



Solution 124.5

Component	Automotive industry
Index	Tooling – asset and/or revenue
Short title	Contract to construct tools – vehicle manufacturers' perspective

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

Property, plant and equipment are tangible assets that an entity [IAS16.6(R.05)]:

- uses in the production or supply of goods or services, rents to others, or uses for administrative purposes; and
- expects to use for more than one period.

Expenditure on property, plant and equipment is recorded as an asset when [IAS16.7(R.05)]:

- it is probable that future economic benefits will flow to the entity; and
- cost can be reliably measured.

How should tools be accounted for by the vehicle manufacturer?

Background

Entity X is a vehicle manufacturer. X entered into a contract with a supplier which requires the supplier to construct tools that will be used to manufacture seats for car type ABC.

Entity X and the supplier have agreed a fixed price for the tools. The contract will take up to 18 months to complete. The legal ownership of the tools will be passed to the vehicle manufacturer once the tools are completed. The tools will remain with the supplier and be used in the manufacture of seats. Entity X has the right to remove the tools at the termination of its contract with the supplier.

Solution

Entity X should recognise the tools at cost as a component of fixed assets at the time of transfer of ownership. The significant risks and rewards of the tools have been transferred to X. The tools will be depreciated when they are available for use.