Ford Motor Company

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

VIA EMAIL: director@fasb.org  
commentletters@ifrs.org

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Ford Motor Company ("Ford"), a global automotive industry leader based in Dearborn, Michigan, manufactures or distributes automobiles across six continents. Ford Motor Credit Company LLC ("Ford Credit"), an indirect, wholly-owned subsidiary of Ford, is one of the world’s largest automotive finance companies, and has provided dealer and customer financing to support the sale of Ford Motor Company products since 1959.

We strongly support the efforts of the Financial Accounting Standards Board and the International Accounting Standards Board (the "Boards") to converge their respective accounting guidance and we appreciate the opportunity to comment on the Proposed Accounting Standards Update, "Revenue Recognition" (the "proposed ASU"). Although we concur with many of the principles emphasized in the proposed ASU, we have specific concerns related to the guidance for product warranties, measurement of revenue, and transition. We have provided responses to specific questions in Attachment I.

We appreciate the Staff’s consideration of these matters.

Sincerely,

Susan M. Callahan
Manager, Global Accounting Policies & Special Studies

Attachment

cc: Kenneth Bement
Ford Motor Company

Responses to Specific Questions for Comment

Measurement of Revenue

Question 5: Paragraph 43 proposes 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 recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?

Response: The proposed guidance defines the transaction price as “the amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services, excluding amounts collected on behalf of third parties.” A logical extension of the definition is to consider a customer’s credit risk in measuring the transaction price, when it can be reasonably estimated. Therefore, we conceptually agree that the measurement of revenue should include consideration of a customer’s credit risk.

The proposed guidance also provides that “the effects of changes in the assessment of credit risk associated with that right to consideration shall be recognized as income or expense rather than as revenue.” We believe that, as a practical matter, Revenue should reflect only the amounts generated from the delivery or production of goods, rendering of services, or other transactions that occur from an entity’s ongoing central operations during the period. Therefore, we also agree (without considering the proposed guidance on the initial assessment) that changes in measurement for credit losses resulting from the reassessment should not be included in Revenue.

However, the proposed guidance would require that registrants report the amount measured in the initial assessment of collectibility in a different line of the financial statements than the line containing the amount measured in the subsequent assessments of collectibility. We believe that both the amount arising from the initial assessment as well as any changes in the amount from subsequent reassessments should be reported in the same line of the financial statements.

Revenue is a key metric for most entities, and it is important that users of financial statements understand the trends associated with the registrant's primary operations. Unfortunately, we believe that the proposal - i.e., (i) including the measurement from the assessment of collectibility in Revenue and (ii) reflecting changes in the assessment of collectibility in a separate line of the financial statements - could easily mask revenue trends and obscure the relationship between revenue and cash.

We urge the Boards to reconsider the proposed guidance and keep both measurements (resulting from the initial assessment and subsequent assessments of collectibility) in the same financial statement line item. We recommend that the measurements be reported as other income or expense. Alternatively, if the Boards conclude that credit risk should be an adjustment to Revenue, we recommend that both the initial measurement and subsequent changes to the measurement be reported as a separate component of Revenue, reported on its own line or in the notes to the financial statements.

Effective Date & Transition

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

Response: The proposed guidance requires retrospective application of the new revenue recognition requirements. Although full retrospective application will achieve consistency and comparability between
the reported periods, we believe that this creates significant operational challenges, especially for companies with a high volume of transactions. Unlike the adoption of certain new standards that require a one-time reclassification of existing debt, or the inclusion or exclusion of a discrete variable interest entity, retrospective application for revenue recognition involves reevaluating a significant volume of actual transactions.

We sell approximately five million vehicles per year globally. Retrospective application would require us either, to maintain parallel systems in order to process sales transactions under two different rules for comparative periods until the effective date, or to restate prior periods by re-analyzing the conditions of historical sale transactions. Both alternatives involve incremental costs and additional control risks. We believe that both the hard costs as well as the soft costs of retrospectively adopting the new rules will outweigh the benefits provided to financial statement users.

We suggest the Boards allow for prospective application of the guidance for transactions occurring after the effective date. Alternatively, we suggest the Boards provide companies with the option to report the change in accounting principle as a cumulative effect adjustment in the year adopted for transactions outstanding (i.e., for revenue not yet recognized) with sufficiently detailed qualitative explanations in the notes to the financial statements.

**Implementation Guidance**

**Question 14:** The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

**Response:** We believe further guidance regarding the Boards’ intent with respect to the words “material” and “significant” would greatly assist in applying the new principles. The implementation guidance makes reference to materiality with respect to determining a performance obligation, the time value of money, a contract itself, a customer’s credit risk, and an option or marketing offer. The proposed guidance refers to significance with respect to loss, changes, discount, etc. Each word is used approximately thirty times in the context of various implied thresholds.

We suggest the Boards provide a standard by which materiality and significance are to be measured. Specifically, with regard to materiality, we recommend that materiality generally should be measured in comparison to an entity’s overall business operations and financial results.

**Question 15:** The Boards propose that an entity should distinguish between the following types of product warranties:

a) A warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.

b) A warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

**Response:** We urge the Boards to reconsider the proposed guidance with respect to accounting for warranties.

*Latent Defects vs. Subsequent Faults.* As noted, the proposed guidance draws a conceptual distinction between a warranty for latent defects (i.e., a quality assurance warranty) and a warranty for faults that occur subsequent to the sale. The proposed implementation guidance requires an entity to differentiate product warranties based on the coverage they provide. If the warranty is for latent defects, revenue
should not be recognized on the components that are likely to be faulty until they are replaced or repaired. On the other hand, if the warranty coverage is for faults that occur after transfer, that warranty gives rise to a separate performance obligation, and a portion of the product transaction price is allocated to that separate performance obligation at contract inception and recognized over the performance period.

The proposed guidance attempts to make a distinction without a difference in the practical application of a manufacturer's warranty. It will be impractical to apply and will result in arbitrary financial results. The differentiation of whether a defect existed when a vehicle was sold or arose after the transfer is neither relevant to our customers nor relevant to our view of our obligation, and therefore should be irrelevant to the users of our financial statements.

For example: Assume an air conditioning button is designed to operate through 100,000 cycles without failure. A customer operates the button through 200,000 cycles and the button fails during the warranty period. Since failure occurred during the warranty period, the owner will take the vehicle to a dealer who will repair or replace the part at no charge to the customer. The dealer then sends a claim to Ford.

This fact pattern may be viewed as coverage for faults arising after the sale of the vehicle. Alternatively, one may argue that the expected life of the button should have been 200,000 cycles; hence, it is a latent defect in the design of the part. A more likely fact pattern is that nobody knows how many times the operator pushed the button. For this reason, it will be almost impossible to distinguish whether a defect is latent or has arisen subsequent to a sale.

Following on the example above, requiring manufacturers to differentiate their quality assurance warranties and to disclose warranties for "latent defects" would be misinterpreted, if taken out of context or used inappropriately.

For example: Judges and juries often rely on publicly-disclosed information for purposes of rendering a decision in lawsuits alleging that a product is defective. The fact that a manufacturer is required to disclose that it has deferred revenue for "defects that exist when the product is transferred to the customer but not yet apparent" may expose manufacturers to misunderstanding or even purposeful misuse of public disclosures. Such misunderstanding, whether innocent or willful, could have serious financial repercussions for manufacturers of all types.

We strongly urge the Boards to reconsider the proposed guidance that requires an entity to distinguish latent defects from subsequent faults. Instead, we recommend that the Boards acknowledge the economic distinctions that already exist in the market which differentiate quality assurance warranties from extended or insurance warranties.

**Revenue Recovery Model vs. Cost Accrual Model.** Whether a manufacturer's quality assurance warranty is considered coverage for latent defects or for subsequent faults, the warranty is offered to all customers with the objective of providing reimbursement for repairs that might be required during a specified warranty period. This type of warranty is considered an essential business cost required in order to remain competitive and fundamental to the successful sale of a product. It is counterintuitive to suggest that a quality assurance warranty should be accounted for either as a deferred revenue model, or a revenue-generating model: It is impractical to attempt to sell a product in today's marketplace without a quality assurance warranty; the manufacturer simply does not generate revenue from providing such a warranty, and the notion of quality assurance warranties as a revenue-generating activity is a contradiction to the very essence of efforts made toward product quality.

For example: An auto manufacturer provides a quality assurance warranty with the vehicle when it is sold to the dealer. Generally, the warranty becomes effective upon the dealer's sale to the retail customer. Auto manufacturers guarantee that they will compensate the dealer for parts used and services performed to replace a defective part on behalf of the dealer's customer. The claims are presented by the dealer to the manufacturer. The manufacturer does not warrant the dealer's service, nor does the manufacturer perform the service. In fact, in many jurisdictions the manufacturer is prohibited by statute from performing warranty services or from competing with
dealers in providing covered services. This quality assurance warranty simply is not a revenue-generating activity.

The proposed implementation guidance for recognizing revenue for warranties is not operationally effective, especially if it is determined that a quality assurance warranty is for coverage of latent defects. A manufacturer implementing the proposed revenue recovery model for amounts deferred for latent warranties will ultimately recognize the revenue based on negative evidence (i.e., the lack of knowledge of outstanding claims), rather than on a positive confirmation of a completed transaction.

For example: Thousands of components and parts work together to operate a single vehicle and are included under a new vehicle warranty. Although we have historical records that could be used to measure, based on statistical probabilities, which component might be faulty, the approximate number that may become faulty and the estimated amount for which to defer income, our present accounting models do not incorporate these probabilities at an individual component level. Instead, we use a cost model: at the time of a vehicle sale, we accrue a per-unit estimated amount representing an obligation of probable future costs based on historical experience related to past warranty claims by vehicle line. The per-unit value is intended to estimate an amount to repair all parts that might be faulty, not specific parts.

The implementation guidance requires a very specific refinements of our present model, including a prediction of which specific component will need to be repaired as well as the incorporation of a "recovery" period over which to earn back the revenue that was originally deferred.

For example: If we defer the recognition for a windshield wiper unit but the radio failed instead, we would continue to defer the revenue associated with the windshield wiper unit and expense the cost of repairing the radio. In the meantime, we would continue to defer the revenue for the windshield wiper unit until the entire warranty period for the very last vehicle sold with that unit was through the warranty period. Because a claim for the repair or replacement of the windshield wiper unit could be submitted at any time during the warranty period, the recognition of revenue under the proposed guidance would be inappropriate until the warranty period ended, i.e., the negative evidence.

We recommend the Boards allow entities to continue using a cost model for quality assurance warranties and a revenue-generating model for insurance warranties. Manufacturers that deliver a quality assurance warranty upon the initial sale of a product are doing so to remain competitive, as all customers have come to expect that the product will be replaced or repaired if found to be faulty during a specific period. Although this warranty is not always legally required, it is a necessary business expense incurred by manufacturers in selling new products, and therefore should continue to be reflected as a cost at the point of sale.

We recommend that Boards require the sales of extended or insurance warranties to follow a revenue-generating accounting model. Generally, a company or a third party separately prices insurance warranties. A separately-priced warranty extends certain elements of the original warranty and/or offers additional maintenance services to help the retail customer avoid major repairs. Separately-priced warranties are revenue generating and should continue to be accounted for following a revenue model.

If the Boards believe that the estimated costs of a warranty issued upon the initial sale of a product should be accounted for as a reduction to Revenue, we recommend the Boards consider requiring a model that follows a similar conceptual basis to that of a marketing incentive in ASC 605-50-25-3 rather than under a revenue recognition model.