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James Grapsas, Senior Lawyer
Investment Managers Team
Australian Securities and Investments Commission

Email: james.grapsas@asic.gov.au

Dear James

Consultation Paper 336 Financial requirements: Treatment of lease assets

We are pleased to respond to the Consultation Paper 336 in respect of the treatment of lease assets for AFS licensees for the purpose of satisfying their financial requirements.

RSM Australia strongly supports the proposal to amend the 'excluded assets' definition in the relevant ASIC instruments, as well as regulatory guide RG166, to provide that a right-of-use asset is not an excluded asset.

We are also supportive of ASIC's proposed approach to implementing the change. This includes support of the following implementation that are proposed to be carried out by ASIC:

- Issuing two legislative instruments, including the amendment of excluded assets definition in the ASIC instrument which will allow a right-of-use asset, is excluded from the definition, and implementation of corresponding changes to the licence conditions of AFS licensees.
- Revising PF 209 and the relevant AFS licence conditions, to enhance the clarification that a right-of-use asset is not an excluded asset; and
- Updating guidance RG 166 in relation to the definition of 'excluded asset'.

We believe that amending the definition of excluded assets would be consistent with AASB 16 Leases, in which right-of-use assets are categorised on the nature of the underlying asset under leases. The proposed amendment would therefore improve consistency between ASIC's requirements the requirements of Australian Accounting Standards, and would also ensure consistency with APRA's view on the treatment of leased assets for regulatory capital purposes, which requires entities to consider the nature of the underlying asset when deciding on whether a right-of-use asset is tangible or intangible.

We set out a more detailed response below to the questions asked of respondents in the Consultation Paper. We would be pleased to discuss our firm's views further with you. Please contact me on 08 9261 9374 should you wish to discuss our comments.



Ralph Martin
National Technical Director
RSM Australia

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RSM'S RESPONSES TO SPECIFIC MATTERS FOR COMMENT [CONSULTATION PAPER 336]	
<p>B1Q1 Do you agree with our proposal? If not, why not?</p> <p>B1 We propose to amend the 'excluded assets' definition in the ASIC instruments to provide that a right-of-use asset is not an excluded asset. If we proceed with this proposed, we intend to implement it by:</p> <ul style="list-style-type: none"> (a) Issuing two legislation instruments – one legislative instrument will amend the definition of 'excluded asset' in the ASIC instruments so that a right-of-use asset is excluded from the definition; the other legislative instrument will implement corresponding changes to the licence conditions of AFS licensees. (b) Revising PF 209 and the relevant AFC licence conditions, to make it clear that right-of-use asset is not an excluded asset; and (c) Updating our guidance in RG 166. 	<p>We agree with the proposal to amend the definition of the excluded assets in the ASIC instruments to provide that right-of-use asset is not an excluded asset.</p> <p>Currently, there is a divergence between the treatment of leased assets to satisfy AFS licensee's financial requirements based on existing ASIC instruments, and their treatment of other regulatory purposes.</p> <p>In ASIC Media Release 19-341MR Financial Reporting Focuses for 31 December 2019, issued on 6 December 2019 an uncertainty was raised in respect of ASIC's view of the treatment of right-of-use asset. This media release stated that right-of-use asset would be treated as intangible assets. On the other hand, in April 2017, the Basel Committee took the position that for regulatory capital purposes, an ROU asset should not be deducted from regulatory capital so long as the underlying asset being leased is a tangible asset.”</p> <p>As a result, we consider the proposed amendment will be in line with the consistency of the requirement of AASB 16 (AASB 16 Leases – explicitly stated that a right-of-use asset should be categorised based on the nature of the underlying asset.) and unify the interpretation of the nature of a right-of-use assets among different regulators in Australia.</p> <p>We also believe that the previous treatment whereby lease liabilities were included but right-of-use assets were excluded was inequitable in that it caused previously compliant entities to find themselves in breach of their AFSL conditions. It also risked unintended consequences by potentially incentivising AFSL holders to ensure their lease terms are as short as possible in order to reduce their lease liabilities, something we do not believe is a desirable outcome.</p>
<p>B1Q2 Are there other options we should consider that might adequately address the concerns about potential unfairness? If yes, please specify.</p>	<p>We believe if ASIC proceeds with the implementation of the proposal, it will effectively address the concerns about unintended consequences (i.e. some AFSL licensees potentially having to increase their NTA for compliance simply due to a change of accounting standard).</p> <p>We also believe ASIC should issue a clarifying media release highlighting the proposed changes to clarify the treatment for NTA calculation purposes and confirm their view in relation to the nature of right-of-use asset for consistency with the accounting treatment under AASB 16 Leases.</p>
<p>B1Q3 Do you agree that changes should be made to the ASIC instruments and the existing requirement in RG 166? If not, why not?</p>	<p>We agree that changes should be made to the ASIC instruments and the existing requirement in RG 166.</p> <p>Under RG 166.152 and Pro Forma 209, excluded assets means, in relation to an AFS licensee:</p> <ul style="list-style-type: none"> (a) Intangible assets (i.e. non-monetary assets without physical substance)

Which does not explicitly include or exclude right-of-use asset under AASB 16 Leases.

We believe that ASIC's current view on the treatment of right-of-use assets are intangible assets based on this definition is inconsistent with AASB 16 itself, which, while not absolutely explicit on the classification of right-of-use assets, requires right-of-use asset to be classified according to the nature of the underlying asset.

As a result, we agree that the changes should be made to the ASIC instruments and the existing requirement in RG 166 to effectively adjust the existing position of ASIC's view, by excluding right-of-use assets from the definition of excluded assets.