HM Treasury

Financial Reporting Advisory Board

IFRS 16 rationale and considerations

Issue:	HMT's IFRS 16 post implementation review committed HM to producing a separate document to FReM listing all IFRS 16 FReM interpretations and adaptations and the reasons for them, as a result of feedback from preparers as part of the review.
Impact on guidance:	N/A
IAS/IFRS adaptation?	N/A
Impact on WGA?	N/A
IPSAS compliant?	N/A.
Interpretation for the public-sector context?	N/A.
Impact on budgetary regime and Estimates?	N/A
Alignment with National Accounts	N/A
Recommendation:	For the Board to note only.
Timing:	N/A

DETAIL

1. Action 1 from the IFRS 16 post-implementation review was for HMT to produce a document setting out the rationale for IFRS 16 FReM interpretations and adaptations as agreed by the Board.
2. This was a result of feedback from preparer respondents, as 40-50% of respondents did not agree that the public sector interpretations and adaptations of IFRS 16 are sufficiently explained in the HMT application guidance and the FReM.
3. Annex A explains the detailed rationale behind each adaptation and interpretation, alongside considerations the Board made and further work the board asked of HMT.
4. Action 5 from HMT's IFRS 16 post implementation review, published in July 2025 was to include on FRAB's forward workplan a review of the IFRS16 adaptations and

interpretations and if they are working as FRAB intended after five years of implementation.

5. HM Treasury believes that there is an opportunity to learn lessons from the implementation of IFRS 16 and proposes bringing forward the review to 25/26 (three years after implementation).

Recommendation: That FRAB agree that HMT should undertake the implementation review of IFRS 16 in 25/26.

Annex A

IFRS 16 *Leases*	
Adaptations	**Rationale and considerations**
1. [A] IFRS 16, as adapted and interpreted by this Manual, will be effective from 1 April 2022, with two exceptions. [B] Early adoption from 1 April 2019 is available for entities where the following criteria are met: 2. the entity has at least one subsidiary that, under the Companies Act, is required to follow IFRS as adopted by the EU, and the total assets of the subsidiary comprise at least 10% of the total assets at the group level; 3. the subsidiary (or subsidiaries) described above have operating lease commitments that comprise at least 10% of the operating lease commitments at the group level; and 4. approval to early adopt has been received from HM Treasury. [C] Early adoption from 1 April 2021 is available for entities where approval has been received from the relevant authority.	*Rationale:* [A] The first deferral from 1 April 2019 to 1 April 2020, due to budgeting complications, has its rationale detailed in FRAB 134 (02) para 7-22. FRAB agreed to two further delays from 1 April 2020 to 1 April 2021 and then 1 April 2022, because of the extraordinary impact the COVID-19 pandemic had on departments. IFRS 16 wasn't considered in isolation, but as part of a larger suite of changes. The rationale for this is detailed in FRAB 140 (02(01)). [B] The rationale for early adoption from 1 April 2019 is detailed in FRAB 134 (02) para 23-26, as a result of the first deferral. [C] The rationale for early adoption from 1 April 2021 was considered by FRAB in an 'out of meeting' paper in November 2020. There was a risk of jeopardising department's momentum towards implementation and FRAB decided that outweighed the risks of making adjustments for WGA and the ONS' national accounts, which require a consistent accounting basis across departments. *Considerations:* [A] HMT's considerations of all options available in light of the COVID-19 pandemic is detailed in FRAB 140 (02(01)). HMT reviewed the appropriateness of the 1 April 2019 financial reporting requirements by reaching out to the resource accounts special interest group (RASIG) and in-depth discussions and in-depth discussions with finance functions charged with preparing the ARAs. Full details, including a quantitative analysis, can be found in FRAB 142 (04). As a result of this analysis,

	HMT recommended to issue similar guidance for 1 April 2020 and FRAB agreed. [B] HMT's consideration and analysis is detailed in FRAB 134 (02) para 27 to 31. HMT spoke to RASIG and the IFRS 16 technical working group when creating the criteria for early adoption from 1st of April 2019. [C] The recommendation HMT gave to FRAB in an 'out of meeting paper' in November 2020 for this adaptation includes considerations of the impact on ONS' national accounts, as well as HMT's own Whole of Government accounts. HMT also did outreach directly to departments to understand the level of interest in implementing at 1 April 2021. FRAB agreed with HMT's recommendation.
2. The definition of a contract is expanded to include intra-UK government agreements where non-performance may not be enforceable by law.	*Rationale:* IFRS 16 Exposure Draft paragraphs 4.5-4.11 covers the rationale in detail. *Considerations:* Of the 28 respondents to this part of HMT's IFRS 16 Exposure Draft, 24 agreed with this adaptation. Based on those positive reactions of stakeholders, HMT recommended the adaptation to FRAB who agreed to it.
3. Peppercorn leases are defined as leases for which the consideration paid is nil[A] or nominal (that is, significantly below market value). Peppercorn leases are in the scope of IFRS 16 if they meet the definition of a lease in all aspects apart from containing consideration. All lessees shall account for peppercorn leases using the following criteria: • Recognise a right-of-use asset and initially measure it at current value in existing use or fair value, depending on whether the right-of-use asset will be held for its operational capacity and as set out in paragraphs 10.1.4-10.1.6. However, if the right-of-use asset meets	*Rationale:* IFRS 16 Exposure Draft paragraphs 4.66-4.69 covers the rationale in detail. Peppercorn leases were already treated as finance leases under IAS 17, and so the adaptation focuses on appropriate valuation for the asset under IFRS 16. *Considerations:* Of the 28 respondents to this part of HMT's IFRS 16 Exposure Draft, 26 agreed with this adaptation. Based on those positive reactions of stakeholders, HMT recommended the adaptation to FRAB who agreed to it, with the exception of [A].

the definition of a heritage asset, it should be initially measured in accordance with paragraphs 10.1.35-10.1.40. • Recognise a lease liability measured in accordance with IFRS 16. • Recognise any difference between the carrying amount of the right-of-use asset and the lease liability as income as required by IAS 20 as interpreted in this Manual. • Subsequently measure the right-of-use asset following the principles of IFRS 16 as adapted and interpreted in this Manual. • Upon transition, any peppercorn leases that were not previously classified as finance leases under IAS 17 shall be recognised as follows[19]: • The right-of-use asset shall be measured at current value in existing use or fair value, depending on whether the right-of-use asset will be held for its operational capacity and as set out in paragraphs 10.1.4-10.1.6. However, if the right-of-use asset meets the definition of a heritage asset, it should be initially measured in accordance with paragraphs 10.1.35-10.1.40. • The lease liability shall be measured at the present value of lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application. • The difference between the carrying amount of the right-of-use asset and lease liability shall be included as part of the adjustment to the opening balances of taxpayers' equity (or other component of equity, as appropriate) per IFRS 16 (C5(b)).	As detailed in FRAB 134 (02) paragraph 47, FRAB members raised concerns about unintended consequences for lease-like arrangements in exchange for nil consideration [A], which HMT recognised may be the case for Church-donated assets and further analysis was undertaken. As detailed in FRAB 135 (02-1) paragraphs 28-30, HMT spoke to DCMS, DfT and DfE who supported an adaptation to include nil consideration leases in the scope of the standard. FRAB agreed to HMT's original recommendation.
Interpretations	Rationale and considerations

1. The option to apply the election in IFRS 16 (5(a)) has been withdrawn. All entities must apply the recognition and measurement exemption for short-term leases in accordance with IFRS 16 (6-8).	*Rationale:* IFRS 16 Exposure Draft paragraphs 4.12-4.14 covers the rationale in detail. *Considerations:* Of the 30 respondents to this part of HMT's IFRS 16 Exposure Draft, 29 agreed with this interpretation. Based on those positive reactions of stakeholders, HMT recommended the adaptation to FRAB who agreed to it.
2. Where lessees cannot readily determine the interest rate implicit in the lease, they are instead required to use the HM Treasury discount rates promulgated in PES papers as their incremental borrowing rate. However, if an entity can demonstrate that another discount rate would more accurately represent their incremental borrowing rate (for example, if they undertake external borrowing independently of the Exchequer), they shall use that discount rate as their incremental borrowing rate.	*Rationale:* IFRS 16 Exposure Draft paragraphs 4.39-4.43 covers the rationale in detail. *Considerations:* Of the 28 respondents to this part of HMT's IFRS 16 Exposure Draft, 26 agreed with this interpretation. Of the 28 who responded, 22 agreed HMT should set the internal rate of borrowing should be set irrespective of the type of underlying asset. Based on those positive reactions of stakeholders, HMT recommended the adaptation to FRAB who agreed to it. Implementation concerns from early adopters were brought to FRAB in June 2020, as detailed in paragraphs 13 and 14 in FRAB 141 (05). FRAB considered the options and paragraph 12 in the minutes from FRAB 141 explain FRAB's position that resulted in no change to the discount rate methodology.
3. The subsequent measurement basis for all right-of-use assets shall be consistent with the principles for subsequent measurement of property, plant and equipment set out in the adaptations to IAS 16 in this Manual. Chapter 10.2 to the FReM sets out how the apply these principles to right of-use assets	*Rationale:* As detailed in FRAB 135 (02) paragraphs 18-20, after balancing various concerns, the nature of leased assets and the IFRS 16 cost model was considered appropriate to use cost as a proxy for current value for most right-of-use assets, whilst acknowledging that, in some cases, cost is not an appropriate proxy for current value measurement. *Considerations:* As detailed in FRAB 135 (02), paragraphs 6 – 27, FRAB members raised

	concerns with HMT's original recommendation for all right-of-use assets to be measured subsequently at cost for reasons of consistency and practical expediency, after HMT had considered feedback from respondents to the IFRS 16 Exposure Draft. FRAB's concerns are listed in paragraph 7. HMT spoke to both key departments, valuers, and CIPFA/LASAAC when doing further analysis, as well as convening two Technical Working Group meetings as a result. HMT then recommended to FRAB that the subsequent measurement of right-of-use assets generally follow the principles of subsequent measurement as set out in the FReM for owned property, plant and equipment.
4. The option to reassess whether a contract is, or contains, a lease at the date of initial application has been withdrawn. All entities shall use the practical expedient detailed in IFRS 16 (C3) (for peppercorn leases, see adaptation 2 above).	*Rationale:* IFRS 16 Exposure Draft paragraphs 4.87-4.90 covers the rationale in detail. *Considerations:* Of the 28 respondents to this part of HMT's IFRS 16 Exposure Draft, 25 agreed with this interpretation. Based on those positive reactions of stakeholders, HMT recommended the adaptation to FRAB who agreed to it.
5. Upon transition, the accounting policy choice to apply IFRS 16 retrospectively to each prior period presented in accordance with IAS 8 has been withdrawn. All entities applying this Manual shall recognise the cumulative effects of initially applying IFRS 16 recognised at the date of initial application as an adjustment to the opening balances of taxpayers' equity (or other component of equity, as appropriate) per IFRS 16(C5(b)).	*Rationale:* IFRS 16 Exposure Draft paragraphs 4.91-4.92 covers the rationale in detail. *Considerations:* Of the 29 respondents to this part of HMT's IFRS 16 Exposure Draft, all 29 agreed with this interpretation. Based on those positive reactions of stakeholders, HMT recommended the adaptation to FRAB who agreed to it.
6. Upon transition, entities shall measure the right-of-use asset for leases previously classified as operating leases per IFRS 16((C8 (b)(ii))): at an amount equal to the lease liability, adjusted by	*Rationale:* IFRS 16 Exposure Draft paragraphs 4.95-4.99 covers the rationale in detail.

the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.	*Considerations:* Of the 28 respondents to this part of HMT's IFRS 16 Exposure Draft, 27 agreed with this interpretation. Based on those positive reactions of stakeholders, HMT recommended the adaptation to FRAB who agreed to it.
7. Upon transition, all entities applying this Manual shall apply the following options for leases previously classified as operating leases: • No adjustments for leases for which the underlying asset is of low value that will be accounted for applying IFRS 16 (6). (IFRS 16 C9 (a)) • No adjustment for leases for which the lease term ends within 12 months of the date of initial application (with a requirement to include the cost associated with those leases in the short term lease expense disclosure). (C10 (c)) • Use hindsight in determining the lease term if the contract contains options to extend or terminate the lease. (C10 (e))	*Rationale:* IFRS 16 Exposure Draft paragraph 4.102 covers the rationale in detail. *Considerations:* Of the 27 respondents to this part of HMT's IFRS 16 Exposure Draft, all 27 agreed with this interpretation. Based on those positive reactions of stakeholders, HMT recommended the adaptation to FRAB who agreed to it.

HM Treasury
20th November 2025