PACIFIC RIM PROPERTY RESEARCH JOURNAL
2021, VOL. 27, NO. 1, 41–53
https://doi.org/10.1080/14445921.2021.1983924

Financial reporting and valuation treatment of property assets by not-for-profit operators

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ABSTRACT

The continued presence of not-for-profit (NFP) operators in the residential aged care (RAC) and retirement village industry in Australia adds to its complexity and diversity. This is an industry focused on the delivery of services through specialised property assets, which often have histories going back decades. NFP operators have greater flexibility in financial reporting when compared to for-profit operators, and the paper examines the accounting treatment and measurement of value in financial reporting of property assets by this group. Considerable diversity in classification and treatment of property assets was noted, plus a strong reliance on directors' valuations. Both RAC and retirement villages have been the subject of government inquiries at the Commonwealth and state levels, which have focused on the financial performance of the industry. The diversity in financial reporting has implications for the transparency of the financial performance of the industry.

ARTICLE HISTORY
Received 30 January 2021
Accepted 19 September 2021

KEYWORDS
Residential aged care; retirement villages; financial reporting

Introduction

Australian not-for-profit (NFP) operators are well entrenched in the residential aged care (RAC), and retirement village industry. Religious and community groups and charities operated 55% of RAC places in 2020 (Australian Institute of Health and Welfare, 2020) and NFPs operated 40% of retirement villages in 2014[1] (Grant Thornton, 2014). The continued presence of NFP organisations adds to the complexity of the industry, with operators ranging across sizes and types including large listed and institutional investors, private family businesses, secular and faith-based NFP organisations and local and state governments (Gadens, 2014). Moreover, the operations of RAC and retirement villages are diverse, RAC is funded and heavily regulated by the Commonwealth government, retirement villages are largely not government funded and regulated at the state level (Gadens, 2014).

This diversity of operators raises challenges in understanding the financial performance of the industry and the role property assets play in this performance. Compared to commercial organisations, NFP organisations face different parameters in the access of equity capital, and they report financial performance to these equity stakeholders, this has differences when compared with reporting to investors (Cordery, Sim, & van Zijl, 2017). Many NFP organisations may have debt funding and financiers demand an

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understanding of the financial performance on which to base decisions (Miles, 2019). NFP operators receive taxation advantages, plus RAC and retirement village operators, and may provide accommodation, and services at concessional prices, and their financial performance are of interest to the wider community (Cordery et al., 2017). The impact on the wider community is demonstrated when NFP RAC operators have been placed into administration (Cranston & LaFrenz, 2021).

RAC and retirement villages comprise an industry where the operational business is focused on delivery through property assets and there is difficulty in separating this operational business from the land and building component (Eichholtz, Kok, & Wolnicki, 2007). In addition to, their specialised nature, there is a history behind many property assets often going back decades, including gifting, peppercorn rentals and Crown leases (Newland, 1989), and property holdings are significant components of balance sheet assets. This connection is further complicated as, in Australia, RAC is geographically rationed with licensed places pertaining to regions and specific properties (Gadens, 2014). Adding to the inflexibility of the industry, faith-based operators are often organised within geographical Parish and Synod boundaries limiting their activities to specific regions and states (Catholic Healthcare, 2019; Morgan, 2006).

Analysis promoting the desirability of investing in the RAC and retirement village industry has classified it as a form of property investment (Cranston, 2018; Jacobs, 2014). There has been little focus on how property and operational businesses are interlinked, and this paper employs a corporate real estate (CRE) framework to examine the financial reporting of a sample of larger NFP RAC operators. CRE refers to the properties from which an organisation conducts their business activities and the ownership or leasing of property is incidental to these primary business activities (CoreNetGlobal, Heywood, Zamora, Coluni, & Donovan, 2015). Similar to the health-care industry (van der Zwart, Arkesteijn, & van der Voordt, 2009), this is an industry that is focused on delivery through property assets coupled with geographical constraints. There has been little focus on how these property assets contribute to financial performance and strategy, and this paper examines the accounting treatment and measurement of the value of property assets and the use of external valuations in reporting by NFP operators in RAC and retirement villages. NFP operators are a significant component of the industry, and this paper adds to an understanding of how property assets contribute to the financial performance of this group.

Framing literature

Financial statements have been used by researchers studying CRE and have identified three themes: the quantum of CRE reported on balance sheets; the transparency and usefulness of information in financial reports; how CRE impacts upon capital valuations and shareholder value and how management of CRE influences this metric (Heywood, 2020, 2021; Louargand, 1999; Rodriguez & Sirmans, 1996; Simpson & McDonagh, 2010). Studies of the quantum of CRE on balance sheets raised the profile of the discipline by identifying the size and importance of these assets to non-real estate businesses (Veale, 1989). Further studies compared this quantum between the countries and identified changes over time (Brounen & Eichholtz, 2005; Holt & Eccles, 2001; Laposa & Charlton, 2001). These studies identified how organisations converted ownership of real estate to leasehold, decreasing demand for capital and enhancing corporate flexibility (Brounen & Eichholtz, 2005). Reporting of financial performance in Australia is governed by accounting standards, which are maintained by the Australian Accounting Standards Board (AASB) and following amendments to AASB16 – Leases (AASB16) organisations were required (since 2019) to include the cost of lease liabilities. The impact of this amendment is to reduce the incentive to move real estate assets from ownership to leasehold (Heywood, 2020, 2021). This use of off-balance sheet leasehold tenure obscured the liabilities associated with CRE amplifying issues with transparency of accounts (Brounen & Eichholtz, 2005; Holt & Eccles, 2001).

The usefulness of financial statements is enhanced by their transparency, enabling investors and stakeholders to examine aspects of an organisation's performance. Studies of CRE have concluded that this information can be parsimonious, creating difficulties in examining the influence of CRE on financial performance (Parker, 2008; Simpson & McDonagh, 2010; Wills, 2008). Further uncertainty stems from the range of valuation methods employed, including depreciated historical costs and market-based fair value performance (Parker, 2007, 2008; Simpson & McDonagh, 2010). This creates further difficulty when attempting to compare the performance of CRE with Real Estate Investment Trusts (REITs).

The relationship between CRE, management of CRE and capital value or market performance has been examined. However, this did not find evidence of a strong relationship (Laposa & Charlton, 2001; Rodriguez & Sirmans, 1996), indicating that factors beyond CRE influence market performance. Examining such a relationship is limited to listed markets where price information (including shareholder value) is readily available. NFP organisations create a further challenge to this analytical theme due to the difficulty of measuring market value and an organisation where equity is not traded regularly nor is it designed to be.

In Australia, public reporting by NFP organisations has been increased through the establishment in 2012 of the Australian Charities and Not-for-profits Commission (ACNC) as the independent national regulator of NFPs and charities (Seymour & Nehme, 2015). Australian NFPs receive benefits through tax concessions and in return provide a range of services to the Australian public, therefore they are required to report financial information annually (Saj & Cheong, 2020). Large NFPs, with revenue of $1 million or more are required to lodge annual financial reports prepared in accordance with Australian accounting standards. The extent of this reporting is self-determined according to an organisation's assessment of the information needs of the users of these financial reports (Saj & Cheong, 2020). Compared to reporting requirements for entities listed on the Australian Securities Exchange, NFPs can take advantage of reduced disclosure requirements, leading to criticism that reports are complex and opaque (Centre for International Corporate Tax Accountability and Research, 2020). Australia is unusual in this regard, as it is the only country that allows NFPs determine the extent of their financial disclosure (Yang & Sinmett, 2020). In addition, RAC operators receive funding from the Department of Health and are required to provide financial reports of their residential care activities with a reduced disclosure report (Department Of Health, 2020).

All Australian entities report according to standards developed and applied by the Australian Accounting Standards Board (AASB) which are informed by International Financial Reporting Standards. There are standards, which govern how NFP entities report asset values and income (International Accounting Standards Board, 2010). NFP entities where a property is held for strategic purposes or to provide a social service account for these under AASB116 – Property, Plant and Equipment (AASB116). Where a property is held for rental return and capital growth, this is accounted for under AASB140 – Investment Property (AASB140). Income of NFP entities is governed by AASB1058 – Income of Not-For-Profit Entities (AASB1058). How property is classified for accounting purposes influences how it is valued for financial reporting (Heywood, 2021; Parker, 2008; Towart, 2018). Where a property asset is accounted for under AASB116 it is initially measured at cost, following this entity has a choice between the cost model or the revaluation model. The cost model measures value at cost less depreciation and impairments and the revaluation model measures value at fair value at the date of revaluation as defined by AASB13 Fair Value Measurement (AASB13). Where a property asset is accounted for under AASB140 an entity has a choice in measuring this either in the fair value model or in the cost model (Yao, Hu, & Percy, 2015). NFP entities have a choice in how they account for and measure property assets; for RAC and retirement village assets, these comprise a significant component of balance sheets.

The amendments to AASB16 required organisations include the value of leasehold property on balance sheets (Heywood, 2020), NFP entities have an exception to this requirement as they often use volunteer services and receive assets where consideration is significantly less than fair value, these transactions are accounted for under AASB1058 (Australian Accounting Standards Board, 2021; Subramanian, 2019). This standard has implications for NFP RAC and retirement village entities as land can be occupied under a peppercorn rent arrangement (Meredith, 1998). These are classified as right of use assets and currently there is a temporary exemption for NFP entities to provide a fair value for these instead relying on cost. Financial reporting by NFP entities is used to analyse the total size of the sector and to determine how efficiently funds are spent (Centre for International Corporate Tax Accountability and Research, 2020). The accurate recording of real estate assets has implications as to the dependability of this analysis (Chelliah, Boersma, & Klettner, 2015). While there are reporting requirements for NFP operators, there is flexibility in the detail and depth of this reporting. Compared to entities listed on the Australian securities exchange, there is less ability to scrutinise financial performance using filed accounts.

Methods and data

The Australian Institute of Health and Welfare publishes lists of RAC operators that are available for download (Australian Institute of Health and Welfare, 2020), from the 2020 list 29 NFP operators each with more than 1,000 residential places, was identified. The most recent financial reports were accessed from the ACNC website; due to insufficient detail and complexity from group reporting of disparate business activities in some financial reports, a total of 20 operators was analysed. The list of these operators is detailed in the Appendix.

Financial reports were examined for the following information: business activities, non-owned sites, accounting classification of property assets, measurement of value of property assets, and the use of independent valuations. Financial data was also obtained to determine the relationship between total revenue from operations and the value of property assets.

Observations

The RAC and retirement village industry is noted for diversity across operators, property assets, and geographies (Towart, 2018). The NFP sector also displays diversity with a range of business activities identified, accounting classification and measurement of assets, this is coupled with the presence of non-owned sites and a reliance on directors' valuations.

Types of business activities

In addition to RAC, 19 of the 20 operators analysed reported on other business activities. Other business activities included retirement villages, social and affordable housing, disability accommodation and services, hospitals and health care and benevolent services. Operators also will silo activities, that is the RAC, retirement villages and social and affordable housing that will each be in separate business units. Some operators were reporting at the group level, and information on individual silos was unavailable, whereas other operators were reporting at the RAC silo level. There appears to be no standard business model for NFP entities with RAC activities. These activities are summarised in Table 1.

The most prevalent other business activity was retirement villages, with 18 operators reporting this activity. This is not surprising given the degree of synergies between these two property activities. Having associated residential aged care, often co-located, assists in the marketing of a retirement village. People are noted for entering retirement villages at increasingly older ages and while they may not immediately need care, the ability to access this at some future point is desirable (Towart, 2020). Operators acknowledge the ability for a retirement village to "feed" residential aged care, providing a regular supply of new residents. Profitability in residential aged care is dependent upon occupancy levels, and operators aim to achieve occupancy greater than 95% (Towart, 2020). The combination of increasingly older residents and proximate or co-located RAC often results in residents entering care at an increased level of frailty with a higher Aged Care Funding Instrument assessment. This higher assessment equates to a higher level of

Table 1. Types of business activities.

Activity	Number of Operators
Residential Aged Care & Delivery of Care Services	20
Retirement Villages	18
Social and Affordable Housing	5
Hospitals and Healthcare	2
Disability Accommodation and Services	1
Commercial Activities	2

residential care subsidy payable to the aged care operator (Towart, 2020). Operators with residential aged care and retirement villages acknowledge that these synergies improve the profitability of both businesses.

Five of the 20 operators had social and affordable housing recorded on their balance sheets, while some also disclosed that they were Community Housing Providers. There are synergies with this use and RAC and retirement village. Operators with older retirement village dwellings, where it is difficult to obtain an incoming capital payment operate these as social housing due to the level of demand for affordable age-appropriate accommodation (Towart, 2020).

Further activities included two of the operators with hospitals and health-care properties, and reasons for this appeared to be largely historic. One operator had disability accommodation and services and acknowledged specific funding. All operators acknowledged some level of benevolent activity, with varying levels of detail. In addition to these activities, the two operators had commercial activities, on which the tax was paid, increasing the complexity and detail of their accounts. All operators had some form of care delivery services, including community care. These are services delivered to clients in their own home and are administered from office space, the space demand for this is not large. There is considerable potential for cross subsidisation of activities, with more profitable activities providing financial support, particularly to benevolent services. Given the level of reporting, it was difficult to determine the quantum of this cross subsidisation.

Non-owned sites

It is not unusual to observe NFP operators occupying sites under a peppercorn rent agreement. Many of these agreements have historical reasons, including the granting of occupancy by a local government to encourage the supply of housing and care for older people (Meredith, 1998). The agreement provides longer term occupancy (99-year lease), often with restrictions on the properties use and the NFP operator constructs the buildings and improvements (Newland, 1989). NFP entities have been granted relief from reporting these under AASB16 due to the difficulties encountered in fair valuing peppercorn leases (Australian Accounting Standards Board, 2021; Subramanian, 2019). Instead, these assets are classified as right of use assets underAASB1058 and NFP operators can measure their value on a cost basis measured by the present value of the future payments under the lease agreement plus any future makes good requirements.

RAC assets are valued on a going concern basis, namely capitalisation of net returns (Lister, 2001). Where an asset is valued on this basis, there is a negligible difference in value between long-term land usage and ownership in perpetuity (Webster, 1997). Land occupied on a peppercorn rent basis assist in the financial feasibility of initial development, and there is less impact on the value of properties.

Five of the 20 operators acknowledged the presence of sites that were not owned, four mentioned that they involved concessional payments, and one provided no details. Two operators acknowledged Crown Leases for land, these are occupied or a more commercial arrangement, and one operator named the properties. The financial impact of non-owned sites is greater for development compared to ongoing ownership of operational property. Nonetheless, the lack of detail makes it difficult to determine the level to which non-ownership of sites has assisted in the supply of RAC and retirement villages.

Accounting classification

All the operators reported RAC properties under AASB116 as property, plant and equipment (PPE). This is similar to listed operators where RAC assets are classified as PPE (Towart, 2018). RAC operations are difficult to separate from land and buildings, notwithstanding the existence of long term property leases in this sector. The rationale is that the operation of RAC is an integral business, therefore, the property assets are a component of these operations. In addition, operators with hospital assets reported these under AASB116.

With retirement villages, 13 operators accounted for these assets under AASB140 as investment property and 5 accounted for them under AASB116. The analysed financial reports contained various levels of detail as to the rationale for this classification and details on the properties. Where a rationale was given for classifying an asset as an investment property, the tendency was to paraphrase AASB140 that the assets were for rental income and capital gain. Two operators named the retirement villages, eight operators acknowledged that the investment property comprised retirement villages and two operators provided no details. One operator provided a list of properties that had been externally revalued during the reporting period, this was a subset of the total number of properties. In contrast to listed operators (Towart, 2018) there was limited information on individual properties, and one operator provided a list of all properties as an appendix with no further details.

Where operators classified retirement village assets under AASB116, the rationale was that such assets were to meet service delivery rather than to earn rental or for capital appreciation. Investment returns were incidental to the purpose of holding these properties. None of these operators provide details on individual properties. One operator had property assets other than retirement villages (details not provided), and these were classified as investment property. While NFP operators converged on their decision to classify RAC assets under AASB116, there was no conversion in the classification of retirement villages, moreover, there is limited detail on individual properties.

Measurement

The NFP operators of RAC and retirement villages demonstrated a range of types of measurements used in financial reporting; this is similar to listed operators (Towart, 2018). Operators could measure PPE and investment property on the basis of cost (less depreciation and impairments), a combination of cost and fair value or as fair value. Further complicating matters, an operator could have both PPE and investment property.

With property assets that had been recorded as PPE, 12 operators measured this at cost, and this was the most common measurement. The three operators measured PPE at cost on initial recognition and then fair value for subsequent reporting periods. Five operators measured PPE assets at fair value. With investment property, operators had a preference for measuring on a fair value basis, only two operators measured these assets are cost, three at cost than fair value and nine measured using fair value.

This has the potential to create problems where assets accounted for under PPE are measured on a cost basis and assets accounted for under-investment property are measured on a fair value basis. Five operators measured RAC assets on a cost basis and their retirement village assets on a cost then fair value or fair value basis. This results in a situation where one type of property asset is measured differently to another type on the same balance sheet. This is even more complex where there is a co-location of RAC and retirement villages. Co-location is common with NFP operators, many have both assets on the same land parcel (Towart, 2013). Where the RAC is measured at cost then this would include an apportionment of value attributable to the land occupied by the RAC. In this situation where the retirement village is measured at fair value, then, that would have to include an apportionment of that component of the site. Technically speaking, this is not difficult, however, this does give rise to the situation where components of one site are valued in different ways. If there were shared community facilities apportioning value between the RAC and retirement village would become more problematical.

NFP operators displayed diversity in their choice of measurement of the value of RAC and retirement village assets. In addition to diversity between operators, there was also diversity within individual operators' portfolios.

Directors' valuations

Listed operators of the RAC and retirement village assets have a greater reliance on directors' valuations when compared to investors in office, retail and industrial property (Towart, 2018). NFP operators of these assets follow this trend with the 13 operators that measure property assets at fair value using directors' valuations in financial reporting. External valuations were used with varying frequencies for these valuations. Four operators stated that the frequency of external valuations was either two or 3 years, and the remaining operators did not state a frequency, other than terms like "periodic." Four operators named the valuation firms that provided the most recent valuations.

Valuation of RAC and retirement village assets is complex and requires information that can only be obtained through operational activity (Lister, 2001; Moschione, 1992). For NFP operators, obtaining external valuation reports every year would be time-consuming and expensive. While the operators examined in this research were large, with significant cash flows, the cost of obtaining annual external valuations would place pressure on financial performance. The valuation of RAC and retirement villages is specialised with only a few companies in Australia providing this service. If all operators were to commission external valuations for 30 June it is unlikely there would be sufficient capacity in the country. The NFP operators examined have large portfolios and would have the prerequisite level of up-to-date operational data required in valuation calculations. Plus, these organisations would have sufficient skilled personnel to undertake the calculations.

Three of the operators stated valuation metrics, including the discount rate, growth rates for property prices and residence duration. Listed operators, in contrast, were more likely to provide this information in annual reporting (Towart, 2018). Both the NFP and listed operators have similar reliance on directors' valuations, the difference is NFP operators provide significantly less detail on the valuation metrics.

Relationship between property assets and revenue from operations

The variation in measurement of RAC and retirement village assets and the reliance on directors' valuations raises questions about reported property values. Given the level of detail in financial reports, it is difficult to compare reported property values between operators. Instead, the relationship between property values and revenue from operations has been compared. It follows that operators with higher revenue from operators would have more properties and therefore these would be worth more. It is acknowledged that as operators had a variety of business activities and there was insufficient detail on segments in many of the reports. Ideally, revenue from RAC and retirement villages should be compared with the value of RAC and retirement village assets, however this was not possible. Given the level of information available, this analysis provides a guide whether property values reported by NFP operators converge or diverge on the basis of measurement of values.

Revenue from operations and value of property assets was extracted from financial reports for all operators, Figure 1 contains this information. The method used in reporting for measuring value is highlighted in this chart. Given the lack of detailed available statistical analysis is problematic, however, visual analysis of this indicates that there is a correlation between the level of revenue and the value of properties. There is little difference between the method of measurement used and this relationship. If operators using the cost method were underreporting assets these would have clustered in the top left-hand quadrant. If anything, there is one operator in the bottom right quadrant that has a number of modern lifestyle retirement villages.

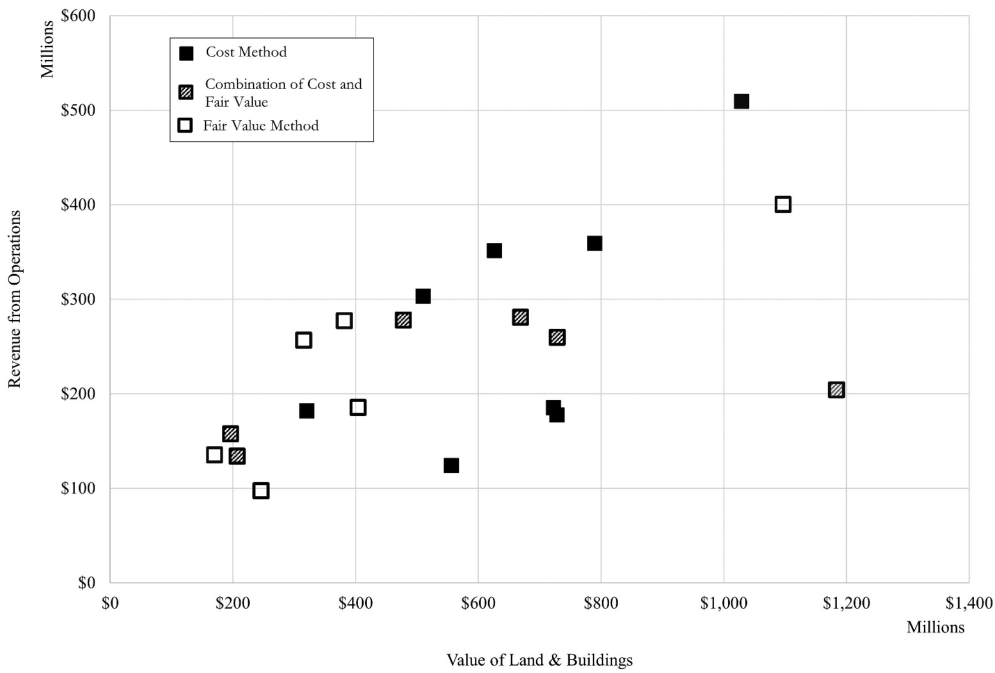

Figure 1. Revenue from operations and value of land and buildings by NFP operators.

It is acknowledged that this analysis is simplistic, however it indicates that NFP operators do not underreport property values and that there is a degree of correlation regardless of the basis of measurement and the use of external valuations.

Discussion and further research

This research has identified similarities between NFP operators and listed operators both groups have a similar reliance on directors' valuations and both classify RAC under AASB116. Similar to listed operators, NFP operators displayed diversity in their classification of retirement village assets and the measurement of value for RAC and retirement village assets. This degree of diversity has implications for the financial transparency of the industry. Both RAC and retirement villages have been the subject of government inquiries at the Commonwealth, and state levels and these enquiries have examined the financial performance of operators. Coupled with diversity, it is difficult to make meaningful comparisons in the financial performance between operators regardless of their taxation status.

The lower level of detail in NFP financial reports compared to listed investors demonstrates that without scrutiny from external equity investors and legal requirements from the listed market operators elect to be parsimonious in the information supplied. NFP operators may have stakeholders and interested parties, however they would need a significant amount of financial literacy to understand the details in the reports supplied. RAC and retirement villages are a complex industry requiring complex financial reporting, and while listed operators may provide sufficient detail, the lack of detail from NFP operators makes understanding the true situation of the industry difficult.

RAC and retirement village valuations are complex, and the continuing reliance of directors' valuations for these assets raises questions with regard to smaller organisations and board composition. Large organisations, such as those examined, can be expected to have sufficient in-house personnel to carry out these calculations. Smaller organisations may lack sufficient in-house personnel, and reliance on directors' valuations could be problematic. Members of the board are expected to rigorously examine these calculations and form an opinion before accepting the valuations. This raises questions about the composition of boards of smaller organisations whether they have sufficient skills to undertake this.

Note

1. Most recent numbers.

Disclosure statement

No potential conflict of interest was reported by the author(s).

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Appendix

List of operators and date of annual report.

Operator	Date
Anglican Aged Care Services Group (Benetas)	30 June 2019
Anglican Community Services	30 June 2020
Baptcare Ltd	30 June 2020
BaptistCare NSW & ACT	30 June 2019
Catholic Healthcare Limited	30 June 2020
Churches of Christ in Queensland	30 June 2019
HammondCare	30 June 2019
Illawarra Retirement Trust	30 June 2019
Mercy Aged and Community Care Ltd	30 June 2020
Ozcare	30 June 2019
Resthaven Inc	30 June 2020
Royal Freemasons' Benevolent Institution	30 June 2019
RSL Care RDNS Limited (Bolton Clarke)	30 June 2019
RSL LifeCare Limited	30 June 2019
Southern Cross Care (NSW & ACT) Limited	30 June 2020
Southern Cross Care (SA, NT & VIC) Incorporated	30 June 2019
The Bethanie Group Incorporated	30 June 2019
The Frank Whiddon Masonic Homes of New South Wales	30 June 2019
Villa Maria Catholic Homes Limited	30 June 2019
Warrigal Care	30 June 2020