



Thursday, 31<sup>st</sup> May 2018

To submissions@xrb.govt.nz

## **Comments and submissions to NZASB Exposure Draft 64 – Leases**

### **Background**

Emerge Aotearoa Group is a charitable trust and operates as a social service provider that is predominately funded through government agencies i.e. DHB's, Ministry of Social Development, Department of Corrections, Ministry of Health. Emerge Aotearoa Group has a number of leases for properties, vehicles and office equipment. The properties leased represent the most material dollar value and the majority of these are residential properties with few commercial properties for office space. While a large number of properties are rented or leased from family landlords at market rent however, a greater proportion of properties that operate residential care services and are rented/leased from Community Group Housing (CGH is a subset of Housing New Zealand). These are typically below market rents due to the social service provided from these properties. We also have a number of properties that we rent to tenants but these typically are captured under the Residential Tenancy Act as opposed to long term leasing arrangements.

Due to the large property portfolio held for residential care service and also our commitment towards social, transitional and emergency housing, Exposure Draft 64 - Leases, is likely to have a significant impact on our accounting and financial statements. On this basis, attention has been given to those areas of greatest impact and consideration for the cost versus benefit.

### **Right-of-use model**

This methodology does raise some concerns with regards to understandability for those that use, read and rely on financial statements particularly in the public sector. For Emerge Aotearoa, those that read and rely on our financial statements are our funders and also our bank. As we are more heavily geared towards the lessee arrangements, the proposed changes in recognition will mean moving away from the traditional operating leases contained in the notes towards the recognition of both a 'right-of-use asset' and also a 'lease liability'. This will essentially gross the balance sheet up as both assets and liabilities will substantially increase but ultimately with very little effect on Net Assets. It is our opinion that this will add very little substance to the understandability of our organisations position.

Although Emerge Aotearoa has very little lessor arrangements, the same underlying concerns are shared for this right-of-use model.

It is recognised that this movement towards accounting for leases on the balance sheet is specifically aimed at reflecting the substance of the underlying transaction and this change is already in motion specifically under IFRS 16 and now with ED 64. Although our concerns still remain over the understandability for readers, Emerge Aotearoa would encourage XRB and NZASB to give consideration to changing IPSAS 1 presentation of financial statements so to provide adequate clarity around the right-of-use model. On this basis, Emerge Aotearoa support the specific departures from IFRS 16 as explored in ED 64. The suggested adoption of the right-of-use

model for both lessees and lessors will add better transparency and consistency across the not for profit sector.

### **Concessionary lease arrangements**

This area of change will have significant impact across the not for profit sector. The recognition of non-exchange revenue has been in place of while now although its extension to expenses has yet to be introduced. This has not had any direct implications for Emerge Aotearoa given the nature of revenues received, however, the proposals under ED 64 Leases for below market leases will potentially have significant impacts. The properties in which we rent/lease from CGH are ring fenced or purpose built for particular community and social housing outcomes. It is therefore arguable that the fair value for such properties would difficult to obtain given their specialized nature or would be more costly to determine.

Further to this, some of the arrangements with Housing New Zealand are on a monthly rolling basis with no expressed length or term. This would imply that such arrangements would not specifically be covered by the introduction of the concessionary components therefore creating a grey area.

All that aside, ED 64 fundamentally proposes the recognition of a day one expense or revenue for the concessionary non-exchange component. Emerge Aotearoa believe that this proposal does not fairly reflect the underlying nature of the transaction which is the expense or revenue (as a result of the subsidy) is fundamentally tied into the length of lease and should be recognised in this manner. The proposed day one recognition will have significant material impacts each year to the Statement of Comprehensive Revenue and Expenses, this is likely to be misunderstood and reflect unfavourably on management as either a very strong healthy year or a poor unsustainable year. The Statement of Comprehensive Revenue and Expenses will become an unnecessary depiction of financial performance and more reliance and emphasis should be put on the Statement of Cashflow as the best source of the truth.

Another factor which should not treated lightly is the cost of compliance with concessionary arrangements. As a charity, the funding received is dedicated to achieving the charitable purpose and there is often a balancing act to ensure the future sustainability and going concern of the charity. Emerge Aotearoa is strongly of the view the costs for compliance would significant outweigh the benefit. Emerge Aotearoa's leased property portfolio with CGH and Housing NZ sits over 200 properties/units and determining whether a subsidy is being received or not would require all properties to be assessed against fair value. This exercise will be carry high administrative costs but also significant costs to contract a reputable and knowledge supplier to assess these across the length of New Zealand. Comments above have already highlighted concerns over the understandability of recognizing the non-exchange subsidy attached to a lessor or lessee arrangement.



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