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To Whom It May Concern

## **ITC 55 – Post-implementation Review of AASB 16 Leases**

The Property Council of Australia (the Property Council) welcomes the opportunity to respond to the Australian Accounting Standards Board's (the AASB's) invitation to comment (ITC) on the post-implementation review of AASB 16 *Leases*.

The Property Council is the peak body for owners and investors in Australia's \$670 billion property industry. We represent owners, fund managers, superannuation trusts, developers, and investors across all four quadrants of property investments: debt, equity, public and private.

The property industry is the country's second largest employer, providing over 1.4 million jobs to Australians, representing a direct gross domestic product (GDP) contribution of \$232 billion, or 10.6 per cent of total GDP, as well as 18.2 percent of total tax revenues totalling \$129.6 billion.

The operation of AASB 16 *Leases* has a direct and ongoing impact on the property industry's resources. CBRE has estimated that an average of 20,000 commercial leases are entered into each year, with about 50 per cent made up of new leases, and the compliance burden associated with the recognition, measurement and disclosure requirements is significant and material.

Whilst AASB 16 is broadly meeting its objectives, some aspects of the standard (particularly as they interact with AASB 15 *Contracts with Customers*) are burdensome and represent little value for users of financial statements.

These requirements draw on limited industry resources and divert them from core operational and strategic activities. Whilst the Australian Government is prioritising the reduction of red tape and regulatory friction on industry, the AASB should use this opportunity to advocate for a streamlined standard that can both meet its broader objectives and reduce the regulatory impact on preparers of financial statements.

For the property industry, many participants are required to prepare their financial statements in line with the requirements of AASB 16. However, in other shareholder communications (such as in directors' reports or investor presentations) alternative performance measures (APMs) are presented that reverse the impact of AASB 16 lease accounting for lessors and reflect instead the

cash receipts from leases to better present how these businesses are run in practice and understood by investors.

The AASB has already acknowledged the feedback from the not-for-profit and public sector, and the constraints that compliance is having on community housing providers (for example).

The Property Council is aware of the broader sectoral impacts of the standard and would support the simplification of requirements on the not-for-profit sector in order to support alignment with government housing policy.

As part of this post-implementation review the AASB must assess whether the benefits of increased granularity required under the standards justify the scale of resource commitment required to comply.

Ultimately, the standard has increased visibility of rental obligations at a high compliance cost. The Property Council prefers stability in the broader standard over wholesale change, supporting international alignment while calling for targeted refinements.

### **Splitting of lease income, trade receivables and other income between AASB 15 and AASB 16**

The Property Council has previously responded to the International Accounting Standards Board's (IASB) post-implementation review of IFRS 15 *Revenue from Contracts with Customers*, which outlined two disclosures which are providing little or no value to users of financial statements. These disclosures are:

- The splitting of lease income and other revenue from contracts with customers (generally the outgoings component)(as required by paragraph 113(a) of IFRS 15)
- The splitting of trade receivables between those relating to leases and those relating to contracts with customers (as required by paragraph 116(a) of IFRS 15)

The split of leasing income was as a result of an interpretation by the major accounting firms that outgoings-related charges (amounts paid by lessees for building costs such as cleaning, security, statutory rates and taxes etc.) to the landlord as part of the lease were not lease revenue under IFRS 16 *Leases*, but rather revenue from contracts with customers under IFRS 15.

Prior to the release of these two standards, this income (together with other immaterial income streams associated with a lease) were grouped with leasing income for reporting purposes.

Broadly, there are two main types of lease agreements:

- Net leases - where the tenant will pay a base rent component and also pay a separate portion of the building operating costs (i.e. outgoings)
- Gross leases - where the tenant will pay a single base rent amount.

There are other variations on these lease types, such as semi-gross leases (where tenants pay a separate amount for a selection of building operating costs), or leases where the tenant will directly pay the full operating costs of a building (usually in a single-tenant building).

As a result of this interpretation by the major accounting firms (and to align with the requirements of IFRS 15 and 16), preparers of financial statements had to determine the split by calculating:

1. What is **lease income** (to be disclosed under IFRS 16), and
2. What is **outgoings/other revenue** from contracts with customers (under IFRS 15), including determining an apportionment for gross leases where the tenant only receives a single charge.

This determination is arbitrary and despite the significant work involved in calculating provides little or no useful information to users of financial statements who are otherwise focused on the total revenue from leases.

In addition, IFRS 15 paragraph 116(a) requires the opening and closing balance of receivables relating to contract assets to be disclosed. In the same manner, this balance is often arbitrarily split between IFRS 15 and IFRS 16.

Furthermore, as amounts paid by tenants often do not specifically relate to any particular charge, customer receivables cannot be meaningfully split between balances relating to leasing income and balances relating to outgoings and other charges.

The Property Council supports reducing the regulatory burden on preparers of financial statements by allowing outgoings and other income incidental to a lease to be treated as variable lease income under IFRS 16.

**Recommendation 1:** amend IFRS/AASB 16 *Leases* to allow outgoings and other income incidental to a lease to be treated as variable lease income.

### Embedded fit outs in investment property leases

As part of its engagement with industry, the Property Council has other matters which require review by the AASB to ensure the standard is working as intended. This issue is also closely connected to the interaction between lease accounting and sustainability standards (S1 and S2), particularly in how lease-related assets and activities are brought into an entity's reporting boundary.

Whilst AASB 16 has removed the separate classification for operating leases for lessees, the distinction remains for lessors between operating and finance leases, with property leases classified as operating leases if they do not transfer the significant risks and rewards of ownership to the lessee.

However, this classification has unintended consequences when considered along the Greenhouse Gas Protocol (GHG Protocol). Lessor entities (such as fund managers) must include emissions from operating leases within their emissions boundary.

This creates a situation where tenant-selected but landlord-funded fit outs are otherwise interpreted as being within the lessor's emissions boundary. This interpretation leads to significant complexity in attributing emissions, for example when:

- The landlord's fit out is connected to the tenant's electrical distribution board and powers tenant-owned equipment,
- The tenant funds the electricity consumption, yet the equipment is deemed to be part of the lessor's boundary, or

- The fit out is jointly funded, resulting in ambiguity over which party is responsible for the emissions generated.

This complexity introduces material regulatory burden on preparers of financial statements, particularly in cases where audit firms interpret embedded fit outs as part of the lessor's boundary.

The commercial reality is that these fit outs often function as finance leases embedded within operating leases, with the cost of the fit out recovered through base rent charges that include an implicit interest component.

The Property Council seeks clarity and further guidance from the AASB on the treatment of fit outs in the context of both IFRS 16 and emerging sustainability reporting requirements. Greater certainty in this area would assist preparers, avoid inconsistent audit interpretations, and otherwise reduce compliance costs.

### **Divergence between the Australian and international standard**

The Property Council supports further investigation and consideration of the feedback provided in this submission; however it wishes to express its strong view that any response by the IASB should not consider divergence from the IFRS framework.

Australia's continued alignment with IFRS is critical to maintaining global consistency, comparability, and investor confidence. Divergence would not only reduce the usefulness of financial statements for global capital providers but would also impose greater administrative complexity and burden on Australian preparers, particularly those operating across multiple jurisdictions.

The Property Council would welcome the opportunity to discuss this submission in more detail. Please contact Dan Rubenach, Policy Manager at [drubenach@propertycouncil.com.au](mailto:drubenach@propertycouncil.com.au)

Yours sincerely



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