

Accounting for Toyota's Recalls*

“According to the U.S. Transportation Department, over the past decade through the end of February, the number of deaths linked to sudden acceleration in Toyota vehicles has increased to 52.”¹

Despite a long-term strategy of building quality into their vehicles (Exhibit 1), Toyota ended the first decade of the twenty-first century mired in controversy and legal claims related to allegations of unintended sudden acceleration. In mid-September 2009, Toyota Motor Sales USA ordered its dealers in the United States to inspect floor mats in all of their cars after a high-speed traffic accident in late August 2009 killed a California Highway Patrol Officer and three members of his family (Exhibit 2). Unintended acceleration caused by an incorrect or misaligned floor mat was suspected. Exhibit 3 summarizes subsequent events. By late September, Toyota urged approximately 4 million Toyota and Lexus owners to remove the driver's side floor mat. About a month later, investigators turned their attention to the design of the accelerator pedal. In a press briefing on November 2, 2009 Toyota Group Vice President and General Manager Bob Carter “categorically denied claims like those in [an] ABC News investigation into the situation wherein owners are claiming electrical or mechanical faults led to unintended acceleration.”²

On November 16, 2009, Japanese media reported that Toyota had made a deal with the U.S. National Highway Traffic Safety Administration (NHTSA) over a recall. Toyota denied any agreement had been reached, but the company admitted it had already “set aside” \$5.6 billion to deal with the issue.³ By late November 2009, Toyota had recalled over four million vehicles in the U.S. to address the risk that floor mats could come loose and trap the accelerator pedal (Exhibit 4).

On January 16, 2010, Toyota notified the NHTSA that accelerator pedals made by its supplier CTS Corp might have a dangerous “sticking” defect. Five days later, Toyota announced a recall of over 2 million vehicles related to sticking pedals (Exhibit 5). Days later, at the urging of the NHTSA, Toyota (i) halted U.S. sales of eight models involved in the recall, including its best-selling Camry and Corolla sedans, and (ii) recalled an additional 1.1 million vehicles due to the

* This case was prepared from publicly available data for class discussion purposes by Robert M. Bowen and Jane Jollineau Kennedy of the Foster School of Business at the University of Washington. The comments of Frank Hodge and D. Shores are appreciated. May 26, 2010.

¹ TradingMarkets.com, March 2, 2010. See http://www.tradingmarkets.com/news/stock-alert/tm_toyota-crisis-a-total-recall-816622.html.

² See <http://jalopnik.com/5395507/toyota-talks-recall-ten-new-models-and-competition> and <http://abcnews.go.com/Blotter/RunawayToyotas/sudden-acceleration-toyota-cars-owners-rebel-accidents/story?id=8980479>

³ Motor Trend, Wide Open Throttle, November 16, 2009. See <http://wot.motortrend.com/6577069/recalls/report-toyota-makes-deal-with-nhtsa-to-fix-accelerator-pedals-on-eight-models/index.html>.

risk that a loose floor mat could trap the accelerator in an open position. This added to the recall of 4.2 million vehicles announced in late November 2009.

Financial impact of the recalls

On January 27, 2010, *Automotive News* estimated that Toyota dealers could lose as much as \$1.5 million in profit every week of the sales “freeze.” Toyota notified NHTSA late in the day that it would expand its late November recall to cover an additional 1.1 million vehicles.

Largely as a result of weeks of bad press, Toyota sales in January 2010 fell 16% from the year earlier to levels not experienced in the prior decade. Toyota's stock price fell approximately 10% overall and about 30% relative to the S&P 500 over the period from early September 2009 through April 2010 (Exhibit 6). In contrast, Ford Motor Company's stock price grew 80% over the same period, suggesting that at least some competitors benefited from Toyota's problems (Exhibit 7).

On March 9, 2010, *The Wall Street Journal* reported that the financial impact on Toyota could exceed \$5 billion over the next fiscal year, including litigation costs, warranty costs, increased marketing and incentive campaigns to counteract the negative publicity surrounding the claims of unintended acceleration. For example, in early 2010, Toyota featured “a 0% interest five-year loan offer, competitive lease prices and free maintenance across 80% of its vehicle line-up.”⁴ While Toyota had already estimated a recall cost of about \$2 billion (180 billion yen) for the current fiscal year, analysts estimated future costs to be much higher, including J.P. Morgan's estimate of \$5.5 billion (500 billion yen). Despite having an approximate \$29 billion in cash and little debt, “ratings agency Fitch placed the company's 'A+' rating on negative watch. Fitch said the recall and sales suspension casts a negative light on Toyota's reputation for quality. A reduction in a company's credit rating can make it more expensive for it to raise money in the debt market.”⁵

On April 19, 2010, Toyota confirmed it would pay a \$16.4 million fine by the NHTSA related to delaying the recall of vehicles experiencing sticking accelerator pedals. Toyota denied any wrongdoing but elected to pay the fine, the largest amount allowed under U.S. federal law.

On May 11, 2010, Toyota reported a \$1.2 billion profit for the fourth fiscal quarter and \$2.2 billion for the fiscal year ended March 31, 2010, despite revealing that it had spent \$1.1 billion on recalling 8 million vehicles and had lost about \$800 million in sales worldwide. Toyota reported a \$233 million operating loss for its North America region – down from a \$1.9 billion loss in the same quarter of 2009. Management expressed optimism and forecasted net income of \$3.4 billion for fiscal 2011.⁶

⁴ “Toyota's Recall Costs Could Top \$5 Billion,” *The Wall Street Journal*, 3/9/10.

⁵ Ibid

⁶ “Toyota Announces Year-End Financial Results” Toyota Investor Relations, 5/11/10.
http://www2.toyota.co.jp/en/news/10/05/0511_1.html

Accounting for warranty provisions and contingent liabilities

Throughout the recall crisis, the financial community looked to Toyota management for guidance on the magnitude and duration of its effects. However, Toyota's May 11 announcement of fiscal 2010 financial results was thin on details.

A difficult challenge for any accounting system is reporting events that have important but uncertain outcomes such as the events surrounding the ultimate recall of millions of Toyota and Lexus vehicles in late 2009 and early 2010. Uncertainty related to the recalls included current and future warranty costs, as well as potential litigation settlement costs. Of these costs, past warranty costs are observable and future warranty costs were likely relatively straightforward to forecast. Toyota management knew the number of recalled vehicles, the approximate cost to repair each vehicle and the number of vehicles yet to be repaired. With this information, management estimated incremental warranty expense and the associated liability related to the recalls.

The accounting entry increased warranty expense, which lowered net income for the period, and increased liabilities for the estimated future warranty work. The liability is reduced as repairs are completed.

More difficult to predict were future costs to settle litigation surrounding the accidents and events leading to the recalls. Such predictions tend to be highly subjective and only result in a reported (contingent) liability under certain conditions. Further complicating the situation was that accounting for contingencies under U.S. GAAP was in a state of flux at yearend 2009 and both the U.S. and Japan were discussing the transition to International Financial Reporting Standards (IFRS) and its materially different approach to reporting contingent liabilities (summarized in Exhibit 8).⁷

At stake was how to report the estimated future implications of Toyota's recalls on the Company's financial statements (or whether to report anything at all). Not surprisingly, different constituencies tended to hold different positions on what the best accounting should be. Preparers and auditors tended to support current U.S. GAAP while consumers of financial data (investors and analysts) tended to be critical of current U.S. GAAP and preferred more disclosure and recognition of uncertain contingent liabilities.

Management's dilemma

As fiscal yearend 2010 approached, Toyota management had an expensive recall campaign under way and was dealing aggressively with public relations challenges.

Toyota and its president, Akio Toyoda, have embarked on a media offensive, after being criticized for its slow response to the burgeoning crisis. Mr. Toyoda last week aimed to rally the troops by speaking in front of thousands of Toyota dealers, suppliers and management. On Monday, he met with Yukio Hatoyama, Japan's prime minister, to discuss his testimony before U.S. Congress and his visit to China.

⁷ Both U.S. and Japanese accounting standards were converging to IFRS. <http://www.ft.com/cms/s/0/fd68dde4-4c13-11df-a217-00144feab49a.html>.

The car maker also lashed out against ABC News, alleging the broadcaster staged part of a report on Feb. 22 that purported to show electronic problems could cause Toyota vehicles to accelerate unexpectedly.

The attack on ABC was part of what the Japanese car maker has called a broader push to rebut critics and win support for its view that the electronics in its vehicles are not defective.

In addition to the public relations offensive, management had to (i) decide how to report the events of the past six months in its annual report to the company's shareholders, and (ii) determine how reporting might differ if IFRS were used instead of U.S. GAAP,⁸ and (iii) address the lingering question was how they could have done a better job of responding to the events surrounding the allegations of sudden acceleration.

⁸ Again, Exhibit 8 summarizes IFRS rules on contingent liabilities and contrasts differences between IFRS and current U.S. GAAP.

Case questions:

1. Managers of manufacturing firms report estimated warranty provisions in their periodic financial statements. Would historical models be useful in making Toyota's fiscal 2010 estimate? Why or why not?
2. Assuming the cost to address the 8 million recalled vehicles world wide was estimated to average \$600 per vehicle, prepare an initial journal entry to record Toyota's warranty costs related to the fiscal 2010 recalls. Assuming 2 million vehicles had been repaired by fiscal yearend 2010, what would be the magnitude of the liability at March 31, 2010? Assuming you were senior management at Toyota, would you have tended to under or overestimate your forecast of these warranty costs? Why?
3. Current U.S. GAAP uses the terms "probable," "reasonably possible" and "remote" to describe the likelihood of future events such as litigation claims. Using probabilities ranging from 0% to 100%, what does each term mean to you? (Don't worry, there is no single correct answer to this question.)
4. How would the likelihood of a loss/liability and an estimate of the magnitude of that loss/liability be different on September 30, 2009 as compared to January 31, 2010? (A qualitative response is fine; no numbers are necessary.)
5. Would investors want Toyota's management to disclose and estimate contingent liabilities associated with sudden acceleration claims? Why or why not?
6. How would Toyota's contingent liabilities associated with sudden acceleration claims be reported under (a) current U.S. GAAP and (b) IFRS?
7. Taking an investor perspective, which reporting regime would you prefer and why: (a) current U.S. GAAP or (b) IFRS?
8. Taking the perspective of Toyota senior management, which reporting regime would you prefer and why: (a) current U.S. GAAP or (b) IFRS?
9. Taking the perspective of Toyota's auditors, which reporting regime would you prefer and why: (a) current U.S. GAAP or (b) IFRS?
10. How should Toyota account for the loss of sales, market share and reputation from these adverse events?

Exhibit 1

“Toyota Traditions: Building Quality into Processes”

In June 1960, Eiji Toyoda, then Executive Vice President of Toyota Motor Co., Ltd. (TMC), laid down guiding principles for quality control in a document named "Requests regarding inspection." In it he introduced the notion of "building quality into processes," pointing out that "the idea behind an inspection is to eliminate the need for inspections." As long as standards in processes could be kept at the highest possible levels, Toyoda thought inspections would, in an ideal world, become unnecessary.

Toyoda decided to produce the document in response to the difficulties TMC had been facing at the time. Increased output in response to the incredible surge in demand due to Japan's rapid motorization at the time, saw a huge influx of insufficiently trained new staff at the factories. This was having serious repercussions on product quality.

In June 1961, TMC decided to adopt the system of Total Quality Control (TQC) to modernize management operations. To realize TQC, all employees in Toyota were required to "regard the next processes (on the production line) as their customers and provide them with the required amount and quality of goods and services on a timely basis." Individual quality control circles studied ways of determining the cause of defects when they occurred and devised countermeasures to prevent reoccurrence. In addition, quality control teams were formed at all levels to promote company-wide participation.

The first product to benefit from these improvements was the third generation Corona. Pressures to bring the second generation Corona to market as quickly as possible to meet market demand had led to early product defects, which although later rectified, caused the car to be widely regarded as inferior in quality.

After company-wide efforts to implement TQC, the new Corona was launched in September 1964, and proved its superior quality in the "100,000-km continuous high-speed driving test" conducted on highways in Japan. The high profile test, the likes of which had never been seen before, meant the Corona soon earned a reputation for exceptional high speed performance and durability. The model had recovered its reputation and was on its way to becoming the best selling passenger car in Japan.



New Corona during the "100,000km continuous high-speed driving test" on the Nagoya-Osaka Expressway. The new Corona reached the milestone of 100,000 km following a non-stop drive for 58 days at 100km/hour



TMC President Fukio Nakagawa (1961-1967) and Dr. W. Edwards Deming

After the success of the new Corona and through further improvements, Toyota's TQC efforts were officially recognized in 1965, when the company was awarded the Deming Application Prize for quality control management. Toyota has stressed the importance of quality control ever since and it is thanks to these continued efforts that the Toyota brand the world over has become synonymous with Quality, Durability and Reliability.

Exhibit 2

Lexus 350 crash caused by sudden acceleration



August 28, 2009: Off-duty California Highway Patrol officer Mark Saylor is traveling on Highway 125 in Santee, California (northeast of San Diego), with three family members, when the 2009 Lexus ES350 he is driving suddenly accelerates out of control, hits another car, tumbles down an embankment and catches fire. While the car is careening down the highway at speeds estimated to exceed 100 mph, one of the occupants calls 911 and reports that the car has "no brakes." The call ends with the sound of a crash. All four people in the vehicle are killed. The vehicle was a loaner from a local Lexus dealer.

Sources: MSNBC.com, Google search

Exhibit 3

Timeline of events relating to allegations of sudden acceleration in Toyota vehicles

Below are milestones leading to the largest recall in Toyota's history:

- August 28, 2009: An off-duty California Highway Patrol officer is driving on a highway northeast of San Diego with three family members when the 2009 Lexus ES350 suddenly accelerates out of control, hits another car, tumbles down an embankment and catches fire. As the Lexus reaches speeds estimated to exceed 100 mph, one of the occupants calls 911 and reports that the car has "no brakes." All four are killed in the ensuing crash.
- September 14, 2009: Preliminary reports from Toyota and local authorities indicate that the Lexus, which had been on loan from Bob Baker Lexus of San Diego, where Saylor's personal Lexus vehicle was being serviced, may have had the wrong floor mats installed, interfering with the gas pedal.
- September 29, 2009: Toyota announces floor-mat "customer safety advisory," saying the floor mats can become entangled with the accelerator and cause it to stick. The company advises people to remove the floor mats from their cars and says it will provide "safe" replacements.
- October 2, 2009: Newly installed Toyota CEO Akio Toyoda publically apologizes to the Saylor family members killed in the accident and to every customer affected by the recall.
- October 18, 2009: *The Los Angeles Times* publishes the first of several stories concerning claims of unintended acceleration in Toyota vehicles. The *Times* article reveals there have been nine separate NHTSA investigations into claims of unintended acceleration by Toyota vehicles in the past decade. Two involved floor mats, and one a trim piece on the Toyota Sienna minivan. Six were dismissed due to lack of evidence. The *Times* story also claims at least five unintended acceleration cases involving Toyota products in the past two years had resulted in fatalities and that "hundreds" of complaints had been filed with the federal government.
- October 25, 2009: The results of an investigation by local authorities and the National Highway Traffic Safety Administration (NHTSA) reveal a set of rubber floor mats designed for the Lexus RX 400 SUV had been placed over the top of the ES 350's stock carpeted floor mats and that the accelerator pedal had become jammed against them, causing the car to accelerate out of control. NHTSA notes brakes were nearly destroyed on the car and that the accelerator pedal was "bonded" to the floor mat. NHTSA also points out the gas pedal on the car was solidly mounted to its stalk, whereas other vehicles use hinged pedals.
- October 30, 2009: Toyota begins sending letters to owners notifying them of an unspecified upcoming recall to fix the unintended acceleration issue. In the letters Toyota states "no defect exists."
- November 2, 2009: NHTSA takes the highly unusual step of publicly rebuking Toyota, calling a company press release re-iterating the statements made in the 30 October letter to owners "inaccurate" and "misleading," noting that the floor mat recall was an "interim" measure and that it "does not correct the underlying defect." Toyota publically apologizes.
- November 4, 2009: Toyota issues another press release denying media reports a problem exists with its drive-by-wire electronic throttle system. However, to support the claim, Toyota simply cites a NHTSA report released two days earlier showing the agency has refused a petition by a Toyota owner to open a new investigation into Toyota's drive-by-wire system. In that report NHTSA had also revealed it had begun an investigation into Toyota's all-weather rubber floor mats in March 2007 after reports of unintended acceleration in 2007 Lexus ES 350s. The investigation would later include 2008 models, and cover a total of 26 claimed unintended acceleration cases, including seven accidents. NHTSA claimed the investigation was closed in October 2007 after Toyota recalled the accessory floor mats and redesigned them.

Exhibit 3 (continued)

Timeline of events relating to allegations of sudden acceleration in Toyota vehicles, p. 2

- November 8, 2009: The *Los Angeles Times* claims Toyota had ignored over 1,200 complaints of unintended acceleration over the past eight years because NHTSA had thrown out those reports that claimed the brakes were not capable of stopping the car under an unintended acceleration scenario. In the story a Toyota spokesman confirms the brakes are not capable of stopping a vehicle accelerating at wide open throttle.
- November 16, 2009: Japanese media reports claim Toyota has made a deal with NHTSA over a recall. Toyota denies any agreement had been reached, but the company admits it had already set aside \$5.6 billion to deal with the issue.
- Nov. 25, 2009: Toyota recalls approximately 4 million vehicles in the United States to address the risk that floor mats can come loose and trap the accelerator pedal. The company also announces that it will redesign its floor mats and install brake-override systems in its new cars. This functionality, standard across some automakers' lines, cuts the throttle when the brake pedal is pressed.
- November 29, 2009: A new *Los Angeles Times* story claims a number of Toyota drivers say their vehicles had still accelerated out of control with the floor mats removed. The *Times* also reports complaints of unintended acceleration increased after Toyota began using its drive-by-wire system in 2002, starting with the ES 300. According to the *Times*, unintended acceleration complaints on Lexus ES 300s jumped from an average of 26 per year in 2001 to 132 per year in 2002, and there had been 19 deaths since 2002 related to unintended acceleration in Toyotas, compared with 11 deaths connected to all other automakers combined. The story also notes Toyota has been investigated for unintended acceleration more times than any other automaker, and that 74 of 132 complaints lodged against the 2007 Lexus ES 350 were for cases of unintended acceleration. Toyota has no explanation, but says its drive-by-wire system is not to blame, again citing the November 2 NHTSA report.

However, the *Times* notes that the agency has only investigated the drive-by-wire system twice in its nine investigations and Toyota had issued three separate service bulletins for 2002 and 2003 Camrys concerning unintended acceleration issues with the drive-by-wire system. The *Times* says NHTSA had asked Toyota to look into an issue with the electronic throttle body on the 2006 Camry, which Toyota immediately delegated to the parts supplier. When the supplier reported there was no problem, NHTSA accepted the finding and quietly closed the report, keeping most of its 74 pages confidential.

- December 5, 2009: Following an op-ed piece in the *Los Angeles Times*, Toyota writes a letter to the paper reiterating its stance that the floor mats were the root cause of most unintended acceleration claims. The company defends NHTSA and its methodology.
- Dec. 15, 2009: NHTSA officials meet Toyota executives in Japan seeking prompt action on safety issues. Toyota commits to improving its responsiveness.
- December 23, 2009: Another story in the *Los Angeles Times*, this time accusing Toyota of hiding defects from customers and regulators over the past decade. The story notes the company has been fined and rebuked by judges several times for failing to turn over evidence in lawsuits, and that many suits brought against the company have been settled out of court for undisclosed sums of money. It also reveals Toyota has only one machine in the U.S. capable of reading onboard data recorders and has often refused to share the information with claimants and law enforcement. Toyota claims it has been unfairly attacked by the paper, but confirms it only has a single data-reading machine and that the software on it is proprietary. Even though California and other states have laws specifying the data on the recorder belongs to the vehicle's owner, Toyota says it shares information in select cases either as a "community service" or when required to do so by a judge. Toyota says it is company policy not to use the software to investigate defect claims. Ten lawsuits over unintended acceleration are pending against the company.

Exhibit 3 (continued)

Timeline of events relating to allegations of sudden acceleration in Toyota vehicles, p. 3

- December 26, 2009: A Toyota Avalon crashes into a lake in Texas after accelerating out of control. All four occupants die. Floor mats are ruled out as a cause because they are found in the trunk of the car.
- January 11, 2010: Toyota announced its brake override software fix will be made global by 2011.
- Jan. 16, 2010: Toyota informs NHTSA that accelerator pedals made by supplier CTS Corp may have a dangerous "sticking" defect.
- Jan. 19: At meeting in Washington including Inaba and U.S. sales chief Jim Lentz, NHTSA asks Toyota to take prompt action. Hours later Toyota tells NHTSA it will issue a recall.
- Jan. 21: Toyota announces recall for about 2.3 million Toyota models to fix sticky pedals. The company says the new recall is unrelated to the floor mat recall, but also announces 1.7 million Toyota vehicles would be affected by both recalls.
- Jan. 25: NHTSA informs Toyota it is legally obliged to stop selling vehicles even if it does not have a remedy.
- Jan. 26: Toyota announces it is immediately halting the sale of all models affected by the January 21 pedal recall, including its best-selling Camry and Corolla sedans, and that it will shut down assembly lines for those models at five North American plants for one week beginning February 1.
- Jan. 27: U.S. **Transportation** Secretary Ray LaHood tells Chicago radio station WGN the government asked Toyota to stop selling the recalled vehicles. Toyota confirms LaHood's statement. Other media reports claim Toyota has quietly informed its dealers and factories the problem lies with pedals made by supplier CTS Corporation of Elkhart, Indiana. Lexus and Scion models, it turns out, use pedals made by Japanese supplier Denso, hence their exemption from the recall. The problem is said to occur after 38,000 miles, though the cause is still under investigation.
- Jan. 27: Allegedly at the urging of NHTSA, Toyota expands its November 25 announcement by recalling an additional 1.1 million vehicles due to the risk that a loose floormat could trap the accelerator in an open position.
- Jan. 28: Toyota meets with NHTSA to review its pedal fix. NHTSA says it has no objections to the fix.
- Jan. 29: NHTSA opens investigation into CTS pedals. NHTSA asks CTS if it sold pedal to other carmakers and when it discovered reports of problems.
- February 1, 2010 – Toyota announces **accelerator-pedal fix**, which involves a shim inserted into the pedal assembly to prevent the throttle from becoming stuck open.
- Feb. 2: Toyota reports a 16 percent drop in January U.S. sales. Monthly U.S. sales drop below 100,000 for the first time in more than a decade and Toyota's U.S. market share falls to its lowest level since January 2006.
- Feb. 2: NHTSA renews investigation into Toyota's electronic throttle control system. U.S. Transportation Secretary Ray LaHood says, "While Toyota is taking responsible action now, it unfortunately took an enormous effort to get to this point." Toyota says it will fully cooperate with NHTSA probe.
- Feb. 3: LaHood warns recalled Toyota owners to stop driving, then withdraws his remarks, saying it was a misstatement. Toyota says it is examining braking complaints about its 2010 model Prius hybrid.
- Feb. 4: NHTSA opens investigation into at least 124 consumer complaints about brakes on Toyota Prius hybrids.

Exhibit 3 (continued)

Timeline of events relating to allegations of sudden acceleration in Toyota vehicles, p. 4

- Feb. 5: After keeping a low profile for nearly two weeks, President Akio Toyoda appears at a news conference to apologize for safety problems. He announces plans to bring in a task force, including outside analysts to review quality. Toyota considers a recall for Prius braking issue.
- February 8, 2010 – Recalls for braking issues are extended to [2010 Prius](#) and 2010 Lexus HS250h because of “inconsistent pedal feel” under braking on slick or uneven surfaces. More than 437,000 vehicles are involved, bringing the total to more than 8.5 million Toyotas recalled.
- February 22, 2010 – A professor from a Podunk university looking to make a name for himself teams up with ABC News to dupe the populace into believing their Toyota has a ghost in the machine, a.k.a. an electronics glitch that can cause acceleration independent of pedal involvement. The process by which he rigged the car to accelerate is shown later by Toyota and a team of researchers from a real college—Stanford—to work on vehicles from virtually any maker.
- February 24, 2010 – Toyota president Akio Toyoda testifies in Congress, apologizes again, and gets scolded.
- April 5, 2010 – NHTSA plans to seek [a \\$16.4 million civil fine from Toyota](#) for the automaker’s failure to acknowledge accelerator pedal defects. This is the maximum amount possible under the government agency’s authority. NHTSA says Toyota knew about sticking pedals in September 2009 but didn’t acknowledge the problem for another four months.

Sources: Reuters, MSNBC, Motor Trend, Car and Driver

Exhibit 4

Example Toyota recall notice for unsecured or incompatible floor mats

Recall Date:

OCT 05, 2009

Model Affected:

2009 TOYOTA CAMRY

Summary:

TOYOTA IS RECALLING CERTAIN MODEL YEAR 2004-2010 PASSENGER VEHICLES. THE ACCELERATOR PEDAL CAN GET STUCK IN THE WIDE OPEN POSITION DUE TO ITS BEING TRAPPED BY AN UNSECURED OR INCOMPATIBLE DRIVER'S FLOOR MAT.

Consequence:

A STUCK OPEN ACCELERATOR PEDAL MAY RESULT IN VERY HIGH VEHICLE SPEEDS AND MAKE IT DIFFICULT TO STOP THE VEHICLE, WHICH COULD CAUSE A CRASH, SERIOUS INJURY OR DEATH.

Remedy:

TOYOTA FILED AN AMENDED DEFECT REPORT ON NOVEMBER 25, 2009, STATING THAT DEALERS WILL MODIFY THE ACCELERATOR PEDAL AND, ON CERTAIN VEHICLES, ALTER THE SHAPE OF THE FLOOR SURFACE UNDER THE PEDAL. THESE CHANGES ADDRESS THE RISK OF PEDAL ENTRAPMENT DUE TO INTERFERENCE WITH THE FLOOR MAT. REDESIGNED ACCELERATOR PEDALS WILL BECOME AVAILABLE BEGINNING IN APRIL 2010 AND DEALERS WILL REPLACE ANY MODIFIED PEDAL WITH THE NEW PEDAL IF DESIRED. ALSO, DEALERS WILL REPLACE ANY GENUINE TOYOTA OR LEXUS ALL-WEATHER FLOOR MATS WITH REDESIGNED ALL-WEATHER MATS, OR REPURCHASE THE PREVIOUS MATS FROM OWNERS WHO DO NOT WANT THE NEW ONES. ADDITIONALLY, SOFTWARE MODIFICATIONS WILL BE INSTALLED ON CAMRY, AVALON AND LEXUS ES 350, IS 350 AND IS 250 MODELS THAT WILL ENSURE THAT THE BRAKE OVERRIDES THE ACCELERATOR IN THE EVENT BOTH BRAKE AND ACCELERATOR PEDALS ARE APPLIED. TOYOTA WILL BEGIN MAILING LETTERS TO OWNERS IN DECEMBER 2009. OWNERS MAY CONTACT TOYOTA AT 1-800-331-4331, LEXUS AT 1-800-255-3987.

Potential Units Affected:

4260319

Notes:

TOYOTA MOTOR NORTH AMERICA, INC. 90L

Exhibit 4 (continued)

Template of Toyota letter to owners warning about unsecured or incompatible floormats

**Certain [Model Year] through [Model Year] Model Year [model]
Potential Floor Mat Interference with Accelerator Pedal
Safety Recall Campaign (Interim Notice)**

[VIN]

Dear Toyota Owner:

This notice is being sent to you in accordance with the requirements of the National Traffic and Motor Vehicle Safety Act. Toyota has decided that a defect which relates to motor vehicle safety exists in certain 200_ through certain 200_ model year [name of model] vehicles. The defect is the potential for an unsecured or incompatible driver's floor mat to interfere with the accelerator pedal and cause it to get stuck in the wide open position. Toyota has determined that this defect does not exist in vehicles in which the driver side floor mat is compatible with the vehicle and properly secured.

Toyota is currently developing a campaign remedy and will notify you when it is ready. In the meantime, we are providing important information regarding the issue and steps you may take in the interim

What is the risk?

A stuck open accelerator pedal may result in very high vehicle speeds and make it difficult to stop the vehicle, which could cause a crash, serious injury or death.

What will Toyota do?

We will notify you again as soon as a campaign remedy is available for your vehicle.

What should you do?

We request that you take out **any removable** driver's floor mat and NOT replace it with any other floor mat until the campaign remedy is ready and implemented on your vehicle.

In the event you choose not to take out your removable floor mat, Toyota strongly recommends that you ensure that the correct floor mat is being used, that it is properly installed and secured, that it is not flipped over with the bottom-side up, and that one floor mat is not stacked over another. Information on proper floor mat installation for your vehicle is enclosed with this notification. Please visit <http://www.toyota.com/floormats> for information on other models.

What should you do if you experience accelerator pedal interference?

Should the vehicle continue to accelerate rapidly after releasing the accelerator pedal, this could be an indication of floor mat interference. If this occurs, Toyota recommends you take the following actions:

First, if it is possible and safe to do so, pull back the floor mat and dislodge it from the accelerator pedal; then pull over and stop the vehicle.

If the floor mat cannot be dislodged, then firmly and steadily step on the brake pedal with both feet. Do NOT pump the brake pedal repeatedly as this will increase the effort required to slow the vehicle.

Shift the transmission gear selector to the Neutral (N) position and use the brakes to make a controlled stop at the side of the road and turn off the engine.

If unable to put the vehicle in Neutral, turn the engine OFF, or to ACC. This will not cause loss of steering or braking control, but the power assist to these systems will be lost.

-If the vehicle is equipped with an Engine Start/Stop button, firmly and steadily push the button for at least three seconds to turn off the engine. Do NOT tap the Engine Start/Stop button.

-If the vehicle is equipped with a conventional key-ignition, turn the ignition key to the ACC position to turn off the engine. Do NOT remove the key from the ignition as this will lock the steering wheel.

Exhibit 5

Sample Toyota recall notice for accelerator pedal stickiness

Recall Date:

JAN 21, 2010

Model Affected:

2009 TOYOTA CAMRY

Summary:

TOYOTA IS RECALLING CERTAIN MODEL YEAR 2005-2010 AVALON, MODEL YEAR 2007-2010 CAMRY, MODEL YEAR 2009-2010 COROLLA, COROLLA MATRIX, RAV4, MODEL YEAR 2010 HIGHLANDER, MODEL YEAR 2008-2010 SEQUOIA, AND MODEL YEAR 2007-2010 TUNDRA VEHICLES. DUE TO THE MANNER IN WHICH THE FRICTION LEVER INTERACTS WITH THE SLIDING SURFACE OF THE ACCELERATOR PEDAL INSIDE THE PEDAL SENSOR ASSEMBLY, THE SLIDING SURFACE OF THE LEVER MAY BECOME SMOOTH DURING VEHICLE OPERATION. IN THIS CONDITION, IF CONDENSATION OCCURS ON THE SURFACE, AS MAY OCCUR FROM HEATER OPERATION (WITHOUT A/C) WHEN THE PEDAL ASSEMBLY IS COLD, THE FRICTION WHEN THE ACCELERATOR PEDAL IS OPERATED MAY INCREASE, WHICH MAY RESULT IN THE ACCELERATOR PEDAL BECOMING HARDER TO DEPRESS, SLOWER TO RETURN, OR, IN THE WORST CASE, MECHANICALLY STUCK IN A PARTIALLY DEPRESSED POSITION.

Consequence:

THE ACCELERATOR PEDAL MAY BECOME HARD TO DEPRESS, SLOW TO RETURN TO IDLE, OR, IN THE WORST CASE, MECHANICALLY STUCK IN A PARTIALLY DEPRESSED POSITION, INCREASING THE RISK OF A CRASH.

Remedy:

DEALERS WILL INSTALL A REINFORCEMENT BAR IN THE ACCELERATOR PEDAL WHICH WILL ALLOW THE PEDAL TO OPERATE SMOOTHLY. GM WILL NOTIFY OWNERS FOR THE PONTIAC VIBE PLEASE SEE 10V-018. THIS SERVICE WILL BE PERFORMED FREE OF CHARGE. THE SAFETY RECALL IS EXPECTED TO BEGIN EARLY FEBRUARY AND WILL BE COMPLETED IN LATE APRIL 2010. OWNERS MAY CONTACT TOYOTA AT 1-800-331-4331.

Potential Units Affected:

2230661

Notes:

TOYOTA MOTOR NORTH AMERICA, INC. AOA

Source: <http://www.automobilemag.com/am/2009/toyota/camry/recalls.html>

Exhibit 6

**Toyota Motor Corporation (ADR) stock price versus S&P 500:
August 2009 – April 2010**



Source: Google Finance

Exhibit 7

**Toyota Motor Corporation (ADR) stock price versus Ford (F) and S&P 500:
August 2009 – April 2010**



Exhibit 8

Toyota Motors
Excerpts from International Accounting Standard #37 on Contingent Liabilities
(noting differences from U.S. GAAP)

Issue	IAS 37	US GAAP Differences
Definitions	<p>A <u>liability</u> is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. (Par. 10)</p>	<p><u>Liabilities</u> are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. (Not in codification, SFAC No. 6) <i>The definitions are similar. Note that the definition above appears to indicate the likelihood of future outflow. But SFAC No. 6 explains: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved</i></p>
	<p>A <u>provision</u> is a liability of uncertain timing or amount. (Par. 10)</p>	<p><i>The codification does not define <u>provision</u>, but see below.</i></p>
	<p>A <u>contingent liability</u> is:</p> <p>(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or</p> <p>(b) a present obligation that arises from past events but is not recognized because:</p> <p>(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or</p> <p>(ii) the amount of the obligation cannot be measured with sufficient reliability. (Par. 10)</p>	<p>A <u>loss contingency</u> is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. The term loss is used for convenience to include many charges against income that are commonly referred to as expenses and others that are commonly referred to as losses. (450-10-20) <i>One obvious difference is that the IAS focuses on defining the liability side and the codification focuses on defining the loss side (the IAS is more consistent with the balance sheet perspective that both boards are currently supporting). The use of the word "existing" above is meant to convey that there is a present obligation, so the codification definition does not encompass part (a) of the IAS definition. Further, part (b) (i) would not be considered a liability and part (b) (ii) would simply be a liability that is not recognized (not a contingent liability) under the current US definition. It would appear that the codification's definition of a loss contingency</i></p>

	<p>For the purpose of this Standard, an outflow of resources or other event is regarded as <u>probable</u> if the event is more likely than not to occur. (Par. 23)</p>	<p><i>(actually, contingency liability if they had defined that) is similar to the IAS's definition of a provision, but this isn't a perfect match because the codification separates the definition of a loss contingency from recognition criteria; whereas, the IAS commingles them (e.g., some loss contingencies are not recognized under the codification but all provisions are recognized under the IAS)..</i></p> <p><u>Probable</u> means the future event or events are likely to occur. (450-20-20) <i>It is open to interpretation whether "likely" is a higher or lower standard than "more likely than not."</i></p> <p><u>Reasonably possible</u> means the chance of the future event or events occurring is more than remote but less than likely. (450-20-20) <i>There is no counterpart for this in the IAS.</i></p> <p><u>Remote</u> means that the chance of the future event or events occurring is slight. (450-20-20)</p>
<p>Recognition</p>	<p>A <u>provision</u> shall be recognized when:</p> <ul style="list-style-type: none"> (a) an entity has a present obligation (legal or constructive) as a result of a past event;* (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation.** (Par. 14) <p>*In rare cases it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period. (Par. 15)</p> <p>**Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognizing a provision.</p>	<p>An estimated loss from a <u>loss contingency</u> shall be accrued by a charge to income if both of the following conditions are met:</p> <ul style="list-style-type: none"> a. Information available before the financial statements are issued or are available to be issued indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. b. The amount of loss can be reasonably estimated.* (450-20-25-2) <p>*The conditions are not intended to be so rigid that they requires virtual certainty before a loss is accrued. Instead, the condition in (a) is intended to proscribe accrual of losses that relate to future periods. The condition in (b) is intended to prevent accrual in the financial statements of amounts so uncertain as to impair the integrity of those statements. That requirement shall not delay accrual of a loss until only a single amount can be reasonably estimated.(450-20-25-3 through 25-5) <i>These are very similar except for terminology (see the discussion under the definition of loss contingency above).</i></p> <p><i>As noted below, the codification agrees that items</i></p>

	<p>(Par. 25)</p> <p>An entity shall not recognize a <u>contingent liability</u>.* (Par. 27)</p> <p>*Contingent liabilities are not recognized as liabilities because they are either:</p> <p>(i) possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits; or</p> <p>(ii) present obligations that do not meet the recognition criteria in this Standard (because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made). (Par.13)</p>	<p><i>meeting the IAS definition of a contingent liability shall not be recognized.</i></p> <p><i>These items would not be recognized because they do not meet the definition of a liability according to the US.</i></p> <p><i>These items are not recognized because they do not meet the recognition criteria noted above for contingent liabilities.</i></p>
<p>Measurement</p>	<p>The amount recognized as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. (Par. 36)</p> <p>Where the provision being measured involves a large population of items (e.g., warranties), the obligation is estimated by weighting all possible outcomes by their associated probabilities. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used. (Par. 39)</p> <p>Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. Where other possible outcomes are either mostly higher or mostly lower than the most likely</p>	<p>If some amount within a range of loss appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. (450-20-30-1) <i>Similar.</i></p> <p>When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued. (450-20-30-1) <i>Different.</i></p>

	<p>outcome, the best estimate will be a higher or lower amount. (Par. 40)</p> <p>The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision. (Par. 42)</p> <p>Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation. (Par. 45)</p> <p>The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted. (Par. 47)</p> <p>Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset. The amount recognized for the reimbursement shall not exceed the amount of the provision. In the statement of comprehensive income, the expense relating to a provision may be presented net of the amount recognized for a reimbursement. (Par. 53-54)</p> <p>Provisions shall be reviewed at the end of each reporting period and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation,</p>	
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	<p>the provision shall be reversed. (Par. 59)</p> <p>A provision shall be used only for expenditures for which the provision was originally recognized. (Par. 61)</p>	
<p>Disclosure</p>	<p>For each class of <u>provision</u>, an entity shall disclose:</p> <ul style="list-style-type: none"> (a) the carrying amount at the beginning and end of the period; (b) additional provisions made in the period, including increases to existing provisions; (c) amounts used (i.e., incurred and charged against the provision) during the period; (d) unused amounts reversed during the period; and (e) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate. <p>Comparative information is not required. (Par. 84)</p> <p>An entity shall disclose the following for each class of <u>provision</u>:</p> <ul style="list-style-type: none"> (a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits; (b) an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events. (c) the amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement. (Par. 85) <p>Unless the possibility of an outflow in settlement is remote, an entity shall disclose for each class of <u>contingent liability</u> at the end of the</p>	<p>Disclosure of the nature of an accrued contingent loss and in some circumstances the amount accrued, may be necessary for the financial statements not to be misleading. (450-20-50-1)</p> <p><i>Remember, loss contingencies recognized according to the codification equate to IAS's provisions</i></p> <p>Disclosure of the loss contingency shall be made if there is at least a reasonable possibility that a loss or an additional loss may have been incurred and either of the following conditions exists:</p> <ul style="list-style-type: none"> a. An accrual is not made for a loss contingency because it is not probable or is not reasonably estimated. b. An exposure to loss exists in excess of the amount accrued. <p>The disclosure shall include both of the following:</p> <ul style="list-style-type: none"> a. The nature of the contingency. b. An estimate of the possible loss or range of loss or a statement that such an estimate cannot be made. (450-20-50-3 and 50-4) <p><i>Similar to part (a) for the IAS.</i></p> <p>Adequate disclosure shall be made of a contingency that might result in a gain but care shall be exercised to avoid misleading implications as to the likelihood of realization. (450-30-50-1)</p>

	<p>reporting period a brief description of the nature of the contingent liability and, where practicable:</p> <ul style="list-style-type: none">(a) an estimate of its financial effect;(b) an indication of the uncertainties relating to the amount or timing of any outflow; and(c) the possibility of any reimbursement. (Par. 86) <p>In extremely rare cases, disclosure of some or all of the information required by paragraphs 84-89 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reasons why, the information has not been disclosed. (Par. 92)</p>	
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