



ASIC
Australian Securities &
Investments Commission

REPORT 689

Response to submissions on CP 336 Financial requirements: Treatment of lease assets

April 2021

About this report

This report highlights the key issues that arose out of the submissions received on [Consultation Paper 336](#) *Financial requirements: Treatment of lease assets* (CP 336) and details our responses to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see [Regulatory Guide 166 Licensing: Financial requirements](#) (RG 166).

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A Overview/Consultation process

1 In [Consultation Paper 336](#) *Financial requirements: Treatment of lease assets* (CP 336), we consulted on proposals to amend the financial requirements for Australian financial services (AFS) licensees. Under our proposals, AFS licensees would be allowed to include right-of-use assets when calculating their ‘adjusted assets’ and, in turn, when calculating net tangible assets (NTA), adjusted surplus liquid funds (ASLF) and surplus liquid funds (SLF).

2 The financial requirements that we impose on AFS licensees are set out in the following ASIC instruments (referred to as ‘the financial requirements instruments’ in this report) and AFS licence conditions:

- (a) [Class Order \[CO 12/752\]](#) *Financial requirements for retail OTC derivative issuers*;
- (b) [Class Order \[CO 13/760\]](#) *Financial requirements for responsible entities and operators of investor directed portfolio services*;
- (c) [Class Order \[CO 13/761\]](#) *Financial requirements for custodial or depository service providers*; and
- (d) [Pro Forma 209](#) *Australian financial services licence conditions* (PF 209).

Note: From 2015, class orders are referred to collectively as ‘ASIC instruments’.

3 Australian Accounting Standard [AASB 16](#) *Leases* (AASB 16) was first published in February 2016, and governs the accounting treatment of leases. AASB 16 requires a lessee to recognise all leases in its balance sheet as both an asset and a liability. A right-of-use asset under AASB 16 will generally be an intangible asset and, as a result, will be an ‘excluded asset’ under the financial requirements instruments and PF 209. An AFS licensee will be unable to include a right-of-use lease asset in its adjusted assets and, consequently, its NTA, SLF or ASLF. However, an AFS licensee that is a lessee will generally be required to include a lease liability in its calculation of NTA, SLF and ASLF.

4 When the remaining lease term is more than 12 months, AASB 16 has the effect that an AFS licensee will not be allowed to count the right-of-use asset and the non-current portion of the lease liability. This is because the right-of-use lease asset and the non-current element of the lease liability will be characterised as non-current in the entity’s balance sheet. When applying the definitions of SLF and ASLF in PF 209, a licensee must not count any non-current assets and non-current liabilities in the calculation of SLF and ASLF. In contrast, when the remaining lease term is 12 months or less, a lessee must recognise the right-of-use asset as a current asset and the lease liability as a current liability.

- 5 CP 336 sought to address the anomaly and potential unfairness stemming from the treatment of right-of-use assets in our financial requirements instruments and [AASB 16](#). That is, an AFS licensee will generally be required to exclude the right-of-use asset as an intangible asset but include the corresponding lease liability.
- 6 In CP 336, we proposed to amend the ‘excluded assets’ definition to provide that a right-of-use asset is not an excluded asset. We proposed to implement this by:
- (a) issuing two legislative instruments—one legislative instrument would amend the definition of ‘excluded asset’ in the financial requirements instruments so that a right-of-use asset is excluded from the definition; the other legislative instrument would 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 [Regulatory Guide 166](#) *Licensing: Financial requirements* (RG 166).
- 7 We sought feedback on our proposal. Specifically, we wanted to know whether:
- (a) respondents agreed with our proposal;
 - (b) there were other options we should consider that might adequately address the concerns about potential unfairness; and
 - (c) respondents agreed that changes should be made to the financial requirements instruments and the existing requirements in RG 166.
- 8 This report highlights the key issues that arose out of the submissions received on CP 336 and our responses to those issues.
- 9 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 336. We have limited this report to the key issues.
- 10 We received 14 non-confidential responses to CP 336, including four from industry bodies. We did not receive any confidential submissions. We are grateful to respondents for taking the time to send us their comments.
- 11 For a list of the responses to CP 336, see the appendix. Copies of these submissions are currently on the [CP 336 page](#) on the ASIC website.

Responses to consultation

- 12 All of the submissions supported the proposals to allow an AFS licensee to include a right-of-use lease asset in the calculation of adjusted assets and, where applicable, the calculation of NTA, SLF and ASLF.
- 13 The issues raised by respondents related to:
- (a) the drafting of PF 209 and RG 166 (see Section B);
 - (b) consistency of treatment of deferred tax assets (see Section C);
 - (c) the calculation of SLF and ASLF, potential unfairness about the treatment of non-current right-of-use lease assets and non-current lease liabilities (see Section D); and
 - (d) potential imbalances in the carrying amounts of right-of-use assets and lease liabilities (see Section E).
- 14 None of the submissions received raised substantive concerns with the two proposed legislative instruments. We have now issued the two legislative instruments:
- (a) [ASIC Corporations \(Licence Conditions—Treatment of Lease Assets\) Instrument 2021/229](#); and
 - (b) [ASIC Corporations \(Amendment\) Instrument 2021/230](#).
- 15 In relation to ASIC Corporations (Licence Conditions—Treatment of Lease Assets) Instrument 2021/229, we made a substantive change to the draft instrument that was included in Attachment 2 to [CP 336](#). This change was the inclusion of a sunset date of 1 May 2026, which is unrelated to the issues covered in the submissions.
- 16 There are no substantive differences between ASIC Corporations (Amendment) Instrument 2021/230 and the corresponding draft legislative instrument that was included in Attachment 1 to [CP 336](#). This legislative instrument amends the financial requirements instruments, which have their own sunset dates under the *Legislation Act 2003*. It was therefore unnecessary to include a sunset date in the amending instrument. The sunset dates for the financial requirements instruments are as follows:
- (a) [\[CO 12/752\]](#) sunsets on 1 October 2022;
 - (b) [\[CO 13/760\]](#) sunsets on 1 October 2023; and
 - (c) [\[CO 13/761\]](#) sunsets on 1 October 2023.

B Proposed drafting of ASIC regulatory documents

Key points

This section outlines the submissions relating to:

- the drafting of our definition in of ‘excluded assets’ in PF 209 (see paragraphs 17–19); and
- the drafting of our guidance on excluded assets in RG 166 (see paragraphs 20–23).

Drafting of PF 209

- 17 In [CP 336](#), we outlined our proposal to revise PF 209 and the relevant AFS licence conditions. The revised wording would make it clear that a right-of-use asset is not an excluded asset.
- 18 Table 2 of CP 336 set out the proposed change to PF 209:
- After paragraph (e) of the definition of ‘excluded assets’ in the ‘Terms and conditions’ section, we are proposing to insert:
- ‘(ea) a right-of-use asset arising under a lease; and’.
- This amendment would change the calculation of NTA, ASLF and SLF under conditions 16–22 of PF 209.
- Note: Table 2 of CP 336 was intended to refer to conditions 19A to 22, inclusive, of PF 209, rather than conditions 16 to 22 of PF 209. Conditions 16 to 19 of PF 209 are no longer in use.
- 19 Several of the submissions indicated that this approach would not produce the intended outcome of allowing an AFS licensee to include a right-of-use asset in their financial requirements calculations. This is because adding paragraph (ea) to the ‘excluded assets’ definition in PF 209 would have the effect of adding a right-of-use asset to the categories of excluded assets.

ASIC’s response

We acknowledge that the original suggested change to the excluded assets definition in PF 209 would not implement the proposals effectively. This is because the suggested wording was not prefaced by ‘but, despite anything in the paragraphs above, does not include the following’, or words to that effect.

We have added a new paragraph (h) to the ‘excluded assets’ definition in the ‘Terms and definitions’ section of [PF 209](#). The new paragraph (h) states that, despite anything in paragraphs (a)–(g) of the ‘excluded assets’ definition, ‘a right-of-use asset arising under a lease is not an excluded asset’.

Drafting of RG 166

- 20 In [CP 336](#) we outlined our intention to revise RG 166 to state that an AFS licensee may include the right-of-use asset in its calculation of, where applicable, NTA, SLF and ASLF.
- 21 Table 2 of CP 336 set out the proposed change to RG 166:
After paragraph (d) in RG 166.152, we are proposing to insert:
'(e) a right-of-use asset arising under a lease.'
This updated guidance will state that an AFS licensee may include the right-of-use asset in its calculation of, where applicable, NTA, ASLF and SLF.
- 22 Several of the submissions considered that this approach would not produce the intended outcome of allowing an AFS licensee to include a right-of-use asset in their financial requirements calculations.
- 23 One respondent suggested the following wording:
(e) despite paragraphs (a) to (d) in RG166.152, a right-of-use asset arising under a lease is not an excluded asset.

ASIC's response

We agree that the original suggested changes to RG 166 would not be effective to implement our proposals. This is because RG 166.152(a)–RG 166.152(d) set out items that are excluded assets, whereas the intended effect of proposed RG 166.152(e) was to explain that a right-of-use lease asset is *not* an excluded asset.

We have updated [RG 166](#) by adding RG 166.158–RG 166.160. The new paragraphs in RG 166 set out that, despite anything in RG 166.152, a right-of-use asset under [AASB 16](#) is not an excluded asset. They also set out the rationale for this approach.

C Treatment of deferred tax assets in the financial requirements instruments

Key points

This section outlines the submissions relating to the treatment of deferred tax assets in the financial requirements instruments.

There were concerns raised that some of the financial requirements instruments carve out deferred tax assets from the intangible assets category of excluded assets, whereas others expressly include them.

The concerns about the treatment of deferred tax assets are outside the scope of CP 336. We will consider these concerns separately in due course.

Deferred tax assets and their treatment in the financial requirements instruments

- 24 Several submissions raised concerns that the financial requirements instruments take an inconsistent approach to deferred tax assets.
- 25 The submissions observed that [\[CO 13/760\]](#) and [\[CO 13/761\]](#) expressly *exclude* deferred tax assets from the intangible assets category of excluded assets. [\[CO 12/752\]](#) expressly *includes* deferred tax assets in the intangible assets category of excluded assets.

ASIC's response

The question of whether deferred tax assets should be excluded assets across all of the financial requirements instruments is discrete from the issue of whether an AFS licensee should be allowed to include a right-of-use asset in its calculation of NTA, SLF and ASLF. The treatment of deferred tax assets is outside the scope of CP 336 and warrants separate consideration.

We will consider whether there is a sound policy rationale for a deferred tax asset being an excluded asset under [\[CO 12/752\]](#), but not under [\[CO 13/760\]](#) and [\[CO 13/761\]](#).

We will continue to consider the treatment of deferred tax assets under the financial requirements instruments.

D Potential unfairness caused by updated calculations

Key points

Some submissions raised concerns that the updated calculations in the proposal may operate unfairly. Under the proposal, an AFS licensee holding a lease with a remaining term of more than 12 months would not be able to include a non-current right-of-use asset and the non-current portion of a lease liability when calculating ASLF and SLF.

We consider that a non-current right-of-use asset and the non-current portion of a lease liability should continue to be excluded from the calculation of SLF and ASLF.

Calculating ASLF and SLF

- 26 Two submissions raised concerns that the proposals would operate unfairly. The submissions pointed out that the proposals would not allow an AFS licensee to include, when calculating ASLF and SLF, a right-of-use asset that is a non-current asset and the non-current liability portion of the lease liability.
- 27 The submissions consider that right-of-use assets are usually presented in their totality as non-current assets, whereas lease liabilities are split into a current and non-current portion. This could result in AFS licensees breaching their SLF and ASLF conditions because current liabilities are deducted in arriving at SLF and ASLF, whereas there are no current right-of-use assets in the balance sheet to add back.

ASIC's response

For a lease that has a remaining term of more than 12 months, a right-of-use asset under [AASB 16](#) must be included in an entity's balance sheet as a non-current asset. In contrast, for a liability for a lease that has a remaining term of more than 12 months, the lease liability should be apportioned in an entity's balance sheet to its current liability and non-current liability components. The current liability component will reflect the lease payments that are due over the next 12 months.

For the calculation of NTA, the proposal intended that a lessee's position in its financial statements, with respect to a lease asset, be reflected in the calculation of adjusted assets and adjusted liabilities. For the calculation of SLF and ASLF, which are designed to ensure that an AFS licensee has adequate liquidity, it remains appropriate to exclude a non-current asset. This includes

a non-current right-of-use asset for a lease with a remaining term of more than 12 months, and a non-current liability, such as a lease liability under AASB 16 for a lease with a remaining term that exceeds 12 months.

We consider that, in relation to ASLF and SLF, it is appropriate to maintain the existing position—that is, that an AFS licensee must not count a non-current asset or a non-current liability in its calculation of ASLF and SLF: see paragraphs 24 and 34 of [CP 336](#). This position should continue to apply, for a lease with a remaining term of more than 12 months, to a non-current right-of-use asset and the non-current portion of the lease liability.

E Potential mismatch between value of asset and value of liability

Key points

Concerns were raised that the proposal in CP 336 would result in an unfair imbalance between the carrying value of a right-of-use asset and the carrying value of the lease liability.

We consider that the accounting treatment of a right-of-use asset and the corresponding liability in an entity's balance sheet should flow through to the calculation of NTA and, with the exception of the exclusion of non-current assets and non-current liabilities, to the calculation of SLF and ASLF.

Potential imbalances in lease asset and liability balances

- 28 One submission raised concerns that the proposal does not fully address the implications of the way [\[CO 13/760\]](#) intersects with [AASB 16](#). The respondent was concerned that the proposal does not address the mismatch that emerges between the value of the right-of-use asset and the value of the lease liability after the initial recognition of a lease contract under AASB 16. The mismatch is driven by the difference between the amount of depreciation of the right-of-use asset and the movement in the lease liability through interest and repayments.
- 29 The submission suggested that, in order to mitigate this imbalance, we should exclude right-of-use assets and lease liabilities from the calculation of NTA, SLF and ASLF entirely.

ASIC's response

An AFS licensee's financial requirements are based on the accounting treatment used in the licensee's financial statements, unless and to the extent that there is a sound policy rationale for ASIC's financial requirements taking a different approach. In the case of a lessee's recognition of lease assets, we consider that the requirements in AASB 16 for bringing a right-of-use lease asset and lease liability should be reflected in the calculation of NTA and, where applicable, SLF and ASLF.

A lessee's right-of-use asset carrying amount will always be lower than the carrying amount of the lease liability. We consider that this difference should flow through to the determination of NTA, ASLF and SLF. This position is consistent with the pre-existing situation for finance leases of lessees. It is also no different from

borrowing money repayable in equal instalments over time to fund the purchase of a depreciating asset.

Our view is that the carrying amounts of right-of-use lease assets and lease liabilities should be reflected in the calculation of NTA and, where applicable, SLF and ASLF, with the exception of the exclusion of a non-current right-of-use lease asset and a non-current lease liability from the calculation of SLF and ASLF.

The carrying amount of a lessee's right-of-use lease asset will be lower than the carrying amount of the corresponding lease liability. That difference should flow through to the determination of NTA and, where applicable, SLF and ASLF.

Appendix: List of non-confidential respondents

- AIMA Australia
- Aware Super
- BDO Australia
- Burrell Stockbroking & Wealth Management
- CAANZ and CPA Australia (joint submission)
- Deloitte
- Ernst & Young
- Financial Services Council
- Macquarie Specialised Asset Management Limited
- Nexia Australia
- Pitcher Partners
- Property Council of Australia
- PricewaterhouseCoopers
- RSM Australia Pty Ltd