Time is running out to review banking covenants

Q1 Does your institution have a borrowing facility?

Q2 Do your borrowing agreements include covenants?

Q3 Have you converted your financial statements to the new SORP format and/or produced forecasts in the new format?

Q4 Do you know whether FRS102 will affect your covenants?

Q5 If you are a "yes, yes, yes, yes" to Q1-4, have you discussed the impact on your banking covenants with your bankers?

If the answer to Q5 is "no", or "not yet", you may want to clear this issue up sooner rather than later. The banks do not need audited accounts to review covenants, and if your case is straightforward, the whole matter can be dealt with quickly and painlessly.

If your answers to Q1 -3 are "yes, yes, yes" but a "no" to Q4, you, and your bankers have some fancy footwork to do soon. You are most of the way there but you and your bankers need to review covenants against your restated figures. It shouldn't take too long, and should be one less worry around year-end and audit season.

If you are in the "yes, yes, no, no" camp, you're a bit behind and need to get cracking to avoid being at the back of the queue for a discussion with your bank. It's urgent now, with three months left until year-end and the arrival of auditors shortly afterwards. Don't let your covenants get a mention in a management letter.

Accounting terms are changing – many existing covenants use out-dated terminology and refer to metrics that no longer work with the new SORP. Whatever your covenants are, it's time to check they are up-to-date and still relevant.

Banking and borrowing terms need not change for the worse and banks are working on the basis of mutual consent to any changes and agreement of definitions and levels that aim for no impact on commercial terms. The banks are not aiming to impose the same covenants on everyone.

What happens if you don't review your covenants in time?

There are provisions in most borrowing agreements to accommodate accounting changes, but lenders want to engage borrowers to find new mutually agreeable financial covenant suites.

New financial covenants should be agreed before 31st July 2016 – the process could be quite lengthy and borrowers could consider "frozen GAAP" to avoid rushed agreements. This means that the borrowing covenants will be calculated using the accounting principles that were in place at the time the original agreement was signed, not as they have evolved over time. But borrowers can't just decide to do this without talking to their lender first.

If you want to use this opportunity to review commercial terms, increase or decrease facilities, or align covenants across facilities, your case could be more complicated and your lenders, and possibly your legal advisers, will need more time. Don't leave it too late – call your bank relationship manager now!

This article is based on a longer piece written by Rich Robinson of Barclays Bank .

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