# Forthcoming New IFRS on *Leases**Public Survey: Impact on Financial Covenants in Loan Agreements*

|  |
| --- |
| **Privacy statement**EFRAG staff will aggregate the results of all the questionnaires received in a summary report but the individual responses will not be on the public record. However, a list of respondents will be included as an appendix. If you explicitly request it, the name of your company will not be included on this list.EFRAG, the IASB and your National Standard Setter, if applicable, will have access to your response to this questionnaire. Your response, omitting any information that would identify you and your company, will be also shared with other national standard setters participating in the exercise and the European Commission (i.e. participants’ identity will remain confidential). |

**Table of contents**

[Background 2](#_Toc425271353)

[Presentation of lease assets, liabilities, expenses and cash flows 2](#_Toc425271354)

[What you are invited to do 3](#_Toc425271355)

[Questions 4](#_Toc425271356)

[General information (question for all respondents) 4](#_Toc425271357)

[Questions for lenders 4](#_Toc425271358)

[Question for respondents who are not lenders 7](#_Toc425271359)

## Background

1. The IASB has completed its decision-making with respect to revising the existing lease accounting requirements*[[1]](#footnote-2)*. The new *Leases* Standard is expected to be issued before the end of 2015. The main change compared to the existing requirements in IAS 17 *Leases* is that lessees will be required to recognise assets and liabilities for all identified leases (whereas, under IAS 17, assets and liabilities are recognised only for finance leases)[[2]](#footnote-3). The amount of newly recognised assets and liabilities is expected to be significant for many entities.
2. Questions have been raised about the possible impact of the new IFRS on *Leases* on financial covenants in loan agreements. This is because such covenants may use ratios that refer to measures such as ‘debt’, ‘net financial position’, ‘interest cover’ or other non-GAAP measures such as EBITDA. When these ratios are based on figures reported in accordance with IFRS, the recognition of existing off-balance sheet leases on a lessee’s balance sheet is likely to affect these ratios (if leasing is material to the lessee). Accordingly, if the ratios are calculated using the new IFRS numbers some entities may find themselves in breach of their covenants. Other measures calculated on the basis of information reported in accordance with IFRS, such as EBITDA, will also be affected by the new IFRS on *Leases*. For instance, EBITDA will increase because of the reclassification of the current operating lease expense and interest cover ratio is likely to decrease.
3. However, it is unclear how many financial covenants will be affected in practice because many of those covenants may not be calculated on the basis of figures reported in accordance with IFRS. For example, if financial covenants are already adjusted to take account of off-balance sheet lease commitments, the impact of the new IFRS on *Leases* will be more limited although it will not necessarily be neutral because the measurement under the new IFRS on Leases may not be the same as the current adjustments being made. Similarly, if financial covenants are based on ‘frozen GAAP’ (i.e. accounting standards effective at the date of the loan agreement), the new IFRS on *Leases* will not have a direct effect on those covenants.
4. EFRAG, the IASB and the National Standard Setters ofFrance, Germany, Italy, Lithuania and the UKare interested in quantitative and qualitative information about how covenants are determined in Europe. The objective is to better understand the effect that the new IFRS on *Leases* might have on those covenants by better understanding the extent to which covenants are based on figures reported in accordance with IFRS.

## Presentation of lease assets, liabilities, expenses and cash flows

1. According to the new IFRS on *Leases* (IASB model), a lessee will present:
	1. Lease assets either as a separate line item in the balance sheet or together with property, plant and equipment.
	2. Lease liabilities (which are financial liabilities) in accordance with IAS 1 *Presentation of Financial Statements*. This means either presenting them as a separate line item or including them in another relevant line item (together with disclosing the amount and the line item within which they are presented). IAS 1 lists amongst others items such as ‘trade and other payables’, ‘provisions’ and ‘financial liabilities’ as separate line items to be included in an entity’s balance sheet. It also requires presentation of additional line items, including disaggregating the items mentioned above, when such presentation is relevant to understanding the entity’s financial position.
2. Regarding the presentation of lease expenses, a lessee will present interest on lease liabilities within finance (interest) costs and the amortisation of lease assets typically within the same line item as depreciation of property, plant and equipment (that is generally within operating expenses).
3. Regarding the presentation of cash flows, a lessee will present the principal portion of cash payments on leases as part of the financing activities in the statement of cash flows, while the interest portion of payments will be presented either as operating or financing activities in accordance with the requirements relating to other interest payments. This is consistent with the general cash flow requirements of IAS 7 *Statement of Cash Flows*.
4. IFRS does not provide an explicit definition of ‘debt’, ‘net debt’, ‘EBITDA’ or similar measures.
5. For additional information about the likely effects of the new IFRS on *Leases* on the financial statements of lessees, please refer to [IASB Leases Project Update - March 2015.](http://www.ifrs.org/Current-Projects/IASB-Projects/Leases/Documents/Practical-implications-Leases-Standard-Project-Update-March-2015.pdf)

## What you are invited to do

1. You are asked to reply to the questions detailed on pages 4 to 7 below. All respondents are asked to answer question 1. Lenders are asked to answer questions 2 to 9 and other respondents are asked to answer question 10.
2. Please document your observations and findings in English in the sections specified. Replies are to be sent to **lease\_in\_covenants@efrag.org***.* You are kindly asked to copy in your reply the contact person of the national standard setter in your country, when available (as per the table below).
3. Participants may choose not to respond to all the questions. In the conclusions to be drawn from this public survey, more weight will be given to responses that are substantiated by facts and analysis.
4. Participants are requested to submit their replies not later than on 30 September 2015.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| ***Country*** | ***Contact*** | ***Contact name*** | ***Phone number*** | ***E-mail address*** |
|  | IASB | Patrina Buchanan | +44(0)2072466468 | pbuchanan@ifrs.org  |
|  | EFRAG | Robert Stojek | +32(0)2-2104404 | robert.stojek@efrag.org  |
| France | ANC | Angélique Courtade-Benlian | +33(0)1-53442983 | angelique.courtade-benlian@anc.gouv.fr |
| Germany | DRSC | Peter Zimniok | +49(0)30-206412-19 | zimniok@drsc.de |
| Italy | OIC | Federica Girolami | +39/06/69766835 | fgirolami@fondazioneoic.it |
| Lithuania | ATT | Kristina Volodkovic | +370-5 212 5464 | k.volodkovic@aat.lt |
| UK | UK FRC | Annette Davis | +44(0)2074922322 | A.Davis@frc.org.uk |

## Questions

### General information (question for all respondents)

Q1. Please provide the following details about your company:

1. Your name or, if you are responding on behalf of an organisation or a company, its name:

|  |
| --- |
|  |

1. Are you:

[ ]  Lender [ ]  User of financial statements [ ]  Preparer [ ]  Other (please specify)

1. Please provide a short description of your activity:

|  |
| --- |
|  |

1. Country where you are located:

|  |
| --- |
|  |

1. Contact details including email address:

|  |
| --- |
|  |

### Questions for lenders

|  |  |  |
| --- | --- | --- |
|  | Yes | No |
| Q2. Do covenants use non-accounting based measures (e.g. based on legal or operating conditions only)? | \_\_\_ | \_\_\_ |
| In what cases / circumstances? Please describe:  |

|  |  |  |
| --- | --- | --- |
|  | Yes | No |
| Q3. Do covenants use accounting-based measures based on IFRS financial statements? | \_\_\_ | \_\_\_ |
| If yes, are covenants calculated on a ‘frozen GAAP' basis (that is they are not based on currently effective Standards but on Standards effective at the date of the loan agreement)? | \_\_\_ | \_\_\_ |
| Do they adjust liabilities for operating lease commitments? | \_\_\_ | \_\_\_ |
| Please provide the details:  |
| Do they adjust profit or loss for the effects of operating leases? | \_\_\_ | \_\_\_ |
| Please provide the details:  |

|  |  |  |
| --- | --- | --- |
|  | Yes | No |
| Q4. Do covenants use accounting-based measures based on National-GAAP? | \_\_\_ | \_\_\_ |
| If yes, are covenants calculated on a ‘frozen GAAP' basis (that is they are not based on currently effective Standards but on Standards effective at the date of the loan agreement)? | \_\_\_ | \_\_\_ |
| Do they adjust liabilities for operating lease commitments? | \_\_\_ | \_\_\_ |
| Please provide the details:  |
| Do they adjust profit or loss for the effects of operating leases? | \_\_\_ | \_\_\_ |
| Please provide the details:  |

|  |  |  |
| --- | --- | --- |
|  | Yes | No |
| Q5. If covenants use accounting-based measures based on reported figures, are covenants based on the individual/separate financial statements of the borrower (that is based not on group/consolidated financial statements)? | \_\_\_ | \_\_\_ |

|  |  |  |
| --- | --- | --- |
|  | Yes | No |
| Q6. Do you apply the same type of covenants for all clients?  | \_\_\_ | \_\_\_ |
| If not, do you apply different type of covenants based on: |  |  |
| The size of the loan? | \_\_\_ | \_\_\_ |
| The size of the client? | \_\_\_ | \_\_\_ |
| The type of client (e.g. listed/not listed, industry, rating, the standards applied by the client – IFRS, national GAAP)? | \_\_\_ | \_\_\_ |
| Please specify the categories used:  |

Q7. If you apply different types of covenants, please provide an indication of:

* 1. The reasons for doing so:

|  |
| --- |
|  |

* 1. The proportion of each type of covenant used. Please specify how you determined the proportion:

|  |
| --- |
|  |

Q8. What do you typically do if accounting requirements change?

|  |  |  |
| --- | --- | --- |
|  | Yes | No |
| Not applicable – covenants do not use accounting measures or are based on ‘frozen GAAP’ | \_\_\_ | \_\_\_ |
| Covenants are automatically adjusted to reflect the changes | \_\_\_ | \_\_\_ |
| Covenants are re-negotiated | \_\_\_ | \_\_\_ |
| Changes are considered when assessing covenants | \_\_\_ | \_\_\_ |
| Strict compliance approach is adopted (that is financial covenants are continued to be applied without adjustments) | \_\_\_ | \_\_\_ |
| Other, please explain:  |
| If different approaches are applied, please explain the reason:  |

Q9. Are you planning on changing your approach to covenants as a result of the new IFRS on *Leases?* Please explain.

|  |
| --- |
|  |

### Question for respondents who are not lenders

Q10. Based on your experience:

|  |  |  |
| --- | --- | --- |
|  | Yes | No |
| Covenants do not use measures based on the financial statements? | \_\_\_ | \_\_\_ |
| Covenants use accounting-based measures based on figures reported in the financial statements (e.g. in accordance with IFRS or National GAAP)? | \_\_\_ | \_\_\_ |
| Covenants are calculated using ‘frozen GAAP' basis – that is based on accounting Standards effective at the date of the loan agreement?  | \_\_\_ | \_\_\_ |
| Covenants use accounting-based measures or are calculated using ‘frozen GAAP’) adjusted to include off-balance sheet (operating) lease commitments? | \_\_\_ | \_\_\_ |
| Covenants are re-negotiated when there are changes to accounting standards? | \_\_\_ | \_\_\_ |

1. The only decision that the IASB has not yet made relates to the effective date of the new IFRS on *Leases*, which it will decide upon later in 2015. [↑](#footnote-ref-2)
2. Under the new IFRS on *Leases*, entities will be able to choose not to recognise assets and liabilities for short-term leases (leases of 12 months or less) and leases of small items (e.g. leases of laptops and office furniture). [↑](#footnote-ref-3)