ASC 842's Unexpected Effect: Lenders Are Rewriting Covenant Playbooks

What Accountants and Financial Executives Need to Know

By Jiayin Li and Alexander J. Sannella

Consider a CFO preparing to renew a long-standing credit facility. The company is performing well. Revenue is growing. Cash flows remain strong. Management expects the renewal process to be straightforward. Yet discussions with lenders quickly turn toward leverage ratios, debt metrics, and balance-sheet strength. Questions that once focused on earnings performance and coverage ratios now center on liabilities and capital structure.

What changed? For many companies, the answer is ASC 842.

When the Financial Accounting Standards Board required companies to recognize operating leases on the balance sheet, most attention focused on compliance. Companies devoted substantial resources to identifying lease populations, implementing systems, and calculating right-of-use assets and lease liabilities. Far less attention was devoted to how lenders might react once those obligations became visible on corporate balance sheets.

What many finance executives did not anticipate was that lenders would respond to the new accounting information by changing the way they structure loan agreements. The implications extend beyond financial reporting. Lease accounting increasingly affects debt negotiations, covenant design, borrowing flexibility, and capital planning. For CFOs, controllers, auditors, and advisers, understanding ASC 842 is no longer simply a financial reporting exercise. It is becoming an important part of understanding how lenders evaluate risk and allocate control rights in modern loan agreements.

Recognition did not merely change presentation; it changed the covenant metrics lenders chose to monitor.

The central finding of our research is that ASC 842 changed more than where lease obligations appear in the financial statements. Once operating lease liabilities were recognized on the balance sheet, lenders adjusted the types of covenants they relied on in new loan agreements. Rather than imposing more covenants overall, they shifted monitoring toward balance-sheet measures, particularly leverage-related metrics that capture debt capacity, liabilities, and financial position. Exhibit 1 summarizes the research design underlying this finding.

EXHIBIT 1

Research Design and Sample

Research element	Focus	Summary
Purpose	**Identification**	Tested whether loan-contract changes were associated with ASC 842 implementation rather than unrelated borrower differences or a general trend in lending contracts.
Sample and data	**2010–2019**	Examined U.S. syndicated loans from Dealscan, linked to borrower financial information in Compustat and lease disclosures from Calcbench.
Sample size	**1,117 deals**	Principal covenant sample included 1,117 deal-year observations from 774 unique borrowers; main regressions used 1,114 observations after exclusions.
Method	**DiD design**	Compared changes in new loan contracts for 2019 ASC 842 adopters with changes for firms that had not yet adopted the standard.
Controls	**Borrower, loan**	Accounted for borrower characteristics, loan characteristics, industry effects, and year effects.
Robustness checks	**Sensitivity**	Used alternative covenant measures, matched samples, pre-implementation timing tests, and analyses of larger lease obligations and higher-quality reporting.

With that research design in mind, the key question is whether recognition changed lender behavior in practice.

A Longstanding Debate

Before ASC 842, operating leases occupied a unique position in financial reporting. Companies disclosed lease commitments in footnotes, but most operating lease obligations did not appear directly on the balance sheet. Critics argued that this approach allowed significant financing obligations to remain less visible than traditional debt. Supporters countered that sophisticated users, particularly lenders and credit analysts, already incorporated lease obligations into their evaluations through footnote analysis and financial statement adjustments.

ASC 842 largely resolved that debate by requiring most lease obligations to be recognized as liabilities. However, implementation created a new question: Would recognition actually change lender behavior? Many practitioners assumed it would not. Our evidence suggests otherwise.

What We Found

Following adoption, lenders increased their use of balance-sheet-based covenants while reducing their reliance on income-statement-based covenants. Balance-sheet covenants commonly include leverage ratios, debt-to-equity ratios, debt-to-net-worth ratios, and other metrics tied directly to liabilities and financial position. Income-statement covenants frequently include interest coverage, fixed-charge coverage, and debt-service coverage measures.

Perhaps most importantly, lenders did not broadly increase contractual restrictions. The overall use of covenants remained largely unchanged. Instead, lenders changed what they chose to monitor. The result was not widespread contractual tightening. It was a reallocation of monitoring.

Why Recognition Matters

The findings raise a broader question: Does recognition matter when users already have access to disclosure? Economically, the lease obligations existed before and after ASC 842. The accounting treatment changed, but the contractual commitments did not. Nevertheless, recognition appears to have influenced contractual design.

Prior to ASC 842, lenders could estimate lease obligations using footnote disclosures, assumptions about discount rates, and present-value calculations. After ASC 842, standardized liabilities appeared directly on the balance sheet. The information became easier to observe, compare, and incorporate into covenant definitions.

Lenders Are Paying Attention to Leverage

The strongest changes occurred among leverage-related provisions. Lenders became more likely to monitor debt burdens, liabilities, and overall capital structure through contractual restrictions. Because ASC 842 directly affects recognized liabilities, lenders appear to focus on covenant provisions closest to debt capacity and financial obligations.

Companies negotiating new credit facilities should review covenant definitions carefully and model the effect of lease renewals, modifications, and future leasing before lender discussions.

Material Lease Obligations Receive Greater Scrutiny

The shift toward balance-sheet-based monitoring was strongest among firms with larger recognized lease obligations. Lease-heavy companies therefore drew the greatest lender attention. This finding is particularly relevant for retail, transportation and logistics, hospitality, health care, manufacturing, and other real estate- or equipment-intensive businesses.

As management evaluates expansion, new facilities, equipment acquisitions, or lease-versus-buy decisions, covenant implications deserve consideration alongside accounting consequences.

Reporting Quality Influences Lender Behavior

The shift toward balance-sheet-based monitoring was stronger among companies with higher-quality financial reporting. It was weaker among firms reporting material internal control weaknesses.

Strong lease accounting processes, documentation, governance, and internal controls may therefore contribute not only to compliance but also to more effective lender relationships.

The Good News: No Evidence of Widespread Lending Disruption

Borrowing costs increased modestly. However, the analysis found no significant changes in loan amendment activity, loan maturity, or measures of financial reporting quality. These findings suggest lenders largely adapted to the new accounting environment rather than treating lease capitalization as evidence of dramatically higher economic risk. ASC 842 changed monitoring practices more than it changed lending relationships.

Another Important Change: Capital Expenditure Restrictions

After implementation of ASC 842, lenders became more likely to include capital expenditure restrictions in new loan agreements. One explanation is that operating leases lost part of their historical reporting advantage once lease obligations appeared on the balance sheet. If companies become more inclined to purchase assets rather than lease them, lenders may respond by restricting capital spending.

The result demonstrates that ASC 842 can affect investment behavior, financing strategies, and creditor monitoring mechanisms.

Exhibit 2 summarizes the main debt-contracting effects of ASC 842 and the related implications for finance leaders.

Why This Matters Now

Many organizations have completed their initial ASC 842 implementation projects, but lease accounting remains highly relevant. ASC 842 is no longer simply an accounting standard. It has become part of the debt-contracting environment in which companies operate.

Organizations evaluating expansion initiatives, new facilities, equipment acquisitions, lease renewals, lease-versus-buy decisions, or credit facility renewals should assess covenant implications alongside accounting consequences.

Exhibit 3 offers CFOs a practical checklist for evaluating covenant implications before renewing or renegotiating credit facilities.

EXHIBIT 2

ASC 842's Impact on Debt Contracting

Summary of findings and practitioner implications

Area	Observed change	Practical implication
Balance-sheet covenants	**Increased**	More reliance on leverage and debt measures.
Income-statement covenants	**Decreased**	Less emphasis on coverage and performance measures.
Overall covenant restrictions	**Largely unchanged**	The mix changed without broad tightening.
Leverage-related provisions	**Increased the most**	Debt capacity receives greater attention.
Large lease obligations	**Stronger effect**	Leasing matters more in negotiations.
Higher-quality reporting	**Stronger effect**	Credibility influences lender reliance.
Capital expenditure restrictions	**Increased**	More oversight of investment activity.
Loan pricing	**Increased modestly**	Some effects appear in borrowing costs.
Loan amendments and maturities	**No significant change**	No evidence of widespread disruption.

EXHIBIT 3

Five Questions CFOs Should Ask When Renegotiating Covenants After ASC 842

A practical pre-negotiation checklist

#	Question and action
1	**Which covenant calculations explicitly include lease liabilities?** Determine whether recognized lease obligations affect leverage calculations, debt ratios, net worth measures, or defined indebtedness.
2	**Have covenant definitions changed since the last agreement?** Compare proposed definitions with prior agreements and identify provisions added or revised following ASC 842.
3	**How much covenant headroom remains?** Recalculate compliance cushions using current lease balances, expected renewals, and planned lease activity.
4	**Will future leasing decisions affect borrowing flexibility?** Model the effects of major leases, renewals, modifications, and lease-versus-buy decisions.
5	**Are internal controls strong enough to support lender confidence?** Ensure lease data, assumptions, reconciliations, approvals, and disclosures are supported by reliable systems and documented controls.

The Bottom Line

ASC 842 did more than change financial statement presentation. It changed how lenders use accounting information.

Rather than broadly increasing contractual restrictions, lenders shifted monitoring toward balance-sheet measures, especially leverage-related metrics. The effect was strongest when lease obligations were substantial and reporting was reliable. Finance leaders should not view ASC 842 as a completed implementation project. Organizations that understand the financing implications before entering lender discussions will be better positioned to negotiate effectively and avoid surprises.

What Finance Teams Should Do Now

For CFOs, the practical takeaway is to treat ASC 842 as part of the financing strategy, not merely as an accounting compliance matter. Before renewing or negotiating credit facilities, finance leaders should confirm how operating lease liabilities flow through each covenant definition, stress-test covenant headroom under current and planned lease activity and assess whether major lease-versus-buy decisions could affect borrowing capacity. CFOs should also ensure that accounting, treasury, legal, and operations are aligned before committing to significant leases, and that lease data, assumptions, modifications, and disclosures are supported by controls lenders can rely on.

When lease activity may materially affect covenant calculations, proactive lender communication can help preserve negotiating flexibility and reduce the risk of surprises late in the process. The companies best prepared for the next credit discussion will be those that can explain, before lenders ask, how lease decisions affect covenant compliance, debt capacity, and financial flexibility.

This study also contributes to research on financial reporting and debt contracting by showing that recognition can change contractual outcomes even when the underlying obligations were previously disclosed. ASC 842 did not simply make lease obligations more visible; it affected the mechanisms through which lenders incorporated accounting information into covenant design, capital expenditure restrictions, and borrower monitoring. The evidence underscores the practical importance of the distinction between recognition and disclosure and shows how reporting quality can shape creditor reliance on financial statement information.

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