HARVARD | BUSINESS | SCHOOL

9-106-021
REV: JULY 10, 2006

GREGORY S. MILLER
DOUGLAS J. SKINNER
LAURA E. DONOHUE

Accounting for Pensions and Employee Benefits at Ford and Toyota

To stage another comeback, GM, Ford and Chrysler must get a grip on the issue of legacy costs—pensions and health-care benefits for employees and retirees. This means not just reducing those costs, but ending management's fixation with the subjects—legacy costs indeed are a problem, but not the only problem. Pension and health-care cost Detroit $1,500 per vehicle more than foreign-based competitors.[1]

—Paul Ingrassia, *The Wall Street Journal*

The Cost of Pensions and Other Post-Employment Benefits

As the twenty-first century opened, U.S. automobile firms' financial statements were burdened by the weight of labor costs for product long since produced and shipped. These "legacy costs" represented pensions and other post-employment benefits (OPEBs) paid to retirees and their dependents. Under UAW contract, domestic automobile manufacturers were fully responsible for generous pensions to retirees and their dependents, as well as fully funded health and other benefits, paid over increasingly longer post-retirement lifetimes. The large liabilities related to these legacy costs loomed larger following the downgrade by rater Standard & Poor's (S&P) of both General Motors (GM) and Ford Motor Company to junk status on May 5, 2005. Further, Wall Street began speculating that soaring retirement and health-care costs concurrent with falling sales in the U.S. core markets of SUVs and trucks could force one or more of the Big Three to seek the protection of a Chapter 11 bankruptcy filing.[2]

Concerns regarding pension and retirement benefits had been building steadily over the last few years and took on a renewed urgency as the poor financial market performance eroded the assets related to the plans and began to create an even larger gap between pension assets and liabilities. **Exhibit 1** shows an increase in media attention to the issues of pensions and other post-employment benefits, as measured by the number of articles found in a database search over five-year increments. Concurrent with this increase in attention, complaints regarding the mandatory pension accounting rules began to grow. Critics such as Warren Buffet and CALPERS argued that the accounting created by Financial Accounting Standard (FAS) 87 resulted in financial statements that often bore little relation to economic reality. They called for pension accounting reform, whether by marking pension investments at fair market value, cleansing operating results of pension plan performance, or increasing disclosure of key assumptions and how they are determined. Ethan Kra, chief actuary of

---

Professor Gregory S. Miller, Professor Douglas J. Skinner, University of Chicago, and Research Associate Laura E. Donohue prepared this case. This case was developed from published sources. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Copyright © 2005 President and Fellows of Harvard College. To order copies or request permission to reproduce materials, call 1-800-545-7685, write Harvard Business School Publishing, Boston, MA 02163, or go to http://www.hbsp.harvard.edu. No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of Harvard Business School.

Mercer HR Consulting, summarized the argument: "If you used the same accounting for the operations side that is used on pension funds, you would be put in jail."[3]

Ford and the UAW: Growing Up Together

Born of a relentless entrepreneur and engineer whose goal was to simplify production and make cars affordable for the masses, Ford pursued efficiency as the ultimate determinant of that goal. The company's greatest contribution to the economy was the moving assembly line, introduced in 1913, which replaced the craft-based production of the nineteenth century. Applying Taylor-like concepts of scientific management, Ford's assembly line allowed individual workers to stay in one place and perform the same task repeatedly on multiple vehicles that rolled by them. Ford's plant combined "precision manufacturing, standardized and interchangeable parts, [and] a division of labor" in mimic of the machines they produced.[4] The efficiencies generated by this skill-building, volume-based approach translated quickly into a low-cost position for the company and lower prices for customers. The common joke about Ford Model T's—you can have any color you want as long as it is black—demonstrated Ford's singular focus on efficiency and streamlining to accomplish his goal of creating an affordable car for the average American.

Ford's passion for the automobile business extended beyond the product to the manufacturing processes and the people it employed. Driven by a personal motto to "help the other fellow," Ford believed that being generous to employees resulted in happier workers and better product. In a revolutionary step, Ford cut one hour off the standard workday, from nine to eight hours, and established a wage of $5 per day (up from $2.34) for all workers, regardless of race or religious beliefs. The above-average wage served as his profit-sharing program and established a precedent for fair distribution of company wealth that greatly influenced later management practices.[5] Also revolutionary was his policy of hiring immigrants—largely Islamic—and minority workers in unprecedented numbers and promoting them to supervisory roles in various departments. In further support of his workers, he insisted on stringently high standards of cleanliness and safety in the work environment. Ford's excellent treatment of his employees extended well beyond the workplace; he constantly sought out ways to improve his workers' home lives as well. Ford's firm opposition to labor unions stemmed from his belief that he and his company should be responsible for meeting all the needs of his workers.

However, there were also complaints regarding Ford's methods of creating production efficiency. The culture of mechanization was firmly established by Ford with his assembly line, creating a "tone about the inherent righteousness of machines that did much to create a metal-bending mentality in Detroit."[6] Some argued that because "engines represented for Mr. Ford the pinnacle of power, efficiency and beauty," his factories dehumanized workers, transforming them into machines whose "flesh trembled in the furious din."[7] His activities outside the workplace were remarkable in their control. In an effort to "mass-produce middle-class Americans who would become obedient employees," he instituted a sociological department whose investigators visited workers' homes to teach English, basic manners, and patriotism.[8] After years of strong opposition to labor unions marked by intense employee surveillance and systematic intimidation,[9] Ford's "reign of terror" came to a climax in the 1937 Battle of the Overpass, during which United Auto Worker (UAW) leafleteers were assaulted by company henchmen. After being found in violation of the 1935 National Labor Relations Act, Ford finally signed a closed-shop union contract in 1941 covering 123,000 employees.[10]

During the 60th anniversary of the Ford-UAW relationship, their respective leaders acknowledged the "struggles and accomplishments of the past, but tried to look forward and build on the proud tradition of working together to produce world-class cars, trucks and services" and take care of the

employees who built them.[11] The relationship had evolved over time from its violent beginnings under Henry Ford to the more cooperative approaches to meeting the competitive threats from foreign rivals at the end of the twentieth century. The original 1941 contract focused on solidifying worker wages, binding Ford to match the industry's highest wage rates, in the spirit of Henry Ford's $5 day. Subsequent contracts introduced employee benefits in stages, often under threat of a strike. The 1948 contract was the first to include pension plans under an expanded definition of job security. The 1955 contract added supplemental unemployment benefits (SUBs) to cover unemployment due to circumstances beyond the employees' control, though these were not guaranteed until after the 1967 general strike, which endured for 45 days. The oil crisis of the 1970s and the subsequent invasion of the lucrative U.S. auto market by cheaper, gas-efficient foreign brands resulted in a loss of 600,000 UAW members, the darkest years of the UAW's existence. Suddenly the interests of Ford and the UAW became aligned, as both began to acknowledge the link between quality, customer satisfaction, and security for the future.

While a 1979 letter introduced the employee involvement program to enlist worker commitment and effort to improve quality and satisfaction, the union quietly pursued expanded benefits programs as it again broadened the definitions of workforce and security. The 1982 contract reintroduced profit sharing to induce extra effort to meet the industry crisis. Contracts in the 1980s also saw a new emphasis on health and safety in recognition of the rising cost of health care and as a trade-off for stagnating wage rates. This allowed the UAW to further enhance its members' economic security without draining Ford's already stretched cash position. By the 1990s, the UAW's mandate had expanded to include workers' dependents, as well as retirees and their dependents. The 1999 contract theme of "bargaining for families" resulted in unprecedented gains for members, families, retirees, and communities under the banner of "health and safety first"; health-care benefits appeared to take precedence even over wages or pensions.[12] In 2000, employees received an average of $8,000 in profit sharing, as well as a home computer, printer, and Internet access.[13]

Toyota: Starting Fresh

Having entered the U.S. in the 1980s, Toyota's assembly plants were considerably newer than those of the Big Three, with sufficient capacity to produce most of the cars they sold in the U.S. Toyota limited its retirement liability by hiring younger workers than the UAW average. These young workers typically demonstrated less interest in labor unions.[14] While Toyota offered comparable benefits in many respects and a guaranteed no-layoff policy at its nonunion U.S. facilities, its wage rate was generally $2–$3 per hour less than the UAW standard. Toyota did not guarantee its pension,[15] which pro-union workers estimated to be less than half of the UAW pension benefit.[16] Despite these differences, workers at Toyota's U.S. plants had repeatedly overturned UAW efforts to unionize.

In 2003 Toyota had only 49 retirees receiving benefits.[17] Their costs were easily subsumed into the labor costs for the 30,000 active hourly workers. Analysts translated these figures into significantly lower pension and retiree health-care costs,[18] though Toyota repeatedly declined to disclose details about retiree, pension, or health-care expenditures. **Exhibits 5, 6,** and **7** provide selected financial statement information regarding employee benefit costs for Toyota. These statements were prepared in accordance with U.S. generally accepted accounting principles (GAAP). This was consistent with Japanese rules that allow cross-listed firms to apply U.S. GAAP in their financial statements.

Retirement benefits were a predominantly postwar phenomenon in Japan. The concept of economic and medical security in retirement had been largely perceived as a national rather than a corporate problem. The primary source of post-retirement benefits for most Japanese retirees was a

two-tiered nationalized pension system, which had only been supplemented by corporate pension programs. The first tier, or National Pension (*kokumin nenkin*), provided a basic, flat-rate monthly pension of approximately $500. This system was originally implemented in 1961 along with National Health Insurance and substantially refined in 1986 in response to growing issues in the system's financial stability. The National Pension was funded by contributions by individuals and a government subsidy. The second tier, the Employees' Welfare Pension Insurance System (*kousei nenkin hoken*), provided additional pension payments for company-employed workers roughly amounting to 60% of preretirement salary. Comparable to the U.S. Social Security system, benefits under WPI included a monthly pension, as well as disability and survivor benefits. The WPI was funded equally by employer and employee contributions, supplemented by government subsidy. These funds were accumulated in an employees' pension fund (EPF), managed by the company, which disbursed the pensions. Japanese companies could additionally voluntarily provide a corporate pension—though many did not—which historically involved a lump-sum payment or other fixed retirement allowance upon retirement based on years of service. Funds for the corporate pension were also accumulated in the EPF, with limited disclosure separating the two disbursements. In 2005, a set of relatively new regulations required the separation of WPI from corporate pension and other restrictions protecting the rights of the employee.

While Toyota did not face the massive obligations of a U.S. manufacturer in 2003, it did see labor issues arising in Japan, where it had been in business an additional 40 years, that might prove a harbinger of things to come in the U.S. With Japan's workforce aging at the fastest rate among industrialized countries, the seniority-based pay system meant rapidly rising labor costs at Japanese plants. The rapid rate of retirement had led some economists to predict the collapse of Japan's National Pension system in the next 20 years.[19] Toyota and other Japanese automakers scrambled to respond to the aging crisis. Toyota and Nissan announced the addition of employee-driven 401(k)-like defined-contribution plans to support the traditional pension but declined to provide details. Shifting production to the more youthful U.S. and shuttering home plants sidestepped Japanese issues but forced Toyota to reckon with U.S.-based issues. For example, in an effort to control escalating prescription drug costs for U.S. workers, Toyota opened its own discount pharmacies at U.S. operations.[20] With the average age of the U.S. workers topping 40, more began thinking about retiring, and retiring healthy.[21] This led to increased support for UAW arguments for union-level pension and health-care benefits.

Putting a Figure on Benefit Costs

The UAW negotiated unprecedented retirement benefits during the competitive cataclysm of the 1980s and 1990s, mitigating the plant closings, outsourcing, and productivity improvements that shrank the active workforce.[22] Thus, under the contract, terminated UAW employees' compensation was deferred rather than eliminated, with employees paid up to 95% of their pay even without work and remaining eligible for pensions at retirement. Thus, the 877,000 GM[23] employees of 20 years ago remained effectively on the payroll in 2005, accruing cost against today's production. The more that U.S. automakers retrenched by trimming employment capacity, the greater the burden of their "legacy" retirement and health-care costs became proportionately. The steady pace of plant closings and production cuts over recent quarters and lower production meant that fixed legacy costs had to spread more thickly across shrunken revenues. For GM, legacy costs made up 2.3% of revenues in 1999, versus 5% by 2004.[24] And with the average age of the U.S. autoworker over 50,[25] and that worker likely to survive into his 80s, the legacy spiraled upward.

Limited public disclosures by automakers challenged investors to put a firm figure on retiree obligations, which had been estimated alternately at $1,000,[26] $1,360,[27] and $1,500,[28] per vehicle,

versus $107 for Honda Motor Company. Focusing on health-care costs alone, Ford estimated a $780 per vehicle cost disadvantage compared with imports from countries with nationalized health care, lower benefits, and fewer retirees.[29] To these retiree costs had to be added an active workforce labor premium of $300 to $400 per vehicle paid by Big Three automakers over Japanese competitors.[30]

The aggregate figures were staggering across the 277,000 active UAW employees[31] and 522,000 retirees and dependents at the Big Three firms. Health-care costs for all UAW retirees totaled $4.5 billion in 2002.[32] Overall, GM recorded 2.5 pensioners for every current employee,[33] while Ford matched retirees evenly for its 109,000 employees.

Criticism of the Mandatory Accounting Treatments

Costs of this magnitude were garnering considerable attention from the investment community (**Exhibit 1**). Unfortunately, putting a firm figure on pension and benefit costs, both current and long term, is challenged by the long-term nature and many uncertainties surrounding this liability. The accounting calculation of pension assets and future obligations relies heavily on various assumptions about the projected timing of the related cash flows. Some assumptions are unavoidably fuzzy and require subjective judgments about the expected timing of future payments: length of employment, mortality, health-care requirements, and cost-escalation rates. The sensitivity of financial results with regard to these assumptions is significant, as shown in 2003 when Ford reduced its health-care inflation rate to 9% from 11%, with each percentage point decrease reducing benefit liabilities by some $3.8 billion.[34]

Analysts and investors were calling for pension accounting reform to force a more accurate reflection of economic reality and expose hidden time bombs in union-based, labor-intensive industries. Suggestions included marking pension investments at fair market value, thereby eliminating the smoothing process that generates "false income";[35] cleansing operating results of pension plan performance, as per S&P's measure of core earnings, which removed pension gains and expenses from operating income then added back interest and service costs, which S&P considered part of the cost of employee compensation;[36] or increasing disclosure of key assumptions and how they are determined. Critics of greater transparency argued that the necessary information already existed in the footnotes to financial statements under new pension disclosure requirements (SFAS 132 and SFAS 132R), allowing investors to separate pension amounts from operating results. While these suggested accounting changes might result in more informative accounting information in the future, companies currently were restricted to applying the required rules.

Regardless of the accounting used, many observes were concerned that the Big Three could not compete with offshore firms under the burden of their legacy costs, resulting in a need to take drastic action (such as bankruptcy) to alter their obligations. However, the competitive problem might be viewed differently over a different time horizon. Some observers noted, "Twenty years from now, these [health-care and pension] concerns are nonissues. Toyota and the other transplants will have their own legacy costs then. But it's going to be mighty rough getting there."[37]

Assignment Questions

In evaluating the creditworthiness of Ford Motor Company, analysts are especially concerned about Ford's pension and OPEB obligations, which affect a number of aspects of its financial reporting such as: (1) quality of earnings, (2) financial position and leverage, and (3) free cash flows. For purposes of comparison, analysts often compare Ford's situation to that of Toyota, an important global competitor with different obligations to its retirees. Certain portions of the two companies' fiscal 2003 annual reports and financial statements are attached in the exhibits, which can be used to answer the following questions:

1. What is the impact of these firms' pension/OPEB plans on their bottom-line net earnings for fiscal 2003? What portion(s) of these effects are not likely to be sustained in the future? How much of these expenses are attributable to currently active employees and how much to former employees who are now retired?

2. What is the impact of these firms' pension/OPEB plans on their balance sheet for 2003?

3. What is the impact of these firms' pension/OPEB plans on their reported cash flows for 2003? What are these firms' near-term (one- to three-year) cash flow obligations with respect to these plans?

4. What is the "interest cost" component of Ford's 2003 pension expense? Can you verify that the amount reported for this component of the expense is reasonable?

5. For 2002 and 2003 indicate whether Ford's penion plan earned a return that was larger or smaller than the "expected" return. What effect does the actual performance of the pension plan (the actual return on its assets) have on Ford's current and future earnings?

6. The assumed "discount rate" on Ford's U.S. plans was reduced from 7.25% in 2002 to 6.75% in 2003. Explain (and quantify if possible) how this change affects Ford's 2003 reported earnings and balance sheet.

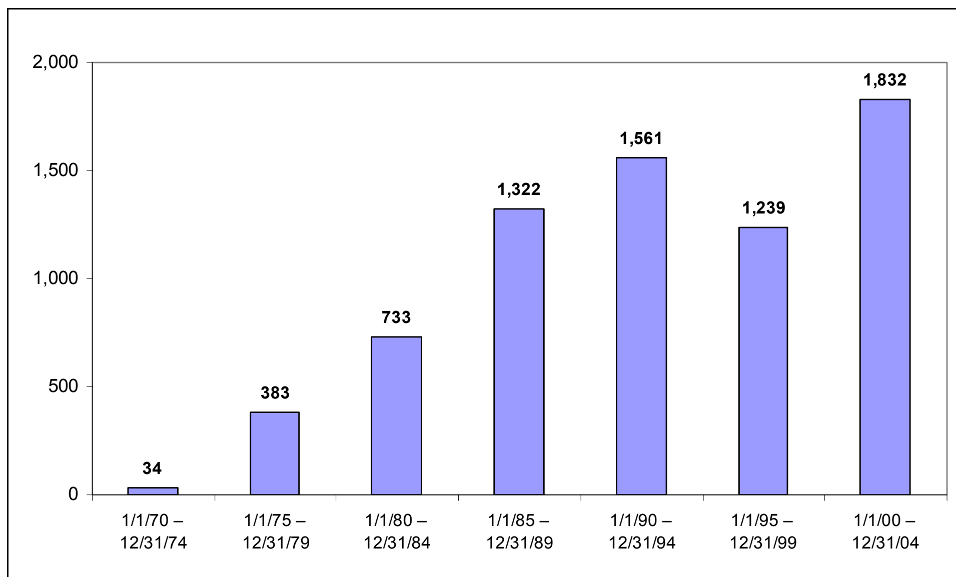
7. How has Ford changed its assumptions with respect to future health-care costs during 2003? What impact will this have on its profitability and financial position, if any?

8. Calculate and compare Ford's and Toyota's gross and net economic obligations for pensions/ OPEBs. How do these numbers compare to the net effect of these plans as reported on the companies' balance sheets? Describe how these numbers are reflected on these companies' balance sheets.

Exhibit 1 Media Interest in Pension Issue

Date Range	Media Articles
1/1/00–12/31/04	1,832
1/1/95–12/31/99	1,239
1/1/90–12/31/94	1,561
1/1/85–12/31/89	1,322
1/1/80–12/31/84	733
1/1/75–12/31/79	383
1/1/70–12/31/74	34

Media Interest in Automotive Pension Issue



Source: Casewriter.

Exhibit 2 2003 Ford Motor Company Annual Report Excerpts

Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

GENERATION OF REVENUE, INCOME AND CASH

Our Automotive sector's revenue, income and cash are generated primarily from sales of vehicles to our dealers and distributors (i.e., our customers). Vehicles we produce generally are subject to firm orders from our customers and generally are deemed sold (with the proceeds from such sale recognized in revenue) immediately after they are produced and shipped to our customers. This is not the case, however, with respect to vehicles produced for sale to daily rental car companies that are subject to a guaranteed repurchase option or vehicles produced for use in our own fleet (including management evaluation vehicles). Vehicles sold to daily rental car companies that are subject to a guaranteed repurchase option are accounted for as operating leases, with lease revenue and profits recognized over the term of the lease. When we sell the vehicle at auction, we recognize a gain or loss on the difference, if any, between actual auction value and the projected auction value. Therefore, except for the impact of the daily rental units sold subject to a guaranteed repurchase option and those units placed into our own fleet, vehicle production is closely linked with unit sales and revenue from such sales.

Our Financial Services sector's revenue is generated primarily from interest on finance receivables, including interest, net of certain deferred loan origination costs that are included as a reduction of financing revenue, and such revenue is recognized over the term of the receivable using the interest method. Also, revenue from operating leases, net of certain deferred origination costs, is recognized on a straight-line basis over the term of the lease. Income is generated to the extent revenues exceed expenses, most of which are interest and operating expenses.

Transactions between the Automotive and Financial Services sectors occur in the ordinary course of business. For example, Ford Credit receives interest supplements and other support cost payments from the Automotive sector in connection with special vehicle financing and leasing programs that it sponsors. Ford Credit records these payments as revenue over the term of the related finance receivable or operating lease. The Automotive sector records the estimated costs of marketing incentives, including dealer and retail customer cash payments (e.g., rebates) and costs of special financing and leasing programs, as a reduction to revenue at the later of the date the related vehicle sales are recorded or at the date the incentive program is both approved and communicated.

KEY ECONOMIC FACTORS AND TRENDS AFFECTING AUTOMOTIVE INDUSTRY

Excess Capacity — According to CSM Worldwide, an automotive research firm, in 2003, the automotive industry's estimated global production capacity for light vehicles (about 65 million units) significantly exceeded global production of cars and trucks (about 53 million units). In North America and Europe, the two regions where the majority of revenue and profits are earned in the industry, excess capacity was an estimated 14% and 17%, respectively, in 2003. We expect that this condition will continue for many years.

Pricing Pressure — Excess capacity coupled with a proliferation of new products being introduced in key segments by the industry will keep pressure on manufacturers' ability to increase prices on their products. In addition, in recent years, Korean-based manufacturers have been increasing the number of vehicles they export for sale in the United States and other key markets, and this has contributed, and is expected to continue to contribute, to pricing pressure. In the United States, the reduction of real prices for similarly contented vehicles accelerated in recent years, and we expect that a challenging pricing environment will continue for some time to come. In Europe, the automotive industry has experienced intense pricing pressure for several years; in 2003, net pricing declined more in Europe than in the United States. Net pricing is a measure of the combined effect of changes in wholesale prices for vehicles sold and marketing incentives incurred on those vehicles, while excluding the effects of changes in unit sales volume and foreign currency exchange rates.

Consumer Spending Trends — We expect, however, that a decline in, or the inability to increase, vehicle prices could be offset by the spending habits of consumers and their propensity to purchase over time higher-end, more expensive vehicles and/or vehicles with more features. Over the next decade, in the United States, we expect that growth in spending on vehicle mix and content will generally track the increase in real GDP per capita. The benefits of this to revenue growth in the automotive industry are significant. In the United States, for example, consumers in the highest income bracket are buying more often and more frequently buying upscale. We believe the share of the premium brand segment in the U.S. automotive industry will approach 13% by the end of this decade, compared with about 10% to 11% presently. With our luxury brands (i.e., Lincoln, Volvo, Jaguar, Land Rover and Aston Martin), we believe we are positioned well to take advantage of this trend.

Exhibit 2 (continued)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Although growth in vehicle unit sales (i.e., volume) will be greatest in emerging markets in the next decade, we expect that the mature automotive markets (e.g., North America, Western Europe and Japan) will continue to be the source of a substantial majority of global industry revenues over the next decade. We also expect that the North American market will continue as the single largest source of revenue for the automotive industry in the world in the next decade.

Health Care Expenses — In the United States, the average annual percentage increase in health care prices we have experienced in the last few years has been in the double digits. In 2003, our health care expenses for United States employees and retirees were $3.2 billion, with about $2.2 billion attributable to retirees and the balance attributable to active employees. Prescription drug costs is the fastest growing segment of our health care expenses and accounted for about one-third of our total United States health care expenses in 2003.

Although we have taken measures to have employees and retirees bear a higher portion of the costs of their health care benefits, we expect our health care costs to continue to increase. For 2004, our trend assumptions for U.S. health care expenses include an initial trend rate of 9% and a steady state trend rate of 5% reached in 2010. These assumptions include the effect of actions we are taking and expect to take to offset health care inflation, including further employee cost sharing, administrative improvements and other efficiencies.

TRENDS AND STRATEGIES

Revenue Management — To address the pricing pressure that exists in the automotive industry, we have employed a customer-focused revenue management strategy to maximize per unit revenue. This strategy is focused on a disciplined approach to utilizing customer demand data — available from many sources, including internet hits, transaction data, customer leads, and research — to help us develop and sell vehicles that more closely match customer desires.

We believe our revenue management strategy has contributed significantly to increases in our revenue per vehicle sold for our Ford North America business unit of $724 and $284 for 2003 and 2002, respectively. (These amounts exclude the incremental effect on revenue from the consolidation of certain dealerships in 2003 related to FIN 46, discussed in Note 13 of the Notes to Financial Statements).

Cost Reduction — Given the difficult economic and operating environment described herein, we continue to focus on reducing our cost structure. During 2003, we reduced our costs by over $3 billion (at constant volume, mix and exchange and excluding special items). Cost reductions were realized in quality-related costs resulting from fewer warranty claims, recalls and customer service actions, as well as reduced manufacturing, engineering and overhead costs. Lower product costs (which are comprised of material and component costs for our vehicles) on carryover vehicles partially offset higher product costs for newly introduced vehicles. Further cost efficiencies will be realized as we continue to implement our Revitalization Plan.

Shared Technologies — One of the strategies we are employing to realize efficiencies in manufacturing, engineering and product costs for new vehicles is the sharing of vehicle platforms and components among various models and the re-use of those platforms and components from one generation of a vehicle model to the next.

REVITALIZATION PLAN PROGRESS

In January 2002, we announced that through the implementation of our Revitalization Plan, we expected to improve our pre-tax profit excluding special items to $7 billion by mid-decade, which we have defined as 2006. We do not expect a linear progression to the target of $7 billion of pre-tax profit excluding special items.

In 2004, we expect that the rate of profit improvement will be less than what we have experienced over the past couple of years. We are still about a year away from introducing new products that are designed in a manner such that the cost to produce them is appropriate in the current pricing environment, and we are about two years away from having those products in significant volume. In addition, as indicated above, rising health care costs remain a concern for us.

We expect, however, to make progress in 2004, as we will focus on significantly improving the performance of our Ford Europe business unit, and filling our global product pipeline with new product introductions, particularly in the passenger car area. Further, as indicated above, we are continuing our efforts to improve quality and our cost structure. Overall, while conditions may slow our rate of improvement in 2004, we believe we are on track to achieve our goal of $7 billion in pre-tax profits, excluding special items, by year-end 2006.

Exhibit 2 (continued)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

AUTOMOTIVE SECTOR RESULTS OF OPERATIONS

Details of Automotive sector income/(loss) before income taxes and income/(loss) before income taxes excluding special items for 2003 and 2002 are shown below (in millions):

	Income/(Loss) Before Taxes			**Income/(Loss) Before Taxes Excluding Special Items**		
	2003	2002	2003 over/(under) 2002	2003	2002	2003 over/(under) 2002
Americas						
- Ford North America	$ 165	$ 2,490	$ (2,325)	$ 1,762	$ 2,490	$ (728)
- Ford South America	(130)	(622)	492	(130)	(622)	492
Total Americas	35	1,868	(1,833)	1,632	1,868	(236)
International						
- Ford Europe	(1,626)	(722)	(904)	(1,113)	(549)	(564)
- Ford Asia Pacific	(25)	(176)	151	(25)	(176)	151
- Premier Automotive Group	164	(897)	1,061	164	(740)	904
- Other International	69	(15)	84	69	(15)	84
Total International	(1,418)	(1,810)	392	(905)	(1,480)	575
Other Automotive	(574)	(1,211)	637	(623)	(641)	18
Total excluding special items				104	(253)	357
Less: special items				(2,061)	(900)	(1,161)
Total Automotive	$ (1,957)	$ (1,153)	$ (804)	$ (1,957)	$ (1,153)	$ (804)

Details of Automotive sector sales and vehicle unit sales for 2003 and 2002 are shown below:

	Sales (in billions)				**Vehicle Unit Sales* (in thousands)**			
	2003	2002	2003 over/(under) 2002		**2003**	2002	2003 over/(under) 2002	
Americas								
- Ford North America	**$83.6**	$87.1	$ (3.5)	(4)%	**3,811**	4,146	(335)	(8)%
- Ford South America	**1.9**	1.5	0.4	27	**209**	195	14	7
Total Americas	**85.5**	88.6	(3.1)	(3)	**4,020**	4,341	(321)	(7)
International								
- Ford Europe	**22.2**	18.9	3.3	17	**1,595**	1,561	34	2
- Ford Asia Pacific	**5.8**	4.4	1.4	32	**353**	300	53	18
- Premier Automotive Group	**24.9**	21.3	3.6	17	**752**	771	(19)	(2)
Total International	**52.9**	44.6	8.3	19	**2,700**	2,632	68	3
Other Automotive	**-**	1.1	(1.1)	-	**-**	-	-	-
Total Automotive	**$138.4**	$134.3	$4.1	3%	**6,720**	6,973	(253)	(4)%

** Includes rental repurchase and Company vehicles sold at auction and excludes new and used vehicle sales by our consolidated dealerships (consolidated beginning third quarter of 2003).*

38 FORD MOTOR COMPANY

Exhibit 2 (continued)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULT OF OPERATIONS

LIQUIDITY AND CAPITAL RESOURCES

AUTOMOTIVE SECTOR

Our strategy is to ensure we have sufficient funding available with a high degree of certainty throughout the business cycle. The key elements of this strategy include maintaining large gross cash balances, generating cash from operating-related activities, having a long-dated debt maturity profile, and maintaining committed credit facilities.

Gross Cash — Automotive gross cash includes cash and cash equivalents, marketable and loaned securities and assets contained in a short-term Voluntary Employee Beneficiary Association trust ("VEBA") (see below). Gross cash as of December 31, 2003, 2002 and 2001 is detailed below (in billions):

	December 31,		
	2003	2002	2001
Cash and cash equivalents	**$ 5.4**	$ 5.2	$ 4.1
Marketable securities	**10.8**	17.4	10.9
Loaned securities*	**5.7**	-	-
Total cash, marketable securities and loaned securities	**21.9**	22.6	15.0
Short-term VEBA assets	**4.0**	2.7	2.7
Gross Cash	**$25.9**	$25.3	$17.7

** As part of our investment strategy, we engage in securities lending to improve the returns on our cash portfolios. See Note 4 of the Notes to Financial Statements for additional discussion on securities lending.*

In managing our business, we classify changes in gross cash into four categories: operating-related (both including and excluding pension/long-term VEBA contributions and tax refunds), capital transactions with the Financial Services sector, acquisitions and divestitures and other (primarily financing related). Our key metric for operating-related cash flow is cash flow before pension and long-term VEBA contributions and tax refunds. This metric best represents the ability of our Automotive operations to generate cash. We believe the cash flow analysis reflected in the table below, which differs from a cash flow statement presented in accordance with GAAP, is useful to investors because it includes cash flow elements that we consider to be related to our operating activities (e.g., capital spending) that are not included in *Cash flows from operating activities before securities trading*, the most directly comparable GAAP financial measure. Changes in Automotive gross cash for the last three years are summarized as follows (in billions):

Exhibit 2 (continued)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

	2003	2002	2001
Gross cash at end of period	**$25.9**	$25.3	$17.7
Gross cash at beginning of period	**25.3**	17.7	20.2
Total change in gross cash	**$0.6**	$7.6	$ (2.5)
Operating-related cash flows			
Automotive income/(loss) before income taxes excluding special items	**$ 0.1**	$ (0.3)	$ (2.9)
Capital expenditures	(7.4)	(6.8)	(6.3)
Depreciation and special tools amortization	5.5	4.9	5.0
Changes in receivables, inventory and trade payables	(1.0)	(1.8)	4.4
Other	2.9	4.3	1.1
Total operating-related cash flows before pension/long-term VEBA contributions and tax refunds	0.1	0.3	1.3
Funded pension plans/long-term VEBA contributions	(4.8)	(0.5)	(0.3)
Tax refunds	1.7	2.6	-
Total operating-related cash flows	(3.0)	2.4	1.0
Capital transactions with Financial Services sector a/	3.6	0.4	0.4
Acquisitions and divestitures	0.5	0.6	(2.3)
Other			
Dividends paid to shareholders	(0.7)	(0.7)	(1.9)
Convertible preferred securities	-	4.9	-
Changes in total Automotive sector debt	(0.1)	(0.1)	1.7
Cash from FIN 46 consolidations b/	0.3	-	-
Other – Primarily net issuance/(purchase) of stock	-	0.1	(1.4)
Total change in gross cash	$ 0.6	$ 7.6	$ (2.5)

a/ Primarily dividends, capital contributions, loans, and loan repayments.
b/ See Note 13 of the Notes to Financial Statements for a discussion of the adoption of FIN 46.

Total 2003 operating-related cash flows before funded pension plan and long-term VEBA contributions and tax refunds was $100 million positive reflecting profits and other operating-related changes, offset partially by increased net capital spending and growth in year-end inventory. The $600 million increase in capital expenditures in 2003 from 2002, reflected primarily increased spending on new products consistent with our product-led revitalization plan. Other operating-related changes, primarily cash tax payments and timing differences between expense or revenue recognition and the corresponding cash payments for costs such as health care, pension, marketing, and warranty, improved our cash flows by $2.9 billion in 2003.

Including funded pension plan and long-term VEBA contributions and tax refunds, operating-related cash flows were an outflow of $3.0 billion. Contributions to our worldwide funded pension plans totaled $2.8 billion in 2003, compared to approximately $500 million in 2002. In 2003, we also contributed $2 billion to a long-term VEBA trust used to pre-fund a portion of Ford's other postretirement benefits liability. This contribution is in addition to the $4 billion contributed to our short-term VEBA, which we include in gross cash. These are assets invested similar to our cash portfolio and are available to fund certain employee benefit obligations in the near term. The $2 billion of long-term VEBA assets are invested similar to our pension fund assets. The assets of the long-term VEBA are not included in our gross cash, but are dedicated to pay longer-term healthcare obligations.

Capital transactions with the Financial Services sector of $3.6 billion in 2003 reflected primarily higher dividends paid by Ford Credit, which in turn reflected improved profitability and asset reductions at Ford Credit. In addition, dividends of $204 million from the Financial Services sector in 2003 are reflected in the table above as divestitures because they resulted from the sale by Ford Credit of its Axus vehicle fleet leasing unit.

Exhibit 2 (continued)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULT OF OPERATIONS

Shown in the table below is a reconciliation between financial statement *Cash flows from operating activities before securities trading* and operating-related cash flows, (calculated as shown in the table above), for the last three years (in billions):

	2003	2002	2001
Cash flows from operating activities before securities trading a/	**$ 1.3**	$9.5	$7.4
Items included in operating-related cash flow			
Capital expenditures	**(7.4)**	(6.8)	(6.3)
Net transactions between Automotive and Financial Services sectors b/	**1.2**	(0.1)	0.6
Other, primarily exclusion of cash flow from short-term VEBA contribution/(draw-down)	**1.9**	(0.2)	(0.7)
Operating-related cash flows	**$(3.0)**	$2.4	$1.0

a/ As shown in our Sector Statement of Cash Flows for the Automotive sector.
b/ Primarily payables and receivables between the sectors in the normal course of business, as shown in our Sector Statement of Cash Flows for the Automotive sector.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

TOTAL COMPANY

Stockholders' Equity — Our stockholders' equity was $11.7 billion at December 31, 2003, up $6.1 billion compared with the level at December 31, 2002. The increase in stockholders' equity reflected primarily the impact of foreign currency translation adjustments and a reduction in our minimum pension liability. For additional discussion of foreign currency translation adjustments, see Notes 1 and 16 of the Notes to Financial Statements.

Pension — We sponsor defined benefit pension plans throughout the world. Pursuant to our collective bargaining agreement with the UAW, under which most of our U.S. hourly employees are covered, we are contractually committed to provide specified levels of pension benefits to retirees covered by the contract. These obligations give rise to significant expenses that are highly dependent on assumptions discussed in Note 19 of the Notes to Financial Statements and under "Critical Accounting Estimates" below. Based on present assumptions and benefit agreements, we expect our 2004 worldwide pre-tax pension expense to be about $865 million, which is about $80 million lower than it was in 2003.

Included in our Stockholders' Equity was a $3.5 billion adjustment for our worldwide minimum pension liability as of December 31, 2003. This was $2.2 billion better than the 2002 adjustment due to the improvement in the funded status of our worldwide pension plans (i.e., the amount by which the present value of projected benefit obligations exceeded the market value of pension plan assets) as of December 31, 2003, compared with December 31, 2002. The primary factor that contributed to the improvement in the funded status was an increase in the actual return on plan assets for 2003, partially offset by decreases in

Exhibit 2 (continued)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULT OF OPERATIONS

the discount rates at December 31, 2003 used to calculate the present value of benefit obligations, in each case compared with the prior year. These changes are shown in the table below:

	December 31,			
	2003		2002	
	Current Year	Change from Prior Year	Current Year	Change from Prior Year
Discount rate				
U.S. plans	**6.25%**	**(0.50) pts**	6.75%	(0.50) pts
Non-U.S. plans	**5.61%**	**(0.04) pts**	5.65%	(0.45) pts
Actual return on plan assets (million)				
U.S. plans	**$7,687**	**$11,022**	$ (3,335)	$ (1,777)
Non-U.S. plans	**2,070**	**3,762**	(1,692)	(761)
Funded status (millions)				
U.S. plans	**$(3,447)**	**$3,829**	$(7,276)	$ (7,872)
Non-U.S. plans	**(8,242)**	**93**	(8.335)	(5.279)

Our pension fund assets consist principally of investments in equities and in government and other fixed income securities. For our major U.S. pension funds, the target asset allocation is 70% equities and 30% fixed income securities. On December 31, 2003, the market value of our U.S. pension fund assets was less than the projected benefit obligation (calculated using a discount rate of 6.25%, which is reduced from 6.75% used at year-end 2002) by $3.4 billion for our U.S. plans (of which $2 billion relates to our U.S. funded plans). For non-U.S. plans, the shortfall as of December 31, 2003, was $8.2 billion, for a total worldwide shortfall of $11.7 billion. Pension funding obligations and strategies are highly dependent on investment returns, discount rates, actuarial assumptions, and benefit levels (which can be contractually specified, such as those under the Ford-UAW Retirement Plan). If these assumptions were to remain unchanged, we project that we would not have a legal requirement to fund our major U.S. pension plans before 2009. However, we review our pension assumptions regularly and we do from time to time make contributions beyond those legally required. For example, in 2003 we made over $2 billion of discretionary cash contributions to our U.S. pension funds. Further, after giving effect to these contributions, based on current interest rates and on our return assumptions and assuming no additional contributions, we do not expect to be required to pay any variable-rate premiums to the Pension Benefit Guaranty Corporation before 2009.

For information related to our expenses and liabilities with respect to health care benefits we provide to our employees and retirees, see "Overview — Key Economic Factors and Trends Affecting Automotive Industry — Health Care Expenses" above and "Critical Accounting Estimates — Other Postretirement Benefits (Retiree Health Care and Life Insurance)" below.

Debt Ratings — Our short- and long-term debt is rated by four credit rating agencies designated as nationally recognized statistical rating organizations ("NRSROs") by the Securities and Exchange Commission:
- Dominion Bond Rating Service Limited ("DBRS");
- Fitch, Inc. ("Fitch");
- Moody's Investors Service, Inc. ("Moody's"); and
- Standard & Poor's Rating Services, a division of McGraw-Hill Companies, Inc. ("S&P").

In several markets, locally recognized rating agencies also rate us. A credit rating reflects an assessment by the rating agency of the credit risk associated with particular securities we issue, based on information provided by us and other sources. Credit ratings are not recommendations to buy, sell or hold securities and are subject to revision or withdrawal at any time by the assigning rating agency. Each rating agency may have different criteria for evaluating company risk, and therefore ratings should be evaluated independently for each rating agency. Lower credit ratings generally result in higher borrowing costs and reduced access to capital markets. The NRSROs have indicated that our lower ratings since 2001 are primarily a reflection of the rating agencies' concerns regarding our automotive cash flow and profitability, declining market share, excess industry capacity, industry pricing pressure and rising healthcare costs.

Exhibit 2 (continued)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULT OF OPERATIONS

RISK FACTORS

Statements included or incorporated by reference herein may constitute "forward looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve a number of risks, uncertainties, and other factors that could cause actual results to differ materially from those stated, including, without limitation:

- greater price competition resulting from currency fluctuations, industry overcapacity or other factors;
- a significant decline in industry sales, particularly in the U.S. or Europe, resulting from slowing economic growth, geo-political events or other factors;
- lower-than-anticipated market acceptance of new or existing products;
- work stoppages at key Ford or supplier facilities or other interruptions of supplies;
- the discovery of defects in vehicles resulting in delays in new model launches, recall campaigns or increased warranty costs;
- increased safety, emissions, fuel economy or other regulation resulting in higher costs and/or sales restrictions;
- unusual or significant litigation or governmental investigations arising out of alleged defects in our products or otherwise;
- worse-than-assumed economic and demographic experience for our postretirement benefit plans (e.g., investment returns, interest rates, health care cost trends, benefit improvements);
- currency or commodity price fluctuations;
- a market shift from truck sales in the U.S.;
- economic difficulties in any significant market;
- reduced availability of or higher prices for fuel;
- labor or other constraints on our ability to restructure our business;
- a change in our requirements under long-term supply arrangements under which we are obligated to purchase minimum quantities or pay minimum amounts;
- a further credit rating downgrade;
- inability to access debt or securitization markets around the world at competitive rates or in sufficient amounts;
- higher-than-expected credit losses;
- lower-than-anticipated residual values for leased vehicles;
- increased price competition in the rental car industry and/or a general decline in business or leisure travel due to terrorist attacks, acts of war, epidemic disease or measures taken by governments in response thereto that negatively affect the travel industry; and
- our inability to implement the Revitalization Plan.

CRITICAL ACCOUNTING ESTIMATES

We consider an accounting estimate to be critical if: 1) the accounting estimate requires us to make assumptions about matters that were highly uncertain at the time the accounting estimate was made, and 2) changes in the estimate that are reasonably likely to occur from period to period, or use of different estimates that we reasonably could have used in the current period, would have a material impact on our financial condition or results of operations.

Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors and the Audit Committee has reviewed the foregoing disclosure. In addition, there are other items within our financial statements that require estimation, but are not deemed critical as defined above. Changes in estimates used in these and other items could have a material impact on our financial statements.

Exhibit 2 (continued)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

PENSIONS

See Note 19 of the Notes to Financial Statements for more information regarding costs and assumptions for employee retirement benefits.

Nature of Estimates Required — The measurement of our pension obligations, costs and liabilities is dependent on a variety of assumptions used by our actuaries. These assumptions include estimates of the present value of projected future pension payments to all plan participants, taking into consideration the likelihood of potential future events such as salary increases and demographic experience. These assumptions may have an effect on the amount and timing of future contributions. The plan trustee conducts an independent valuation of the fair value of pension plan assets.

Assumptions and Approach Used — The assumptions used in developing the required estimates include the following key factors:

- Discount rates
- Salary growth
- Retirement rates
- Inflation
- Expected return on plan asset
- Mortality rates

We base the discount rate assumption on investment yields available at year-end on corporate long-term bonds rated AA. Our inflation assumption is based on an evaluation of external market indicators. The salary growth assumption reflects our long-term actual experience, the near-term outlook and assumed inflation. The expected return on plan assets assumption reflects asset allocation, investment strategy and the views of investment managers and of other large pension plan sponsors regarding the market. Retirement and mortality rates are based primarily on actual plan experience. The effects of actual results differing from our assumptions are accumulated and amortized over future periods and, therefore, generally affect our recognized expense in such future periods.

Sensitivity Analysis — Sensitivity of our worldwide pension funded status and stockholders' equity to the indicated increase/decrease in the discount rate assumption is shown below. Although not an estimate, we've also included sensitivity around the actual return on pension assets. Note that these sensitivities may be asymmetric, and are specific to the base conditions at year-end 2003. They also may not be additive, so the impact of changing multiple factors simultaneously cannot be calculated by combining the individual sensitivities shown. The December 31, 2003 funded status is affected by December 31, 2003 assumptions. Pension expense for 2003 is affected by December 31, 2002 assumptions. The impact on our funded status, equity and U.S. pension expense from a one percentage point change in these assumptions is shown below (millions):

		Increase / (Decrease) in:			
	Percentage	December 31, 2003			**2003**
	Point	**U.S. Plans**	**Non-U.S. Plans**		**U.S.**
Assumption	**Change**	**Funded Status**	**Funded Status**	**Equity**	**Expense**
Discount rate	+/- 1.0 pt.	$4,110 / $(4,580)	$3,300 / $ (3,850)	$2,870 / $ (4,910)	$(20) / $20
Full year 2003, actual return on assets	+/- 1.0	290 / (290)	130 / (130)	180 / (180)	-
Full year 2003, expected return on assets	+/- 1.0	-	-	-	(350) / 350

Exhibit 2 (continued)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULT OF OPERATIONS

The foregoing indicates that changes in the discount rate and return on assets can have a significant effect on the funded status of our pension plans and Stockholders' Equity. As stated above, we base the discount rate assumption on investment yields available at year-end on corporate long-term bonds rated AA. We cannot predict these bond yields or investment returns and, therefore, cannot reasonably estimate whether adjustments to our Stockholders' Equity for minimum pension liability in subsequent years will be significant.

OTHER POSTRETIREMENT BENEFITS (RETIREE HEALTH CARE AND LIFE INSURANCE)

See Note 19 of the Notes to Financial Statements for more information regarding costs and assumptions for other postretirement benefits.

Nature of Estimates Required — The measurement of our obligations, costs and liabilities associated with other postretirement benefits (i.e., retiree health care and life insurance) requires that we make use of estimates of the present value of the projected future payments to all participants, taking into consideration the likelihood of potential future events such as health care cost increases, salary increases and demographic experience, which may have an effect on the amount and timing of future payments.

Assumptions and Approach Used — The assumptions used in developing the required estimates include the following key factors:

- Health care cost trends
- Discount rates
- Salary growth
- Retirement rates
- Inflation
- Expected return on plan assets
- Mortality rates

Our health care cost trend assumptions are developed based on historical cost data, the near-term outlook, efficiencies and other cost-mitigation actions (including further employee cost sharing, administrative improvements and other efficiencies) and an assessment of likely long-term trends. We base the discount rate assumption on investment yields available at year-end on corporate long-term bonds rated AA. Our inflation assumption is based on an evaluation of external market indicators. The salary growth assumptions reflect our long-term actual experience, the near-term outlook and assumed inflation. The expected return on plan assets reflects asset allocation, investment strategy and the views of investment managers and of other large pension plan sponsors regarding the market. Retirement and mortality rates are based primarily on actual plan experience. The effects of actual results differing from our assumptions are accumulated and amortized over future periods and, therefore, generally affect our recognized expense in such future periods.

Sensitivity Analysis — The December 31, 2003 postretirement obligation is affected by December 31, 2003 assumptions. Postretirement benefit expense for 2003 is affected by December 31, 2002 assumptions. Note that these sensitivities may be asymmetric, and are specific to the base conditions at year-end 2003. They also may not be additive, so the impact of changing multiple factors simultaneously cannot be calculated by combining the individual sensitivities shown. The effect of the indicated increase/decrease in selected assumptions is shown below (in millions):

		Effect on U.S. and Canadian Plans: Increase / (Decrease)	
Assumption	**Percentage Point Change**	**December 31, 2003 Obligation**	**2003 Expense**
Discount rate	+/- 1.0 pt.	$(4,100) / $ 5,000	$ (260) / $ 280
Healthcare cost trends – total expense	+/- 1.0	4,600 / (3,800)	560 / (460)
Healthcare cost trends – service and interest expense	+/- 1.0	4,600 / (3,800)	310 / (260)

Exhibit 3 Ford Motor Company Financial Statements

CONSOLIDATED STATEMENT OF INCOME

FORD MOTOR COMPANY AND SUBSIDIARIES
For the Years Ended December 31, 2003, 2002 and 2001 (in millions, except per share amounts)

	2003	2002	2001
Sales and Revenues			
Automotive sales	**$ 138,442**	$ 134,273	$ 130,736
Financial Services revenue	**25,754**	27,983	29.768
Total sales and revenues	**164,196**	162,256	160,504
Automotive interest income	**870**	834	765
Costs and expenses			
Cost of sales	**129,821**	125,043	128,348
Selling, administrative and other expenses	**23,902**	24,894	25,007
Interest expense	**7,690**	8,836	10,818
Provision for credit and insurance losses	**2,357**	3,275	3,661
Total costs and expenses	**163,770**	162,048	167,832
Automotive equity in net income/(loss) of affiliated companies	**74**	(91)	(856)
Income/(loss) before income taxes	**1,370**	951	(7,419)
Provision for/(benefit from) income taxes	**135**	301	(2,096)
Income/(loss) before minority interests	**1,235**	650	(5,323)
Minority interests in net income/(loss) of subsidiaries	**314**	367	24
Income/(loss) from continuing operations	**921**	283	(5,347)
Income/(loss) from discontinued/held-for-sale operations	**(8)**	(62)	(106)
Loss on disposal of discontinued/held-for-sale operations	**(154)**	(199)	-
Cumulative effect of change in accounting principle	**(264)**	(1,002)	-
Net income/(loss)	**$ 495**	$ (980)	$ (5,453)
Income/(loss) attributable to Common and Class B Stock after Preferred Stock dividends	**$ 495**	$ (995)	$ (5,468)
Average number of shares of Common and Class B Stock outstanding	**1,832**	1,819	1,820
AMOUNTS PER SHARE OF COMMON AND CLASS B STOCK			
Basic income/(loss)			
Income/(loss) from continuing operations	**$ 0.50**	$ 0.15	$ (2.96)
Income/(loss) from discontinued/held-for-sale operations	**-**	(0.04)	(0.06)
Loss on disposal of discontinued/held-for-sale operations	**(0.09)**	(0.11)	-
Cumulative effect of change in accounting principle	**(0.14)**	(0.55)	-
Net income/(loss)	**$ 0.27**	$ (0.55)	$ (3.02)
Diluted income/(loss)			
Income/(loss) from continuing operations	**$ 0.50**	$ 0.15	$ (2.96)
Income/(loss) from discontinued/held-for-sale operations	**-**	(0.03)	(0.06)
Loss on disposal of discontinued/held-for-sale operations	**(0.09)**	(0.11)	-
Cumulative effect of change in accounting principle	**(0.14)**	(0.55)	-
Net income/(loss)	**$ 0.27**	$ (0.55)	$ (3.02)
Cash dividends	**$ 0.40**	$ 0.40	$ 1.05

The accompanying notes are part of the financial statements.

2003 ANNUAL REPORT **67**

Exhibit 3 (continued)

CONSOLIDATED BALANCE SHEET

FORD MOTOR COMPANY AND SUBSIDIARIES
For the Years Ended December 31, 2003 and 2002 (in millions)

	2003	2002
ASSETS		
Cash and cash equivalents	**$ 21,770**	$12,221
Marketable securities	**11,872**	18,271
Loaned securities	**5,667**	-
Receivables, less allowances of $384 and $374	**2,721**	2,047
Finance receivables, net	**110,893**	97,007
Net investment in operating leases	**31,859**	39,727
Retained interest in sold receivables	**13,017**	17,618
Inventories	**9.181**	6,977
Equity in net assets of affiliated companies	**2,959**	3,569
Net property	**43,598**	37,923
Deferred income taxes	**7,389**	2,978
Goodwill	**6,147**	5,468
Other intangible assets	**1,115**	1,060
Assets of discontinued/held-for-sale operations	**456**	3,029
Other assets	**35,950**	29,227
Total assets	**304,594**	277,122
LIABILITIES AND STOCKHOLDERS' EQUITY		
Payables	**$ 20,420**	$ 18,936
Accrued liabilities	**29,591**	25,059
Debt	**179,804**	162,212
Other liabilities and deferred income	**53,899**	56,270
Deferred income taxes	**8,439**	2,311
Liabilities of discontinued/held-for-sale operations	**131**	1,074
Total liabilities	**292,284**	265,862
Company-obligated mandatorily redeemable preferred securities of subsidiary trusts holding solely junior subordinated debentures of the Company	**-**	5,670
Minority interests	**659**	-
Stockholders' Equity		
Capital stock		
Common Stock, par value $0.01 per share (1,837 million shares issued)	**18**	18
Class B Stock, par value $0.01 per share (71 million shares issued)	**1**	1
Capital in excess of par value of stock	**5,374**	5,420
Accumulated other comprehensive income/(loss)	**(414)**	(6,531)
Treasury stock	**(1,749)**	(1,977)
Earnings retained for use in business	**8,421**	8,659
Total stockholders' equity	**11,651**	5,590
Total liabilities and stockholders' equity	**304,594**	277,122

The accompanying notes are part of the financial statements.

2003 ANNUAL REPORT **69**

Exhibit 3 (continued)

CONSOLIDATED STATEMENT OF CASH FLOWS

FORD MOTOR COMPANY AND SUBSIDIARIES
For the Years Ended December 31, 2003, 2002 and 2001
(in millions)

	2003	2002	2001
CASH AND CASH EQUIVALENTS AT JANUARY 1	**$12,221**	$ 7,184	$ 4,776
Cash flows from operating activities before securities trading	**18,388**	24,742	20,517
Net sales/(purchases) of trading securities	**1,807**	(6,229)	1,263
Net cash flows from operating activities	**20,195**	18,513	21,780
Cash flows from investing activities			
Capital expenditures	**(7,749)**	(7,278)	(6,952)
Acquisitions of receivables and lease investments	**(62,980)**	(81,690)	(93,982)
Collections of receivables and lease investments	**42,727**	45,767	45,121
Net acquisitions of daily rental vehicles	**(1,505)**	(1,846)	(1,412)
Purchases of securities	**(10,074)**	(4,055)	(13,223)
Sales and maturities of securities	**9.382**	3,924	14,625
Proceeds from sales of receivables and lease investments	**21,145**	41,289	41,419
Proceeds from sale of businesses	**281**	257	-
Repayment of debt from discontinued operations	**1,421**	-	-
Cash paid for acquisitions	**-**	(289)	(2,735)
Cash recognized in initial consolidation of joint ventures	**771**	407	622
Net cash (used in)/provided by investing activities	**(6,325)**	(3,514)	(16,517)
Cash flows from financing activities			
Cash dividends	**(733)**	(743)	(1,929)
Net sales/(purchases) of Common Stock	**9**	287	(1,385)
Proceeds from mandatorily redeemable convertible preferred securities	**-**	4,900	-
Preferred Stock – Series B redemption	**-**	(177)	-
Changes in short-term debt	**1,305**	(14,171)	(18,306)
Proceeds from issuance of other debt	**23,086**	15,842	46,256
Principal payments on other debt	**(28,780)**	(16,619)	(27,315)
Other	**(19)**	346	76
Net cash (used in)/provided by financing activities	**(5,132)**	(10,335)	(2,603)
Effect of exchange rate changes on cash	**811**	373	(252)
Net increase/(decrease) in cash and cash equivalents	**9,549**	5,037	2,408
CASH AND CASH EQUIVALENTS AT DECEMBER 31	**$ 21,770**	$ 12,221	$ 7,184

The accompanying notes are part of the financial statements.

2003 ANNUAL REPORT **71**

Exhibit 3 (continued)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

FORD MOTOR COMPANY AND SUBSIDIARIES
For the Years Ended December 31, 2003, 2002 and 2001 (in millions)

				Comprehensive Income/(Loss)				
YEAR ENDED DECEMBER 31, 2001	**Capital Stock**	**In Excess of Par Value**	**Retained Earnings**	**Foreign Currency Translat.**	**Minimum Pension Liability**	**Derivative Instrumnt and Other**	**Other**	**Total**
Balance at beginning of year	$ 19	$ 6,174	$ 17,884	$ (3,103)	$ (440)	$ 111	$ (2,035)	$ 18,610
Comprehensive income/(loss)								
Net loss			(5,453)					(5,453)
Foreign currency translation				(1,240)				(1,240)
Net loss on derivatives (net of tax of $592) (Note 16)				129		(1,228)		(1,099)
Minimum pension liability (net of tax of $3)					(5)			(5)
Net holding loss (net of tax of $74)						(137)		(137)
Comprehensive loss								(7,934)
Common Stock issued for employee benefit plans and other		(173)						(173)
ESOP loan and treasury stock							(788)	(788)
Cash dividends			(1,929)					(1,929)
Balance at end of year	$ 19	$ 6,001	$ 10,502	$ (4,214)	$ (445)	$ (1,254)	$ (2,823)	$ 7,786
YEAR ENDED DECEMBER 31, 2002								
Balance at beginning of year	$ 19	$ 6,001	$ 10,502	$ (4,214)	$ (445)	$ (1,254)	$ (2,823)	$ 7,786
Comprehensive income/(loss)								
Net loss			(980)					(980)
Foreign currency translation				2,938				2,938
Net gain on derivatives (net of tax of $822) (Note 16)				(15)		1,541		1,526
Minimum pension liability (net of tax of $2,870)					(5,331)			(5,331)
Net holding gain (net of tax of $134)						249		249
Comprehensive loss								(1,598)
Common Stock issued for employee benefit plans and other		(524)						(524)
Preferred Stock Series B redemption		(57)	(120)					(177)
ESOP loan and treasury stock							846	846
Cash dividends			(743)					(743)
Balance at end of year	$ 19	$ 5,420	$ 8,659	$ (1,291)	$ (5,776)	$ 536	$ (1,977)	$ 5,590

Exhibit 3 (continued)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

FORD MOTOR COMPANY AND SUBSIDIARIES
For the Years Ended December 31, 2003, 2002 and 2001 (in millions)

				Comprehensive Income/(Loss)				
YEAR ENDED DECEMBER 31, 2003	**Capital Stock**	**In Excess of Par Value**	**Retained Earnings**	**Foreign Currency Translat.**	**Minimum Pension Liability**	**Derivative Instrumnt and Other**	**Other**	**Total**
Balance at beginning of year	$ 19	$ 5,420	$ 8,659	$ (1,291)	$ (5,776)	$ 536	$ (1,977)	$ 5,590
Comprehensive income/(loss)								
Net income			495					495
Foreign currency translation				3,075				3,075
Net gain on derivatives (net of tax of $430) (Note 16)				(191)		989		798
Minimum pension liability (net of tax of $1,208)					2,243			2,243
Net holding gain (net of tax of $1)						1		1
Comprehensive income								6,612
Common Stock issued for employee benefit plans and other		(46)						(46)
Treasury stock							228	228
Cash dividends			(733)					(733)
Balance at end of year	$ 19	$ 5,374	$ 8,421	$ 1,593	$ (3,533)	$ 1,526	$ (1,749)	$ 11,651

The accompanying notes are part of the financial statements.

72 FORD MOTOR COMPANY

Exhibit 4 2003 Ford Motor Company Notes to Financial Statements Excerpts

NOTES TO FINANCIAL STATEMENTS

NOTE 17. OPERATING CASH FLOWS BEFORE SECURITIES TRADING

The reconciliation of *Net income/(loss) from continuing operations* to cash flows from operating activities before securities trading is as follows (in millions):

	2003		2002		2001	
	Automotive	Financial Services	Automotive	Financial Services	Automotive	Financial Services
Net income/(loss) from continuing operations	$ (1,091)	$ 2,012	$ (985)	$ 1,268	$ (6,152)	$ 805
Depreciation and special tools amortization	5,472	8,791	4,896	10,181	4,997	10,139
Impairment charges (depreciation and Amortization	-	-	-	-	3,828	-
Amortization of goodwill and intangibles	24	10	21	18	296	31
Net loss/(earnings) from equity investments in excess of dividends remitted	(2)	-	134	13	845	(5)
Provision for credit/insurance losses	-	2,357	-	3,275	-	3,661
Foreign currency adjustments	160	-	51	-	(201)	-
Loss on sale of business	-	-	519	-	-	-
Stock option expense	154	19	-	-	-	-
Provision for deferred income taxes	785	1,274	(1,378)	595	(2,241)	538
Decrease/(increase) in accounts receivable and other current assets	(1,445)	1,353	2,568	(2,533	1,225	(837)
Decrease/(increase) in inventory	(505)	-	(650)	-	1,125	-
Increase/(decrease) in accounts payable and accrued and other liabilities	(1,786)	1,132	3,928	2,678	4,707	(974)
Other	(430)	104	377	(234)	(989)	(281)
Cash flows from operating activities before securities trading	$ 1,336	$ 17,052	$ 9,481	$ 14,261	$ 7,440	$ 13,077

Automotive sector cash equivalents at December 31, 2003 and 2002 were $4.0 billion and $4.4 billion, respectively; Financial Services sector cash equivalents at December 31, 2003 and 2002 were $14.2 billion and $5.3 billion, respectively.

Cash paid/(received) for interest and income taxes was as follows (in millions):

	2003	2002	2001
Interest	$ 7,553	$ 7,748	$ 9,946
Income taxes	(1,046)	(1,883)	929

92 FORD MOTOR COMPANY

Exhibit 4 (continued)

NOTES TO FINANCIAL STATEMENTS

NOTE 19. RETIREMENT BENEFITS

EMPLOYEE RETIREMENT PLANS

We have two principal qualified defined benefit retirement plans in the U.S. The Ford-UAW Retirement Plan covers hourly employees represented by the UAW, and the General Retirement Plan covers substantially all other Ford employees in the U.S hired on or before December 31, 2003. The hourly plan provides noncontributory benefits related to employee service. The salaried plan provides similar noncontributory benefits and contributory benefits related to pay and service. Other U.S. and non-U.S. subsidiaries have separate plans that generally provide similar types of benefits for their employees. We established, effective January 1, 2004, a defined contribution plan generally covering new salaried U.S. employees hired on or after that date. Ford-UAW Retirement Plan expense accruals for UAW-represented employees assigned to Visteon ("Visteon Hourly Employees") are charged to Visteon.

In general, our plans are funded, with the main exceptions of the U.S. defined benefit plans for senior management and certain plans in Germany; in such cases, an unfunded liability is recorded.

We also sponsor defined contribution plans for certain of our U.S. and non-U.S. employees. Our expense, primarily for matching contributions, for various plans was $37 million in 2003, $23 million in 2002 and $167 million in 2001.

POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

We, and certain of our subsidiaries, sponsor plans to provide selected health care and life insurance benefits for retired employees. Our U.S. and Canadian employees generally may become eligible for those benefits if they retire; however, benefits and eligibility rules may be modified from time to time.

In 2003, we agreed to relieve Visteon of its responsibility for the postretirement health care and life insurance liability related to service prior to June 30, 2000 for the Visteon Hourly Employees. This resulted in a one-time charge to expense of $1,646 million, and the forgiveness of associated Visteon promissory notes previously included in plan assets. Pursuant to the agreement, the expense associated with service after June 30, 2000 for Visteon Hourly Employees is charged to Visteon.

Postretirement health care and life insurance expense for former salaried Ford employees who transferred to Visteon and met certain age and service conditions at June 30, 2000 (the "Visteon Salaried Employees", and, together with the Visteon Hourly Employees, the "Visteon Employees") is also charged to Visteon.

A long-term receivable representing Visteon's remaining costs of postretirement health care and life insurance liability for the Visteon Employees in the amount of $480 million has been recorded by Ford. We expect the receivable to increase with expense charged to Visteon and to decrease as Visteon or the Visteon Voluntary Employees Beneficiary Association trust ("VEBA") makes cash payments to us directly in case of a payment from Visteon or to us as Ford Plan Administrator, in case of a payment from the Visteon VEBA.

Visteon has agreed to make a series of cash payments to the Visteon VEBA so that by December 31, 2049, the assets in the Visteon VEBA will equal Visteon's postretirement healthcare and life insurance liability for the Visteon Employees on that date. The cash payments to the Visteon VEBA will commence no later than January 2, 2006 for the Visteon Hourly Employees and January 1, 2011 for the Visteon Salaried Employees.

On December 8, 2003, the President signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003. The law provides for a federal subsidy to sponsors of retiree healthcare benefit plans that provide a benefit at least actuarially equivalent to the benefit established by the law. We provide retiree drug benefits that exceed the value of the benefits that will be provided by Medicare Part D, and our retirees' out-of-pocket costs are less than they would be under Medicare Part D. Therefore, we have concluded that our plan is at least "actuarially equivalent" to the Medicare Part D plan and that we will be eligible for the subsidy. We have reflected the impact of the subsidy as an unrecognized gain, which reduced our benefit obligation by $1.8 billion at December 31, 2003. Final authoritative guidance, when issued by the FASB, could require us to re-determine the impact of this legislation.

Exhibit 4 (continued)

NOTES TO FINANCIAL STATEMENTS

The measurement date for our worldwide postretirement benefit plans is December 31. Our expense for pension, postretirement health care and life insurance benefits was as follows (in millions):

	Pension Benefits						Health Care and Life Insurance		
	U.S. Plans			Non-U.S. Plans					
	2003	2002	2001	**2003**	2002	2001	**2003**	2002	2001
Service cost	**$ 600**	$ 556	$ 531	**$ 492**	$ 377	$ 396	**$ 521**	$ 427	$ 374
Interest cost	**2,442**	2,453	2,410	**1,170**	977	974	**2,004**	1,801	1,697
Expected return on assets	**(3,202)**	(3,646)	(3,697)	**(1,382)**	(1,265)	(1,184)	**(37)**	(85)	(161)
Amortization of:									
Prior service costs	**472**	529	532	**135**	137	138	**179**	145	114
(Gains)/losses and other	**33**	(130)	(367)	**148**	25	(101)	**(179)**	(145)	(114)
Separation programs	**-**	107	303	**128**	39	8	**-**	16	114
Visteon pre-spin liability	**-**	-	-	**-**	-	-	**1,646**	-	-
Allocated costs to Visteon	**(88)**	(62)	(58)	**-**	-	-	**(314)**	(228)	(149)
Net expense/(income)	**$ 257**	$ (193)	$ (346)	**$ 691**	$ 290	$231	**$ 4,173**	$2,096	$ 1,922

The year-end status of these plans was as follows (in millions):

	Pension Benefits				Health Care and Life Insurance	
	U.S. Plans		Non-U.S. Plans			
	2003	2002	**2003**	2002	**2003**	2002
Change in Benefit Obligation						
Benefit obligation at January 1	**$ 37,153**	$ 35,223	**$ 20,698**	$15,991	**$ 30,263**	$ 25,433
Service cost	**600**	556	**492**	377	**521**	427
Interest cost	**2,442**	2,453	**1,170**	977	**2,004**	1,801
Amendments	**1,282**	(3)	**5**	133	**(372)**	(264)
Separation programs	**-**	132	**80**	102	**-**	16
Plan participant contributions	**39**	39	**134**	95	**28**	14
Benefits paid	**(2,697)**	(2,806)	**(1,018)**	(921)	**(1,419)**	(1,232)
Foreign exchange translation	**-**	-	**3,269**	1,980	**12**	4
Actuarial (gain)/loss	**1,644**	1,559	**(40)**	1,964	**1,325**	4,064
Benefit obligation at December 31	**$ 40,463**	$ 37,153	**$ 24,790**	$ 20,698	**$ 32,362**	$30,263
Change in Plan Assets						
Fair value of plan assets at January 1	**$ 29,877**	$ 35,819	**$ 12,363**	$ 12,935	**$ 2,834**	$ 2,692
Actual return on plan assets	**7,687**	(3,335)	**2,070**	(1,692)	**10**	64
Company contributions	**2,168**	181	**1,029**	611	**3,500**	893
Plan participant contributions	**39**	39	**134**	95	**-**	-
Benefits paid	**(2,697)**	(2,806)	**(1,018)**	(921)	**(877)**	(815)
Foreign exchange translation	**-**	-	**1,924**	1,322	**-**	-
Visteon Promissory Notes/Other	**(58)**	(21)	**46**	13	**(1,902)**	-
Fair value of plan assets at December 31	**$ 37,016**	$ 29,877	**$ 16,548**	$ 12,363	**$ 3,565**	$ 2,834
Funded status	**$ (3,447)**	$ (7,276)	**$ (8,242)**	$ (8,335)	**$ (28,797)**	$ (27,429)
Unamortized prior service costs	**3,640**	2,831	**790**	784	**(1,352)**	(1,161)
Unamortized net (gain)/losses and other	**3,917**	6,742	**7,122**	6,874	**11,075**	10,423
Net amount recognized	**$ 4,110**	$ 2,297	**$ (330)**	$ (677)	**$ (19,074)**	$ (18,167)

Exhibit 4 (continued)

NOTES TO FINANCIAL STATEMENTS

NOTE 19. Retirement Benefits (continued)

	Pension Benefits				Health Care and Life Insurance	
	U.S. Plans		Non-U.S. Plans			
	2003	2002	**2003**	2002	**2003**	2002
Amounts Recognized in the Balance Sheet Consist of Assets/(Liabilities)						
Prepaid assets	**$ 5,230**	$ 3,420	**$ 2,724**	$ 1,728	**$ -**	$ -
Accrued liabilities	**(5,807)**	(8,921)	**(7,792)**	(7,449)	**(19,074)**	(18,167)
Intangible assets	**2,916**	2,797	**874**	890	**-**	-
Accumulated other comprehensive income	**1,771**	4,992	**3,864**	4,154	**-**	-
Net amount recognized	**$ 4,110**	$,2,297	**$ (330)**	$ (677)	**$ (19,074)**	$ (18,167)
Pension Plans in Which Accumulated Benefit Obligation Exceeds Plan Assets at December 31						
Accumulated benefit obligation	**$ 22,334**	$ 35,305	**$ 21,145**	$,17,569		
Fair value of plan assets	**19,378**	29,773	**15,832**	11,756		
Accumulated Benefit Obligation at December 31	**$ 38,786**	$ 35,394	**$ 21,797**	$ 18,110		
Weighted Average Assumptions at December 31						
Discount rate	**6.25%**	6.75%	**5.61%**	5.65%	**6.25%**	6.75%
Expected return on assets	**8.75%**	8.75%	**8.38%**	8.40%	**6.20%**	6.00%
Average rate of increase in compensation	**4.50%**	5.20%	**3.80%**	3.80%	**-**	-
Initial health care cost trend rate	**-**	-	**-**	-	**9%**	11%
Ultimate health care cost trend rate	**-**	-	**-**	-	**5%**	5%
Yea ultimate trend rate is reached	**-**	-	**-**	-	**2010**	2008
Assumptions Used to Determine Net Benefit Cost for the Year Ending December 31						
Discount rate	**6.75%**	7.25%	**5.65%**	6.10%	**6.75%**	7.25%
Expected return on assets	**8.75%**	9.50%	**8.40%**	8.70%	**6.00%**	6.00%
Average rate of increase in compensation	**5.20%**	5.20%	**3.80%**	3.80%	**-**	-
Weighted Average Asset Allocation at December 31						
Equity securities	**72.2%**	67.0%	**63.7%**	58.7%	**0.0%**	0.0%
Debt securities	**26.3%**	31.9%	**34.5%**	39.5%	**100.0%**	100.0%
Real estate	**0.2%**	0.3%	**1.1%**	1.2%	**0.0%**	0.0%
Other assets	**1.3%**	0.8%	**0.7%**	0.6%	**0.0%**	0.0%

A one percentage point increase/(decrease) in the assumed health care cost trend rate would increase/(decrease) the postretirement health care benefit obligation by approximately $4.6 billion/$(3.8) billion and the service and interest component of health care expense by $310 million/$(260) million.

96 FORD MOTOR COMPANY

Exhibit 4 (continued)

NOTES TO FINANCIAL STATEMENTS

COMPANY CONTRIBUTIONS

Our policy for funded plans is to contribute annually, at a minimum, amounts required by applicable laws, regulations, and union agreements. We do from time to time make contributions beyond those legally required. For example, in 2003 we made over $2 billion of discretionary cash contributions to our U.S. pension funds.

During 2004, we expect worldwide Company cash outflow in respect of our defined benefit pension plans will total $1.1 billion, consisting of contributions to pension funds and benefit payments for unfunded plans.

PLAN ASSET INFORMATION

Our investment strategy has a long-term horizon and is tolerant of return volatility, in keeping with the long-term nature of the liabilities. The target asset allocation for our major plans worldwide generally is 70% equities, 30% fixed income. The present allocation to alternative investments is below 1%. All assets are externally managed and investment managers have discretion to invest globally within their respective mandates. A diverse array of investment processes within asset classes reduces volatility. Most assets are actively managed; manager skill and broad mandates have generally produced long-term returns in excess of common market indices. Ford securities comprised less than one-half of one percent of the value of our worldwide pension plan assets during 2003 and 2002.

The equity allocation shown at year-end 2003 and 2002 includes public equity securities, private equity investments, and REITS. Real estate investments shown separately reflect a liquidation strategy that has been in place for several years. Other assets include cash held for near-term benefit funding; cash held by investment managers for liquidity purposes is included in the appropriate asset class balance.

The long-term return assumption at year-end 2003 is 8.75% for the U.S. and averages 8.38% for non-U.S. plans. A consistent approach generally is used worldwide to develop this assumption. This approach utilizes long-run equilibrium assumptions from a range of advisors for capital market returns, inflation and other variables, adjusted for specific aspects of our strategy. This exercise is conducted periodically, and changes in our assumption reflect changes in equilibrium views over time; we do not expect to modify this assumption frequently. The long-term performance of our funds generally has been in excess of long-term return assumptions worldwide.

We previously established a VEBA to pay a portion of U.S. hourly retiree health and life insurance benefits. In December 2003, we contributed $3.5 billion to the trust, and all the assets were invested in short-term fixed income securities. Subsequent to year-end, VEBA assets of $2.0 billion were invested in long-term investments, to be managed in a strategy similar to the pension investment strategy described previously. The remaining VEBA assets will continue to be invested in short-term fixed income securities, a portion of which is managed internally, with the remainder externally. The long-term expected return assumption applicable to the total retiree VEBA is 6.2%, reflecting the weighted average of the expected returns on the long-term and short-term portions of the portfolio.

Exhibit 5 2003 Toyota Motor Corporation Annual Report Excerpts

Message from Chief Finance & Accounting Officer

Performance Overview

Toyota has adapted to changes in global markets through a policy of aggressive overseas investment and by developing a comprehensive product lineup. As a result, despite fluctuations in exchange rates, we have steadily increased profits and achieved a significant improvement in capital efficiency over the past 10 years. During this period, Toyota's total assets doubled while its operating income increased by a factor of five. In other words, the Japanese economy's "lost decade" has been a decade of remarkable advances for Toyota.

In fiscal 2003, ended March 31, 2003, Toyota's consolidated net revenues increased 9.2%, to ¥15.50 trillion, operating income rose 16.3%, to ¥1.27 trillion, and net income was up 34.9%, to ¥750.9 billion—each representing a new high. Moreover, ROE reached 10.4%, surpassing our short-term target of 10%. Looking ahead, Toyota will work to further strengthen its profitability.

Balanced Financial Strategy

Toyota's key financial strategy is to maintain a solid financial base that enables it to strike a balance between enhancement of short-term profitability and forward-looking investment for long-term, stable growth. With a view to future growth, we implemented capital expenditures of approximately ¥1 trillion and recorded ¥668 billion in R&D expenses in the year under review. At the same time, we maintained positive free cash flow in automotive operations. Our management policies give priority to cash flows to enable us to respond quickly to changes in the operating environment and to steadily increase corporate value for our shareholders. In our view, sacrificing long-term growth to boost short-term profits is not an appropriate financial strategy for the manufacturing industry. We believe the sector should create markets based on new technologies. Toyota's basic approach to business rests on the conviction that the best way to achieve sustained growth of shareholder value is to heighten its profitability in conjunction with adequate provision of funds to fulfill such social responsibilities as environmental investment, returning benefits to local communities, and employee welfare.

Dividends and Treasury Stock Repurchases

In addition to the abovementioned policies, we use most of our free cash flows for dividend payments and the repurchase of treasury stock to underscore the status of Toyota's shares as a long-term, stable asset stock.

In fiscal 2003, the Company paid its highest-ever annual dividend—¥36.00 per share, up ¥8.00 from the previous fiscal year. This marked the fourth consecutive year of increased dividends. Total dividends were ¥125.8 billion, while the dividend payout ratio was 19.8%. Further, as of the end of July 2003, we had repurchased almost all of the 170 million shares authorized at the Ordinary General Shareholders Meeting in June 2002.

In order to increase capital efficiency and to pursue a dynamic capital policy, we have actively acquired treasury stock since the first year of its recognition by Japan's Commercial Code in the fiscal year ended March 31, 1997. As of March 31, 2003, treasury stock repurchased by the Company totaled ¥1.38 trillion, or 416 million shares, and total shares issued and outstanding—excluding treasury stock—had decreased to 3.45 billion shares. In addition, at fiscal year-end the percentage of shares held by banks had approximately halved from 32% at the end of fiscal 2000 to 15%. Toyota believes that the release of its shares by banks has peaked.

Accounting Standards

The financial statements included in this annual report have been prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP). Toyota also prepares consolidated financial statements in accordance with generally accepted accounting principles in Japan. Henceforth, Toyota's consolidated financial statements will only be issued in accordance with U.S. GAAP. This will make our financial statements easier to understand and speed up their preparation and disclosure. We are also taking steps to further heighten the transparency of disclosures and to fulfill accountability obligations to all of our stakeholders through dialogue. With those goals in mind, in April 2003 we established the Disclosure Committee based on section 302 of the U.S. Sarbanes-Oxley Act, and from 2004 we will put in place internal controls based on section 404 of the same Act.

July 2003

Ryuju Araki,
Executive Vice President
Chief Finance & Accounting Officer

Exhibit 5 (continued)

CRITICAL ACCOUNTING POLICIES

The consolidated financial statements of Toyota are prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the use of estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. Toyota believes that of its significant accounting policies, the following may involve a higher degree of judgments, estimates and complexity:

Warranty

Toyota generally warrants its products against certain manufacturing and other defects. Product warranties are provided for specific periods of time and/or usage of the product and vary depending upon the nature of the product, the geographic location of its sale and other factors. All product warranties are consistent with commercial practices. Toyota provides a provision for estimated product warranty costs as a component of cost of sales at the time the related sale is recognized. The accrued warranty costs represent management's best estimate at the time of sale of the total costs that Toyota will incur to repair or replace product parts that fail while still under warranty. The amount of accrued estimated warranty costs is primarily based on historical experience as to product failures as well as current information on repair costs. The amount of warranty costs accrued also contains an estimate as to warranty claim recoveries from suppliers. The foregoing evaluations are inherently uncertain, as they require material estimates and some products' warranty extend for several years. Consequently, actual warranty costs will differ from the estimated amounts and could require additional warranty provisions. If these factors require a significant increase in Toyota's accrued estimated warranty costs, it would negatively affect future operating results of the automotive operations.

Allowance for Doubtful Accounts and Credit Loss

Sales financing and finance lease receivables consist of retail installment sales contracts secured by passenger cars and commercial vehicles. Collectibility risks include consumer and dealer insolvencies and insufficient collateral values (less costs to sell) to realize the full carrying values of these receivables. As a matter of policy, Toyota maintains an allowance for doubtful accounts and credit losses representing Toyota's management's estimate of the amount of asset impairment in the portfolios of finance, trade and other receivables. Toyota determines the allowance for doubtful accounts and credit losses based on a systematic, ongoing review and evaluation performed as part of the credit-risk evaluation process, historical loss experience, the size and composition of the portfolios, current economic events and conditions, the estimated fair value and adequacy of collateral and other pertinent factors. This evaluation is inherently judgmental and requires material estimates, including the amounts and timing of future cash flows expected to be received, which may be susceptible to significant change. Although management considers the allowance for doubtful accounts and credit losses to be adequate based on information currently available, additional provisions may be necessary due to (i) changes in management estimates and assumptions about asset impairment, (ii) information that indicates changes in the expected future cash flows, or (iii) changes in economic and other events and conditions. A prolonged economic downturn in North America and Western Europe could increase the likelihood of credit losses exceeding current estimates. To the extent that sales incentives remain an integral part of sales promotion with the effect of reducing new vehicle prices, resale prices of used vehicles and, correspondingly, the collateral value of Toyota's sales financing and finance lease receivables could experience further downward pressure. If these factors require a significant increase in Toyota's allowance for doubtful accounts and credit losses, it could negatively affect future operating results of the financial services operations.

Investment in Operating Leases

Vehicles on operating leases, where Toyota is the lessor, is valued at acquisition cost and depreciated over its estimated useful life using the straight-line method to its estimated residual value. Toyota utilizes industry published information and its historical experience to determine estimated residual values for these vehicles. Toyota evaluates the recoverability of the carrying values of its leased vehicles for impairment when there are indications of declines in residual values. In recent years, the resale values of returned vehicles have been depressed, primarily because of an increased supply of used vehicles in the market that has depressed market prices. In addition, to the extent that sales incentives remain an integral part of sales promotion (reducing new vehicle prices), resale prices of used vehicles and, correspondingly, the carrying value of Toyota's leased vehicles could be subject to further downward pressure. If resale prices of used vehicles decline, future operating results of the financial services operations are likely to be adversely affected by incremental charges to reduce estimated residual values.

Impairment of Long-Lived Assets

Toyota periodically reviews the carrying value of its long-lived assets held and used and assets to be disposed of, including goodwill and other intangible assets, when events and circumstances warrant such a review. This review is performed using estimates of future cash flows. If the carrying value of a long-lived asset is considered impaired, an impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its fair value. Management believes that the estimates of future cash flows and fair value are reasonable; however, changes in estimates of such cash flows and fair value would affect the evaluations and negatively affect future operating results of the automotive operations.

Exhibit 5 (continued)

Employee Costs

Pension and other postretirement benefits costs and obligations and post-employment benefit costs are dependent on assumptions used in calculating such amounts. These assumptions include discount rates, health care cost trend rates, benefits earned, interest cost, expected return on plan assets, mortality rates and other factors. Actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect recognized expense and the recorded obligation in future periods. While management believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions may affect Toyota's pension and other postretirement costs and obligations and post-employment benefit costs.

Derivatives and Other Contracts at Fair Value

Toyota uses derivatives in the normal course of business to manage its exposure to foreign currency exchange rates and interest rates. The accounting is complex and continues to evolve. In addition, there are the significant judgments and estimates involved in the estimating of fair value in the absence of quoted market values. These estimates are based upon valuation methodologies deemed appropriate in the circumstances; however, the use of different assumptions may have a material effect on the estimated fair value amounts.

Marketable securities

Toyota's accounting policy is to record a write-down of such investments to realizable value when a decline in fair value below carrying value is other than temporary. In determining if a decline in value is other than temporary, Toyota considers the length of time and the extent to which the fair value has been less than the carrying value, the financial condition and prospects of the company and Toyota's ability and intent to retain its investment in the company for a period of time sufficient to allow for any anticipated recovery in market value.

66

Exhibit 6 2003 Toyota Motor Corporation Financial Statements

Consolidated Balance Sheets

Toyota Motor Corporation
March 31, 2003 and 2002

	Yen in millions		U.S. dollars in millions
ASSETS	2002	2003	2003
Current Assets:			
Cash and cash equivalents	¥ 1,657,160	¥ 1,592,028	$ 13,245
Time deposits	19,977	55,406	461
Marketable securities	600,737	605,483	5,037
Trade accounts and notes receivable, less allowance for doubtful accounts of ¥28,182 million in 2002 and and ¥29,489 ($246 million) in 2003	1,456,935	1,475,797	12,278
Finance receivables, net	2,020,491	2,505,140	20,841
Other receivables	508,970	513,952	4,276
Inventories	961,840	1,025,838	8,534
Deferred income taxes	433,524	385,148	3,204
Prepaid expenses and other current assets	413,211	463,441	3,856
Total current assets	8,072,845	8,622,233	71,732
Noncurrent finance receivables, net	2,671,460	2,569,808	21,379
Investments and other assets:			
Marketable securities and other securities investments	1,531,126	1,652,110	13,745
Affiliated companies	1,321,950	1,279,645	10,646
Officers and employees receivables	21,151	21,270	177
Other	580,188	804,029	6,689
	3,454,415	3,757,054	31,257
Property, plant and equipment:			
Land	1,032,381	1,064,125	8,853
Buildings	2,421,918	2,521,208	20,975
Machinery and equipment	6,959,054	7,089,592	58,982
Vehicles and equipment on operating leases	1,584,161	1,601,060	13,320
Construction in progress	234,224	211,584	1,760
	12,231,738	12,487,569	103,890
Less – Accumulated depreciation	(7,124,728)	(7,283,690)	(60,596)
	5,107,010	5,203,879	43,294
Total assets	¥19,305,730	¥ 20,152,974	$ 167,662

The accompanying notes are an integral part of these financial statements.

68

Exhibit 6 (continued)

	Yen in millions		U.S. dollars in millions
LIABILITIES AND SHAREHOLDERS' EQUITY	2002	2003	2003
Current Liabilities:			
Short-term borrowings	¥ 1,825,564	¥ 1,855,648	$ 15,438
Current portion of long-term debt	1,158,814	1,263,017	10,508
Accounts payable	1,420,608	1,531,552	12,741
Other payables	575,011	618,748	5,148
Accrued expenses	928,160	1,063,496	8,848
Income taxes payable	327,713	300,718	2,502
Other current liabilities	436,288	420,757	3,500
Total current liabilities	6,672,158	7,053,936	58,685
Long-term liabilities:			
Long-term debt	3,722,706	4,137,528	34,422
Accrued pension and severance costs	754,403	1,052,687	8,758
Deferred income taxes	467,061	371,004	3,086
Other long-term liabilities	133,669	101,353	843
Total long-term liabilities	5,077,839	5,662,572	47,109
Minority interest in consolidated subsidiaries	291,621	315,466	2,625
Shareholders' equity:			
Common stock, no par value, authorized: 9,780,185,400 share in 2002 and 9,740,185,400 shares in 2003; issued: 3,649,997,492 shares in 2002 and 3,609,997,492 shares in 2003	397,050	397,050	3,303
Additional paid-in capital	490,538	493,790	4,108
Retained earnings	6,804,722	7,301,795	60,747
Accumulated other comprehensive loss	(267,304)	(604,272)	(5,027)
Treasury stock, at cost, 46,449,606 shares in 2002 and 158,940,796 shares in 2003	(160,894)	(467,363)	(3,888)
Total shareholders' equity	7,264,112	7,121,000	59,243
Commitments and contingencies			
Total liabilities and shareholders' equity	¥ 19,305,730	¥ 20,152,974	$ 167,662

69

Exhibit 6 (continued)

Consolidated Statements of Income

Toyota Motor Corporation
For the years ended March 31, 2003, 2002 and 2001

	Yen in millions			U.S. dollars in millions
	2001	2002	2003	2003
Net revenues:				
Sales of products	¥ 12,402,104	¥ 13,499,644	**¥ 14,793,973**	**$123,078**
Financing operations	553,133	690,664	**707,580**	**5,887**
	12,955,237	14,190,308	**15,501,553**	**128,965**
Costs and expenses:				
Cost of products sold	10,218,599	10,874,455	**11,914,245**	**99,120**
Cost of financing operations	427,340	459,195	**423,885**	**3,527**
Selling, general and administrative	1,518,569	1,763,026	**1,891,777**	**15,739**
	12,164,508	13,096,676	**14,229,907**	**118,386**
Operating income	790,729	1,093,632	**1,271,646**	**10,579**
Other income (expense):				
Interest and dividend income	71,358	55,778	**52,661**	**438**
Interest expense	(40,886)	(26,786)	**(30,467)**	**(253)**
Foreign exchange gain (loss), net	(5,954)	(16)	**35,585**	**296**
Other income (loss), net	292,042	(150,507)	**(102,773)**	**(855)**
	316,560	(121,531)	**(44,994)**	**(374)**
Income before income taxes, minority interest and equity in earnings of affiliated companies	1,107,289	972,101	**1,226,652**	**10,205**
Provision for income taxes	523,876	422,789	**517,014**	**4,301**
Income before minority interest and equity in earnings of affiliated companies	583,413	549,312	**709,638**	**5,904**
Minority interest in consolidated subsidiaries	(12,129)	(10,835)	**(11,531)**	**(96)**
Equity in earnings of affiliated companies	103,614	18,090	**52,835**	**439**
Net income	674,898	556,567	**750,942**	**$ 6,247**
Net income per share:				
- Basic	¥ 180.65	¥ 152.26	**¥ 211.32**	**$ 1.76**
- Diluted	¥ 180.65	¥ 152.26	**¥ 211.32**	**$ 1.76**
Cash dividends per share	¥ 25.00	¥ 28.00	**¥ 36.00**	**$ 0.30**

The accompanying notes are an integral part of these financial statements.

70

Exhibit 6 (continued)

Consolidated Statements of Shareholders' Equity

Toyota Motor Corporation
For the years ended March 31, 2003, 2002 and 2001

	Yen in millions					
	Common stock	Additional paid-in capital	Retained earnings	Accumulat. other comprehen. income	Treasury stock, at cost	Total
Balance at March 31, 2000	¥ 397,020	¥ 487,531	¥ 6,156,396	¥ (125,347)	¥ (3,460)	¥ 6,912,140
Issuance during the year	30	1,124				1,154
Comprehensive income:						
Net income			674,898			674,898
Other comprehensive income (loss) –						
Foreign currency translation adjustments				161,280		161,280
Unrealized losses on securities, net				(304,995)		(304,995)
Minimum pension liability adjustments				(13,429)		(13,429)
Total comprehensive income						517,754
Dividends paid			(88,625)			(888,625)
Purchase and retirement of common stock			(263,596)		(1,416)	(265,012)
Balance at March 31, 2001	397,050	488,655	6,479,073	(282,491)	(4,876)	7,077,411
Issuance during the year		1,883				1,883
Comprehensive income:						
Net income			556,567			556,567
Other comprehensive income (loss) –						
Foreign currency translation adjustments				133,897		133,897
Unrealized losses on securities, net				(3,576)		(3,576)
Minimum pension liability adjustments				(114,344)		(114,344)
Net losses on derivative instruments				(790)		(790)
Total comprehensive income						571,754
Changes in subsidiaries' year-ends			(3,061)			(3,061)
Dividends paid			(98,639)			(98,639)
Purchase and retirement of common stock			(129,218)		(156,018)	(285,236)
Balance at March 31, 2002	397,050	490,538	6,804,722	(267,304)	(160,894)	7,264,112
Issuance during the year		3,252				3,252
Comprehensive income:						
Net income			750,942			750,942
Other comprehensive income (loss) –						
Foreign currency translation adjustments				(139,285)		(139,285)
Unrealized losses on securities, net				(26,495)		(26,495)
Minimum pension liability adjustments				(171,978)		(171,978)
Net gains on derivative instruments				790		790
Total comprehensive income						413,974
Dividends paid			(110,876)			(110,876)
Purchase and retirement of common stock			(142,993)			(142,993)
Balance at March 31, 2003	¥ 397,050	¥ 493,790	¥ 7,301,795	¥ (604,272)	¥ 467,363)	¥ 7,121,000

Exhibit 6 (continued)

	U.S. dollars in millions					
	Common stock	Additional paid-in capital	Retained earnings	Accumulat. other comprehen. income	Treasury stock, at cost	Total
Balance at March 31, 2002	$ 3,303	$ 4,081	$ 56,612	$ (2,224)	$ (1,338)	$60,434
Issuance during the year		27				27
Comprehensive income:						
Net income			6,247			6,247
Other comprehensive income (loss) –						
Foreign currency translation adjustments				(1,159)		(1,159)
Unrealized losses on securities, net				(220)		(220)
Minimum pension liability adjustments				(1,431)		(1,431)
Net gains on derivative instruments				7		7
Total comprehensive income						3,444
Dividends paid			(922)			(922)
Purchase and retirement of common stock			(1,190)			(1,190)
Balance at March 31, 2003	$ 3,303	$ 4,108	$ 60,747	$ (5,027)	$ (3,888)	$ 59,243

The accompanying notes are part of the financial statements.

71

Exhibit 6 (continued)

Consolidated Statements of Cash Flows

Toyota Motor Corporation for the years ended March 31, 2003, 2002 and 2001

	Yen in millions			US dollars (mil)
	2001	2002	2003	2003
Cash flows from operating activities:				
Net income……………………………………………..	¥ 674,898	¥ 556,567	**¥ 750,942**	**$ 6,247**
Adjustments to reconcile net income to net cash --				
Depreciation…………………………………………	784,784	809,841	**870,636**	**7,243**
Provision for doubtful accounts and credit losses…...	27,131	44,407	**99,837**	**831**
Pension and severance costs, less payments………...	45,138	53,543	**55,637**	**463**
Loss on disposal of fixed assets……………………..	33,409	46,834	**46,492**	**387**
Unrealized losses on trading securities, net…………	13,377	-	**-**	**-**
Unrealized losses on available-for-sale securities net.	(11,107)	179,649	**111,346**	**926**
Realized gain on disposition of ownership interest….	(180,950)	-	**-**	**-**
Gain on sec. contrib. to employee retire. benefit trust	(161,151)	-	**-**	**-**
Deferred income taxes……………………………….	49,325	(142,811)	**(74,273)**	**(618)**
Minority interest in consolidated subsidiaries……….	12,129	10,835	**11,531**	**96**
Equity in earnings of affiliated companies…………..	(103,614)	(18,090)	**(52,835)**	**(439)**
Changes in operating assets and liabilities:				
(Increase) decrease in notes, accounts receivable….	(111,632)	61,997	**(46,068)**	**(383)**
(Increase) decrease in inventories………………….	(49,374)	11,705	**(38,043)**	**(316)**
(Increase) decrease in other current assets…………	4,486	(253,993)	**(58,036)**	**(483)**
Increase (decrease) in accounts payable……………	(7,911)	(809)	**116,946**	**973**
Increase (decrease) in accrued income taxes……….	141,525	74,888	**(27,340)**	**(227)**
Increase in other current liabilities…………………	220,357	139,954	**181,595**	**1,511**
Other…………………………………………………	58,198	(41,857)	**136,680**	**1,136**
Net cash provided by operating activities…………	1,428,018	1,532,660	**2,085,047**	**17,347**
Cash flows from investing activities:				
Additions to finance receivables……………………….	(3,697,376)	(3,853,741)	**(6,481,200)**	**(53,920)**
Collections of finance receivables……………………..	2,801,160	2,453,540	**5,252,685**	**43,700**
Proceeds from sale of finance receivables…………….	507,811	624,393	**572,771**	**4,765**
Additions to fixed assets excluding equipment leased…	(762,274)	(940,547)	**(1,005,931)**	**(8,369)**
Additions to equipment leased to others……………….	(439,132)	(608,046)	**(604,298)**	**(5,027)**
Proceeds from sales of fixed assets excluding leases…..	61,265	56,525	**61,847**	**515**
Proceeds from sales of equipment leased to others…….	337,047	412,191	**286,538**	**2,384**
(Increase) decrease investments and other assets………	(70,906)	(28,450)	**(30,481)**	**(254)**
Purchases of marketable securities and investments…...	(949,058)	(653,756)	**(1,113,998)**	**(9,268)**
Proceeds from sales of marketable securities and invest	234,608	147,722	**197,985**	**1,647**
Proceeds on maturity of marketable securities, investm.	597,409	604,081	**723,980**	**6,023**
(Increase) decrease in time deposits……………………	45,190	31,519	**(33,379)**	**(278)**
Payment for additional investments in affiliates net…...	(34,204)	(27,510)	**(28,229)**	**(235)**
Other…………………………………………………..	49,722	(28,732)	**55,503**	**460**
Net cash used in investing activities………………..	(1,318,738)	(1,810,811)	**(2,146,407)**	**(17,857)**
Cash flows from financing activities:				
Purchase of common stock……………………………..	(265,012)	(285,236)	**(454,611)**	**(3,782)**
Proceeds from issuance of long-term debt……………..	1,117,360	1,701,727	**1,686,564**	**14,031**
Payments of long-term debt……………………………	(958,475)	(1,012,523)	**(1,117,803)**	**(9,300)**
Increase in short-term borrowings……………………..	28,039	73,884	**30,327**	**252**
Dividends paid…………………………………………	(88,625)	(98,639)	**(110,876)**	**(922)**
Other…………………………………………………..	-	12,935	**4,074**	**34**
Net cash provided by (used in) financing activities…	(166,713)	392,148	**37,675**	**313**
Effect of exchange rate changes on cash and equivalents..	39,057	32,271	**(41,447)**	**(345)**
Net increase (decrease) in cash and cash equivalents……	(18,376)	146,268	**(65,132)**	**(542)**
Cash and cash equivalents at beginning of year………….	1,529,268	1,510,892	**1,657,160**	**13,787**
Cash and cash equivalents at end of year……….............	¥ 1,510,892	¥ 1,657,160	**¥ 1,592,028**	**$ 13,245**

The accompanying notes are an integral part of these financial statements.

Exhibit 7 2003 Toyota Motor Corporation Notes to Financial Statements Excerpts

Notes to Consolidated Financial Statements

Toyota Motor Corporation

1. NATURE OF OPERATIONS:

Toyota Motor Corporation (the "parent company") and its subsidiaries (collectively "Toyota") are primarily engaged in the design, manufacture, assembly and sale of passenger cars, recreational and sport-utility vehicles, minivans, trucks and related parts and accessories throughout the world. In addition, Toyota provides retail and wholesale financing, retail leasing and certain other financial services primarily to its dealers and their customers related to vehicles manufactured by Toyota.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The parent company and its subsidiaries in Japan maintain their records and prepare their financial statements in accordance with accounting principles generally accepted in Japan, and its foreign subsidiaries in conformity with those of their countries of domicile. Certain adjustments and reclassifications have been incorporated in the accompanying consolidated financial statements to conform with accounting principles generally accepted in the United States of America. These adjustments were not recorded in the statutory books.

Significant accounting policies after reflecting adjustments for the above are as follows:

Basis of consolidation and accounting for investments in affiliated companies –

The consolidated financial statements include the accounts of the parent company and those of its majority-owned subsidiary companies. Certain foreign subsidiary results were reported in the consolidated financial statements using December 31 yearends. During the year ended March 31, 2002, the year-ends of certain of these foreign subsidiaries were changed from December 31 to March 31. As a result, Toyota decreased retained earnings by ¥3,061 million to reflect the impact of conforming the yearends at March 31, 2001. All significant intercompany transactions and accounts have been eliminated. Investments in affiliated companies in which Toyota exercises significant influence, but which it does not control, are stated at cost plus equity in undistributed earnings. Consolidated net income includes Toyota's equity in current earnings of such companies, after elimination of unrealized intercompany profits. Investments in which Toyota does not exercise significant influence (generally less than a 20% ownership interest) are stated at cost.

Estimates –

The preparation of Toyota's consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The more significant estimates include: product warranties, allowance for doubtful accounts and credit losses, residual values for leased assets, impairment of long-lived assets, postretirement benefits costs and obligations and post-employment benefit costs and other-than-temporary losses on marketable securities.

Translation of foreign currencies –

All asset and liability accounts of foreign subsidiaries and affiliates are translated into Japanese yen at appropriate year-end current rates and all income and expense accounts of those subsidiaries are translated at average-period exchange rates. The resulting translation adjustments are included as a component of accumulated other comprehensive income / loss.

Foreign currency receivables and payables are translated at appropriate year-end current rates and the resulting transaction gains or losses are taken into income currently.

Revenue recognition –

Revenue from sales of vehicles and parts is generally recognized upon delivery which is considered to have occurred when the dealer has taken title to the product and the risk and reward of ownership have been substantively transferred, except as described below.

Toyota's sales incentive programs principally consist of cash payments to dealers calculated based on vehicle volume or a model sold by the dealer in a certain period of time. Toyota specifies those volume, model or period covered in the incentive programs. Toyota accrues these incentives as revenue reductions at the sale of a vehicle corresponding to the program by the amount determined in the related incentive program.

Revenue from the sale of vehicles under which Toyota conditionally guarantees the minimum resale value is recognized on a pro rata basis from the date of sale to the first exercise date of the guarantee in a manner similar to lease accounting. The underlying vehicles of these transactions are recorded as assets and are depreciated in accordance with Toyota's depreciation policy.

Revenue from retail financing contracts and finance leases is recognized using the effective yield method. Revenue from operating leases is recognized on a straight-line basis over the lease term.

Toyota on occasion sells finance receivables in transactions subject to limited recourse provisions. These sales are to trusts and Toyota retains the servicing and is paid a servicing fee. Gains or losses from the sales of the finance receivables are recognized in the period in which such sales occur.

Other costs –

Advertising and sales promotion costs are expensed as incurred. Advertising costs were ¥276,596 million, ¥319,657 million and ¥326,972 million ($2,720 million) for the years ended March 31, 2001, 2002 and 2003, respectively.

Exhibit 7 (continued)

Toyota generally warrants its products against certain manufacturing and other defects. Provisions for product warranties are provided for specific periods of time and/or usage of the product and vary depending upon the nature of the product, the geographic location of its sale and other factors. Toyota provides a provision for estimated product warranty costs at the time the related sale is recognized based on estimates that Toyota will incur to repair or replace product parts that fail while still under warranty. The amount of accrued estimated warranty costs is primarily based on historical experience as to product failures as well as current information on repair costs. The amount of warranty costs accrued also contains an estimate as to warranty claim recoveries from suppliers.

Research and development costs are expensed as incurred and were ¥475,716 million, ¥589,306 million and ¥668,404 million ($5,561 million) for the years ended March 31, 2001, 2002 and 2003, respectively.

Cash and cash equivalents –
Cash and cash equivalents include all highly liquid investments, generally with original maturities of three months or less, that are readily convertible to known amounts of cash and are so near maturity that they present insignificant risk of changes in value because of changes in interest rates.

Marketable securities –
Marketable securities consist of debt and equity securities. Debt and equity securities designated as available-for-sale are carried at fair value with changes in unrealized gains or losses included as a component of accumulated other comprehensive income/loss in shareholders' equity, net of applicable taxes. Should Toyota acquire securities in the future and designate them as held-to-maturity investments, such securities would be carried at amortized cost. Individual securities classified as either availablefor-sale or held-to-maturity are reduced to net realizable value for other-than-temporary declines in market value. In determining if a decline in value is other-than-temporary, Toyota considers the length of time and the extent to which the fair value has been less than the carrying value, the financial condition and prospects of the company and Toyota's ability and intent to retain its investment in the company for a period of time sufficient to allow for any anticipated recovery in market value. Realized gains and losses, which are determined on the average cost method, are reflected in the statement of income upon realized.

Security investments in non-public companies –
Security investments in non-public companies are carried at cost as fair value is not readily determinable. If the value of a nonpublic security investment is estimated to have declined and such decline is judged to be other-than-temporary, Toyota recognizes the impairment of the investment and the carrying value is reduced to its fair value. Determination of impairment is based on the consideration of such factors as operating results, business plans and estimated future cash flows. Fair value is determined principally through the use of the latest financial information.

Finance receivables –
Finance receivables are recorded at the present value of the related future cash flows including residual values for finance leases.

Allowance for credit losses –
Allowances for credit losses are established to cover probable losses on receivables resulting from the inability of customers to make required payments. The allowance for credit losses is based primarily on historical loss experience. Other factors affecting collectibility are also evaluated in determining the amount to be provided.

Losses are charged to the allowance when it has been determined that payments will not be received and collateral cannot be recovered or the related collateral is repossessed and sold. Any shortfall between proceeds received and the carrying cost of repossessed collateral is charged to the allowance. Recoveries are credited to the allowance for credit losses.

Allowance for Residual Value Losses –
Toyota is exposed to risk of loss on the disposition of off-lease vehicles to the extent that sales proceeds are not sufficient to cover the carrying value of the leased asset at lease termination. Toyota maintains an allowance to cover probable estimated losses related to unguaranteed residual values on its present owned portfolio. The allowance is evaluated considering projected vehicle return rates and projected loss severity. Factors considered in the determination of projected return rates and loss severity include historical and market information on used vehicle sales, trends in lease returns and new car markets, and general economic conditions. Management evaluates the foregoing factors, develops several potential loss scenarios, and reviews allowance levels to determine whether reserves are considered adequate to cover the probable range of losses.

The allowance for residual value losses is maintained in amounts considered Toyota to be appropriate in relation to the estimated losses on the present owned portfolio. Upon disposal of the assets, the allowance for residual losses is adjusted for the difference between the net book value and the proceeds from sale.

Inventories –
Inventories are valued at cost, not in excess of market, cost being determined on the "average cost" basis, except for the cost of finished products carried by certain subsidiary companies which is determined on the "specific identification" basis or "last in, first out" ("LIFO") basis. Inventories valued on the LIFO basis totaled ¥190,565 million and ¥153,879 million ($1,280 million) at

Exhibit 7 (continued)

19. EMPLOYEE BENEFIT PLANS:

Pension and severance plans –

On terminating employment, employees of the parent company and subsidiaries in Japan are entitled, under most circumstances, to lump-sum indemnities or pension payments as described below, based on current rates of pay and lengths of service. Under normal circumstances, the minimum payment prior to retirement age is an amount based on voluntary retirement. Employees receive additional benefits on involuntary retirement, including retirement at the age limit. With respect to directors' resignations, lump-sum severance indemnities calculated by using a similar formula are normally paid subject to approval of the shareholders.

The parent company and most subsidiaries in Japan have contributory funded defined benefit pension plans, which are pursuant to the Japanese Welfare Pension Insurance Law. The contributory pension plans cover a portion of the governmental welfare pension program ("substitutional portion"), under which the contributions are made by the companies and their employees, and an additional portion representing the noncontributory pension plans. The defined benefits under the noncontributory portion of the plans, in general, cover more than fifty percent of the indemnities under the existing regulations to employees. The remaining portion of the indemnities is covered by severance payments by the companies. The pension benefits are determined based on years of service and the compensation amounts as stipulated in the aforementioned regulations, and are payable, at the option of the retiring employee, as a monthly pension payment or in a lump-sum amount. The contributions to the plans are funded with several financial institutions in accordance with the applicable laws and regulations. These pension plan assets consist principally of investments in government obligations, equity and fixed income securities, and insurance contracts.

Toyota revised its pension plan during the years ended March 31, 2001 and 2002, which reduced the projected benefit obligation. These effects of the reductions in the projected benefit obligations have been reflected as an unrecognized prior service cost.

July 1, 2002, the benefits under the noncontributory defined benefit pension plan of the parent company was reduced by approximately 12.5% in exchange for assets of an equivalent amount being contributed to the newly established defined contribution plan. This plan amendment reduced accumulated benefit obligation of the defined benefit plan by ¥36,807 million ($306 million), which equivalent to the benefits transferred to the defined contribution plan, and the difference between that amount and the relevant amount of projected benefit obligation resulted in ¥10,401 million ($87 million) being treated as negative prior service cost.

Most foreign subsidiaries have defined benefit pension plans or severance indemnity plans covering substantially all of their employees under which the cost of benefits is currently invested or accrued. The benefits for these plans are based primarily on current rate of pay and lengths of service.

Toyota recorded an additional minimum liability totaling ¥222,997 million and ¥513,506 million ($4,273 million) at March 31, 2002 and 2003, respectively, for plans where the accumulated benefit obligation exceeded the fair market value of plan assets and accrued pension and severance costs. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for which the accumulated benefit obligations exceed plan assets and accrued pension and severance costs are as follows:

	Yen in millions		U.S. dollars in millions
	March 31,		March 31,
	2002	2003	2003
Projected benefit obligation	¥1,688,348	¥1,896,710	$15,780
Accumulated benefit obligation	1,437,233	1,640,142	13,645
Fair value of plan assets	859,464	768,308	6,392

94

Exhibit 7 (continued)

Information regarding Toyota's defined benefit plans is as follows:

	Yen in millions		U.S. dollars in millions
	March 31,		March 31,
	2002	2003	2003
Change in benefit obligation:			
Benefit obligation at beginning of year	¥1,880,582	¥2,238,398	$18,622
Service cost	74,926	71,873	598
Interest cost	58,149	49,030	408
Plan participants' contributions	12,515	5,765	48
Actuarial loss	202,345	96,760	805
Acquisition and other	80,192	2,110	18
Benefits paid	(62,633)	(70,601)	(587)
Plan amendment	(10,678)	(47,208)	(393)
Benefit obligation at end of year	2,238,398	2,346,127	19,519
Change in plan assets:			
Fair value of plan assets at beginning of year	1,123,899	1,097,035	9,126
Actual return on plan assets	(87,984)	(170,647)	(1,420)
Employer contributions	41,352	37,580	313
Acquisition and other	37,178	708	6
Plan participants' contributions	12,515	5,765	48
Benefits paid	(29,925)	(38,275)	(318)
Fair value of plan assets at end of year	1,097,035	932,166	7,755
Funded status	1,141,363	1,413,961	11,763
Unrecognized actuarial loss	(693,143)	(961,756)	(8,001)
Unrecognized prior service cost	135,129	131,366	1,093
Unrecognized net transition obligation	(65,127)	(45,497)	(379)
Net amount recognized	¥518,222	¥538,074	$4,476
Amounts included in consolidated balance sheets comprise:			
Accrued pension and severance costs	¥754,403	¥1,052,687	$ 8,758
Prepaid pension and severance costs	(13,184)	(1,107)	(9)
Investments and other assets	(5,401)	(3,595)	(31)
Accumulated other comprehensive income	(217,596)	(509,911)	(4,242)
Net amount recognized	¥518,222	¥538,074	$4,476

	March 31,		
	2001	2002	2003
Weighted average assumptions:			
Discount rate	3.1%	2.5%	2.1%
Expected return on plan assets	3.3%	2.7%	2.1%
Rate of compensation increase	2.0 – 6.5%	1.5 – 6.0%	0.8 – 9.7%

95

Exhibit 7 (continued)

	Yen in millions			U.S. dollars in millions
	For the years ended March 31,			For the year ended March 31,
	2001	2002	2003	2003
Components of net periodic (benefit) cost:				
Service cost………………………………….	¥ 68,084	¥ 74,926	¥ 71,873	$ 598
Interest cost………………………………….	53,118	58,149	49,030	408
Expected return on plan assets…………….	(29,184)	(29,465)	(23,003)	(191)
Amortization of prior service cost…………..	(8,867)	(12,723)	(14,272)	(119)
Recognized net actuarial loss………………	2,184	17,228	22,977	191
Amortization of net transition obligation…...	18,960	19,055	19,630	163
Net periodic pension cost…………………	¥ 104,295	¥ 127,170	¥ 126,235	$ 1,050

The parent company and its Japanese subsidiaries represent substantially all of the pension obligation at March 31, 2002 and 2003. The weighted-average assumptions used for the discount rate and expected return on plan assets to determine the pension obligation for the parent company and the Japanese subsidiaries were 2.5% and 2.5% as of March 31, 2002, and 2.0% and 2.0% as of March 31, 2003, respectively.

Recognized net actuarial losses for the year ended March 31, 2002 and 2003 were primarily due to changes in estimates made for actuarial assumptions in addition to lower returns on plan assets in 2001 and 2002.

Transfer to the government of the substitutional portion of the Employee Pension Fund Liabilities –
Originally, the Japanese government pension plan consisted of two tiers, "Basic National Pension" and "Welfare Pension Insurance Relating to Salaries". "Basic National Pension" is funded by an employer to the government and "Welfare Pension Insurance Relating to Salaries" is funded by the contributions both by the employer and employees to the government. Companies are allowed to establish private pension plans in lieu of participating in the "Welfare Pension Insurance Relating to Salaries." In order to give more benefits to its employees, Toyota established such a private employee pension fund which consists of the portion substituting "Welfare Pension Insurance Relating to Salaries" (the "Substitutional Portion"), and the portion of additional employee pension fund (the "Corporate Portion").

In June 2001, the Contributed Benefit Pension Plan Law was enacted and allows a company to transfer the Substitutional Portion to the government thereby eliminating the company's responsibility for the benefits related to future employee service. In order to transfer the Substitutional Portion, a company must obtain approval from the Minister of Health, Labor and Welfare of the exemption from the payment of the benefits related to future employee service. In addition, a company must obtain approval from the same body for separation of the remaining benefit obligation of the Substitutional Portion which relates to past employee services. On obtaining that approval, the remaining benefit obligation of the Substitutional Portion (that amount earned by past services) as well as government-specified portion of the plan assets will be transferred to the government.

In the year ended March 31, 2003, the parent company and certain domestic subsidiaries applied for exemption from the payments of the benefits related to future employee services and received approvals from the Minister of Health, Labor and Welfare, and also made applications for separation of the remaining substitutional portion that was related to past services.

The final approvals for separation of the remaining benefit obligation of the Substitutional Portion is expected to be granted by the government in the year ending March 31, 2004 and the actual transfer of the Substitutional Portion of the benefit obligation and related plan assets to the government is also expected to complete in the year ending March 31, 2004. Accordingly, no effects of these transactions have been recognized in the accompanying consolidated financial statements for the year ended March 31, 2003. The possible impacts of these transactions on Toyota's consolidated financial statements for the future periods could not be determined at this present time due to, among other matters, possible changes in the unrecognized actuarial gain or loss for the period up to the date of the actual transfer of Substitutional Portion and actual amount of the related plan assets to be transferred to the government.

Postretirement benefits other than pensions and postemployment benefits –
Toyota's U.S. subsidiaries provide certain health care and life insurance benefits to eligible retired employees. In addition, Toyota provides benefits to certain former or inactive employees after employment, but before retirement. These benefits are currently unfunded and provided through various insurance companies and health care providers. The cost of these benefits are recognized over the period the employee provides credited service to Toyota. Toyota's obligations under these arrangements are not material.

Endnotes

[1] Paul Ingrassia, "Junk Cars," *The Wall Street Journal*, May 17, 2005, available from ProQuest, ABI/Inform, http://proquest.com, accessed July 12, 2005.

[2] "How much worse can it get? Ford and General Motors," *The Economist*, April 23, 2005, p. 72.

[3] Joseph McCafferty, "Funding Fun House," *CFO Magazine*, January 1, 2003, http://www.cfo.com/printable/article.cfm/3007698, accessed July 15, 2005.

[4] Ford Motor Company, "The Life of Henry Ford," The Henry Ford website, http://www.hfmgv.org/exhibits/hf/chrono.asp, accessed July 15, 2005.

[5] Ibid.

[6] Bill McGraw, "Fords Built Detroit and Changed the World," *Knight Ridder Tribune Business News,* March 12, 2003, available from ProQuest, ABI/Inform, http://proquest.com, accessed July 13, 2005.

[7] Ibid.

[8] Ibid.

[9] UAW-Ford National Programs Center, "Sixty Years of Progress: 1941–2001," http://www.uawford.com, accessed August 2, 2005.

[10] Ford Motor Company, "The Life of Henry Ford," The Henry Ford website, http://www.hfmgv.org/exhibits/hf/chrono.asp, accessed July 15, 2005.

[11] UAW-Ford National Programs Center, "Sixty Years of Progress: 1941–2001," http://www.uawford.com, accessed August 2, 2005.

[12] Ibid.

[13] Ibid.

[14] Bill Koenig, "Nissan Workers Prepare for Union Vote," *The Detroit News*, September 29, 2001, http://www.detnews.com/2001/autos/ 0110/02/autos-306136.htm, accessed August 2, 2005.

[15] Jamie Butters, "Toyota Plans Gas-Electric Hybrid to be Built in U.S.," *Detroit Free Press*, January 12, 2005, http://www.freep.com/money/autoshow/2005/japan-toyota12e_20050112.htm, accessed August 2, 2005.

[16] Bill Koenig, "Nissan Workers Prepare for Union Vote," *The Detroit News*, September 29, 2001, http://www.detnews.com/2001/autos/0110/02/ autos-306136.htm, accessed August 2, 2005.

[17] Geoffrey Colvin, "Detroit's Health-care Crisis—and Ours," *Fortune,* September 29, 2003, available from ProQuest, ABI/Inform, http://proquest.com, accessed August 3, 2005.

[18] CNN Money, http://money.cnn.com/2005/01/09/markets/spotlight/spotlight_tm/, accessed September 5, 2005.

[19] Sebastian Moffett, "Going Gray: For Ailing Japan, Longevity Begins to Take Its Toll—Rapidly Aging Population Adds to Economic Mess," *The Wall Street Journal,* February 11, 2003, available from ProQuest, ABI/Inform, http://proquest.com, accessed August 3, 2005.

[20] Andy Serwer, "Toyota Rolls Out a New Economy-Class Drug Plan," *Fortune,* January 24, 2005, available from ProQuest, ABI/Inform, http://proquest.com, accessed August 3, 2005.

[21] Bill Koenig, "Nissan Workers Prepare for Union Vote," *The Detroit News*, September 29, 2001, http://www.detnews.com/2001/autos/0110/02/ autos-306136.htm, accessed August 2, 2005.

[22] Maryann Keller, "Showdown Over Legacy Costs," *Automotive Industries,* March 2003, p. 20.

[23] "How much worse can it get? Ford and General Motors," *The Economist*, April 23, 2005, pp. 72–74.

[24] Ibid.

[25] Terry Box, *Knight Ridder Tribune Business News,* July 14, 2003, available from ProQuest, ABI/Inform, http://proquest.com, accessed July 13, 2005.

[26] Amy Wilson, "Gilmour: Health Care Topped List of Thorny Issues," *Automotive News,* December 20, 2004, p. 17.

[27] John Lippert, "Union's Trade-off," *Seattle Post-Intelligencer*, May 19, 2003, http://seattlepi.nwsource.com/business/122524_unionlabor19.htm, accessed August 3, 2005.

[28] Paul Ingrassia, "Junk Cars," *The Wall Street Journal*, May 17, 2005, available from ProQuest, ABI/Inform, http://proquest.com, accessed July 12, 2005.

[29] Harry Stoffer, "Medicare Bill Will Save Big 3 a Bundle," *Automotive News,* December 1, 2003, p. 47.

[30] Sholnn Freeman, "The Economy: U.S. Auto Makers' Troubles Deepen—Profitability Figures Leave Big Three, UAW on Edge Ahead of Contract Talks," *The Wall Street Journal,* June 19, 2003, available from ProQuest, ABI/Inform, http://proquest.com, accessed July 13, 2005.

[31] Ibid.

[32] Jeffrey McCracken, "UAW Retirees to Rally in Support of Health Care Benefits," *Knight Ridder Tribune Business News,* July 16, 2003, available from ProQuest, ABI/Inform, http://proquest.com, accessed July 13, 2005.

[33] "How much worse can it get? Ford and General Motors," *The Economist*, April 23, 2005, pp. 72–74.

[34] "Finance and Economics: Murk in the Gloom," *The Economist*, October 30, 2004, p. 97.

[35] Ibid.

[36] Joseph McCafferty, "Funding Fun House," *CFO Magazine*, January 1, 2003, http://www.cfo.com/printable/article.cfm/3007698, accessed July 15, 2005.

[37] Terry Box, *Knight Ridder Tribune Business News,* July 14, 2003, available from ProQuest, ABI/Inform, http://proquest.com, accessed July 13, 2005.