10 December 2010

International Accounting Standards Board
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Financial Accounting Standards Board
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Dear Board Members

**Invitation to comment – Exposure draft Leases**

Shoprite Holdings Ltd Group (SHP) is a multinational retailer, constituting the largest fast moving consumer goods (FMCG) retail operation trading on the African continent. The Group has an annual turnover of close to $10 billion generated by 1 166 corporate stores in 16 countries. SHP thanks the Board for the opportunity to comment on the leases exposure draft and would appreciate the Board considering the remarks listed below.

Exposure draft - Leases will greatly impact SHP in the following areas:

1. Financial Statements
2. Level of modelling required for estimations and reliability of measurement
3. Operational systems to capture, analyse and accumulate the necessary data related to the rental portfolio
4. Restatement of all comparative periods for purposes of investor analysis

**Financial statements**

The current treatment of leases under IAS 17 resulted in a financial reporting position for SHP that reflects the economic substance and benefits of the underlying transactions. The proposed changes will greatly change the group’s statement of comprehensive income and statement of financial position as well as the ratio’s used by the investor community. These changes will not represent SHP’s financial position or cash flows better. As an example EBITDA of SHP will increase by an estimated 35% as the current rent expense is replaced by depreciation and interest.

The Boards’ approach has been that leases are forms of financing. SHP however feels that there are fundamental differences between the retail property leases it is involved in and other lease transactions. Property leases in the retail environment is not necessarily a financing agreement as SHP commonly decides to lease in order to retain operational flexibility and to share business risk with landlords. There are many instances, such as in shopping malls, that it is impossible to buy retail space and leasing is the only option. Most other leases normally have a negligible residual value, this is not the case of retail property leases. Furthermore the lease liability can be avoided by cancellation of the lease, this is common practice and early settlement can easily be negotiated with a lease cancellation fee.
Level of modelling required for estimations and reliability of measurement

SHP also feels it would be inappropriate to include contingent rentals in the measurement of the lease obligation. Contingent rentals are related to the underlying sales transaction and should not be recognised until the relevant sale occurred. This is in line with recognition of other cost elements (such as cost of goods sold or commission) that are only recognised when the sale is recognised. The reliability of the measurement of the lease liability, which includes estimated contingent rental based on management forecasts, could be questioned given the very nature of uncertainty surrounding contingent rentals. Furthermore the information to calculate the contingent rentals (as the lessor) is not available at all as we do not have insight into the lessee’s financial records and forecasts. Estimations will more often than not be based on guess work.

The inclusion of renewal option periods when “more likely than not” will also bring the reliability of the measurement of the lease liability in doubt as management judgement needs to be applied to a very large number (more than 1 500) of leases and subleases. The measurement criteria of virtually certain or economic reality would be more appropriate.

Current financial systems do not contain the level of modelling required for the measurement of the lease liability and the level of estimations required could lead to unreliable financial data being reported.

Operational systems to capture, analyse and accumulate the necessary data related to the rental portfolio

Current financial and rent roll systems do not contain the necessary data and detail required for the measurement and amortisation of the lease liability and asset. SHP is utilising a SAP software solution for the group’s rent roll requirements. This software solution does not cater for the complex adjustments required by the Leases ED. SHP, and we are certain other as well, will have to invest considerable resources to implement the necessary systems to ensure accurate and timely reporting as it is the lessee in more than 500 contracts.

Restatement of all comparative periods for purposes of investor analysis

As the recognition of the right-of-use asset and related liability will lead to significant changes in the ratio’s used for performance measurement by the investor community and other stakeholders, comparative information for multiple periods will have to be recalculated. Even though this might not be required by IFRS, the investor community will need clear historical financial data to evaluate SHP future growth potential and intrinsic value. This information is regularly supplied for a period of 5 years.

In conclusion SHP believes that the proposed scope exclusions should include an exclusion referring to leases that are not classified as financing transactions for example when assets are not available for purchase by the lessee.

I thank you for your time in reviewing these comments

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For and on behalf of Shoprite Holdings Ltd Group