

February 25, 2013

Hans Hoogervorst, Chairman  
International Accounting Standards Board  
30 Cannon Street  
London, EC4M 6XH  
United Kingdom

Leslie Seidman, Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116

VIA EMAIL: [hhoogervorst@IFRS.org](mailto:hhoogervorst@IFRS.org)  
[lseidman@FASB.org](mailto:lseidman@FASB.org)

Dear Chairmen:

We appreciate the opportunities we have had to discuss our observations regarding the 2011 Exposure Draft on Revenue Recognition (“2011 ED”) with several members of the FASB, the IASB and with your staffs. Despite these efforts, we remain concerned about how we might apply the proposed guidance within the automotive industry. We have compared the vehicle sales practices and related activities of our companies. We have different customers and practices depending on jurisdictional legal and economic environments<sup>1</sup>, as a result, we anticipate a diversity of practice even within our industry. We, as a representative group, submit for consideration three practical expedients that will help minimize the diversity and allow us to balance the anticipated costs with the benefits of complying with the new guidance.

We believe that the guidance as tentatively agreed by the Boards may broaden the scope of what we refer to as revenue generating activities today to include discounted products and services bundled with our vehicles, for example, products and services provided by unrelated third parties. We believe the guidance will increase the number of items we account for separately to include free or discounted services that are inconsequential to the value of our vehicles or that provide our customers with little incremental economic value. Additionally, we are concerned about the tentative conclusions made in September 2012 regarding incentives that we offer pre- or post-sale. Based on our current understanding of the proposed guidance for performance obligations we have concluded that it will cause significant complexity for our global operating systems and business practices with little value to users of our financial statements. Furthermore, the financial reporting processes, systems and controls will have a difficult time keeping pace with the creativity of our marketing incentives and the speed with which they change.

We have performed an *initial* assessment of the impact on our systems and estimate that the cost of compliance could be substantial; we estimate the range of cost may vary from approximately \$100 million for some companies to \$300 million for other companies, depending on the free or discounted services offered and the IT systems used. These estimates have *not* considered the implications and additional complexities for hedging, taxes, transfer pricing, and forecasting. These cost estimates assume the need for an IT solution that will account for the vehicles on an individual basis and a global implementation effort that will likely take three to eight years, depending on the related IT system interfaces.

We believe, however, that we could reasonably implement the proposed standard at a portfolio level. To do so, three practical expedients for applying the guidance will be necessary. Therefore, we respectfully submit to you for consideration three expedients that we believe are critical in order to apply the guidance

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<sup>1</sup> In certain jurisdictions, the manufacturer can sell directly to the retail consumer. In other jurisdictions, like the U.S., the law prohibits the manufacturer from selling products or offering services other than through a dealer or distributor.

at a portfolio level. These expedients will also help us avoid the excessive costs of building a sophisticated IT system to perform the accounting at the individual vehicle level.

In summary, we sincerely urge the Boards to find acceptable our proposed practical expedients. We believe these will help minimize the potential for diversity in practice, balance the cost of complying with the 2011 ED, enable global implementation in a more controlled manner and provide investors with a clear understanding of the economics of our transactions, and the nature of our contracts with our customers.

We appreciate your attention to this matter and would like an opportunity to meet with you to discuss any questions you might have. Please contact Susan Callahan (313-845-2211).

This letter is being submitted with the support and input of the following companies:

BMW Group - Elmar Schramm, Vice President Financial Statements, Periodical Reporting

Chrysler Group LLC - Alessandro Gili, Vice President – Corporate Controller and Chief Accounting Officer

Chrysler Group LLC - Bonnie Catlin, Chief Technical Accounting Officer

Daimler AG - Silvia Nierbauer, Director, Accounting & Financial Reporting Daimler Group

Fiat S.p.A.- Carlo Moschietto, Chief Accounting Officer

Ford Motor Company – Stuart Rowley, Vice President and Controller

Ford Motor Company - Susan Callahan, Manager Global Accounting Policy and Special Studies

General Motors – Nicholas Cyprus, Vice President, Controller and Chief Accounting Officer

General Motors - Brian Leiter, Assistant Controller Global Technical Accounting

Nissan North America, Inc. - Sean Gibbons, Director, Accounting & Reporting

PSA Peugeot Citroen - Magalie Durrèche, Head of Group Accounting Standards

## **Description of proposed practical expedients**

We respectfully request that the Boards consider the following three practical expedients we propose to apply in an effort to comply with the proposed accounting in the 2011 ED.

**1. A material right.** The industry often bundles free or discounted products or services with vehicles as marketing incentives offered for limited periods. Other services such as roadside assistance/courtesy transportation have been bundled with our vehicles for such a long time that our customer, the independent dealer, and the end retail consumer perceive it as “attached” to the vehicle just as other standard vehicle components, no different from windshield wipers. These items are included with the vehicle to enhance the retail consumer’s experience, and to build brand loyalty; they provide our customer and/or the retail consumer with minor economic benefit compared with the value of the vehicle. Some of us in the industry actually perform services that are bundled with the vehicle; others arrange for an independent party to perform the services for a fixed fee per service. Some of us separately sell the same service; some of us sell different but similar services bundled with other products. In some cases, we discontinue separately selling a product or service once we offer it free.

We believe evaluating whether goods or services in a contract are “inconsequential” is important when identifying performance obligations to our customer. We believe this concept is consistent with similar guidance in the proposed standard that is used to identify when options in a contract are separate performance obligations. In our view, paragraphs IG20-IG24 of the 2011 ED should be applied to the counterparty to our contract (generally, the independent dealer); we understand that others believe paragraphs IG20-IG24 should be applied to the customer’s customer. As a result, what constitutes the measure of a “material right” may differ depending on one’s interpretation. As a practical means of reconciling these different views, we propose a definition of “inconsequential products or services” which we could use to evaluate whether we have a separate performance obligation that provides “a material right to the customer that it would not receive without entering into that contract.”<sup>2</sup> For this purpose, we would propose the following definition:

*“Inconsequential products or services” are those items bundled with the primary deliverable (e.g., the vehicle) that either (1) are provided to the customer or the customer’s customer for a period not to exceed one year; or (2) that provide limited economic benefit to the customer or the customer’s customer, are not integral to the operation of the delivered item or are not of value apart from the delivered item (i.e., vehicles cannot be purchased without it, control of the products or services remain attached to the vehicle, the customer cannot negotiate a price reduction in lieu of the product or service, the product or service cannot be sold by the customer or used separately from the vehicle, etc.).*

Examples of inconsequential products or services include, but are not limited to, items such as providing six months free Satellite radio, arranging for shipment, covering limited in-transit insurance, providing non-assurance roadside assistance “attached” to the vehicle, and offering certain limited maintenance. Inconsequential products or services would also include free or discounted services that a customer or customer’s customer may receive for less than one year like navigation and telematics services that a company may also sell separately. The complexity in the processes, systems and controls and the related costs associated with these arrangements or incentives outweigh the benefits of separating them and accounting for them as performance obligations, recognizing revenue, costs and a margin, especially if within a twelve-month period.

Applying this definition to help us assess whether inconsequential items provide the customer a material right will reduce the number of items that we have to report as separate performance obligations. It will enhance comparability across the industry and will avoid unnecessary confusion to the users of our financial statements. Furthermore, the application of this definition will provide us with the ability to

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<sup>2</sup> 2011 ED, paragraph IG 21.

respond systematically on a timely basis to the more significant items that our marketing and sales operations may bundle with a vehicle, now and in the future.

**2. Allocation of price based on relative selling price of all performance obligations.** The industry sells approximately 80 million vehicles a year. We all sell multiple variations of vehicle option combinations (i.e., a vista roof, truck bed liner, all-wheel drive, towing package, leather seats, etc.) and the price range for a vehicle product line can be significant. We believe that because of the significant range in price, it will be difficult to allocate the transaction price to separate performance obligations based on relative selling price (e.g., between the vehicle and free or discounted products or services for which revenue should be deferred). Consequently, we believe it will require sophisticated systems to measure and allocate the transaction price. Furthermore, the accounting will not reflect the economic value of *either* the vehicle *or* the free or discounted item.

The transaction price allocated to free products or services that are bundled with low priced vehicles will differ from the transaction price allocated to the same product or service and bundled with high priced vehicles in the same product line. However, the value attributed by our customer and/or the customer's customer will be the same for the same product or service. Allocating transaction prices based on a relative selling price will result in the recognition of thousands of different revenue amounts for the same item. This outcome not only results in complications for accounting, but it will become inherently challenging to forecast and to create and manage budgets.<sup>3</sup>

Therefore, we urge the Boards to provide more flexibility in the use of the residual method. We propose that we identify the stand-alone selling prices for separate performance obligations, and we allocate any difference between the sum of all stand-alone selling prices and the transaction price as a reduction to the vehicle revenue. This method of allocating the transaction price will avoid making every item bundled with our vehicle, including the vehicle, a variable-priced item because of vehicle option combinations. Instead, we will recognize a transaction price that more closely reflects the value attributed by the customer.

**3. Pre-sale and post-sale incentives.** At the September 24, 2012 meeting, "the Boards tentatively decided that if the promise to transfer goods or services regarded as sales incentives was made in the contract or implied in the circumstances described in paragraph 24 of the 2011 ED, those promised goods or services should be accounted for as a performance obligation. However, if the promise was made after the transfer of control of the product to the intermediary, the Boards tentatively decided that the promise would not be a performance obligation."<sup>4</sup>

We agree in concept that if we offer free goods or services after we sell a vehicle to a customer, we will recognize no additional revenue and therefore the incentives (or changes in incentives) we offer post-sale reflect a cost. However, applying different accounting models to account for the same bundled goods and services depending on whether we have offered/modified them pre- or post-sale will be confusing to our investors and will add significant complexity to the accounting and process controls for these items.

We offer free goods and services as marketing incentives to our customer and to our customers' customers. We change the incentives frequently; we change their character (cash vs. non-cash), we change the offer period, and we change their value. When we offer an incentive, we make certain assumptions regarding the market penetration, which incentive the dealer or retail consumer will choose, and under some incentive programs, whether they will choose cash or a non-cash item. Regardless of our best efforts and because the retail consumer generally does not exist at the time of the vehicle sale to the dealer, we regularly record adjustments to our estimates for the actual results.

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<sup>3</sup> It is common for companies to use a comparison to the forecast as a compensating control for the financial statements.

<sup>4</sup> December 2012 Staff Paper, Effects of joint IASB and FASB deliberations on the November 2011 Exposure Draft Revenue from Contracts with Customers, page 6.

It is unclear to us whether the tentative decision made by the Boards in September regarding pre- and post-sale incentives applies to changes in the value of cash rebates offered to eligible retail consumers who purchase vehicles from independent dealers' existing inventories; it is unclear whether it applies to changes in the offer period; and it is unclear whether it applies to the adjustments we need to make to recognize the actual penetration compared to our estimated penetration.

The following might help illustrate the complexity involved as a result of the September 2012 decision for pre- and post-sale incentives.

We offer a one-year free extended warranty (e.g., a warranty that would otherwise be purchased separately) to retail consumers who purchase a vehicle from an independent dealer during March. The offer applies to vehicles ordered by dealers in March as well as to vehicles in dealers' inventories in March (i.e., purchased by dealers prior to March but not sold by the dealers). In April, we increase the offer to two years for eligible vehicles purchased by retail consumers from dealers by the end of the year. The two-year extended warranty applies to new vehicles sold to dealers after the announcement in April as well as to vehicles in dealers' inventories at the time of the announcement. On December 31, we discontinue the incentive and future retail sales by dealers are no longer eligible for any extended warranty contracts.

For this example, we have concluded that a free extended warranty contract is a material right. The accounting under the tentative conclusion of the Boards as of the September 2012 meeting might require the following:

In March

- We would recognize the free one-year extended warranty contracts as performance obligations on vehicles sold in March. A portion of the vehicle transaction price would be allocated to the extended warranty; revenue, cost and an allocated margin would be recognized over the related service period.
- We would recognize the free one-year extended warranty contracts as a cost for vehicles delivered/sold to the dealer prior to the announced incentive in March.

In April

- We would recognize the free two-year extended warranty contracts as performance obligations on vehicles sold in April through December. A portion of the vehicle transaction price would be allocated to the extended warranty on the vehicles sold after the announcement; revenue, cost and an allocated margin would be recognized over the related service period.
- We would recognize the additional free one-year warranty as a cost for vehicles delivered/sold to dealers prior to the announcement of the enhanced offer in April.

In December

- We would need to reverse our deferred revenue for the portion of the incentive deemed a performance obligation and reverse the accrued liability for the portion of the incentive deemed a cost – for vehicles remaining in dealer inventory when the incentive is discontinued in December. The amount to reverse and whether to reverse the amount through revenue or cost cannot be determined without the ability to track the incentive on a vehicle by vehicle basis.

During the service period

- We would need to be able to identify an appropriate methodology to earn the deferred revenue and report the associated costs and margin for service claims covered under the extended warranties recognized as performance obligations.
- We would need to be able to identify service claims covered under the extended warranties already expensed as a cost.
- Neither can be done without the ability to track the incentive on a vehicle-by-vehicle basis.

The complexity of applying the pre- and post-sale guidance in the above example would be compounded if we are required to re-allocate the transaction price as proposed in the 2011 ED.

We urge the Boards to consider accepting our proposal that we account for subsequent changes in an offer to our customer (or our customer's customer) as a revenue reduction, *without* re-performing a reallocation of the transaction price. We believe our proposal for pre- and post-sale incentives will provide results that are conceptually consistent with our proposed method of applying the residual method; adjustments due to both changes in the incentives offered and for actual experience differing from estimates result in a reduction of revenue from the sale of vehicles.

We believe the Boards' agreement with our proposed application for inconsequential items, the ability to apply the residual method in the allocation of the transaction price, and the proposed application for pre- and post-sale incentives will minimize diversity in practice, and significantly reduce the complexities and costs of complying with the proposed guidance while maintaining the integrity of the standard's core principles.