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Accounting Standards Board
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29 January 2010

By email to: ukgaap@frc-asb.org.uk

For the attention of: Peter Godsall

Dear Sirs

Policy Proposal: The Future of UK GAAP

Morgan Stanley appreciates and welcomes the opportunity to comment on the Accounting Standards Board's ("ASB") Consultation Paper – Policy Proposal: The Future of UK GAAP (the "CP") issued on 11 August 2009.

Morgan Stanley is a US firm, but has a significant presence in the UK, with over 200 subsidiaries currently applying UK GAAP or EU adopted IFRS. The firm has, in addition, a significant number of other subsidiaries that apply IFRS or its local equivalent. We therefore have a particular interest in ensuring that any changes to UK GAAP enhance the reporting framework by enabling a co-ordinated approach to financial reporting commensurate with the needs of 'users' that are often within the global firm.

We have set out our responses to the detailed questions posed in the CP in the attached appendix, but have detailed below our key concerns with the proposals. These relate to the availability of exemptions for wholly-owned subsidiaries and greater clarity over the approach to group accounts:

Wholly owned subsidiaries

We broadly agree with the definition of 'public accountability' and the proposal that an entity meeting this definition should apply full IFRS. Where a wholly-owned subsidiary is itself publicly accountable, we believe such entities should have the same responsibility to provide information to the public as a standalone publicly accountable entity. However, wholly-owned subsidiaries which are not publicly accountable have limited users external to the group. We believe that exemptions similar to those currently available under UK GAAP for wholly-owned subsidiaries should be incorporated into the proposed framework. This would significantly reduce the challenge of financial reporting for these entities under full IFRS, without significantly reducing the benefit of the accounts to the limited external users, whilst at the same time enabling financial reporting to be maintained on a consistent platform. Our reasoning is further set out in response to Question 4.

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Group accounts

We believe greater clarity is required regarding the application of the proposals to groups. Firstly, it is unclear how the "primary business" criteria within the definition of publicly accountable in paragraph 2.3(ii) of the CP should be applied on consolidation. For example, if a subsidiary is publicly accountable, would the ultimate UK parent also be publicly accountable even if the subsidiary's activity is not considered a primary business of the broader group? What would the status be for any intermediate parent company? As "primary business" is not a concept raised in the first part of the definition under paragraph 2.3(i), is the intention that a group with a subsidiary that falls under 2.3(i) would always be publicly accountable?

Further, should a publicly accountable subsidiary prepare consolidated accounts (assuming it is a parent company), or is it exempt from consolidation if it has a 'higher' parent company which prepares consolidated accounts that comply with IFRS? If the subsidiary is publicly accountable under paragraph 2.3(i) of the CP because it lists debt or equity instruments, IAS 27 paragraph 10(b) would require the subsidiary to prepare consolidated accounts, even if an ultimate parent undertaking presents consolidated accounts under IFRS. Conversely, if the subsidiary is publicly accountable because of deposit-taking activity under 2.3(ii) of the CP, it would be exempt from preparing consolidated accounts under IAS 27 if it has a 'higher' parent company which prepares consolidated accounts that comply with IFRS. In the above examples, a different position could be reached dependent on whether a subsidiary falls under paragraph 2.3(i) or (ii). Due to this conceptual inconsistency, we recommend that the ASB clarifies its intentions for groups.

I hope you find our feedback helpful. If there are any comments that are unclear, or if you would like to discuss anything further, please do not hesitate to contact me on 0207 425 8551 or Jonathan Payne on 0207 425 6828.

Yours faithfully

Alex Brougham
Managing Director
European Accounting Standards and Control

Morgan Stanley

Appendix

Question 1 – Which definition of Public Accountability do you prefer: the Board's proposal (paragraph 2.3) or the current legal definitions (paragraph 2.5)? Please state the reason for your preference. If you do not agree with either definition, please explain why not and what your proposed alternative would be?

We prefer the Board's principles based proposal rather than the current legal definitions. The inclusion of a criteria based on size would ignore the broader facts and circumstances of the entity and may result, for example, in intermediate holding companies being potentially considered publicly accountable, even though there would be no incremental public interest.

We do however believe that greater clarification could be given to the application of the definition. As highlighted in our letter, it is unclear how the "primary business" criteria should be applied to consolidated accounts and at what level within the group consolidated accounts should be prepared.

Question 2 – Do you agree that all entities that are publicly accountable should be included in Tier 1? If not, why not?

We agree that all entities that are publicly accountable should be included in Tier 1.

Question 3 – Do you agree with the Board's proposal that wholly-owned subsidiaries that are publicly accountable should apply EU adopted IFRS? If not, why not?

We have consistently supported the development of accounting standards by an independent global body and our strong preference will always be for the EU to allow IFRS, as issued by the IASB, to be used in the EU without amendment. However, consistency of accounting framework between those falling under the IAS Regulation and those deemed publicly accountable under the proposals in the CP is of key importance. We therefore agree that, given the current EU legal framework, wholly-owned subsidiaries that are publicly accountable should apply EU adopted IFRS. We encourage the ASB to continue to support the standard setting efforts of the IASB and to lobby for prompt European adoption of IFRS in full without amendment.

Question 4 – Do you still consider that wholly-owned subsidiaries which are publicly accountable should be allowed reduced disclosures? If so, it would be helpful if you could highlight such disclosure reductions as well as explaining the rationale for these reductions.

As noted in our letter and our response to Question 1, we broadly agree with the definition of public accountability in paragraph 2.3 and we do not believe therefore that wholly-owned subsidiaries, which are publicly accountable, should be allowed reduced disclosures.

However, wholly-owned subsidiaries which are not themselves publicly accountable (i.e. Tier 2 entities) require further consideration. Under the proposal these entities can either adopt IFRS for SMEs or 'upgrade' to IFRS. IFRS for SMEs has a number of recognition and measurement differences from IFRS and the timescales for updating IFRS for SMEs differ from the roll out of new IFRS standards. Tracking these differences for a group which reports under IFRS at the consolidated level will be challenging, increasing operational risk and resulting in confusion for both preparers and users. However, IFRS has significant disclosure requirements which similarly result in significant challenges if applied in full to all subsidiaries, yet for very little benefit. It is for this reason that many groups in the UK have not adopted IFRS for their subsidiaries under the current framework. Neither IFRS for SMEs nor IFRS provide an acceptable cost benefit solution for these entities.

Typically, the users of the financial statements of non publicly accountable wholly-owned subsidiaries are more limited and often comprise only other members of the group. Furthermore, the nature of group-wide operations often results in certain information at the group level being more meaningful for financial reporting than that at the individual subsidiary level. We therefore believe that wholly-owned subsidiaries which are not publicly accountable should be allowed reduced disclosure requirements.

As a minimum, non-publicly accountable subsidiaries of a group (which reports under IFRS at the consolidated level) which elect to apply IFRS, should be allowed an exemption from IFRS 7 disclosures consistent with the current disclosure exemption for wholly-owned subsidiaries under FRS 29 and with the omission of this disclosure from IFRS for SMEs. Risk management is often conducted on a group-wide basis through central treasury, market and credit risk management operations. There is therefore little benefit of disclosure at an individual entity level, unless the individual entity is itself publicly accountable.

The following additional exemptions currently available under UK GAAP would also help to reduce the challenges of applying full IFRS for wholly-owned subsidiaries, without significantly reducing the benefit of the accounts to their primary users:

- Cash flow statements – Cash flow is relatively meaningless for a wholly-owned subsidiary as most large groups operate central treasury arrangements, so cash flow for a particular subsidiary can rarely be effectively assessed on a standalone basis; and

- Related party disclosures – For wholly-owned subsidiaries, related party transactions disclosures can be extensive and thus costly to produce, yet provide little value added information to the users, who are predominantly other group undertakings.

Question 5 – Do you agree with the Board's proposal that the IFRS for SMEs should be used by 'Tier 2' entities?

We agree that the IFRS for SMEs is a suitable alternative to UK GAAP for Tier 2 entities. We also agree that Tier 2 entities should have the option to apply IFRS.

Question 6 – Do you agree with the Board's proposal that the IFRS for SMEs should be adopted wholesale and not amended? If not, why not? It would be helpful if you could provide specific examples of any amendments you think should be made, as well as the reason for recommending these amendments.

We agree that the IFRS for SMEs should be adopted wholesale except where amendments are required to comply with relevant legislation. However, consistent with our response to Question 4, wholly-owned subsidiaries which are Tier 2 entities, should be allowed disclosure exemptions from related party disclosures and cash flow statements consistent with exemptions currently available under UK GAAP.

Question 7 – Do you agree with the Board's proposal that large Non-Publicly Accountable Entities should be permitted to adopt IFRS for SMEs? Or do you agree that large entities should be required to use EU adopted IFRS? Please give reasons for your view.

We believe that the correct way to determine the appropriate accounting regime is on the basis of whether an entity is publicly accountable or not. As per our response to Question 1, we broadly agree with the definition of public accountability and we do not think that quantitative size criteria should be included in the definition.

Question 8 – Do you agree with the Board that the FRSSE should remain in force for the foreseeable future?

Question 9 – Do you agree that the FRSSE could be replaced by the IFRS for SMEs after an appropriate transition period, following the issuance of the IFRS for SMEs?

No comments.

Question 10 – Do you agree with the Board's current views on the future role of SORPs? If not, why not?

We agree with the Board's views on the future role of SORPs.

Questions 11 – 14 regarding public benefit entities.

No comments.

Question 15 – If you are an entity whose basis of preparing financial statements will change under these proposals, what are the likely effects of applying those new requirements? Please indicate both benefits and costs and other effects as appropriate. If you are a user of financial statements (such as an investor or creditor) what positive and negative effects do you anticipate from the implementation of the proposals set out in this paper?

If the proposals are implemented as drafted we believe there will be significant implications for groups. The differences between IFRS for SMEs and IFRS will be challenging within a group, whilst the alternative of applying full IFRS disclosures to all companies will be a significant undertaking for minimal benefit. Differences between EU adopted IFRS and IFRS as issued by the IASB will further exacerbate these issues for global groups.

However, if the proposals are amended in line with our comments, the implementation will be less of a challenge and more of a benefit, providing significant operational improvements and risk reduction through more closely aligning the reporting framework for all entities within a group and ensuring the relevance of financial reporting.

Given the uncertainty over these amendments and over the approach to group accounts, combined with uncertainty over the regulatory and taxation impacts of the proposals, it is difficult at this time to estimate the effects of applying the new requirements.

Question 16 – What are your views on the proposed adoption dates?

As an entity would need to prepare an opening balance sheet as at 1 January 2011, we do not believe that the proposed adoption date of 2012 is realistic. Further, IFRS 9 will have a significant impact on reporting so it would be preferable to time the mandatory conversion to be no earlier than the mandatory application date of that standard in 2013.

However, given the potential benefits of the proposals if they are amended in line with our comments, it would be beneficial if the ASB were to allow early adoption.