Morgan Stanley

October 22, 2010

Mr. Russell G. Golden
Technical Director
File Reference No. 1820-100 Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116 Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update – Revenue from Contracts with Customers

Dear Mr. Golden:

Morgan Stanley appreciates and welcomes the opportunity to comment on the Proposed Accounting Standards Update, Revenue from Contracts with Customers (the "Proposed Update"). We have chosen to submit our response to the FASB based on the understanding that our comments will be shared with the IASB.

We have participated in the preparation of the responses to the Proposed Update submitted by the Association of Financial Markets in Europe ("AFME") and The Securities Industry and Financial Markets Association Asset Management Group ("SIFMA AMG") and, are generally supportive of these responses.

We are supportive of the FASB and IASB (the "Boards") efforts to develop a single, converged financial reporting model for revenue recognition from contracts that provides users with the most useful, transparent, and relevant information regardless of industry. We are supportive of the fundamental principles in the Proposed Update and agree that entities should:

- Identify the performance obligations contained within contracts with customers and determine the transaction price based on the consideration the entity receives or expects to receive in exchange for the transfer of goods or services.

- Recognize the probability-weighted amount of expected revenue as performance obligations are satisfied by transferring goods and services to customers evidenced by the transfer of control if the transaction price can be reasonably estimated.

Although we support a number of the principles outlined in the Proposed Update, we do have reservations regarding some of the tentative conclusions reached by the Boards. Our primary areas of concern are as follows:

- In the Proposed Update, the Boards have identified several factors that reduce the relevance of the entity's experience when determining transaction price. We believe
that those factors should be considered by the entity in making a reasonable estimate of revenue rather than being determinative of whether revenue may be recognized, which is consistent with the principle in the Proposed Update that requires entities to recognize the probability-weighted amount of expected revenue.

- In determining transaction price, it is proposed that the amount of consideration should be reduced to reflect a customer’s credit risk. We believe that commingling diverse components such as revenue and credit risk in this manner obscures information. In our experience, users want to understand the contractual revenue separate from how credit risk is managed. Doing so helps them evaluate the amount that companies are being compensated for the value of goods or services provided as well as the extent to which credit deterioration may be eroding that value.

- The Proposed Update requires that onerous performance obligations be assessed at the performance obligation level. We do not believe a revenue recognition standard to be the most appropriate place to address what is really a liability or expense accrual matter involving the accelerated accrual of future operating expenses required to deliver goods or services. We strongly recommend that any proposed changes in this area be addressed as part of the relevant liability or contingency standards rather than in this Proposed Update.

- We generally support the Boards’ efforts in the Proposed Update to provide users of financial statements with additional useful and relevant disclosures regarding revenue recognition in a manner that incorporates cost-benefit considerations as it is consistent with the objectives of the FASB’s Conceptual Framework. However, we believe that the proposed reconciliations of contract assets, contract liabilities and onerous performance obligations are inconsistent with those objectives as they are overly focused on accounting mechanics rather than providing the users with useful and relevant information such as insight into a company’s future, expected revenues, revenue mix or revenue trends that could assist them in making investment or other decisions. As such, we believe the time, effort and cost to implement systems to track this particular information greatly outweighs any potential benefits.

- Retrospective application is required in the Proposed Update. We believe that the requirement for retrospective application will be operationally challenging and burdensome for entities to implement and as such, companies are going to need a sufficiently long transition period for implementation.

Further detail of these concerns is included in the responses to certain questions raised in the invitation to comment in the attached Appendix.
We hope you find our feedback helpful. If there are any comments that are unclear, or you would like to discuss anything further, please do not hesitate to contact me at 212-276-7716.

Sincerely,

[Signature]

Gregory A. Sigrist
Managing Director
Global Accounting Standards and Control
Appendix

Below are more detailed responses to certain questions raised in the invitation to comment that we believe are worth highlighting.

**Question 4:** The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

Paragraph 35 in the Proposed Update states that the transaction price should reflect the probability-weighted amount of consideration that an entity expects to receive from the customer. Paragraphs 38-40 in the Proposed Update state an entity can recognize revenue when the transaction price can be reasonably estimated. We agree with both of these fundamental principles.

However, we find certain other language in the same paragraphs to be overly prescriptive and confusing. For example, Paragraphs 38-40 go on to say that an estimate is reasonable only if an entity has experience with similar types of contracts (or access to the experience of other entities if it has no experience of its own) and does not expect circumstances surrounding those types of contracts to change significantly. The relevance of experience can be reduced by the impact of external factors (e.g. volatility in the market), the length of time until the uncertainty about the amount of consideration is expected to be resolved, the extent of the experience and the number of possible consideration amounts. The existence of one or more of the factors required to be considered in determining if the transaction price based on variable consideration is reasonably estimable, may or may not be sufficient to prevent an entity from making a reasonable estimate of that transaction price. We believe that those factors should be considered by the entity in making a reasonable estimate of revenue rather than being determinative of whether revenue may be recognized. As such, we recommend that the Boards remove the language that states that the factors in Paragraph 39 reduce the relevance of the entity’s experience and instead include language that states that the entity consider those factors when making an estimate of the variable consideration amount.

Additionally, we are concerned that Example 18 under IG 76 in the Proposed Update will set a threshold that requires all market-related fees (or other variable/contingent fees) to be precluded from recognition until the measurement period is completed. Based on previous Board discussions, we do not believe that was the intention of the Boards as it would be inconsistent with the principle in the Proposed Update that entities recognize the probability-weighted amount of expected revenue. In the example, an asset management entity concludes that the variable component of management fees (based on an index measurable at year-end) cannot be reasonably estimated until the end of the contract year. Although the entity has entered into many similar contracts previously, the entity determines that its experience with those types of contracts is not relevant because the circumstances surrounding those types of contracts could change significantly—the consideration is highly
susceptible to external factors, the uncertainty is not expected to be resolved until the end of the year, and the contract has a large number of possible consideration amounts. We are concerned that the threshold set by this example will preclude most asset management and private equity entities from recognizing performance/incentive fees until the end of the contract period, which can typically range from 5-15 years.

We strongly believe an entity can develop a reasonable estimate of the variable consideration amount in circumstances where certain factors noted in Paragraph 39 may exist. In our view, those factors should be incorporated into the entity’s estimate of the probability-weighted variable consideration amount which would be consistent with the underlying principle in the Proposed Update. As such, we recommend that the Boards remove the example described above or provide an example that illustrates how an entity may take into account the existence of the factors identified in Paragraph 39 to arrive at a reasonable estimate of the variable consideration amount before the end of the contract period. Such an example would demonstrate the concept in Paragraph 40 that states the existence of these factors would not preclude an entity from making a reasonable estimate of the transaction price.

Question 5: Paragraphs 43 proposed that the transaction price should reflect the customer’s credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer’s credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?

The Proposed Update states that in determining transaction price, an entity shall reduce the amount of promised consideration to reflect the customer’s credit risk.

As revenue is a measure of the value of goods or services provided, it is not clear to us why identical services provided to two different customers would result in different values because of the customers’ individual credit risks. Commingling credit risk against revenue reduces transparency and obscures information from a user perspective. If revenue and credit information is commingled on both the balance sheet and the income statement, users will lose the ability to separate contractual revenue from bad debt expense and comparability across entities as well as key performance information will be lost. We note that users have expressed wide support for a pure interest income model not impacted by credit risk in response to the Financial Instruments Exposure Draft. In general, we would expect users to express similar views with respect to this aspect of the revenue recognition model. Accordingly, we would not support a model that commingles the customer’s credit risk with revenue recognition.

Additionally, we note that there is a scope issue presented by the interrelationship between the Proposed Update and the Boards’ proposals on impairment of financial instruments. While financial instruments are specifically scoped out of the Proposed Update, having satisfied a performance obligation, the entity will recognize a trade receivable for the amount of revenue recorded. This trade receivable will then fall within the scope of the proposed impairment rules for financial instruments.

We believe it would be more appropriate for the Proposed Update to address solely the recognition of revenue excluding any adjustment related to customer credit. Under our proposal, credit risk would not be incorporated in the probability-weighted amount of expected revenue. The credit risk would however be taken into account when recognizing
the trade receivable upon initial recognition and, subsequently, under the impairment rules for financial instruments. In addition to simplifying financial reporting, our proposed approach will help users evaluate the amount that companies are being compensated for the value of goods or services provided and separately identify the extent to which credit deterioration may be eroding that value.

As such, we strongly recommend that the Boards remove the consideration of a customer’s credit risk from the revenue recognition guidance and instead incorporate it only within the impairment model in the Financial Instruments project.

**Question 7: Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?**

We agree with the fundamental concept that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. However, we disagree with the extension of this process in Paragraph 54 that requires an entity to recognize a liability and a corresponding expense if a performance obligation is onerous.

Paragraph 54 in the Proposed Update requires an entity to assess performance obligations at contract inception and at each reporting date to determine whether the obligation has become onerous (e.g. when the present value of the probability-weighted direct costs to satisfy the obligation exceeds the transaction price allocated to it).

We believe that guidance regarding the assessment of onerous performance obligations should be excluded from the revenue standard and addressed by the relevant liability or contingency standards. However, if this guidance is retained in the final revenue standard, we are concerned that it would not reflect the economics of transactions particularly when an individual performance obligation is not profitable but the overall contract is profitable. This could result in the entity recognizing a liability and corresponding expense if a performance obligation is deemed onerous, resulting in “day one” losses recorded on a performance obligation even though that may not be a true reflection of the cost of doing business related to the contract as a whole. Also, we believe that the users of the financial statements are primarily interested in the outcome of the contract as a whole rather than the separate performance obligations therein.

Additionally, the requirement to remeasure onerous performance obligations each reporting period will likely be both impractical and operationally challenging. The potential benefits of doing so will not outweigh the time, effort and costs to implement this requirement.

As such, we recommend that the Boards consider the contract level as the appropriate unit of account for assessing onerous contracts.
Question 10: The object of the boards proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cashflows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

We are supportive of the Boards’ efforts and objective to provide users of financial statements with useful, transparent and relevant information about an entity’s revenue and cashflows arising from contracts with customers. However, we do not believe that some of the proposed disclosure requirements meet that objective.

Specifically, we note that the Proposed Update requires an entity to provide reconciliations ("rollforwards") from opening to closing balances of contract assets, contract liabilities and onerous performance obligations that detail the amounts recognized in the statement of comprehensive income. Those proposed disclosures focus on accounting mechanics rather than providing insight into a company’s future, expected revenues, revenue mix or revenue trends that could assist the users of financial statements in making investment or other decisions. As such, we do not believe that these disclosure requirements will provide meaningful information to the users of the financial statements. Additionally, we believe that the time, effort and cost to implement systems to track this information are onerous and greatly outweigh the benefits of providing the additional disclosure. As such, we recommend that the Boards remove these disclosure requirements in the final standard.

Question 13: Do you agree that an entity should apply the proposed requirements retrospectively (i.e. as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think its better.

We believe that the requirement for retrospective application will be operationally challenging and burdensome for entities to implement. However, retrospective application promotes consistency between periods from a user perspective. As such, we recommend that the Boards allow for a sufficiently long transition period to ease the burden of implementing this guidance.