Dear Sirs,

Discussion Paper on “Preliminary Views on Financial Statement Presentation”

Morgan Stanley appreciates and welcomes the opportunity to comment on the Discussion Paper on Preliminary Views on Financial Statement Presentation issued by both the IASB and FASB in October 2008 (the “DP”). We have chosen to submit our response to the IASB on the understanding that our comments will be shared with the FASB.

In general, we support the objectives and direction of the DP. We do however have a number of reservations about the DP as it currently stands, which we believe suggest that significant further work will be required before an Exposure Draft can be issued.

Our principal concern is that there are some aspects of the DP that we believe would make financial information less useful and understandable. In particular:

- We are not convinced that the arguments in support of presenting the statement of cash flows using the direct method are strong enough to justify the significant additional costs of collating the necessary information;

- We believe that the current proposals could result in a significant increase in the amount of disaggregation, particularly in the statement of comprehensive income and the statement of cash flows. This could result in less useful and less relevant financial information. We encourage the Boards to state more explicitly their intention, which is that disaggregation should only be applied to the extent that it provides more useful and more relevant financial information;

- We agree that the management approach to classification will result in more meaningful and useful financial information and we would encourage the Boards to retain this key principle. We also acknowledge that this approach may potentially reduce comparability although we believe that this risk can be mitigated by qualitative disclosure of management’s decisions on classification;

- It is important that any new standard on financial statement presentation adopted by both the IASB and FASB results in comparable financial information for both US GAAP and IFRS reporters. To that end, we encourage the Boards to work closely to ensure that the resulting accounting framework prevails over the domestic legal framework (e.g. US public companies are currently required to comply with the SEC’s S-X regulations); and
• We believe that certain proposed disclosure requirements should be included within the scope of the relevant standards where appropriate, e.g. maturities of short-term contractual assets and liabilities should be addressed within the scope of IFRS 7 Financial Instruments: Disclosures or the equivalent US GAAP standard (e.g. FAS 107).

Our detailed responses to specific questions raised in the DP can be found below. We have not sought to respond to every question posed in the DP, but have focused on those most relevant to our own circumstances.

**Question 1**

*Would the objectives of financial statement presentation proposed in paragraphs 2.5–2.13 improve the usefulness of the information provided in an entity’s financial statements and help users make better decisions in their capacity as capital providers? Why or why not? Should the boards consider any other objectives of financial statement presentation in addition to or instead of the objectives proposed in this discussion paper? If so, please describe and explain.*

We broadly agree with the objectives as set out in paragraph 2.4 of the DP. However, we believe that the DP needs to demonstrate more clearly how these objectives are consistent with the qualitative characteristics of financial statements as set out in the Framework.

We accept that the disaggregation objective is an important one and that financial information that is disaggregated may be more useful to users of financial statements than information that is not. However, there is a limit to the extent of disaggregation beyond which the financial information becomes less understandable and useful for users. We are not convinced that the DP, as currently drafted, is sufficiently explicit in requiring that disaggregation should only be applied to the extent that it is useful for the users of financial statements. We are concerned that the DP’s emphasis on disaggregation may mean that some preparers may take an unnecessarily “conservative” approach and disclose significantly more information on the face of the primary statements than is useful to users of the accounts. For these reasons, we believe that serious consideration should be given to allowing or requiring entities to disclose the more disaggregated information in the notes to the financial statements rather than on the face of the primary statements themselves. It is clear from the examples in the DP and from the initial feedback from the field testing that the number of line items in the primary statements are expected to increase significantly, potentially to an extent that will be unhelpful to users of the financial statements.

There also seems to be insufficient focus on ensuring the usefulness of financial information in assessing stewardship. The ED issued in May 2008 (The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information) states that financial reporting should provide information to capital providers that is decision useful. It goes on to say that capital providers are interested in assessing the entity’s ability to generate net cash inflows and management’s ability to protect and enhance the capital providers’ investments. As it stands, the disaggregation and liquidity and financial flexibility objectives are designed to ensure users have sufficient information to make assessments about future cash flows and an entity’s ability to meet financial commitments as they fall due. These are forward looking objectives. Although the cohesiveness objective is consistent with the stewardship concept, we feel that there should be an explicit objective to provide users with better information to allow them to assess management’s stewardship over the entity.
Question 2

*Would the separation of business activities from financing activities provide information that is more decision-useful than that provided in the financial statement formats used today (see paragraph 2.19)? Why or why not?*

We support the separation of business and financing activities in the primary statements and generally agree that this would provide users with more decision-useful information. This should allow users to better identify the value creating activities of an entity from the way that it finances those activities.

However, we have some concerns that such a separation between business and financing activities may be less useful for users of financial statements of reporting entities in some industries. In particular, financial institutions tend to finance their activities in many different ways, for example stock lending, repo financing, structured note issuances, deposits and long-term borrowings. In general, management would consider that the selection of appropriate sources of financing will be part of the entity’s trading activity and therefore more appropriately included in the operating rather than the financing section. Users of such financial information would also expect to see certain sources of finance included within operating rather than financing activities. For example, when assessing the performance of a bond portfolio which is held for trading, a user of financial statements would expect the costs of financing that portfolio to be presented in the same section. The portfolio is most likely to be financed using sale and repurchase agreements. To include such sources of finance in the financing section without a clear link to the assets being funded would not provide users with decision-useful information which reflects the entity’s business model.

We support the management approach to classification and we are not suggesting that the Boards develop any industry specific guidance. Our view is that, in general, a financial institution should include its core financing, i.e. those assets and liabilities that finance the entity’s capital requirements and are not directly attributable to a trading activity, in the financing section. However, we recognise that the management approach to classification may result in different judgements being made about how an asset or liability is used in the business which may affect the comparability of financial statements. We do not consider this to be a problem as long as the key management decisions on classification are qualitatively disclosed and justified.

Question 3

*Should equity be presented as a section separate from the financing section or should it be included as a category in the financing section (see paragraphs 2.19(b), 2.36 and 2.52–2.55)? Why or why not?*

We agree that equity should be presented as a separate section and should not be included within financing. This approach is more consistent with the cohesiveness objective in that transactions with owners are not included in the statement of comprehensive income.

The current direction of the Boards’ joint project on financial instruments with characteristics of equity will continue to distinguish equity from financial liabilities and we believe that this distinction should be recognised in the primary statements. We note that the DP proposes that only financial assets and financial liabilities should be included in the financing section and, as such, it would be inappropriate and inconsistent to include equity in this section.
Morgan Stanley

Question 5

The proposed presentation model relies on a management approach to classification of assets and liabilities and the related changes in those items in the sections and categories in order to reflect the way an item is used within the entity or its reportable segment (see paragraphs 2.27, 2.34 and 2.39–2.41).

(a) Would a management approach provide the most useful view of an entity to users of its financial statements?
(b) Would the potential for reduced comparability of financial statements resulting from a management approach to classification outweigh the benefits of that approach? Why or why not?

We generally support the management approach to classification. We strongly believe that the classification of assets and liabilities should be based on how those assets and liabilities are used in the business and that management are in the best position to determine this. This approach is also consistent with the current guidance in IFRS 8/FAS 131 on operating segment reporting which requires disclosure of information that management already uses internally to manage the business. The use of a management approach will inevitably require a certain amount of judgement in determining the appropriate classification of assets and liabilities which, as stated above, may lead to a reduction in comparability of financial statements. However, as proposed in the DP, we agree that the rationale for the classification should also be disclosed in the financial statements so that the user can fully understand management’s decisions. As the classification is an accounting policy choice we believe that this should prevent management arbitrarily changing their classification decisions as to do so would require retrospective application and disclosure of the reasons why the new classification is more appropriate. As such, we believe that the benefits of the management approach outweigh the potential for reduced comparability, the risks of which should be mitigated by the proposed disclosure.

Another advantage of the management approach is that obtaining the information necessary to enable management to classify assets and liabilities should not be an onerous or costly process. As the classification reflects the way that the business itself is managed, that information should be readily available.

We would encourage the Boards to quickly resolve the outstanding issues relating to (i) when the use of an asset or liability changes and (ii) when an asset has more than one use in the business. We would urge that any proposed solution to these outstanding matters remains consistent with the management approach.

Question 7

Paragraphs 2.27, 2.76 and 2.77 discuss classification of assets and liabilities by entities that have more than one reportable segment for segment reporting purposes. Should those entities classify assets and liabilities (and related changes) at the reportable segment level as proposed instead of at the entity level? Please explain.

We agree with the Boards’ proposal that classification of assets and liabilities should be at the reportable segment level. This is consistent with the management approach which we generally support.
Morgan Stanley

Question 8

The proposed presentation model introduces sections and categories in the statements of financial position, comprehensive income and cash flows. As discussed in paragraph 1.21(c), the boards will need to consider making consequential amendments to existing segment disclosure requirements as a result of the proposed classification scheme. For example, the boards may need to clarify which assets should be disclosed by segment: only total assets as required today or assets for each section or category within a section. What, if any, changes in segment disclosures should the boards consider to make segment information more useful in light of the proposed presentation model? Please explain.

It is important that any changes to IFRS 8/FAS 131 as a result of the DP do not result in management having to provide information that is not already provided to the Chief Operating Decision Maker ("CODM"). To the extent that the CODM does not receive segmental information disaggregated into the proposed sections or categories then this disclosure should not be required by IFRS 8/FAS 131. Generally, IFRS 8/FAS 131 only require disclosure to the extent that the information is already provided internally to management. We believe that any amendments to IFRS 8/FAS 131 as a result of this project should retain this principle. Otherwise this information would have to be collated at a segment level simply to meet a disclosure requirement which would conflict with the “through the eyes of management” objective.

Question 9

Are the business section and the operating and investing categories within that section defined appropriately (see paragraphs 2.31–2.33 and 2.63–2.67)? Why or why not?

We agree with the overall approach of providing high level definitions rather than prescriptive guidance with regard to the business section and the operating and investing categories.

It is helpful that the DP proposes that assets and liabilities which cannot be clearly identified as operating, investing or financing should be presumed to be reported within the operating category. This should reduce the risk of financial information being less comparable across different reporting entities, and should result in a better approach for those industries, such as financial services, where it is harder to determine the distinction between operating and financing activities.

Question 10

Are the financing section and the financing assets and financing liabilities categories within that section defined appropriately (see paragraphs 2.34 and 2.56–2.62)? Should the financing section be restricted to financial assets and financial liabilities as defined in IFRSs and US GAAP as proposed? Why or why not?

Please see our response to question 2 for our views on the definition of the financing section.
In addition, we are unclear why the Boards propose to restrict this section to financial assets and financial liabilities. Although by definition the vast majority of assets and liabilities included in this section would be financial, it is not intuitive why this should be a mandatory restriction and it is not consistent with the overall management approach. The rationale provided in the DP for this is that it adds objectivity to the classification; however it is not clear why objectivity is required in this case given that the overall classification guidance is intended to be principles based and to reflect management’s view.

**Question 11**

Paragraph 3.2 proposes that an entity should present a classified statement of financial position (short-term and long-term subcategories for assets and liabilities) except when a presentation of assets and liabilities in order of liquidity provides information that is more relevant.

(a) What types of entities would you expect not to present a classified statement of financial position? Why?

(b) Should there be more guidance for distinguishing which entities should present a statement of financial position in order of liquidity? If so, what additional guidance is needed?

We believe that many financial institutions that have a short-term liquidity cycle would consider that presenting assets and liabilities in order of liquidity provides more relevant and useful information. We do not believe that additional guidance in this area is required.

**Question 12**

Paragraph 3.14 proposes that cash equivalents should be presented and classified in a manner similar to other short-term investments, not as part of cash. Do you agree? Why or why not?

We agree that cash equivalents should not be presented in the same manner as cash and should be classified in a manner similar to other short-term investments. Many reporting entities, particularly financial institutions, have a short liquidity cycle and as such the distinction between cash and cash equivalents can be a significant one that should be reflected in the financial statements.

**Question 13**

Paragraph 3.19 proposes that an entity should present its similar assets and liabilities that are measured on different bases on separate lines in the statement of financial position. Would this disaggregation provide information that is more decision-useful than a presentation that permits line items to include similar assets and liabilities measured on different bases? Why or why not?

We generally agree with this proposal although given the number of current measurement bases that can be applied to assets and liabilities, we believe that the disaggregation should be at a reasonably high level, e.g. between assets and liabilities with a cost based measurement or fair value based measurement basis.
We would also recommend that this information can be disclosed in the notes to the financial statements where to do otherwise would result in too much information on the face of the primary statements. We believe that this should result in providing users with more useful and understandable information, and would encourage a greater level of information overall.

**Question 14**

*Should an entity present comprehensive income and its components in a single statement of comprehensive income as proposed (see paragraphs 3.24–3.33)? Why or why not? If not, how should they be presented?*

There should be a single statement of comprehensive income as there is no clear practical or conceptual justification for doing otherwise.

We would also agree that, within the single statement of comprehensive income, the distinction between the profit or loss/net income and other comprehensive income line items should remain, as we believe that this does provide users with decision useful information.

**Question 16**

*Paragraphs 3.42–3.48 propose that an entity should further disaggregate within each section and category in the statement of comprehensive income its revenues, expenses, gains and losses by their function, by their nature, or both if doing so will enhance the usefulness of the information in predicting the entity's future cash flows. Would this level of disaggregation provide information that is decision-useful to users in their capacity as capital providers? Why or why not?*

We have outlined our views on disaggregation in our response to question 1. Although we generally support the disaggregation principle we are concerned that it may result in too much data and not enough useful information. It is important that preparers, when applying the disaggregation to the statement of comprehensive income, should only do so to the extent that the ensuing information is decision useful. We feel that this point needs to be emphasised more clearly in the proposals.

**Question 18**

*Paragraph 3.63 proposes that an entity should present foreign currency transaction gains and losses, including the components of any net gain or loss arising on remeasurement into its functional currency, in the same section and category as the assets and liabilities that gave rise to the gains or losses.*

(a) *Would this provide decision-useful information to users in their capacity as capital providers? Please explain why or why not and discuss any alternative methods of presenting this information.*

(b) *What costs should the boards consider related to presenting the components of net foreign currency transaction gains or losses for presentation in different sections and categories?*

We accept that the Boards' proposal to include foreign currency (“FX”) transaction gains and losses in the same section and category as the asset or liability that gives rise to the gain or loss is more consistent with the cohesiveness objective.
However, we believe that there would be significant practical difficulties with this approach. Where the FX gain or loss arises on a single asset or liability then the allocation should clearly be simple. However, where it arises on assets or liabilities that impact more than one section in the statement of comprehensive income then any allocation would be less meaningful.

Many entities manage or hedge their FX risk on a net basis. It is not clear how any gain or loss in these circumstances could be allocated to the different sections and categories. Any allocation would be arbitrary and involve significant judgement which may affect the usefulness of such information.

Question 19

*Paragraph 3.75 proposes that an entity should use a direct method of presenting cash flows in the statement of cash flows.*

(a) *Would a direct method of presenting operating cash flows provide information that is decision-useful?*

(b) *Is a direct method more consistent with the proposed cohesiveness and disaggregation objectives (see paragraphs 3.75–3.80) than an indirect method? Why or why not?*

(c) *Would the information currently provided using an indirect method to present operating cash flows be provided in the proposed reconciliation schedule (see paragraphs 4.19 and 4.45)? Why or why not?*

We are not convinced that the arguments in support of presenting the statement of cash flows using the direct method are strong enough to justify the significant costs and difficulties of collating the necessary information. Although we understand that the direct method is more consistent with the cohesiveness and disaggregation objectives of the DP, with which we broadly agree, we do not believe that these objectives fully justify the proposed requirement. Paragraph 2.16 of the DP acknowledges that meeting the cohesiveness objective in every circumstance may not be feasible. In addition, paragraph 2.10 states that excessive disaggregation should be avoided as this could have a detrimental effect on the usefulness of financial statements.

Although we accept that there are some users of financial statements who would find the information provided by the direct method useful, we would also argue that there are other users who find the indirect method equally, if not more, valuable. Indeed, we understand that EFRAG has discussed this issue with users and found that more users would prefer to retain the indirect method as this more directly reconciles operating cash flows to operating profit.

Another consideration is that businesses are generally not managed in a manner consistent with the direct cash flow method, which is why this information is not readily available at present. We believe that the indirect method not only meets the needs of the majority of users, but also reflects the way that businesses are actually managed and therefore consistent with the management approach principle in the DP.
Question 20

What costs should the boards consider related to using a direct method to present operating cash flows (see paragraphs 3.81–3.83)? Please distinguish between one-off or one-time implementation costs and ongoing application costs. How might those costs be reduced without reducing the benefits of presenting operating cash receipts and payments?

As stated above, most entities do not collate information about gross operating cash flows and to do so would require extensive modification of existing systems or in some cases new system implementations. The one-off costs associated with this would be substantial and the on-going costs would not be insignificant. In addition, we do not agree that using an “indirect/direct” method to produce cash flow data would be a significantly less onerous process. Such information would be provided purely to meet an accounting “compliance” requirement and would have no commercial value to the business and as such the costs of extracting the relevant data and performing the necessary additional calculations and validations would be a wholly incremental cost to the business, again with no management benefit. As the information is not used by management for any other purpose, there is also the risk that the information would be less reliable.

Question 22

Should an entity that presents assets and liabilities in order of liquidity in its statement of financial position disclose information about the maturities of its short-term contractual assets and liabilities in the notes to financial statements as proposed in paragraph 4.7? Should all entities present this information? Why or why not?

We generally support the majority of the disclosure requirements in chapter 4 of the DP. However, we believe that the disclosure of the maturities of short-term contractual assets and liabilities should be addressed within the scope of the appropriate accounting standard (e.g. IFRS 7 Financial Instruments: Disclosures). The recent amendments to IFRS 7 require that entities disclose the expected maturity dates of non-derivative liabilities if the entity manages liquidity on that basis. We believe that any disclosure requirements included as part of a financial statement presentation standard should refer to IFRS 7.

Question 23

Paragraph 4.19 proposes that an entity should present a schedule in the notes to financial statements that reconciles cash flows to comprehensive income and disaggregates comprehensive income into four components: (a) cash received or paid other than in transactions with owners, (b) accruals other than remeasurements, (c) remeasurements that are recurring fair value changes or valuation adjustments, and (d) remeasurements that are not recurring fair value changes or valuation adjustments.

(a) Would the proposed reconciliation schedule increase users’ understanding of the amount, timing and uncertainty of an entity’s future cash flows? Why or why not? Please include a discussion of the costs and benefits of providing the reconciliation schedule.

(b) Should changes in assets and liabilities be disaggregated into the components described in paragraph 4.19? Please explain your rationale for any component you would either add or omit.
(c) Is the guidance provided in paragraphs 4.31, 4.41 and 4.44–4.46 clear and sufficient to prepare the reconciliation schedule? If not, please explain how the guidance should be modified.

We generally agree that the proposed reconciliation should provide more decision useful information and we agree with the suggested disaggregated components. However although providing useful information, the requirement to reconcile on a line by line basis from the statement of cash flows to the statement of comprehensive income could be time consuming and onerous and much of the data disclosed would have limited or no value to users of the financial statements.

Again, we would stress that it is important that the Boards emphasise in the proposals that disaggregation should only be applied to the extent that this results in information that is both useful and relevant. Our concern is that, in an effort to ensure compliance, preparers will disaggregate to an unnecessary level of detail which will have a detrimental effect on the usefulness and understandability of the financial information.

The proposed disaggregation would be difficult to implement for many financial institutions with trading portfolios. Most financial institutions are currently unable to fully separate realised from unrealised trading profit and loss. Therefore, although we generally support the concept of having a reconciliation, we would encourage the Boards to give further consideration to how this could be applied to financial institutions with trading portfolios.

Question 24

Should the boards address further disaggregation of changes in fair value in a future project (see paragraphs 4.42 and 4.43)? Why or why not?

As mentioned in the previous response, we believe that disaggregation of fair value changes may provide users with useful information but at the moment most entities would currently not be able to produce such information so any such proposal requires due consideration as part of a future project. Disaggregating the effect of certain variables on the fair value of some financial instruments can be complicated and in some circumstances requires significant judgement particularly where the level of interaction between relevant variables is high. Any such disaggregation should not be at the expense of providing reliable information and we would suggest that the cost of providing this information would be significant.

Question 25

Should the boards consider other alternative reconciliation formats for disaggregating information in the financial statements, such as the statement of financial position reconciliation and the statement of comprehensive income matrix described in Appendix B, paragraphs B10–B22? For example, should entities that primarily manage assets and liabilities rather than cash flows (for example, entities in the financial services industries) be required to use the statement of financial position reconciliation format rather than the proposed format that reconciles cash flows to comprehensive income? Why or why not?

We agree with the view that there are entities within certain industries that manage assets and liabilities rather than cash flows. Certainly most entities within the financial services industry would manage their businesses in this manner. Users of financial information produced by these entities would tend to focus on balance sheet movements and the income statement when looking at the performance and liquidity of the entity.
For these reasons we believe that entities should have the option of using the statement of financial position format rather than the format proposed in the DP. We acknowledge that this may not necessarily be the most relevant format for all entities and so we would not propose that its use be mandatory. Management should be able to choose the format that it believes provides users with the most relevant and useful information and should disclose the basis for the decision in the notes.

**Question 26**

*The FASB’s preliminary view is that a memo column in the reconciliation schedule could provide a way for management to draw users’ attention to unusual or infrequent events or transactions that are often presented as special items in earnings reports (see paragraphs 4.48–4.52). As noted in paragraph 4.53, the IASB is not supportive of including information in the reconciliation schedule about unusual or infrequent events or transactions.*

(a) *Would this information be decision-useful to users in their capacity as capital providers? Why or why not?*

(b) *APB Opinion No. 30 Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, contains definitions of unusual and infrequent (repeated in paragraph 4.51). Are those definitions too restrictive? If so, what type of restrictions, if any, should be placed on information presented in this column?*

(c) *Should an entity have the option of presenting the information in narrative format only?*

We are not supportive of the proposals to include a memo column in the reconciliation to describe any unusual or infrequent events or transactions. As stated in the DP, the notion of unusual or infrequent events or transactions does not exist in IFRS. By its nature, the memo column would not form part of the reconciliation and so it could be confusing to disclose it here. We would expect that any significant unusual events or transactions would be included in the management commentary in the context of a general discussion of the results for the period.

I hope you find the responses to the above questions helpful. If there are any comments that are unclear, or you would like to discuss anything further, please do not hesitate to contact me on 0207 425 8551 or Craig Withers on 0207 677 2239.

Yours faithfully,

Alex Brougham
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