

Lessee's Incremental Borrowing Rate (IFRS 16 Leases)—September 2019

The Committee received a request about the definition of a lessee's incremental borrowing rate in IFRS 16. The request asked whether a lessee's incremental borrowing rate is required to reflect the interest rate in a loan with both a similar maturity to the lease and a similar payment profile to the lease payments.

Applying IFRS 16, a lessee uses its incremental borrowing rate in measuring a lease liability when the interest rate implicit in the lease cannot be readily determined (paragraph 26 of IFRS 16). Appendix A to IFRS 16 defines a lessee's incremental borrowing rate as 'the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment'. The lessee's incremental borrowing rate is therefore a lease-specific rate that the Board defined 'to take into account the terms and conditions of the lease' (paragraph BC162).

In determining its incremental borrowing rate, the Board explained in paragraph BC162 that, depending on the nature of the underlying asset and the terms and conditions of the lease, a lessee may be able to refer to a rate that is readily observable as a starting point. A lessee would then adjust such an observable rate as is needed to determine its incremental borrowing rate as defined in IFRS 16.

The Committee observed that the definition of a lessee's incremental borrowing rate requires a lessee to determine its incremental borrowing rate for a particular lease considering the terms and conditions of the lease, and determine a rate that reflects the rate it would have to pay to borrow:

- a. over a similar term to the lease term;
- b. with a similar security to the security (collateral) in the lease;
- c. the amount needed to obtain an asset of a similar value to the right-of-use asset arising from the lease; and
- d. in a similar economic environment to that of the lease.

The definition of a lessee's incremental borrowing rate in IFRS 16 does not explicitly require a lessee to determine its incremental borrowing rate to reflect the interest rate in a loan with a similar payment profile to the lease payments. Nonetheless, the Committee observed that, in applying judgement in determining its incremental borrowing rate as defined in IFRS 16, it would be consistent with the Board's objective when developing the definition of incremental borrowing rate for a lessee to refer as a starting point to a readily observable rate for a loan with a similar payment profile to that of the lease.

The Committee concluded that the principles and requirements in IFRS 16 provide an adequate basis for a lessee to determine its incremental borrowing rate. Consequently, the Committee decided not to add the matter to its standard-setting agenda.