



## Solution 124.7

<b>Component</b>	Automotive industry
<b>Index</b>	Tooling – asset and/or revenue
<b>Short title</b>	Does a tooling agreement contain a lease?

**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

IFRIC 4 addresses the issues [\[IFRIC4.5\]](#):

- (a) how to determine whether an arrangement is, or contains, a lease as defined in IAS 17;
- (b) when the assessment or a reassessment of whether an arrangement is, or contains, a lease should be made; and
- (c) if an arrangement is, or contains, a lease, how the payments for the lease should be separated from payments for any other elements in the arrangement.

When does a tooling contract contain a lease?

### Background

Entity Y is a car parts supplier entering into an arrangement with entity X (vehicle manufacturer) to supply steering wheels for a specified period of time.

The outlines of the arrangement are the following:

- To fulfil the arrangement entity Y designs and constructs a plant adjacent to the productive site of entity X.
- To fulfil the arrangement entity Y shall develop and custom build the tooling, consequently the cost for the tooling is the sum of development costs and cost of material.
- Inventions and know-how embedded in the tooling belong to entity Y, which is also responsible for repairs, maintenance and capital expenditure.
- The arrangement does not contain a purchase option for the tooling.
- Potentially, the tooling could be adapted and used for manufacturing other kinds of steering wheels for alternative customers. Entity Y is allowed by



contract to sell a significant portion of its production at the replacement parts market (and entity Y as a history of doing so).

- The arrangement requires entity Y to guarantee entity X with a minimum productive capacity. The designed capacity of the plant exceeds the current needs of entity X and entity Y maintains ownership and control over all significant aspects of operating the plant.
- Entity X is required to pay a fixed price per component for the actual quantity taken and is not committed to repay the investments on the tooling. Even if the vehicle manufacturer's needs are such that they do not need the stated minimum quantity, entity X should pay just for the actual quantity taken.
- Entity Y has the right to fulfil the arrangement by shipping the steering wheels from another of its sites; however due to the high cost of transportation it would be uneconomic for an extended period of time.
- Entity X has the contractual right to perform PDE (Pre Delivery Inspection) at any time for each steering wheel exiting the line and retains the right to reject defective wheels that do not comply with the contractual specifications.
- Entity Y does not have the right to access to the premises of entity X except to perform the PDE.

### Solution

The tooling agreement does not contain a lease in accordance with IFRIC 4.

The fulfilment of the arrangement depends on the use of a specific asset [IFRIC4.6]: the plant is explicitly identified in the arrangement and fulfilment of the arrangement depends on the facility. Although entity Y has the right to supply steering wheels from other plants, this would be uneconomic.

The arrangement does not convey to entity X the right to use the asset because [IFRIC4.9(a),(c)]:

- a) it does not have the ability to operate the asset;
- b) it has no physical access to the assets;
- c) other parties will take more than an insignificant amount of the output.

Entity Y recognises the assets in its financial statement, depreciates them over their useful life, and recognises revenues at the delivery of goods.