Should there be a standardised discount rate for Statutory Boards?

SB-FRS 116 paragraph 26 sets out that when measuring the lease liability at commencement date, lease payments shall be discounted using the *interest rate implicit in the lease*, if this rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's *incremental borrowing rate*.

Interest Rate Implicit in Lease

SB-FRS 116 defines this as 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. As the interest rate implicit in the lease is a *company-specific measure to the lessor*, lessees will find it difficult to determine the interest rate implicit in the lease due to the lack of information made available to them. Therefore, lessees will usually use their incremental borrowing rate.

Lessee's Incremental Borrowing Rate

SB-FRS 116 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**".

SB-FRS 116 also states that, as a practical expedient, a lessee may apply a single discount rate to a portfolio of leases with reasonably similar characteristics (such as leases with a similar remaining lease term for a similar class of underlying assets in a similar economic environment).

Applying the above principles, the lessee's incremental borrowing rate is an interest rate which is specific to the lessee (i.e. *entity-specific)* and specific to the lease term and economic conditions at the time the lease is entered into etc. (i.e. *lease-specific)*.

As every SB is unique (*entity-specific*), and each lease entered into within any single SB is also unique (*lease-specific*), **SB-FRS 116 does not allow a standardised discount rate set by a central agency to be applied across all SBs**. SBs which are lessees will have to determine a discount rate for every lease* to which it applies the new lessee accounting model under SB-FRS 116, unless:

i. The lease is fully prepaid, such that there is no future lease payments to discount;
ii. The payments made to the lessor are all variable and depend on sales or usage; or
iii. The lease recognition exemptions apply i.e. short-term leases and leases of underlying assets that are of low value.

The principles for determining discount rate can be found here.

*SBs may apply the practical expedient to use a portfolio approach and determine a single discount rate for a portfolio of leases with similar characteristics. However, this is only permitted if the SB expects thiat this approach would not differ materially from applying SB-FRS 116 to individual leases.