



## Solution 124.1

<b>Component</b>	Automotive industry
<b>Index</b>	Tooling – asset and/or revenue
<b>Short title</b>	Manufacturing contract

**Attention:** This guidance is based on the revised standards and interpretations that are mandatory for accounting periods commencing 1 January 2005. A company may early adopt an individual revised standard, but only in its entirety.

### Issue

The recognition criteria should be applied to separately identifiable components of a single transaction in order to reflect the substance of the transaction [IAS18.13(R.05)].

How should management recognise revenue on a contract with separate elements?

### Background

Entity X is a vehicle manufacturer. Entity X entered into a long term supply arrangement with Y, a supplier. The contract will last for a period of six years. Supplier Y is required to manufacture seats for car type ABC over the contract period to X's specification. The seat is specific for car type ABC so Y is required to construct tools that will be used to manufacture the seats.

They have agreed a fixed price per seat over the contract period. This price (also called "piece price" reimbursement) is expected to cover Y's cost of producing the tools based on an indicative production schedule. However, X does not commit to a minimum order of seats that will guarantee Y to recover its costs of producing the tools.

The contract to construct the tools will take up to 18 months to complete. The risk and reward of ownership (including the legal ownership) of the tools stays with Y.

### Solution

Supplier Y has no contract to sell the tools to X and thus cannot recognise any revenue on tooling. The tools are for own use and the contract is not accounted for as a construction accounting under IAS 11.

The tooling is accounted for by Y as property, plant and equipment because the tools "are tangible items that are held for use in the production or supply" of seats [IAS16.6(R.05)]. The tools should only be capitalised if [IAS16.7(R.05)]:



- a) it is probable that future economic benefits associated with the tools will flow to the supplier; and
- b) the cost of the tools can be measured reliably.

### The contract to manufacture seats

There is no construction or service contract between X and Y because the contract does not meet the definition of such a contract. It is a contract between a supplier and a purchaser for production of goods. The contract is for the production of a series of assets that are not interrelated. The seats are not interrelated because one seat is not connected to or dependent on another seat in any way. The contract is a contract to sell goods and IAS 18 is applicable.