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Technical Director – File Reference No. 2018-240
Financial Accounting Standards Board
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File Reference: Comments on Exposure Draft, Collaborative Arrangements (Topic 808): Targeted Improvements

Ford Motor Company ("Ford"), a global automotive industry leader based in Dearborn, Michigan, manufactures and distributes automobiles across six continents. Ford Motor Credit Company LLC, an indirect, 100% owned subsidiary of Ford, is one of the world's largest automotive finance companies. We appreciate the opportunity to comment on the Proposed Accounting Standards Update Exposure Draft "*Collaborative Arrangements (Topic 808) – Targeted Improvements*." We support updating ASC 606 – *Revenue Recognition* and ASC 808 – *Collaborative Arrangements* to reduce diversity in practice related to the accounting for transactions between partners in a collaborative arrangement. However, we do not believe the proposed changes will reduce this reporting diversity, and if implemented as proposed, these changes may cause additional reporting issues and complexities.

Diversity in Reporting

We do not believe the proposed update will reduce diversity in practice. Defining the output of an entity's ordinary activity requires management judgment and drives diversity in what entities classify as revenue today. Some entities define outputs of their ordinary activities very broadly and include the entire value stream of activities that an entity performs as part of its daily operations, from inception of an idea to ultimate disposal of the final product. Others define outputs of their ordinary activities very narrowly and only include those outputs the entity regularly sells to third parties. An example would be engineering activities of a consumer products company. Some consumer product companies include consideration received for engineering services performed for third parties as revenue because engineering is part of the value stream for creating the finished product even though engineering services are not sold to third parties on a regular basis. Removing the guidance in ASC 606-10-15-3 that excludes counterparties to a contract when there are shared risk and benefits from the definition of a customer may increase diversity in reporting. If this scope exception is removed, revenue



classification will be dependent exclusively on what an entity defines as an output of its ordinary activities, which is subject to significant management judgment. Without clarification of what is included in the definition of revenue, diversity in reporting will remain not only for payments between collaborative partners, but also for total revenue reporting. Therefore, we request that the Board consider providing guidance to better define what constitutes the output of an entity's "ordinary activity."

Definition of a customer

We agree that simplifying the definition of a customer to eliminate specific guidance related to collaborative arrangements will reduce judgment in determining the proper accounting for consideration received from a partner in a collaborative arrangement. However, we see a number of issues with this when applied to collaborative agreements that provide only for the sharing or reimbursement of costs incurred to provide services that are an output of an entity's ordinary activities. This is typical of research and development collaborative arrangements, when both parties agree to share research and development expenditures, which require net reconciling payments between the parties each period.

First, we believe classifying consideration received in a collaborative cost sharing arrangement (zero profit) as revenue is contrary to the basic principal of ASC 606, which is that revenue should compensate an entity for costs incurred to satisfy a performance obligation and provide a return on those costs (ASC 606 - BC143). For example, ASC 606-10-32-34 requires a profit margin to be included in determining the stand-alone selling price of a good or service. ASC 606-10-55-11 concludes that an entity's right to payment for performance completed to date must include a profit margin. A cost sharing collaborative arrangement generally does not include profit margin and thus, should not be accounted for as a revenue generating arrangement.

Second, classifying consideration received in a collaborative cost sharing arrangement as revenue will result in grossing up the income statement while negatively affecting operating margins. The negative impact on operating margin is significant for companies in mature industries since operating margin, not revenue, is often the primary metric used by third parties to compare performance relative to competitors. Scoping zero margin cost sharing transactions into revenue will inappropriately penalize these more mature companies for entering into arrangements to jointly develop new technology. In addition, collaborative cost sharing arrangements are not significantly different from non-monetary exchanges, as entities are contracting with each other to exchange services in lieu of goods. The present revenue guidance specifically scopes out nonmonetary exchanges of goods between entities. The Board cited that even though the nonmonetary transfer of the good to the counterparty is an ordinary activity of the entity, the outcome of the transaction on the financial statements would be inappropriate because it would gross up revenue and expenses, and make it difficult for users of the financial statements to assess the entity's performance and gross margins during the reporting period (ASC 606 - BC58).



Finally, including collaborative cost sharing arrangements within the scope of ASC 606 may create unnecessary accounting complexities and cause an issue with revenue recognition timing, which may increase earnings volatility. Today, because there are shared risk and benefits in most cost sharing arrangements, they are generally not accounted for under ASC 606. Therefore, payments from the counterparty are recognized as an offset to costs incurred when received. If these payments are scoped into revenue as proposed by the exposure draft, consideration received to reimburse costs incurred may be recognized as revenue based on the guidance in ASC 606, depending on an entity's definition of ordinary activities. ASC 606-10-25-27 specifies that revenue must be recognized at the point in time the performance obligation is satisfied unless certain criteria are met. Specifically, revenue can be recognized as payments are received only if an entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment (including profit margin). Entities may enter into cost sharing arrangements to develop new technologies for future use and payments received to reimburse costs incurred do not include a profit margin. Therefore, the consideration received must be deferred and recognized as revenue when the collaborative agreement is complete. This could be a number of years depending on the scope of the technology being jointly developed.

To eliminate these issues, if the Board proceeds with the proposed change to the definition of a customer, we suggest adding a scope exception to the revenue standard for collaborative cost sharing / reimbursement agreements. The scope exception would be similar to the exception provided today for nonmonetary exchanges. Additionally we suggest the Board add guidance for determining if a contract is a cost sharing agreement. This could be done by providing indicators of a cost sharing / cost reimbursement contract. Examples of these could be:

- The agreement is part of a collaborative agreement and clearly states that the entity is being reimbursed for costs incurred
- The counterparty making payment requires verification of costs incurred by the entity before payment is made
- There is no profit margin (either implied or explicit)

IFRS Reporting

We are concerned that the proposed changes to the revenue and collaborative arrangements guidance to classify certain transactions between collaborative partners as revenue could increase divergence between IFRS and U.S. GAAP reporting. Convergence was one of the significant achievements of the new revenue standard. Ford, like many large multinational companies, has statutory IFRS reporting requirements for subsidiaries located outside the United States. Convergence between the standards is of significant importance as differences drive accounting complexity and increased cost. We believe that in addition to the proposed change to the definition of a customer, our suggestions to better define what constitutes an output of an entity's ordinary activity and to add a scope exception to the revenue standard to specifically exclude cost sharing arrangements, will help to achieve the goal of reducing diversity in reporting while maintaining convergence with



IFRS reporting. Since the proposed changes along with our recommendations will only clarify the scope and application of the present guidance, it will still be aligned with IFRS.

Transition:

We recommend the Board allow for prospective adoption of any change to the accounting of collaborative arrangements. As implementation of the revenue standard confirmed, the process of opening up existing contracts to determine how the contract would have been accounted under the new standard from inception of the contract is a time consuming and costly process that may result in little impact to the comparative financial statements. Under a prospective method, payments between collaborative partners post-adoption date will be accounted for under the new standard. Accounting for payments prior to implementation will remain unchanged. Additionally, we recommend a one year minimum implementation timing with early adoption permitted. This will allow companies with extensive collaborative agreements the required time to review these contracts while enabling companies the option to implement early.

We appreciate the Board's consideration of our views.

Sincerely

A handwritten signature in black ink that reads "Jashepherd".

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