Morgan Stanley

March 13, 2012

Technical Director
File Reference No. 2011-230
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 Technical Director:

Morgan Stanley appreciates 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 are generally supportive of the views expressed therein.

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 expected value or most likely amount of expected revenue as performance obligations are satisfied as evidenced by the transfer of control if the transaction price can be reasonably assured.

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:

Performance-Based Fees

- In the Proposed Update, the Boards have identified several indicators that are presumed to limit an entity’s experience from being “predictive” when determining the amount of variable consideration to which the entity is reasonably assured to be entitled. We believe that those factors should be considered by the entity in arriving at an appropriate measurement of the amount of variable consideration to which the entity is entitled 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 expected value or most likely amount of expected revenue. Indeed, preparers of financial statements in a number of sectors have experience in evaluating and quantifying the impact of such indicators of uncertainty when measuring fair value to comply with the requirements of other accounting standards.
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As managers of various asset classes, we earn performance fees on the underlying performance of hedge funds ("incentive fees") and are also allocated a percentage of appreciation in the underlying funds ("carried interest"), collectively referred to as "performance-based fees." We believe performance-based fees in the form of incentive fees and/or carried interest should be recognized as revenue based on fund performance considering that the general partner is entitled to an allocation of a proportion of that performance as of the balance sheet date, regardless of positive or negative adjustments in future periods. Separately, we are supportive of the view that carried interest should be regarded as an equity instrument and therefore should not fall within the scope of the Proposed Update, as discussed further in our answer to Question 3.

Onerous Performance Obligations

- The Proposed Update requires that onerous performance obligations be assessed at the performance obligation level. We are of the view that it is more appropriate to evaluate whether a contract as a whole is onerous as pricing decisions are generally made at a contract level rather than on an individual performance obligation basis and as such, focusing on the contract level for financial statements purposes, best reflects economic reality.

Disclosures

- The proposed interim and annual disclosures of reconciliations of contract assets, contract liabilities and onerous performance obligations are overly focused on accounting mechanics rather than providing the users with useful and relevant information such as insight into management judgment and expectations of a company's future 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 and maintain system changes to track this particular information greatly outweighs any potential benefits.

Further detail of these concerns is included in the responses to certain questions raised in the invitation to comment in the attached Appendix.

In addition to the issues outlined in our responses to specific questions in the Appendix, we would like the Boards to provide additional guidance regarding the allocation of the transaction price to separate performance obligations in a multiple element arrangement. For example, a contract with a customer may include a service element and an element that is a financial instrument. We believe an entity should first apply the requirements under other relevant accounting guidance, i.e., ASC 820, Fair Value Measurements and Disclosures, to measure the financial instrument element in the contract. The non-financial instrument element, i.e., the service element in our example, would separately be subject to the guidance under the Proposed Update. We believe that additional clarification in this area is necessary in order to prevent diversity in practice.

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) 761-1136 or Dave Bonnar (212) 276-7824.

Sincerely,

Peggy Capomaggi
Managing Director
Assistant Global Controller
Appendix

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

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity’s experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

Paragraph 55 in the Proposed Update states that the transaction price should reflect the expected value or the most likely amount of consideration that an entity expects to receive from the customer. Paragraphs 81-83 in the Proposed Update state an entity can recognize revenue when the transaction price is reasonably assured. We agree with both of these fundamental principles. However, we believe that the indicators listed in paragraph 82 should be considered by the entity in the measurement of the variable consideration rather than being presumed to be determinative of whether revenue may be recognized, which is consistent with the principle in the Proposed Update that requires entities to recognize the expected value or most likely amount of expected revenue. Indeed, preparers of financial statements in a number of sectors have experience in evaluating and quantifying the impact of such indicators of uncertainty when measuring fair value to comply with the requirements of other accounting standards.

We strongly believe an entity can have predictive experience in circumstances where those factors may exist. In our view, those factors should be incorporated into the entity’s estimate of the expected value.

Our asset management business, which specializes in managing alternative asset classes such as private equity funds, real estate funds, hedge funds etc, like other managers of alternative assets, earns performance fees on the underlying performance of the hedge funds (“incentive fees”) and is also allocated a percentage of appreciation in its private equity, real estate and infrastructure funds (“carried interest”).

We believe performance-based fees in the form of incentive fees and/or carried interest should be recognized as revenue based on fund performance considering that the general partner is entitled to an allocation of a proportion of that performance as of the balance sheet date, regardless of positive or negative adjustments in future periods. Termination provisions which entitle the fund manager to a portion of the allocated carried interest in the event of an early termination, typically exist in the fund agreement for those funds. This provides further evidence the calculated revenue based on the cumulative fund performance should be viewed as “reasonably assured” at an interim date. We also believe that this approach results in revenue recognition that more appropriately reflects the manager’s performance (i.e., higher revenue in periods in which the manager’s performance has exceeded the specific performance targets) and results in better matching of such revenues against the associated expenses (e.g., compensation expenses) for income statement presentation purposes.

We continue to be concerned that Example 13 under IG 70 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. In the example, an asset management entity concludes that the variable component of management fees (based on an index measureable at year-end) cannot be
reasonably assured until the end of the contract year. The example considers that the entity’s experience is not considered predictive due to the existence of external factors (e.g., volatility in the market), and the number of possible consideration amounts—such a conclusion was reached without the example discussing how management evaluated whether the indicators actually precluded ability to predict the revenue entitlement. We are concerned that the example does not allow for the use of judgement in determining whether an entity’s experience can be predictive and could be interpreted to require deferral of the variable component of management fees based on market events in all circumstances.

Additionally, we understand that there are divergent views regarding the accounting for carried interest in the asset management sector. We are supportive of the view that carried interest should be regarded as an equity instrument. The general partner of the underlying real estate, private equity and infrastructure funds is entitled to receive a proportionate share of underlying funds appreciation alongside the limited partners. Carried interest is calculated during interim periods based on cumulative fund performance to date, which in turn is based on the fair value of the fund’s underlying investments and realized values of disposed assets. As such, carried interest is reflective of the fair value in an interim reporting period. As the carried interest represents an equity investment in an underlying fund, we believe that this is a financial instrument which is outside the scope of the Proposed Update.

**Question 4:** For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognize a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

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, whilst we acknowledge the usefulness of the practical expedient for performance obligations with less than a one-year duration, we disagree with the extension of this process in Paragraph 86 that requires an entity to recognize a liability and a corresponding expense if a performance obligation is onerous.

Paragraph 86 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., if the lowest cost of settling the performance obligation exceeds the amount of the transaction price allocated to that performance obligation).

We are concerned that the Proposed Update approach would not reflect the economics of transactions as pricing decisions are generally made at a contract level rather than on an individual performance obligation basis. In other words, an individual performance obligation may not be profitable on a standalone basis but the overall contract may be profitable. This could result in the entity recognizing a liability and corresponding expense if a performance obligation is deemed onerous, potentially resulting in “day one” losses recorded on a performance obligation even though that may not be a true reflection of the overall profitability of the contract as a whole. We believe this bifurcation approach is not useful to users of the financial statements who 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 obligations.
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Question 5: The Boards propose to amend Topic 270 and IAS 34 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial statements. The disclosures that would be required (if material) are:

1. The disaggregation of revenue (paragraphs 114–116)
2. A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
3. An analysis of the entity’s remaining performance obligations (paragraphs 119–121)
4. Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
5. A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial statements? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance these benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial statements.

We are supportive of the Boards’ efforts and objective to provide users of financial statements with useful information and improve disclosures about an entity’s revenue arising from contracts with customers. However, we do not believe that some of the proposed interim and annual disclosure requirements will meet that objective. We believe the proposed interim and annual disclosures are excessive and may obscure useful information. It would be more appropriate for the Boards to consult separately on the extent of expanded disclosure in the context of a broader discussion of the purpose of interim financial statements and the principles underlying determination of what disclosure is relevant.

The proposed interim and annual requirement to disaggregate revenue (paragraphs 114-116) might duplicate disclosures already required by the segment reporting standards. Additionally, the proposed disclosure requirement to provide reconciliations (“rollforwards”) from opening to closing balances of contract assets, contract liabilities and onerous performance obligations (paragraphs 117-123) focuses 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. Further, the proposed disclosures will add significantly to the volume of disclosures already required and may require entities to develop new systems to capture the necessary information. We believe that the time, effort and cost to implement and maintain system changes 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 standards.