

International Accounting Standards Committee Foundation
30 Cannon Street,
London EC4M 6XH,
United Kingdom

Dear Board members of IASB,

This comment letter is written in my own capacity, and do not represent the view of Department National Treasury of South Africa. The following are my responses for the IASB question asked.

Question 1 and 2

I would like seek the board advices whether software licences, software services acquired with a service level agreement (SLA) meet the scope of IAS 17. The following are my views:

- Under propriety software model, software vendor like SAP, Microsoft, etc. will request you to pay an annual licence fee in return, software vendor provide you the right to use the software (with certain restriction) (i.e. right of use of asset).
- Under open source software model, software vendor like Red Hat, Canonical Ltd, etc. request you to pay under a SLA contract (charged annually), in return they provide you support i.e. (security) update that is necessary to operate or maintain you computer system (i.e. right of use of a service).

Base on the above, in my view software licence fee paid to software vendor meet the scope of IAS 17. If short term lease included as a new part of the new statement, I would need to recognised software licence fee as lease and not prepaid expenses.

Question 3, 4 and 5

I agree with the board with the analysis of right and obligation to a simple lease.

Question 6, 7, 13 and 14

I agree with the board to use the incremental borrowing rate; however I would like the board to specific. I would like to know what is the board view, do we recognise lease liability using expect usage pattern or the actual lease liability. The following is the example.

The company rented a parking space next to the Office Building for its chief executives; we have a (lease) contract to occupy the Office Building for 5 year, under the agreement with the parking company, we need to give 1 month notice to terminate the lease. The park bay cost the company \$100 per month. Company incremental borrowing rate is 10%.

Calculation in Excel

PV = ?

PMT = -100

i = 10%
n = 5 * 12 = 60

Approach 1

Dr Right to use parking asset	\$90.91
Dr Right to terminate the contract	\$905.81
Cr Lease liability	\$996.72

Recognise liability using expected usage pattern and recognise the option to terminate the contract as asset

Approach 2

Dr Right to use parking asset	\$996.72
Cr Lease liability	\$996.72

Recognise liability using expected usage pattern without recognise the option to terminate the contract

Approach 3

Dr Right to use parking asset	\$90.91
Cr Lease liability	\$90.91

Offset the right of option and right of liability

I would like the board to clarify the above initial treatment and would like the board to clarify the term incremental borrowing rate. Base on the above example, the company cost of capital is 15%, however the company cost to borrow a property (under a mortgage) is 10%. The question is whether the statement allows the company cost of capital use as a universal incremental borrowing rate or use it as per class of asset under lease. Also the board should clearly stated whether the method of choosing this rate is a accounting policy, therefore need to apply uniformly to consolidated financial statements.

After this I would like to continue with the question raised related to software licences, Consider the following examples:

A Company rolled out the new financial system at the beginning of the financial year. The following are the cost:

- Feasibility study \$ 500,000
- Development cost \$ 1,000,000
- Licence fee – IBM D/B 2 \$ 250,000 p.a.
- Licence fee – SAP (Fi, Co) \$ 350,000 p.a.
- SLA with Red Hat Inc \$ 100,000 p.a.
- Hardware cost \$ 1,000,000

The company expect the system to be used for 10 years. 5 years after it has been used the company invested hardware into the financial system and expected the system to run another 10 years.

I would like the board to clarify if software licence or SLA met the scope of short term lease then whether I should recognise the licence fee to IBM and SAP using 10 years (expected usage) or only 1 year (according to contract) (Question 13). There is no obligation for me to keep their product after 1 year. Is the treatment of the annual SLA with Red Hat Inc, counted the same way as propriety software?

(Question 14) After 5 years, I agree with the board view that obligation to pay rentals require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances.

Question 15

I would agree with the board.

Question 8

I agree with board to use amortised cost-based approach to subsequent measurement.

Question 9

No, it should not be allowed because it is more consistence with IAS 39, the treatment for held-to-maturity investments as my view is that this lease contract is more related to held-to-maturity investments.

Question 10 and 11

Yes, it needs to revise and agree to specify the required accounting for the obligation to pay rentals.

Question 12

Decrease in value of the right-of-use asset should be described as rental expense. It creates lesser confusion with the current standard. It also separate expense of normal depreciation therefore the payment did not loss its nature on the face of the financial statement as depreciation. Also users of financial statement are used to depreciation as expenses (de-valuation) of asset that they owned and not leased.

Question 16 and 17

I support treatment proposed by board members stated in par 7.12. When retail store are rented in a shopping centre, lessee normally take advantage of fact that the owner of the shopping centre will organised function to maintain a level of flow of people within the shopping centre. The shopping centre owner takes the risk and promoting the shopping centre as a whole to gain possible contingent income from lessee. In a degree the contingent rental paid to lessor depends on how successful the shopping centre owner promotes the shopping centre, which is uncontrollable in lessee point of view. In my view, except there is clear certainty that lessee will paid contingent rent otherwise contingent rental can't be capitalised.

For example

The company need to paid rental every month to the greater of \$100,000 or 10% of revenue from stores. The likelihood of revenue is as follows:

- \$ 1,500,000 – 100%
- \$ 2,000,000 – 80%
- \$ 2,300,000 – 60%
- \$ 2,500,000 – 40%

The contingent rental need to capitalise is $(\$1,500,000 * 10\% - \$100,000 = \$50,000)$.

Question 18 and 19

I support this proposed approach.

Question 20

(b) recognise any change in the liability as an adjustment to the carrying amount of the right-of-use asset.

For CPIX/index, I don't think indexes are controllable for management, management normally don't have the same bargaining power to negotiate terms and condition of a lease contract compare to items like financial instruments. Recognise profit or loss base on an event not controllable by management could be incorrect.

Question 21

Can't answer this question as I am not an expert in this area.

Question 22 and 23

Agree with preliminary view of the board.

Question 25

Yes

Question 26

I support the view of lease contract transfers a portion of the leased item (the first discussed approach).

Question 27

Yes the board should explore more.

Example

A Company purchase a car for \$100,000 from VW. Under the agreement, the bank finance the car paid VW \$100,000, ownership transfer to the company, however after 3 years, if the car travel less than 50,000 Km, passed the 101 test and purchase a new car from VW. VW will guarantee to pay for \$ 50,000 for the car. The company intend to comply with the above conditions, on the other hand VW have no control over whether the transaction or the guarantee are required. In the view of substance over form, I would like to know whether the board view of this type of transaction. Is it a lease transaction or not? How revenue should be recognise by VW.

Question 28

No Comments.

Wing Cheuk Kan, CA(SA), CISA, B.Sc(Computer Science) (Hons)
Deputy Director
Department National Treasury South Africa