents Advisory Group for the Internet

U.K.

Business in the Community

The Corporate Responsibility Group

The International Business Leaders Forum

U.S.

Business for Social Responsibility

Center for Corporate Citizenship at Boston College

The Conference Board

United States Chamber of Commerce — Center for Corporate Citizenship

United States Council for International Business (CSR Committee)

Uruguay

DERES Responsabilidad Social de las Empresas

Looking Ahead

Global citizenship is a goal that can never be fully achieved. The social and economic problems it addresses are simply too enormous and complex for the work to ever be completed. At Microsoft, our approach is to evaluate where and how we can do the most good, respond thoughtfully to changing needs, and continually increase the positive influence of our business in the global community.

Our programmatic goals for fiscal year 2005 are framed by the four pillars of the Microsoft Global Citizenship Initiative described earlier in this report:

- Responsible Business Practices
- Internet Safety and Policy Leadership
- Digital Inclusion and Education
- Economic Opportunity

While we are pleased with our progress to date, and with the extraordinary contributions of Microsoft employees around the world, our work continues.

MICROSOFT BUSINESS COMMITMENTS FOR FISCAL YEAR 2005	
	<ul style="list-style-type: none"> Provide breakthrough, high-quality integrated innovation Deliver best-in-class customer responsiveness Make our platform best for developers Deliver simple, high-value experiences and services Reignite customer enthusiasm and tell the Microsoft story Build our talent pool and increase productivity
MICROSOFT GLOBAL CITIZENSHIP: NEXT STEPS FOR FISCAL YEAR 2005	
	<ul style="list-style-type: none"> Demonstrate that Microsoft is a values-driven company, motivated by its mission to help people and businesses realize their potential Address the challenges created by our technology and its impact on society, and ensure the benefits of our technology are more broadly available Continue to make our business practices more open and transparent Develop citizenship-related performance measurements
RESPONSIBLE BUSINESS PRACTICES: NEXT STEPS FOR FISCAL YEAR 2005	
Compliance	<ul style="list-style-type: none"> Expand New Employee Orientation compliance training Develop specific training programs tailored for each business group Launch an internal Web-based allegation's submission tool Audit reporting of third-party vendors Develop and launch a campaign to increase employee awareness of our Business Conduct Line Ensure that all employees are aware of Microsoft's non-retaliation policies Expand the current Microsoft Global Compliance Network Develop a framework for establishing more formalized compliance committees within subsidiaries Establish specific benchmarks to measure progress in fiscal year 2006 and beyond



Cybercare Program, Malaysia

RESPONSIBLE BUSINESS PRACTICES: NEXT STEPS FOR FISCAL YEAR 2005 (continued)

Responsible Industry Leadership	Expand Shared Source program offerings based on what we learn from our ongoing engagement with governments, independent developers, other technology companies, and academia
Supply Chain Management	<ul style="list-style-type: none"> Reinforce the importance of compliance across the supply base Continue training of the supply base Ensure that first-tier suppliers see our commitment as a joint responsibility to be implemented across their supply base Enforce zero tolerance Produce lead-free products Host a supplier compliance summit for first-tier suppliers
Environment	<ul style="list-style-type: none"> Develop and implement a comprehensive, corporate-wide environmental policy Improve cross-group coordination and issue management Eliminate PVC in packaging by the end of calendar year 2005
Responsible Employer	Implement a corporate diversity and inclusion scorecard

INTERNET SAFETY AND POLICY LEADERSHIP: NEXT STEPS FOR FISCAL YEAR 2005

	<ul style="list-style-type: none"> Work with our partners to increase consumer awareness of how they can help protect themselves online Continue to improve the security features of our products Enhance our internal security practices Simplify the consumer experience Expand our collaboration and partnerships with law enforcement authorities to pursue online criminals
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DIGITAL INCLUSION AND EDUCATION: NEXT STEPS FOR FISCAL YEAR 2005

Partners in Learning	<ul style="list-style-type: none"> Provide development opportunities for 500,000 teachers Provide technology or technology training opportunities to 5 million students Localize the Partners in Learning curriculum in 20 additional languages Expand Fresh Start for Donated Computers program to cover 500,000 desktops
Unlimited Potential (UP)	<ul style="list-style-type: none"> Make substantial progress toward our goal of providing technology access and skills training resources to 250 million people worldwide by calendar year 2008 Localize the UP curriculum into additional languages including Simplified Chinese, Russian, Arabic, and Brazilian Portuguese Launch the global support network in three regions
Local Language Program	Release Windows XP and Office 2003 Language Interface Packs in approximately 34 additional languages

ECONOMIC OPPORTUNITY: NEXT STEPS FOR FISCAL YEAR 2005

	<ul style="list-style-type: none"> Demonstrate Microsoft's commitment to local economic growth and development by continuing to build a robust and diverse partner network that supports local jobs Encourage the growth of the local ICT industry through investments in local innovation centers, investments in R&D, and the availability of localized tools that extend the accessibility of software and ICT to marginalized populations
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