

# Determining lessee's incremental borrowing rate under IFRS 16

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# Determining lessee's incremental borrowing rate

At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.

In which:

- **Interest rate implicit in the lease** is the rate of interest that causes the present value of (a) the lease payments and (b) the unguaranteed residual value to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor
- **Lessee's incremental borrowing rate** is 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

Determining the 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:

- Over a similar term to the lease term
- With a similar security to the security (collateral) in the lease
- The amount needed to obtain an asset of a similar value to the right-of-use asset arising from the lease
- In a similar economic environment to that of the lease



## Conclusion

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. 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.

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