

The Degree of IFRS 16 Adoption in Algerian Banks

A Case Study at the Bank of Agriculture and Rural Development (BADR)

REDDA Khadidja*

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Abstract: This study seeks to demonstrate how well IFRS 16 is being implemented in Algerian banks by taking a look at the accounting treatment of the leases contracts and what impact this has on the financial statements under the Algerian accounting system for both the lessor and the lessee. Given the nature of the subject, a descriptive and analytical approach will be used, as well as a case study at the level of the Bank of Agriculture and Rural Development. Among the findings is that there is considerable convergence between the Algerian and international sides in this area.

Keywords: International Financial Reporting Standard IFRS 16, lease contracts, banks.

JEL Classification: M41.

ملخص: تهدف هذه الدراسة إلى بيان مدى تطبيق معيار المحاسبة الدولي *IFRS16* في البنوك الجزائرية، من خلال عرض المعالجة المحاسبية لعقود الإيجار مع بيان آثارها على القوائم المالية حسب النظام المحاسبي المالي الجزائري بالنسبة للمؤجر والمستأجر، ونظراً لطبيعة الموضوع سيتم الاعتماد على المنهج الوصفي التحليلي، وكذلك دراسة حالة على مستوى بنك الفلاحة والتنمية الريفية. ومن بين النتائج التي تم التوصل إليها هو وجود تقارب كبير بين الجانبين الجزائري والدولي فيما يتعلق بهذا المجال.

الكلمات المفتاحية: معيار المحاسبة الدولي *IFRS16*، عقود الإيجار، البنوك.

تصنيف JEL: M41.

*Senior lecturer A, Khemis Miliana University, Algeria, k.redda@univ-dbkm.dz

1-Introduction:

Banks have always been one of the most important financial institutions driving various economies, as they act as financial intermediaries between different economic actors through their primary function of receiving deposits and granting loans, such as lease contracts.

Lease contract is a type of contract based on an agreement between two parties, the lessor and the lessee, which results in the transfer of the right to use the asset and the risks associated with it from the owner (lessor) to the customer (lessee) for a certain period, in exchange for a set of economic benefits.

Given the importance of this contract and the privileges and facilities it offers to both the lessee and the lessor in the production process, it was necessary to establish a general framework for its accounting treatment at both the international and the local levels.

Internationally, the International Accounting Standards Board (IASB) addressed these contracts by issuing International Financial Reporting Standard (IFRS) 16 in 2016. Locally, this was ensured by the SCF financial accounting system, which is mainly inspired by international accounting standards. This research paper aims to determine the extent of compatibility between these two accounting treatments.

Problem:

Given the foregoing, we can state that the primary issue of this research is:

How widely are Algerian commercial banks using the International Accounting Standard IFRS 16?

Sub-questions:

The following sub-questions might be asked in order to offer thorough responses to the primary issue:

- How do the Algerian financial accounting system and the International Financial Reporting Standard IFRS 16 differ in how leases are treated in accounting?
- Are Algerian banks, especially the Bank of Agriculture and Rural Development (BADR), truly using the IFRS 16 accounting standard?

Assumptions:

We use the following assumptions in order to respond to the different questions:

Since the financial accounting system is founded on International Accounting Standards, the accounting treatment of leases is the same throughout them. Indeed, the Bank of Agriculture and Rural Development (BADR) and other Algerian banks use IFRS 16.

Study Objectives:

The purpose of this study is to:

- Identify the procedures that Algerian banks use when awarding a lease contract.
- Show how Algerian banks use the international accounting standard IFRS 16, while examining the accounting treatment at the lessee as well as the lessor.
- Understand the reality of the lease contracts in Algeria through a case study at the Bank of Agriculture and Rural Development.

Study Methodology:

To address this topic, a descriptive and analytical approach will be adopted. This approach will be conducted by examining the theoretical and analytical framework of previous studies and various sources and references, including books, articles, and journals. A case study will also be used to analyze and discuss the leasing situation at the Bank for Agriculture and Rural Development (BADR).

Literature review:

- Study of : A. MIMOUN Iman, A. BOUCHANDA Rafik: Importance of the change in the accounting treatment of leases for the lessee according to the financial accounting system (IAS 17, IFRS 16 and SCF) – Comparative study, review of Les Cahiers du POIDEX, issue 7, 2017, Algeria.

This study addresses the following issue: how should the lessee account for leases according to the new IFRS 16 accounting standard? What is the importance of the change in accounting treatment under the SCF for the lessee according to IFRS 16?

The purpose of this study was to analyze the accounting principles for leases for the lessee and to compare accounting valuation methods in accordance with the accounting standards issued by the International Accounting Standards Board (IASB) and the International Accounting Standards Board (IASB) and by the National Accounting Council through the financial accounting system – SCF.

This is due to the lack of transparency and reliability of financial information provided to users of financial statements in accordance with IAS 17.

- Study established by: DEBBAH Manel, HESSIANI Abd El Hamid, Accounting treatment of finance leases by SCF and IFRS 16 at the lessee (case study univers

detergent), Journal of Economics, Management and Business Sciences, issue 12, pp 857-873, 2019, Algeria.

This study addresses the following issue: Within the framework established by international standards, how are finance leases treated for the lessee under IFRS 16 and SCF?

The aim of this paper was to review the most important aspects of the accounting system, starting with the legal texts that show its application. The authors also discussed the subject of finance leases in terms of definition and all that matters in it, especially by the accounting treatment of financial leases by the lessee according to SCF, And according to IFRS 16. The most important results are the need to keep abreast of the developments in the accounting field of financial leasing contracts, in accordance with IFRS 16, in order to increase transparency in the financial statements to benefit its users more honestly.

2-Theoretical literature on lease contracts:

Leasing offers institutions an alternative financing method to acquire assets for production, especially when liquidity is limited or retaining it is preferred. Banks are among the providers of leasing services.

2-1-Reasons for issuing IFRS 16:

The main reasons for the emergence of this standard were mainly centered on the inadequacy of the accounting treatment of leases under IAS 17, as it does not provide stakeholders with a comprehensive view of the assets controlled and used by the lessee, nor even the obligations arising from leases. The problem arose mainly because IAS 17 requires operating leases to be recorded in the income statement, which means that both the asset resulting from the right to use and benefit from it, and the obligation arising from the lessee's commitment to pay throughout the term of the contract remain outside the lessee's balance sheet, even though both the right of use and the commitment to pay meet the concept of an asset and a liability in accordance with the conceptual framework. This treatment is in fact what is known as “off-balance sheet financing”, as it is not explicitly considered by the lessee as a debt and therefore not included as a liability (Bunea-Bonita &C.A, 2017).

Furthermore, International Accounting Standard IAS 17 permits the classification of leases as either operating or finance leases, this has made it possible for institutions to manipulate their financial statements in an effort to make a positive impact, and as a result, many leases are treated as operating leases even though they are actually finance leases (Rulment, 2016). The value of the right-of-use asset and the quantity of the obligation were two important values that were taken out of the institutions' financial situation by deceptive actions. Due to this flaw in IAS 17, stakeholders were compelled to

look for more data and make changes in order to properly evaluate the institution's performance (Charchafa Elias & Kimouch Bilal & Chroun Azzedine, 2020).

2-2-Definition of a lease contract according to IFRS 16:

According to International Financial Reporting Standard (IFRS) 16, a lease is “a contract or part of a contract that transfers the right to use an asset for a period of time in exchange for a specified consideration”. In other words, it is a contract between the lessor and the lessee that transfers the asset's right of use from the owner (lessor) to the client (lessee) for a predetermined amount of time in return for a transfer of financial gains. The standard advises verifying that the lessee has complete control over the asset and the benefits resulting from its usage during the asset's use period in order to ascertain if the contract conveys the right to use the asset for a given amount of time (Charchafa Elias & Kimouch Bilal & Chroun Azzedine, 2020).

2-3-Classification of leases according to IFRS 16:

IFRS 16 eliminates the IAS 17 distinction between finance and operating leases, treating all leases as finance leases. According to the standard, leases can only be categorized as operating leases under certain conditions, specifically (IASB, 2016):

- 1- The contract period is less than 12 months and the contract excludes a purchase option.
2. The rental value is negligible (e.g., simple office equipment or personal PCs).

2-4-Main differences between IAS 17 and IFRS 16:

The new IFRS 16 standard on leases has introduced some new concepts, classifications, and accounting treatments that were not present in IAS 17. As a result, some important differences have emerged, which can be summarized as follows (Hani Ahmed Nimer Al-Aridi, 2017):

The concept of lease contracts: The idea of lease contracts has not changed much between the two standards; however, IFRS 16 gives more weight to the lessee's control and management of the particular asset, as well as the need of separation of lease and non-lease components, particularly those that are renewable.

Classification and accounting treatment: IFRS 16 has eliminated the classification of operating leases, so that all leases are now classified as finance leases, with two exceptions mentioned above, which are expected to be rare. This has necessitated a change in the accounting treatment of leases from that in IAS 17, which dealt with leases. IFRS 16 has abolished the two accounting models mentioned in IAS 17 and replaced them with the Right of Use Model. As a result, there are no longer any lease contracts outside the lessee's financial statements except in the two rare cases mentioned above.

2-5-IFRS 16 lease accounting :

IFRS 16 uses the right-of-use asset model, classifying all leases as finance leases. The following summarizes the accounting requirements for both lessees and lessors (IASB, 2016):

• **Accounting for leases from the lessee's perspective:** At the beginning of the lease term, the lessee recognizes the leased asset on the asset side and classifies it as an asset with a right of use. The obligations arising from the lease are recognized on the liability side.

The asset used at the beginning of the contract is recognized at the value of the lease liability plus any direct costs incurred by the lessee. If the lessee receives incentives from the lessor or makes payments prior to the contract date, these are calculated and the necessary adjustments are made to the recognized value.

• **Accounting for leases from the lessor's perspective:** There has been no significant change in the accounting for leases by lessors in IFRS 16 on leases from what was applied in IAS 17. In other words, at the beginning of the contract, the lessor records the finance lease as a debit account in the balance sheet at a value equal to the net investment in the lease, and then recognizes the finance income based on a model that reverses the fixed periodic rate of return on the lessor's net investments and represents the value of the lease received by the lessor (Jaarat Khalid, 2017).

2-6-Definition of lease agreements under Algerian law:

The Algerian legislature defined this contract in Decree No. 09-96 of January 10, 1996, entitled "Leasing Credit," and addressed its definition in Articles 7, 8, and 9 as follows (Algerian legislature, 1996):

- Each contract obliges the lessor to lease to the lessee movable property consisting of equipment, fixtures, or tools for professional use in exchange for payment of the rental value agreed upon between the lessee and the lessor.
- Any contract under which the lessor undertakes to lease to the lessee real estate or facilities purchased or built on his behalf, under the terms, specifications, and rental value specified in the contract.
- Any contract under which the lessor undertakes to lease a commercial premises or craft establishment owned by him, in return for payment of the agreed price.

3-Analysis of the leasing contract approval process at BADR Bank:

In the following, We will present the lease contract's contents and its compliance with accounting standards, based on the Agricultural and Rural Development Bank's provided contract.

Presentation of the lease contract: The contract is an agreement between the Bank for Agriculture and Rural Development and Farmer (X), signed on December the 25th 2019, for the lease of agricultural equipment.

- Name: xxx Date of birth: mm/day/yyyy
- Place of residence:
- **Special leasing's conditions:**
- Type of loan: lease-purchase loan
- Loan amount: 1,927,000.00 DZD
- Loan term: 66 months
- Variable interest rate agreed at 6%
- Payment account number:
- **Current guarantees and precautions:**
- Undertaking to grant the agency to the bank to register insurance on the financed equipment
- Personal contribution: 318,024.81 DZD
- Reservation of the PREG insurance amount
- Registration of the lease agreement between the parties (lessor loan and lessee loan)
- Promissory notes + registered loan agreement + letter of undertaking
- Undertaking to pay the harvest to the grain and dry legumes cooperative and to repay his debts through direct deductions from the grain and dry legumes cooperative.
- All risks insurance policy on the harvest (wheat)
- Certificate of non-taxation or installment payment schedule
- **Other guarantees and precautions:**
- Insurance against all risks throughout the term of the loan
- Annual repayment period
- Domiciliation of income
- With regard to the term requirement and the need for the lease term to be specified and known in the IFRS 16 accounting standard, we find that the farmer's lease loan has been set from November the 2nd 2020 to December the 31st 2025. Therefore, this contract complies with IFRS 16.

- With regard to lease payments, each payment is specified with the obligations and interest accrued as specified in the farmer's lease contract, with the first payment set at 398,704.47 DZD. All other payments are also specified as shown in the following table:

Table No. (01): Loan consumption table for agricultural machinery (DZD):

Day	Loan consumption	Interest	Payment
Nov the 2 nd 2020	00	00	00
Oct the 31 st 2021	1,378,601.61	92,655.77	398,704.47
Dec the 31 st 2022	1,062,613.24	82,716.10	398,704.47
Dec the 31 st 2023	727,665.56	63,756.79	398,704.47
Dec the 31 st 2024	372,621.02	43,659.93	398,704.47
Oct the 31 st 2025	0.00	26,083.47	398,704.47
Total		308,872.06	1,993,522.37

Source: Informations provided by the BADR bank

- Transfer of ownership of the machine at the end of the lease term to the farmer (lessee), which is in line with IFRS 16.
- The lessee (farmer) bears the risk insurance for the agricultural machine, which is in line with IFRS 16.

3-1-The Bank for Agriculture and Rural Development's accounting measurement of lease contracts:

Starting with:

3-1-1-Accounting for the lease contract:

The value of the agricultural machinery is 1,927,000.00 DZD, divided as follows:

- Loan amount: 1,927,000.00
- Loan term: 66 months (5 years and 6 months)
- Agreed variable interest rate: 6%
- Personal contributions: 318,024.81 DZD
- At the beginning of the contract year nov the 2nd 2020, the accounting for the lessee (farmer) is as follows:
 - At the beginning of the lease, the asset is recognized alongside the assets;
 - Recognition of the asset at the value of the liability plus any costs incurred by the lessee;

A- Accounting for the first payment on: nov the 2nd 2020:

614		Rental expenses	318,024.81	
4456		State: Tax on business turnover	60,424.71	
616		Insurance premiums	00	
	512	Banks Current accounts		378,449.52

The leased asset at its fair value is as follows:

215 4456		Transportation equipment and tools State: Tax on business turnover	1,927,000.00 00	
	167	Debts incurred on rent		1,927,000.00

➤ **year credits accounting:** at dec the 31st 2020:

681		Provisions for depreciation, amortization, and impairment losses	64,233.33	
	2815	Technical facilities, equipment, and industrial tools		64,233.33

B-Year 2021:(oct the 31st)

➤ **year credits accounting:**

167 4456 661		Debts incurred on rent State: Tax on business turnover Rights of the state: interests	306,048.70 58,149.25 92,655.77	
	512	Banks Current accounts		398,704.47

➤ **Accounting for depreciation:**

681		Provisions for depreciation, amortization, and impairment losses	385,400.00	
	2815	Technical facilities, equipment, and industrial tools		385,400.00

C-Year 2022:(oct the 31st)

➤ **year credits accounting:**

167 4456 661		Debts incurred on rent State: Tax on business turnover Rights of the state: interests	306,048.70 58,149.25 92,655.77	
	512	Banks Current accounts		398,704.47

➤ **Accounting for depreciation:**

681		Provisions for depreciation, amortization, and impairment losses	385,400.00	
	2815	Technical facilities, equipment, and industrial tools		385,400.00

D-Year 2023:(oct the 31st)➤ **year credits accounting:**

167		Debts incurred on rent	306,048.70	
4456		State: Tax on business turnover	58,149.25	
661		Rights of the state: interests	92,655.77	
	512	Banks Current accounts		398,704.47

➤ **Accounting for depreciation:**

681		Provisions for depreciation, amortization, and impairment losses	385,400.00	
	2815	Technical facilities, equipment, and industrial tools		385,400.00

E-Year 2024:(oct the 31st)➤ **year credits accounting:**

167		Debts incurred on rent	306,048.70	
4456		State: Tax on business turnover	58,149.25	
661		Rights of the state: interests	92,655.77	
	512	Banks Current accounts		398,704.47

➤ **Accounting for depreciation:**

681		Provisions for depreciation, amortization, and impairment losses	385,400.00	
	2815	Technical facilities, equipment, and industrial tools		385,400.00

F-Year 2025:(dec the 31st)➤ **year credits accounting:**

167		Debts incurred on rent	306,048.70	
4456		State: Tax on business turnover	58,149.25	

661	512	Rights of the state: interests Banks Current accounts	92,655.77	398,704.47
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➤ **Accounting for depreciation:**

681	2815	Provisions for depreciation, amortization, and impairment losses Technical facilities, equipment, and industrial tools	642,333.10	642,333.10
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In the end, the farmer keeps the machine and the accounting is as follows:

167		Debts incurred on rent	xxx	
4456		State: Tax on business turnover	xxx	
	512	Banks Current accounts		xxx

3-1-2-The accounting for the Agricultural Bank and Rural Development BADR:

At the Bank of Agriculture and Rural Development level, the customer's file that benefits from agricultural equipment is treated as follows in terms of accounting:

Contract commencement date: December 25, 2019

A- Bank commitment:

9021	99031	Financing commitments Other commitments to finance customer needs	1,378,601.61	1,378,601.61
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B-Actual granting of the loan 02/11/2020:

99031		Other commitments to finance customer needs	1,378,601.61	
	9021	Financing commitments		1,378,601.61
366		Leasing financing for agricultural equipment	1,378,601.61	
300		Customers	306,048.39	
	777...	Check supplies		1,684,650.00

C- Accounting of the payment amount:

120...	702...	Financing commitments Other commitments to finance	398,704.47	398,704.47
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		customer needs		
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D- Collection of payment at the end of the contract:

Ownership will be transferred on 12/31/2025 to the farmer.

300		Customers Equipment provided in the form of a lease loan	1,927,000.00	1,927,000.00
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Accounting treatment of lease contracts in financial statements:

3-2-Lessee balance sheet:

Agricultural machinery shall be disclosed in the balance sheet assets as if it were owned by the lessee, with an explanation of its accumulated depreciation.

Table No. (02): Inclusion of lease contracts in the balance sheet

Assets		Liabilities	
Fixed assets		Current liabilities	
Agricultural machinery	1,927,000.00	Lease obligations	1,993,522.37
(Depreciation)	(1,734,300.00)	Non-current liabilities	
Leased assets		Total liabilities	
Total assets	xxx	Current liabilities	xxx

Source: Prepared by the researcher based on the information provided from the BADR bank.

3-3-Lessee income statement table:

Table No. (03): Inclusion of lease contracts in income statements

Depreciation and impairment provisions	1,734,300.00
Operating result	xxx
Financial income	
Financial expenses (interest expenses arising from lease agreements)	308,872.06
Financial result	xxx

Source: Prepared by the researcher based on the information provided from the BADR bank.

4-Conclusion:

The aim of this study was to determine the extent to which Algerian banks apply accounting standards, particularly IFRS 16 on leases. We conducted a field study at the Bank of Agriculture and Rural Development and arrived at the following conclusions:

- Banks grant lease loans with terms and conditions that comply with IFRS 16 on leases.
- The accounting treatment of lease loans is the same as that stipulated by international accounting standards;
- We can therefore conclude that Algerian banks apply IFRS 16.

Testing Assumptions:

After studying many parts of the topic, the following findings were obtained on the testing of assumptions:

- Based on specific indicators, leases must first be classified as finance leases and subsequently as operating leases in compliance with the financial accounting system modeled after International Accounting Standard IAS 17. However, for accounting purposes, the lessee now treats all leases as finance leases in accordance with IFRS 16.
- Yes, leasing contracts are regarded a source of financing in Algerian banks, in compliance with IFRS 16, according to a field research conducted at the Bank of Agriculture and Rural Development.

Recommendations:

Based on the findings of this study, we can make a number of recommendations, the most important of which are:

- The accounting and financial regulations and rules applicable to Algerian banks should be amended to make them more flexible in order to best meet customer requirements.
- Standardize accounting terms when translating them from French and English into Arabic.
- Encourage companies to prepare early for the implementation of IFRS 16 by reviewing the classification of assets according to the requirements of the new standard.

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