26 February 2021

Mr James Grapsas,
Senior Lawyer
Investment Managers Team
Australian Securities and Investments Commission
By email: james.grapsas@asic.gov.au

Dear Mr Grapsas

ASIC consultation paper 336 Financial Requirements: Treatment of Lease assets

As the representatives of over 200,000 professional accountants in Australia, Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia thank you for the opportunity to comment on the above consultation paper (CP).

We support ASIC's proposal to amend the "excluded asset" definition in various ASIC instruments imposing financial requirements on Australian Financial Service Licensees (AFSLs) and the supporting guidance in PF 209 and RG 166, to clarify that a right-of-use (ROU) asset is not an excluded asset. This will ensure that ROU assets are included, along with the corresponding lease liabilities, when AFSLs perform the Net Tangible Assets (NTA) calculation to demonstrate they have adequate financial resources.

In supporting this approach, we appreciate ASIC's recognition that the introduction of AASB 16 *Leases* (AASB 16) has resulted in a significant change to the way leases are reported on the balance sheets of lessees. While this change was designed to more fairly reflect the underlying economic substance of leasing transactions, we agree that the recognition of ROU assets and lease liabilities under AASB 16 has created new challenges for compliance with existing Australian Financial Service Licensee (AFSL) financial requirements.

We also support ASIC's view set out in paragraph 21 that leases are executory contracts, whereby if the lessee's right to use the underlying asset ceases for some reason, the corresponding lease liability is also likely to cease. Therefore, including lease liabilities in an AFSL's NTA calculation, without recognising the associated ROU asset unfairly penalises AFSL entities who have chosen to finance their activities using leasing.

In reaching its conclusion, the CP makes some observations in respect of the lease assets and liabilities arising from AASB 16. We do not expect that these matters will have major practical impact on the implementation of these proposals but believe they are important for proper stakeholder understanding and application. We therefore recommend ASIC reconsider its rationale in preparing their final published requirements. These matters are:

1. Paragraph 16 of the CP states that "a right of use asset will generally be an intangible asset." We question this assumption, considering that the generally held view is that the classification of the ROU asset should follow the nature of the underlying asset.

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a. We note that under the predecessor standard AASB 117 Leases (AASB 117), assets arising from finance leases were generally classified on the balance sheet in a manner that reflected the nature of the underlying asset (see AASB 117 paragraph 31 (a)). Therefore, assets arising from finance leases that were classified as tangible assets would have been included in the NTA calculation along with their corresponding finance lease liabilities. Although ROU assets are measured differently under AASB 16, essentially, they represent assets arising from leases that would have been treated as finance or operating leases under AASB 117. We are unaware of any change in the underlying economic circumstances, or requirements in AASB 16 that would result in a conclusion that all ROU assets should be characterised as intangible assets, when this was not the case under AASB 117.

b. The Basel Committee on Banking Supervision expressed a view in a frequently asked question (FAQ) published in 2017 that "for regulatory capital purposes, a ROU asset should not be deducted from regulatory capital so long as the underlying asset being leased is a tangible asset". Similarly in Australia, the Australian Prudential Regulation Authority's formal guidance on this issue states that "Where the leased asset is tangible in nature, APRA considers it appropriate that the right of use asset ought to likewise be considered tangible and not deducted."

2. Paragraph 24 of the CP assumes that the lease asset and lease liability are always subject to the same current or non-current classification. This does not accurately reflect the requirements of AASB 16, with paragraph 58 of AASB 16 stating that long term lease liabilities should be split between current (lease liabilities falling due within the next 12 months) and non-current (lease liabilities falling due after 12 months). In contrast, the rules that determine whether the corresponding ROU asset is classified as current or non-current are based on the nature of the underlying asset, not the lease term.

If you have any questions about our submission, please contact either Amir Ghandar (CA ANZ) amir.ghandar@charteredaccountantsanz.com. or Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au.

Your sincerely

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