

**The DCS Covenant Manager<sup>SM</sup>: A Best-in-Class Debt Compliance Process**

In January 2017, a Big Four accounting firm audited the debt compliance of a client, one of the five largest utilities in the United States. The lead manager reported to the treasurer that the company had a best-in-class debt compliance process. That judgment speaks to the value provided by the DCS Covenant Manager<sup>SM</sup> with its complete audit trail. Here is what we do for our clients.

**A Risk-Based, Categorized Covenant Checklist**

The core of our process is a risk-based, consolidated checklist of all active covenants in all of the company's unique agreements. Figure 1 shows how the checklist drives the questionnaire process of the DCS Compliance Manager<sup>SM</sup>, the required debt deliverable process of the DCS Calendar Manager<sup>SM</sup> and the permitted basket analysis of the DCS Debt Manager<sup>SM</sup>.

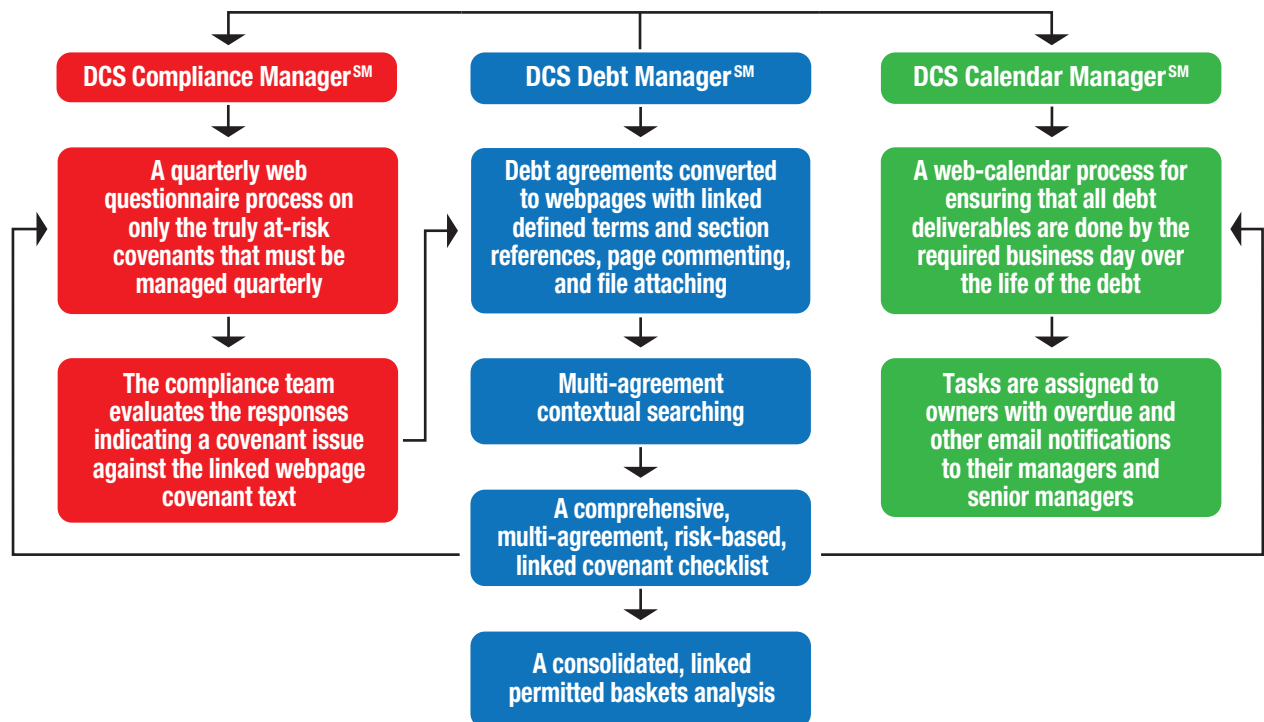
Our checklist includes every active requirement the borrower faces, no matter how insignificant, whose

failure to comply would give the lender the right to call it a default. Every covenant is a categorized section reference with at least one question about the company's compliance with the section's requirements.

We categorize covenants and their questions by the lender's objective in imposing them, such as: Retain Collateral, Maintain Status Quo, Minimize Claims, Make Payments, Preserve Assets, etc. These logical objectives facilitate accurately identifying controlling and similar or subordinated covenants in multiple agreements.

We also identify the independent covenants that trigger dependent covenants, covenants that are not effective until the event of the independent covenant occurs. For example, asset sales trigger the dependent covenants of notification, a reinvestment plan, notification of the investment made, and mandatory prepayment.

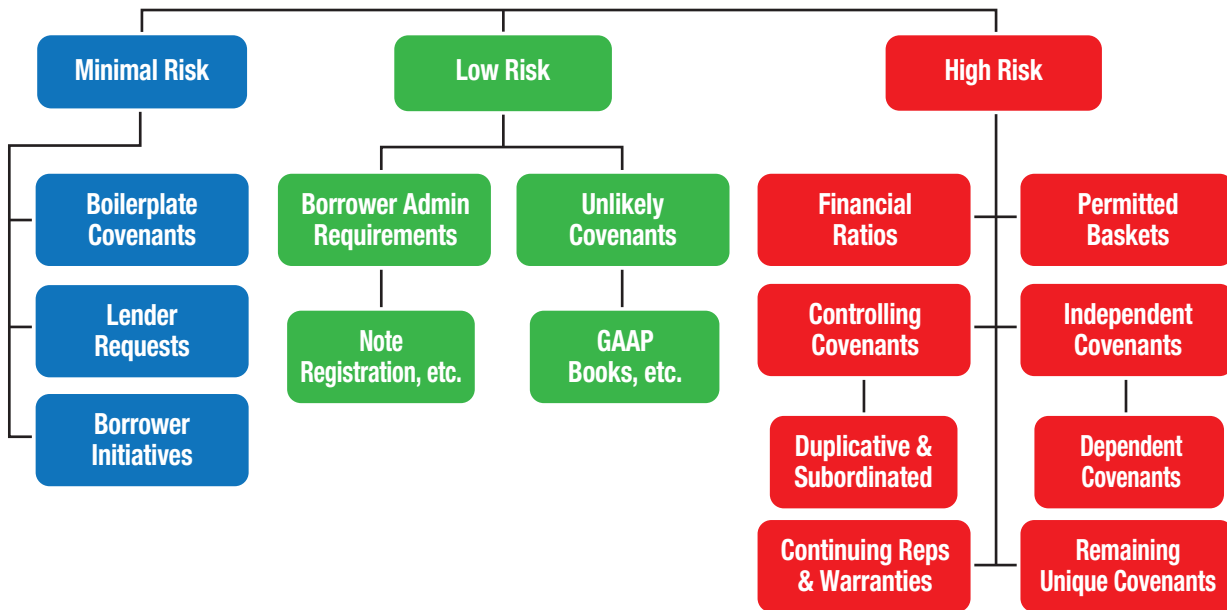
**Figure 1: The DCS Covenant Manager<sup>SM</sup>**



**Evaluating Covenant Risk**

Figure 2 shows how we evaluate covenant risk using the default cure periods and covenant type:

**Figure 2: Covenant Risk Analysis**

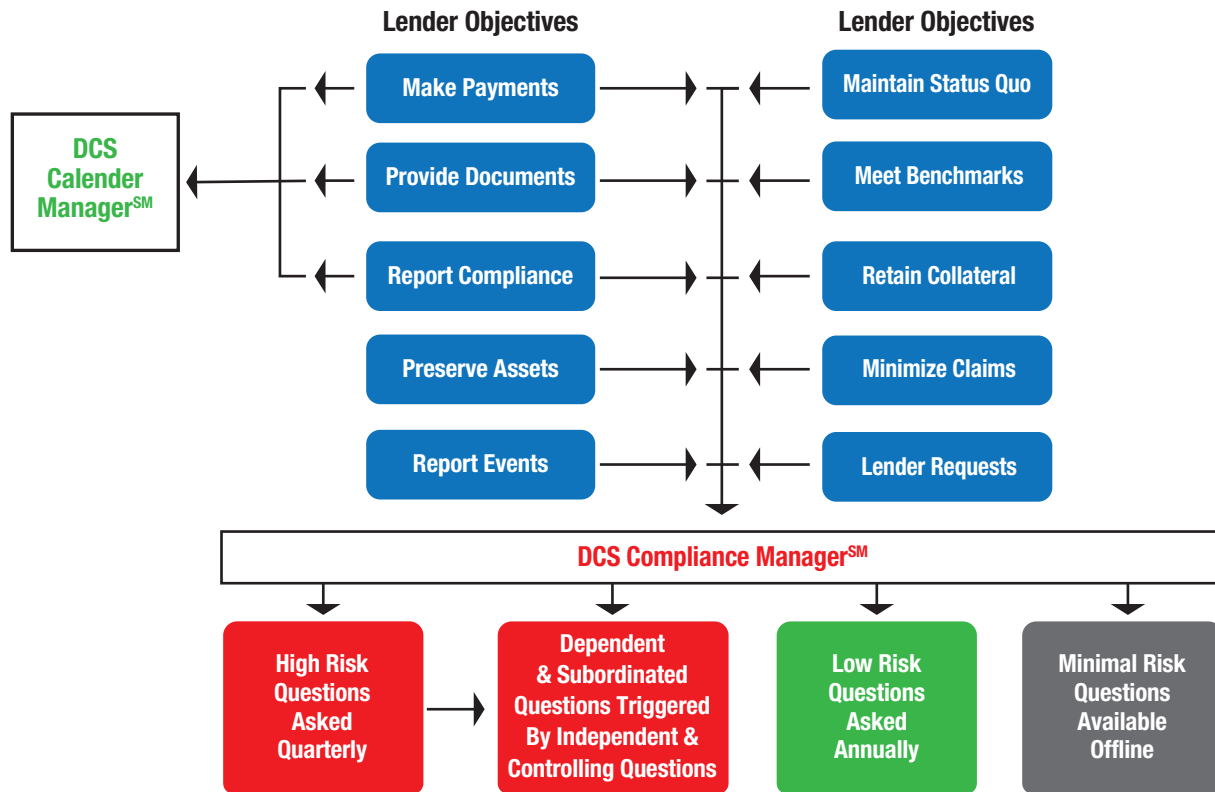


**Writing, Linking and Allocating Questions**

Each question is written in understandable English in a yes or no format asking whether the covenant's event or requirement happened or not. To be legally precise, we use the covenant's defined terms in the questions. The defined term is shown with a dotted underline that clicks open to a pop-up box with the term's actual definition. In addition, all the questions link back to their covenant text in the DCS Debt Manager<sup>SM</sup> in case the respondent needs further clarification.

Controlling and independent covenant questions are usually high risk and asked quarterly. Their subordinated and dependent questions are put into inactive questionnaires that are automatically activated when there are negative responses to their respective controlling or independent questions. Similarly, the minimal risk questions are available but not always asked. Figure 3 on the next page shows how we use lender objectives and these distinctions to structure the questionnaires in the DCS Compliance Manager<sup>SM</sup> and the calendar items in the DCS Calendar Manager<sup>SM</sup>.

**Figure 3: Allocating Questions to the DCS Calendar Manager<sup>SM</sup> and the DCS Compliance Manager<sup>SM</sup>**



**Reporting Questionnaire Responses**

Depending upon the agreement, covenants may apply to the consolidated group or specific group entities. The client allocates all covenant questions by the applicable entity by respondents and reviewers knowledgeable about that entity’s compliance with the covenants.

All questionnaire reports link the questions and their responses to their debt agreement covenant text in the DCS Debt Manager<sup>SM</sup>. The compliance team uses the General Report, the Questions with Different Answers Report and the Two Quarter Issue Comparison Report to ensure that the questions have been fully and accurately answered, referring as necessary to detailed requirements and exceptions of the actual covenant text.

**Evaluating Covenant Issues**

In the Issues Evaluation Report, the compliance team evaluates the issues generated by the responses

against their interpretation of the covenant text. This is the gold standard of debt compliance, rather than against some necessarily incomplete summary of the covenant. Some issues will be evaluated as nice to know but minor, some might need to be monitored or managed going forward, and some may need to be discussed with the treasurer, the general counsel, the CFO and possibly the lenders.

**Powerful Linking and Contextual Search**

Assisting in this interpretation process — or in any other researching of the debt agreements — are the DCS Debt Manager<sup>SM</sup>’s powerful linking and searching capabilities. Every agreement is converted into webpages that link all defined terms and section references. Each webpage includes an index showing where the page’s defined term or section is used elsewhere in the agreement. The DCS Debt Manager<sup>SM</sup> has a powerful contextual search engine that allows searching issues across multiple agreements and quickly identifying relevant pages.

### **A Complete Audit Trail**

For the auditors, the Audit Trail Report provides a complete audit trail of the quarter's compliance work. It shows all of the covenants; all of their questions; how those questions were allocated to active and inactive questionnaires by unit, respondent and reviewer; how they were answered or not answered; and how the responses were assessed in the Issue Evaluation Report. This report and all other questionnaire and calendar reports are available at any time for historic quarters.

For many covenants, a company will be able to show satisfactory evidence of compliance with the documented review by the compliance team's evaluations of the responses. However, positive assertions to questions posed in the quarterly questionnaires about compliance with the requirements for document delivery and payments, permitted basket amounts and financial ratio limits are not by themselves satisfactory evidence of compliance.

The Completed Tasks Report in the DCS Calendar Manager<sup>SM</sup> provides an audit trail of how the required documents and payments were delivered on time. The company prepares the spreadsheets calculating the quarter's basket amounts and ratios. Completing the audit trail, these spreadsheets are stored with the executed Officer's Certificate in the Compliance Archive of the DCS Debt Manager<sup>SM</sup> with any other important compliance work papers.

### **Pricing**

Prepaid service fees and the annual service fee pricing is a function of the number and complexity of the debt agreements and the Managers requested. Each Big 4 auditor has issued opinions supporting capitalizing the prepaid service fees over the life of our SaaS service agreement. There is no seat charge. We have clients with nearly 100 users worldwide.

### **For More Information**

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