

25 February 2021

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

email: james.grapsas@asic.gov.au

Dear Mr Grapsas,

Response to ASIC Consultation Paper 336 Financial requirements: Treatment of lease assets

We welcome the opportunity to provide the Australian Securities and Investments Commission (ASIC) with our views on Consultation Paper 336 Financial requirements: Treatment of lease assets.

Nexia Australia Pty Ltd represents the six independent chartered accounting firms comprising the Nexia Australia network with over 74 partners servicing clients from small to medium enterprises, large private companies, not-for-profit entities, subsidiaries of international companies, and listed public companies.

We have previously expressed our concern that the introduction of AASB 16 *Leases* had the potential to unfairly impact the ability of some Australian financial service (AFS) licensees to satisfy certain financial requirements that apply to them. We were concerned that a licensee's capital adequacy and licencing requirements would be adversely affected by an accounting standard change notwithstanding there was no underlying commercial change to the licensee's business, operations or liquidity. We welcomed ASIC's 'no action' position in July 2020.

Our comments on ASIC's proposals follow.

Q1 Do you agree with our proposal? If not, why not?

We are supportive of ASIC's attempt to mitigate the adverse effects of AASB 16 on AFS licensees and nothing in our submission should be read as suggesting that ASIC should not address the impact of AASB 16 on AFS licensees.

- We agree that including the right of use asset and lease liability in the calculation of NTA will reduce, but not eliminate, the concerns regarding the effect of AASB 16 on AFS licensees. This is because AASB 16 requires the right of use asset and lease liability to amortise using different methods and rates. Hence, the carrying values of the right of use asset and the lease liability will not completely offset at all times during the lease term.

Given the choice between including the right of use asset in NTA calculations and retaining the existing ASIC approach of excluding the right of use asset, we prefer the former.

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Notwithstanding the above, we are concerned that the inclusion of the right of use asset and lease liability will adversely affect SLF and ASLF calculations and disagree with the following statements in CP 336:

- Paragraph 16 of CP 336 states, "Under AASB 16, a lessee must categorise a right-of-use asset as a non-current asset on its balance sheet when the remaining lease term exceeds 12 months. In this situation, the lessee must also recognise the lease liability as a non-current liability. If the remaining lease term is 12 months or less, the lessee must recognise the right-of-use asset and corresponding liability as a current asset and current liability, respectively."

Furthermore, paragraph 24 of CP 336 states, "When the remaining lease term is more than 12 months, AASB 16 has a neutral impact on a licensee's calculation of SLF and ASLF. This is because the right-of-use asset and corresponding liability are characterised as non-current in the entity's balance sheet and, applying the definitions of ASLF and SLF in PF 209 (see paragraph 7), a licensee must not count in the calculation of ASLF and SLF any non-current assets and non-current liabilities. In contrast, when the remaining lease term is 12 months or less, a lessee has to recognise the right-of-use asset as a current asset and the lease liability as a current liability."

Paragraph 69(c) of AASB 101 requires a liability be classified as current when the liability is due to be settled within twelve months after the reporting period. In our opinion, where the remaining lease term exceeds 12 months, that amount of the total lease liability payable within 12 months after balance date should be classified as a current liability and that amount of the total lease liability payable more than 12 months after balance date should be classified as a non-current liability.

Where the remaining lease term is more than 12 months, we disagree with the comment in paragraphs 16 and 24 of CP 336 that the lease liability will be classified in its entirety as a non-current liability and that AASB 16 will have a neutral impact on a licensee's calculation of SLF and ASLF.

In our opinion, Australian Accounting Standards require the total lease liability to be classified between that amount due within 12 months (as a current liability) and that amount due more than 12 months after balance date (as a non-current).

- Furthermore, we disagree with the inference in paragraphs 16, 24 and 34 of CP 336 that a right-of-use asset would be reclassified from a non-current asset to a current asset in the last 12 months of the lease term. Items of property, plant and equipment recognised under AASB 116, or intangible assets recognised under AASB 138, that are of a long-term nature are classified as non-current assets during their entire estimated useful life and are not reclassified as a current asset in the final 12 months of its useful life. Similarly, in our opinion, a right-of-use asset relating to a long-term lease is classified as a non-current asset throughout its entire lease term and is not reclassified as a current asset in the final 12 months of the lease term.

As a consequence, ASIC's proposal fails to fully resolve the concerns regarding the impact of AASB 16 on SLF and ASLF requirements.

Q2 Are there other options we should consider that might adequately address the concerns about potential unfairness? If yes, please specify.

For the reasons described above, the proposal in CP 336 will reduce, but not eliminate, the adverse effects of AASB 16 on an AFS licensee's NTA calculations. In addition, it will not eliminate the adverse effects on a licensee's SLF and ASLF calculations.

Rather than ASIC's proposal to include the right of use asset in a licensee's NTA, SLF and ASLF calculations, we suggest that an alternative approach to entirely eliminate the adverse effects of

AASB 16 on those license conditions would be to exclude both the lease liability and right of use asset from those calculations.

This alternative approach would remove the problem associated with classifying lease liabilities between current and non-current, which effects SLF and ASLF; and also addresses the mismatch that occurs between the carrying values of the right of use asset and the lease liability during the lease term.

Adopting this alternative approach does not invalidate or suggest that AASB 16 is not an appropriate accounting standard. The determination of NTA, ASLF and SLF are regulatory measures designed for a specific purpose; in the same way as APRA, ASX and other regulatory bodies issue their own rules to determine specific regulatory measures and indicators. For example, APRA allow certain financial liabilities determined under AASB 9 *Financial Instruments* to be included as part of an entity's regulatory capital measures.

As a result, we believe there is no impediment to ASIC defining NTA, SLF or ASLF measures in the context of AFS license conditions in a way that does not necessarily align with Accounting Standards. Similarly, we see no impediment to those specific AFS licence condition measures being calculated differently to other regulatory measures applied by other regulators.

Q3 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 with ASIC's proposal.

Should you wish to discuss any aspects of our submission, please contact the undersigned.

Sincerely

Nexia Australia Pty Ltd



Martin Olde

National Technical Director