



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

CLASSIFICATION CIRCULAR 5 OF 2008/09

CLASSIFICATION OF SOFTWARE LICENSES AND INTANGIBLE SOFTWARE ASSETS IN THE STANDARD CHART OF ACCOUNTS (SCOA)

1. Purpose

The purpose of this classification circular is to provide guidance to all government financial practitioners on the classification of software licenses and intangible software assets in the budget, financial system (BAS) and clarify the utilisation of the new segments and accounts in the chart of accounts.

This circular does not elaborate on the treatment of assets. Users should refer to the Asset Management Guide and the Guide for the Preparation of Annual Reports (Disclosure Notes) for guidance on how to treat software and other intangible assets in the Annual Financial Statements.

2. Definitions

“Asset” – An asset is a resource controlled by an entity as a result of past events and from which future economic benefits or service potential is expected to flow to the entity. A good meets the definition of an asset when:

- The entity controls the benefits or can prevent others from sharing benefits derived from its use. In many cases a legal title and physical possession are good indicators of control.
- Some past event or transactions transferred control to the entity (for example the purchase).
- The good contributes, directly or indirectly, to the cash and cash equivalents of the entity or in providing a service to another party.

“Economic benefits” – A good purchased for resale will result in cash flowing to the entity.

“Service potential” – A good purchased to facilitate the delivery of a service (for example primary health care) will contribute towards the entity achieving its strategic objectives.

“External computer services: software licenses” – Payment made annually to obtain a certificate granting permission for the use of computer programs to ensure that the developers of materials and resources are acknowledged and rewarded for their development, as well as ensuring that the materials are used legally and without risk of prosecution.

“SITA software licenses” – Software license fees paid annually to SITA for the utilisation and management of Software license agreements such as Vulindlela, BAS, PERSAL, LOGIS etc. on behalf of a department.

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“Software and other intangible assets” – An intangible is an identifiable non-monetary asset without any physical substance. Examples of intangible fixed assets are mineral exploration rights; computer software; literary and artistic originals; and miscellaneous other intangible fixed assets. To qualify as a fixed asset, the item must be intended for use in production for more than one year and its use must be restricted to the units that have established ownership rights over it or to units licensed by the owner. (The units that have established ownership rights refer to the entity that created the software for example “Microsoft” and units licensed by the owner refers to the unit buying a license to use or the right to use the software, but will not be able to change the software).

“Goods and services” – Includes payments for all goods and services to be used by a government unit, excluding purchases of capital assets.

“Computer software” - Computer software includes programs, program descriptions and supporting materials for both systems and applications software that are expected to be used for more than one year. It also includes the purchase or development of large databases that the unit expects to use for more than one year.

“Project” - A project is a collection of tasks to achieve a certain goal, for example the construction of a new road or the development of a new integrated financial system.

3. Discussion

The Guide for the completion of the Annual Financial Statements provides some description of the term “Intangible assets”.

In general terms, intangible assets represent recognisable rights to future economic benefits and service potential. They may be purchased or internally generated, but are separately identifiable. Intangible assets can be sold or acquired separately from other assets, for example patents, databases and concessions and have a determinable market value.

The assets in these categories include computer software, as well as any other intangible asset that can be used continuously or repeatedly in production for at least one year. (Research, staff training and market research do not constitute intangible capital assets. Payments on such items should be classified under *goods and services*.)

As mentioned above, intangible assets are either purchased or created by a department. Before an item can be recognised as an intangible asset the four characteristics of intangible assets must be present. These are:

- ✓ Does the department control the item and can the department expect to derive future economic benefits or service potential from its use?
- ✓ Does it lack physical substance?
- ✓ Is the item identifiable?

Is the item non-monetary?

The incidence of intangible assets is potentially much broader in the public sector than in the private sector due to the wide scope of the powers of the government to create and delegate powers and rights. Examples of intangible assets held by public sector entities include:

- Rights under licensing agreements for films, videos, plays and manuscripts in entities such as broadcasting, tourism, arts and culture;

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- Patents and copyrights held by government entities in fields such as tourism, research, education, health, agriculture, archives;
- Databases and database management software created and maintained by government entities, such as those containing information on the demographic statistics of the population, land ownership, private sector entity ownership and registers of securities and charges;
- Airport landing rights;
- Licenses to operate radio or television stations;
- Import/export licenses;
- Fishing quotas;
- Right to control the extraction of mineral resources; and
- Agreements with other entities which give that other entity a right to provide utilities;

Software vendors licence their products under the applicable copyright law. The disclosure of an intangible asset registered in terms of the applicable copyright law should therefore reflect this fact.

According to the Generally Accepted Accounting Practices of South Africa (GAAP), some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a licence or patent) or film.

4. Elements of cost

It is important to note that the cost elements included in the total cost of Property Plant and Equipment (PPE) comprise of the elements as contained in paragraph .25 of GRAP 17 and would therefore also be applicable to an intangible asset such as a network database or software system. Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of being operated in the manner intended by management will therefore be part of the cost of the asset.

Examples of directly attributable costs may include:

1. Costs of site preparation;
2. Installation costs;
3. Costs of testing whether the asset is functioning properly; and
4. Professional fees

5. Basic principles

In view of the above, the following basic principles must be applied in order to classify the different categories of computer software licenses, operating systems, and systems development in SCOA.

5.1 Annual software license renewals/purchases

Software licenses that must be renewed annually by means of a payment to a service provider, either from SITA or an external service provider must be classified as current expenditure under goods and services. This entails that the licenses purchased are only valid for one year and need to be renewed on an annual basis. The items on SCOA that should be used are:

- Software licenses obtained from SITA: SITA software licenses BAS code 2435; and

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- Software licenses purchased from an external service provider: External computer service: Software licenses BAS code 2426

5.2 Operating systems included in original purchase of computer equipment

On initial purchase of computer equipment, where the operating systems software is included in the package as part of the computer equipment, such operating systems software should be included in the purchase price of the computer equipment and must therefore be allocated as such. This does not constitute an identifiable non-monetary asset without physical substance that needs to be disclosed separately.

The item to be used should be either equipment less than R5000 or capital equipment depending on the total price of the computer including software. The BAS items to be used are:

- Computer equipment valued more than R5000: Computer hardware and systems BAS code 2852
- Computer equipment valued less than R5000: Computer equipment <R5000: Computer hardware and systems BAS code 2847

5.3 Software licenses

Software licenses purchased as stand alone items from any service provider having a useful life of more than one year should be recognised as intangible assets.

- Computer software valued at less than R5000: Equipment <R5000: Software and other intangible assets BAS code 2885
- Computer software valued more than R5000: Software and other intangible assets BAS code 1435

5.4 Systems development

The purchase or development of large databases or systems that a government unit expects to use for more than one year can contain two components. The first component consists of external sources such as consultants to develop and implement the intangible asset and the second component comprises the in-house development part where government employees develops or implements the project.

Software developed in-house is valued at its cost of production and all related elements of costs must be capitalised.

When the development and implementation of systems is outsourced to a private company all costs relating to the development and implementation is carried by the company contracted to develop and implement the project. Such projects are implemented via a tender process where the tender includes the client specifications and stipulates the use of specific software/programs or software specifications.

When development of systems is outsourced, the relevant items under goods and services and specifically those under the subcategories contractors/consultants or computer services should be used as provided for on the item segment. This should be linked with the 'Intangible Asset' component in the *Asset segment*.

As an example: In the item segment the following items might be used (although this list is not exhaustive):

- Consultants and professional services: Business and advisory services: Project management BAS code 2810
- External computer services: Specialised computer services BAS code 2427

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- External computer services: System adviser BAS code 2428
- External computer services: System development BAS code 2429
- Purchase/construction of capital assets: Machinery and equipment: Computer hardware and systems BAS code 2852
- Computer equipment <R5000: Computer hardware and systems BAS code 2847

In the *Asset segment* these items should be linked to Software and other intangible assets BAS code 35.

On the *Project segment* the asset should be linked to a capital project namely: Projects not related to Infrastructure assets: project capital BAS code 24.

In addition, where own employees form part of the development or implementation project, or additional costs are incurred that do not form part of the initial tender contract for example cabling for installation of a network, the relevant items such as compensation of employees or inventory items in the Item segment should also be used, linking these expenses to the 'Intangible Capital Asset' on the *Asset segment*.

In this scenario, the following items might be utilised:

- Salaries and wages: Basic salary (Residents) BAS code 474
- Salaries and wages: Overtime (Residents) BAS code 474
- Inventory Materials and supplies: Electrical supplies BAS code 1843
- Inventory Stationary and Printing: Computer consumables BAS code 1764
- Purchase/construction of capital assets: Machinery and equipment: Computer hardware and systems BAS code 2852
- Computer equipment <R5000: Computer hardware and systems BAS code 2847

On the *Asset segment* the items should be linked to Software and other intangible assets BAS code 35.

On the *Project segment* the asset should be linked to a capital project namely: not related to Infrastructure assets: project capital BAS code 24.

Important to note is that most of the accounts as referred to above are non-posting level items and the financial system allows for the breakdown on these accounts. Where breakdown is allowed for these accounts, departments should create posting level accounts for the posting of expenditure.

6. Summary

It is recommended that the above principles be applied in the classification of software licenses and intangible software assets namely:

- a) Software licenses purchased annually – current expenses under goods and services.
- b) Recognize operating systems software included in the initial purchase of computer equipment as part of the computer equipment.
- c) Recognize software licenses and the development of information technology systems, with a useful life of more than one year as intangible assets.

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7. Effective date and transitional provisions

The classification circular applies to computer software licenses and intangible computer software purchased after 1 April 2009. In the event of departments already classifying Software licenses and intangible software assets according to this circular no changes are necessary.

Please contact the SCOA Technical Committee via the **SCOA call center** at **(012) 315 5311** or by sending a concise mail to scoa@treasury.gov.za if further clarity or discussion is required regarding the changes highlighted above.

SCOA Technical Committee

Date: 19 September 2008

BAS Allocation codes – Software licenses and intangible software assets		
Item segment	Asset segment	Project segment
<p>Buying of an electronic “project management system” from an external service provider to assist the Department to keep track of infrastructure projects. Original cost for product R1million.</p> <p>Implementation and further development cost also to be done by the external service provider R5 million</p> <p>Various items can be used, i.e.:</p> <ul style="list-style-type: none"> • External computer service: Software licenses BAS code 2426 (R1 million) • External computer service: System development BAS code 2429 (R5 million) 	<p>Intangible asset; Software and intangible assets BAS code 35</p>	<p>Project not related to infrastructure Capital BAS code 24</p>
<p>Contracting a private firm to develop a system to be used by the Department for “asset management”. The development part in terms of the tender specifications will be outsourced. The initial development cost amounts to R10 million.</p> <p>Employees employed by the department will be involved in the implementation and further development of the project and the estimated cost amounts to R2 million.</p> <p>Various items can be used, i.e.:</p> <ul style="list-style-type: none"> • External computer service: System development BAS code 2429 • Consultants: Advisory services project management BAS code 2810 • Compensation of employees: Basic salary BAS code 474 • Overtime BAS code 479 • Inventory: Materials and supplies: Electrical supplies BAS code 1843 • Inventory: Stationary and printing: Computer consumables BAS code 1764 • Purchase/construction of capital assets: Machinery and equipment: Computer hardware and systems BAS code 2852 • Computer equipment <R5000: Computer hardware and systems BAS code 2847 	<p>Intangible asset; Software and intangible assets BAS code 35</p>	<p>Project not related to infrastructure Capital BAS code 24</p>

<p>Buying of an Microsoft Excel package having a useful life of more than one year, for a new post created at a financial section (R1000.00) Software and other intangible assets <R 5000 BAS code 2885</p>	<p>Intangible asset; Software and intangible assets <R 5000 BAS code 501</p>	<p>Stand alone current BAS code 16</p>
<p>Annual upgrade license of Microsoft Excel package bought for new post created at financial section (R500.00) External computer services: Software and licenses BAS code 2626.</p>	<p>Non assets related BAS code 31</p>	<p>Stand alone current BAS code 16</p>
<p>Buying of a new computer (R7000) with accompanying enabling software (R3000) Purchase/construction of capital assets: Machinery and equipment: Computer hardware and systems BAS code 2825</p>	<p>Asset Computer Hardware and systems BAS code 466</p>	<p>Stand alone capital BAS code 17</p>
<p>Monthly payments to SITA for various computer services rendered relating to Government systems such as BAS and PERSAL Use Items: SITA data lines BAS code 2430 SITA information services BAS code 2431 SITA Internet service charges BAS code 2432 SITA mainframe time BAS code 2433 SITA printing works BAS code 2434 SITA software licences BAS code 2435 SITA Specialised computer services BAS code 2436 SITA system advisers BAS code 2437 SITA system development BAS code 2438</p>	<p>Non assets related BAS code 31</p>	<p>Stand alone current BAS code 16</p>