

Letter of Comment No: 127
File Reference: 1125-001
Date Received: 1/8/03

January 8, 2003

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: File Reference No. 1125-001

Dear Ms. Bielstein:

Toyota Motor Credit Corporation ("TMCC") welcomes the opportunity to comment on the Financial Accounting Standards Board's ("Board") Proposal on the *Principles-Based Approach to U.S. Standard Setting Proposal* ("Proposal") dated October 21, 2002.

TMCC is an indirectly wholly-owned subsidiary of Toyota Motor Corporation ("TMC"). TMC, headquartered in Toyoda City, Japan, is the world's third largest automaker. TMCC provides retail and wholesale financing, retail leasing and certain other financial products and services to authorized Toyota and Lexus vehicle dealers, and to a lesser extent other domestic and import franchised dealers and their customers in the United States ("U.S."). TMCC also provides retail, lease and wholesale financing to industrial and other equipment dealers throughout the U.S.

We support the proposal for a principles-based approach for U.S. standard setting to promote accounting that places greater emphasis on the economic substance of the transactions rather than the form or structure. We recommend framing the Standards with over-riding principles while also providing more specific rules or "bright-lines" in certain circumstances. Since TMCC operates in a global environment, including reporting entities in South America and investors in Asia and the European Union, TMCC supports aligning U.S. reporting with the International Accounting Standards ("IAS"), allowing investors and creditors to make sound decisions without adding to the complexity associated with interpreting different forms of accounting and reporting. However, in adopting a principles-based approach, the unique characteristics associated with U.S. culture, legal, and regulatory environments, must be considered in developing the overall framework; these characteristics present risks that will need to be mitigated in order for the framework to become operative within the U.S. marketplace.

We will address the following points in order to contribute to this important discussion:

1. TMCC's support of the adoption of a principles-based approach to standard setting.
2. Risks associated with replacing the existing framework and mitigating factors to assist in implementation.
3. Success factors to converting to a principles-based approach.

TMCC's Support of the Adoption of a Principles-Based Approach to Standard Setting

Current Reporting Environment

This Proposal is timely and will be very useful to the Securities and Exchange Commission ("SEC") in connection with Section 108(d) of the Sarbanes-Oxley Act of 2002, which requires the SEC, by July 2003, to conduct a study on "the adoption by the U.S. financial reporting system of a principles-based accounting system." Recent events have confirmed the critical importance of clear, consistent and operational accounting Standards for the preservation of fair and efficient global financial markets. To counter recent events in the U.S. accounting reporting environment, we believe new initiatives, such as this Proposal, could lead to strengthened public confidence in accounting and financial reporting. However, TMCC believes that adopting a principles-based approach to standard setting will not be a "silver bullet," alleviating the U.S. from the recent accounting scandals, as a principles-based approach could potentially be misapplied by professionals not acting in good faith.

Reporting Objectives for Decision-Useful Information

Our belief is that current U.S. accounting Standards are based on underlying theory and principles; however, hard-line rules within the Standards have swung the application of such Standards away from the economic substance, adding to the complexity and lack of transparency found in current reporting. Practitioners are often pressured to find ways "around the rules" rather than recording transactions based on the economic substance taking into account the underlying accounting principle. For example, in conjunction with one of Toyota Auto Receivables, asset backed security ("ABS") transactions, TMCC preferred debt treatment, as opposed to sale treatment. To achieve, TMCC included a small amount of non-financial assets in the transaction, achieving an on-balance sheet result. Without these non-financial assets, off-balance sheet treatment would have prevailed under Statement of Financial Accounting Standards ("SFAS") No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The legal opinion, however, was not altered by the inclusion of the non-financial assets resulting in a situation that is at odds with the accounting treatment. In the unlikely event of TMCC entering into bankruptcy proceedings, TMCC would not be able

to claim those assets sold in this particular transaction, however, the assets are recorded on our balance sheet (as upheld in the LTV Steel case). These conflicting views and interpretations confuse investors and issuers alike.

The present network of detailed rules, exceptions and implementation guidance can, through its complexity, lead to situations in which economically identical transactions yield different accounting outcomes, thereby frustrating the goal of transparent reporting. Framing the Standards within over-riding principles should simplify financial reporting, resulting in more clear and decision-useful information to investors/readers. If a principles-based approach is properly implemented, the quality and transparency of financial reporting could greatly improve.

The primary decision-specific qualities, described in FASB Statement of Concepts No. 2, *Qualitative Characteristics of Accounting Information*, (“CON 2”) are relevance and reliability, and “if either of those qualities is completely missing the information will not be useful”. CON 2 continues by stating that the qualities of consistency and comparability contribute to the usefulness of the information, but are secondary to relevance and reliability. Presently, the current rules-based system focuses more on consistency, rather than the primary qualities of relevance and reliability. For example, SFAS No. 133, *Accounting for Derivatives and Hedging Activities* (“FAS 133”), as amended, provides for specific rules that require all companies to account for derivatives dependant on its specific characteristics and that each company apply the rules in the same manner. Often the rules require that the derivative is disassociated from its hedged asset or liability, and therefore, does not achieve the goal of reporting the economic intent of hedging. We believe that our FAS 133 adjustment is inconsistent with the economics of our portfolio, as it does not account for the positive market value of our receivable portfolio. To support this view, in the *Financial Reporting of Derivatives & the Effect on US Corporations*, Moody’s Investor Service stated that “the changed accounting procedures imposed by FAS 133 generally have no direct economic implications” and “expects that it will ‘look through’ this incremental financial reporting volatility if it is not reflective of additional volatility.” As a result, we believe that an investor/reader is not able to decipher the relevant information as to whether TMCC’s hedging program is successful, and how it compares to our competitors. The consistency gained by rules, sacrifices the decision-useful qualities of relevance, reliability, and comparability of financial reporting.

In addition, the complexity associated with the current rules-based system may have sacrificed understandability for purposes of consistency and comparability. CON 2 states “information cannot be useful to decision makers who cannot understand it, even though it may otherwise be relevant to a decision and be reliable”. The complexity and fragmented nature associated with the current rules have made it difficult even for those who have a reasonable understanding of the business and have invested a reasonable amount of time interpreting the information. TMCC believes that relevance, reliability, consistency, and comparability are all necessary for decision-useful information and therefore, adopting a principles-based framework should focus on all these attributes.

Complexity Associated with the Current Rules-based System

The proliferation of rules-based Standards in the U.S. has made it very difficult for preparers and their auditors to remain current on all of the significant changes in accounting principles and made it extremely challenging to apply in a timely fashion. An improvement may be achieved if the Standards were framed within overriding principles, providing for a more open-ended guidance that can be applied to future situations. Although the transition to a principles-based approach to standard setting is arduous and requires a significant time commitment, the development of robust principle-based standards should prove to be more flexible to current and newly created complex transactions requiring less modification (if any) in the future.

Risks Associated with Replacing the Existing Framework and Mitigating Factors to Assist in Implementation

Although there are many risks inherent with converting to a principles-based approach, we discuss the following risks below, followed by mitigating factors to ease the transition:

- Cultural differences between the U.S., the European Union, and the rest of the world
- U.S. legal framework
- Increasing presence of regulatory agencies

Cultural Differences Between the U.S., the European Union, and the Rest of the World

The U. S. cultural differences need to be considered when choosing the optimal framework for U.S. standard setting. The U.S. is the world's leader in capital markets and produces the most innovative transactions. The framework adopted needs to be efficiently integrated into the U.S. so that the pace of the economy is not affected by new and confusing accounting regulations.

U.S. Legal Framework

No market place is as litigious as the U.S., and the differences in legal environments to those countries that follow IAS needs to be an important consideration. The risk associated with the loss of safe harbors provided in the current rules-based guidance needs to be mitigated to ensure that the principles-based framework is successful. Litigation protection is afforded when guidance provides for a "check the box" approach requiring less judgment in accounting application to determine the proper interpretation. Ultimately, protection from litigation based on sound professional judgment must be

distinguished from intentional fraud in order to secure the principles-based framework. A conversion to a principles-based approach will not only require a significant change in the current mindset of preparers, auditors, investors, creditors, and regulatory agencies – but also that of the judicial system in which this country operates.

Increasing Presence of Regulatory Agencies

A principles-based approach could conflict with the current rules-based legislation governed by the regulatory agencies. For example, the guidance issued recently under Sarbanes-Oxley Act of 2002, provides stringent rules and ramifications. The final rules must take into account the current reporting environment. The adoption of additional rules recently issued by the SEC is an attempt to foster comfort in the minds of readers/investors, while an open-ended principles-based methodology could conflict with this approach. Due to the increasing oversight from regulatory agencies such as the SEC, involvement of the SEC and other regulatory agencies is necessary in the overall development of a principles-based framework. The agreement of these agencies to principles-based Standards needs to be evident in order to secure successful implementation and protect issuers and practitioners acting in good faith and with sound professional judgment from second-guessing by regulators who will have the benefit of reviewing transactions from the perspective of hindsight.

Effective Implementation Guidance

We believe to effectively implement principles-based Standards, some level of implementation guidance will be required. Incomparability and inconsistency could become more prevalent if there is insufficient implementation guidelines, which would then include rules and bright lines. The preparers and practitioners will need to fully understand how to apply the new methodology in an efficient manner. Otherwise, issuers and practitioners will continue to rely on the existing rules-based Standards.

Establishment of Working Groups Under the Auspices of the Board

In order to develop robust accounting principles, preparers and practitioners need to be involved in the process to ensure that the principles achieve practical application. For example, establishing industry working groups for implementation guidelines would help mitigate the misapplication of rules and principles, as such groups would be required to work together. In addition, for broad-based principles, consensus would need to be reached by cross-industry working groups to ensure the principles consider the wide array of transactions. TMCC believes that the Board should be the primary Standard setter for ruling on the ultimate guidelines, with emphasis on the working groups supporting the Board for the prioritization, planning, and implementation. The working groups could help mitigate the loss of safe harbors by fostering common understanding in the Standard setting and implementation guidance process. Perhaps the working groups could be set up in a fashion similar to those that are associated with the Emerging Issues Task Force

("EITF"). However, accessibility and involvement must be made easier in order for there to be effective industry participation.

IAS "True and Fair Override"

Although the working groups should foster common understanding, two professionals in good faith interpreting the same guidance, could arrive at two different results. Therefore, as final protection for those professionals acting in good faith, the framework should include the IAS "true and fair override" principle to ensure financials more clearly convey economic substance of transactions and events.

Success Factors to Converting to a Principles-Based Approach

For the Board to be able to develop a clear and well-articulated process, it must develop a solid framework and sound foundation for resolving accounting and reporting issues. The Board will need to consider those aspects of the current Standards that are incomplete, inconsistent, and conflicting with other Standards. We believe that the goal of such an initiative should be gradual and incremental. Incremental movement toward a greater reliance on principles-based accounting in the U.S. would not require total replacement of current guidance for a wide range of financial products and transaction structures. Review of the current guidance needs to take place in order to determine where the bright lines are necessary, what existing guidance should remain, and to identify those sections that are fragmented and too complex, thus requiring modification.

A consideration in developing the overall framework is the hierarchy in the current Standard setting. Perhaps the Concepts Statements could be placed with higher priority as the basic threshold on which ultimate decisions are benchmarked. In addition, when developing the overall framework, one consideration is the overriding reporting focus. The current guidance focuses more heavily on how to account and report for assets and liabilities with the premise that income and net equity will "fall out." Although accurate reporting of assets and liabilities is critical information for investors/readers, TMCC also believes that investors/readers also place great emphasis on income and net equity in order to make decisions about the Company's performance. The Board should carefully weigh the effects of the Standard-setting on both the income statement and balance sheet in order to develop the best overall position.

The Board will need to gain a full understanding of how the International Accounting Standards Board's ("IASB") principles are determined and applied in practice. The Board should also note that current IAS guidance is not flawless and also has room for improvement. The IAS guidance on derivatives (IAS 39) is also complex, providing bright lines and requiring practitioners to look toward the U.S. to fill any remaining gaps. This project will need to be closely monitored by the IASB to ensure that the proper foundation is developed and reaches the goal of improving alignment with International Standards. Finally, the principles-based approach that the EITF has taken recently in its issue resolutions could be used as a test pilot. For example, the task force's discussion on

EITF 02-9, *Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold* and EITF 02-12, *Permitted Activities of a Qualifying Special-Purpose Entity in Issuing Beneficial Interests under FASB Statement No. 140*, leaned toward a more principles-based resolution, preventing the need to develop additional specific rules.

We appreciate your attention to this important matter and would encourage you to contact Maura Mizuguchi, National Treasury Manager, at 310-468-5986 to provide additional or clarifying information.

Sincerely,

/s/ John Stillo

John Stillo
Vice President and Chief Financial Officer
Toyota Motor Credit Corporation