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

Consultation Paper 336 “Financial requirements: Treatment of lease assets”

Ernst & Young Australia is pleased to comment on the above Consultation Paper. We welcome the opportunity to contribute to the ASIC’s efforts to develop regulatory guidance in Australia.

We believe the proposals contained in the Consultation Paper will address the incongruity in the treatment of right-of-use assets and the corresponding lease liability that arise from the one contract.

Our detailed responses to the questions raised in the Consultation Paper are provided in the Appendix to this letter.

We would be pleased to discuss our comments further with either yourself or members of your staff. If you wish to do so, please contact Frank Palmer on (02) 9248 5555 or Rita Da Silva on (02) 8295 6142.

Yours sincerely

Ernst + Young

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## Appendix

## Specific matters for comment

*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 proposal, we intend to implement it by:*

*(a) issuing two legislative 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 AFS licence conditions, to make it clear that a right-of-use asset is not an excluded asset; and*

*(c) updating our guidance in RG 166.*

*B1Q1 Do you agree with our proposal? If not, why not?*

We agree with the proposal set out in the Consultation Paper.

In support, we have the following comments:

- AASB 16 *Leases* does not provide explicit guidance on whether a right-of-use (ROU) asset is a tangible or an intangible asset. The FASB accounting standard for leases, ASC 842 *Leases*, which is mostly aligned with AASB 16 for initial recognition, also contains no explicit guidance on whether ROU assets are tangible or intangible.
- Whilst AASB 16 is unclear whether the ROU asset is tangible or intangible, it is clear that it is a non-financial asset (IFRS 16.BC45(d)), and considered to reflect an entity's control over the leased item's economic benefits over the lease term.
- Currently, an AFS licensee is required to exclude the ROU asset but include the corresponding lease liability in their NTA/ SLF/ ASLF calculations. This distorts the AFS licensee's solvency and net assets position, as the ROU asset and lease liability are intrinsically linked.
- Whilst the amendment of the definition of 'excluded assets' to exclude ROU assets from the definition is for the purpose of regulatory reporting, having consistency between regulatory reporting and statutory reporting results in more intuitive and meaningful information.

*B1Q2 Are there other options we should consider that might adequately address the concerns about potential unfairness? If yes, please specify.*

We have no other comments.

*B1Q3 Do you agree that changes should be made to the ASIC instruments and the existing requirements in RG 166? If not, why not?*

We agree that changes should be made to the ASIC instruments and the existing requirements in RG 166.

Separate to these changes, we would like to highlight another matter relating to the definition of ‘excluded assets’ that could be clarified at the same time.

Class Order 12/752[1] provides that a deferred tax asset is an intangible asset and therefore is an ‘excluded asset’. Class Orders 13/760[2] and 13/761[3] provide that a deferred tax asset is not an intangible asset and therefore is not an ‘excluded asset’. We recommend consistent treatment across the class orders, including PF 209 and RG 166.

[1] Class Order 12/752 defines ‘excluded assets’ as: *in relation to a financial services licensee: (a) intangible assets (including, for the avoidance of doubt, a deferred tax asset); and…*

[2] Class Order 13/760 defines ‘excluded assets’ as: *in relation to a financial services licensee: (a) intangible assets (excluding, for the avoidance of doubt, a deferred tax asset); and…*

[3] Class Order 13/761 defines ‘excluded assets’ as: *in relation to a financial services licensee: (a) intangible assets (excluding, for the avoidance of doubt, a deferred tax asset); and…*