Factoring

A Training Guide to Secured Financing

Eleventh Edition

by

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- The Commercial Finance Institute

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Table of Contents

Introduction to Factoring

Factoring has been a common form of financing for thousands of years. Evidence suggests that it's origin may have started more than 4500 years ago during Babylonian times. Further evidence supporting this theory is a written assignment of a debt on a "tablet" dating back to the period between 455 BC and 403 BC. Many historians believe it began in the agricultural industry and migrated into other trades.

Factoring immigrated to the United States sometime in the sixteenth century between the new colonies and merchant bankers in Europe. Because transportation was slow, merchants on both continents had to appoint agents in the territory. These agents held merchandise on consignment, identified buyers and delivered the goods on behalf of the seller. These agents became known as "mercantile agents" and eventually began guaranteeing payment to the seller. These mercantile agents began to accumulate vast amounts of wealth and eventually began to offer sellers an early "advance." This was the beginning of the modern day factor.

Factoring rose to a prominent position during the industrial revolution in the apparel, textile and furniture manufacturing industries. In the late 1970's factors began their expansion into other industries. Today, factors provide the desperately needed cash flow to virtually every industry imaginable.

What is Factoring?

Factoring is a very simple process that is utilized by millions of businesses every hour of every day around the world. Each time you use a credit card the merchant accepting the card is taking a discount on the sales price to receive immediate cash from the credit card issuer.

Factoring as it relates to commercial finance is simply a business that is discounting an invoice from its face value, in exchange for immediate cash. Once a business has supplied a product or service to a creditworthy business, they now have a negotiable instrument to assign (the invoice).

Example 1.

Sample Company, Inc.

Outstanding Accounts Receivables

Customer	1-30	31-60	61-90	91+	Total
Walmart®	168,256.32	258,235.36	58,269.32	17,256.33	503,017.33
KB Toys®	89,789.00	107,126.33	29,256.36	7,256.99	233,428.68
Target®	101,256.00	211,588.21	348,269.33	43,569.63	704,683.17
K-mart®	24,569.00	48,555.24	8.633.75	0	81,757.99
Total	383,870.32	625,505.14	444,428.76	68,082.95	**1,522,887.**

Sample Company, Inc., is a manufacturer of toys. Due to historical operational losses over the last 2 years (result of a poorly selling product line) and a deficit net worth, their bank has asked them to retire their term loan of $900,000 which will require them to seek an alternative form of financing. Because Sample Company sells goods to highly creditworthy businesses, it is an excellent candidate for a factoring facility.

Example 2.

Sample Company, Inc.

Accounts Receivables Eligibility

Total Accounts Receivable	$1,522,887
High Concentration	46.27%
Cross Age	(0)
Total Eligibility	1,522,887
Advance %	80%
Total Advance Available to Client	**$1,218,309.60**

Example 2 indicates that if the prospect was to sell its accounts receivables, it would have the capability to payoff it's existing lender and have the immediate usage of an additional $318,309.60 in cash. Sample Company would also have immediate eligibility on any new invoices generated from a going forward position which would supplement it's daily cash operating requirements.

Typical day-to-day factoring mechanics are as follows:

1. Client provides goods or services to another creditworthy business on terms.

2. Client invoices customer and provides a copy of the invoice to the factor along with any support documentation (i.e. purchase orders, contracts, bills of lading, proof of delivery, time-sheets, etc.)

3. Factor utilizes various methods to verify the validity of the invoice and debt owed.

4. Factor issues a predetermined advance to the client. In example 2, it is an 80% advance against eligible accounts.

Example 3.
Sample Company, Inc.
Advance Process

a. 80% of the face amount of each invoice is advanced to client;
b. 20% of each invoice amount is applied to a reserve account.

5. Both factor and client monitor the position and age of the invoice. Necessary receivables management functions are employed.

6. Factor receives payment from the account debtor in the normal course of business.

Example 4.
Sample Company, Inc.
Reserve Release

a. Factor receives payment from account debtor;
b. Factor takes back the initial advance amount plus all accrued fees;
c. Factor releases remaining reserve balance.

7. Process continues with each new submission of invoices.

Why Businesses Factor?

A large percentage of business to business transactions occur on terms whereas the seller is granting the buyer a certain period of time to pay for the goods or services provided. Terms can range anywhere from 5 to 120 days and everywhere in between. The problem is elementary as most business simply have more cash out-flow than incoming. Factoring solves the cash flow gap between the time a company invoices and collects payment.

Cash flow is a perpetual problem which is further fueled by the burden of credit extension. If the world operated on strictly a cash on delivery basis, there would be no need for factors. Credit extension is a necessary evil and with it comes starvation to a business without efficient and timely cash collections, cash reserves or borrowing capacity.

Most factoring candidates are unable to qualify for traditional bank loan products. Some reasons a business may not be a candidate for a traditional bank loan are:

1. Insufficient operating history. A loan candidate generally will need to have a minimum operating history of 3 to 5 years.

2. Profitability. A loan candidate must demonstrate through audited or reviewed financial statements a minimum of 3 to 5 years of profitable operating history.

3. Collateral. A loan candidate generally must have a collateral base which supports any loan request by a minimum of a 2:1 ratio. Acceptable collateral may include, accounts receivables, inventory, fixed assets, real-estate or other boot collateral that the lender deems reasonable.

4. Debt to equity. A loan candidate generally must have a debt to equity ratio above 2:1.

5. Debt service coverage. A loan candidate must factually demonstrate how the potential loan will enhance the overall business via increased sales and therefore spin-off enough in profits to pay the interest and principle that comes with the loan as well as all other operating expenses.

6. Guarantors. A loan candidate must have acceptable personal guarantors to support any loan request. The personal credit of the owners is a major factor when considering a loan request.

7. Past Bankruptcies. A loan candidate or guarantor with a bankruptcy within the last 7 to 10 years may disqualify the borrower.

8. Industry Preferences. Many banks have certain appetites for specific industries. If a loan candidate is in an industry where the lender has had a bad experience, it may be a difficult proposition.

There are many reasons beyond the short list as to why a business may not be a candidate for a traditional loan.

Factoring is a truly unique form of commercial finance as factors view the potential funding relationship from a different perspective than a bank.

Important Note

> Clarification is necessary as factoring is not a loan. Factoring is an absolute purchase of an asset. Therefore factors are not considered to be a lender and factoring clients are not considered borrowers. Proper legal definition of the relationship and parties is necessary, as factoring rates would be considered usurious under most State lending laws.

A factor may take many of the considerations listed above to heart in their decision to extend a factoring facility, however the accounts receivables are a unique animal from all other forms of collateral available.

For instance, accounts receivables represent the most liquid asset available as they can be converted to cash within a short period of time. It is this liquidity that attracts factors.

A business is a reasonable candidate for factoring as long as it can demonstrate the following:

- It is providing reasonable credit to other creditworthy businesses;
- It's accounts receivables are unencumbered;
- It has the ability to absorb or pass on the factoring fees;
- It is operationally compatible with the factor;
- Factoring will improve the company's cash position and enable it to accommodate increased sales.

Factor's have a unique relationship with their collateral and ultimately their cash exposure (risk), which can be adjusted on a day-by-bay basis by simply monitoring advances, cash collections and reserve releases. It is this level of control that gives a factor its comfort and overall incredible control in the relationship.

Factoring companies exercise a greater degree of decision making autonomy than their banking counterparts. This autonomy and flexibility allows a factor to respond rapidly to new opportunities and client needs. In a traditional lending relationship, it may take weeks or even months to approve a traditional loan. Factors are generally able to originate transactions in as little as 10 days from an initial prospect introduction. First funding's typically take between 3 to 10 business days upon receipt of executed legal documents and submission of invoices. Funding from a going forward perspective is within 24 to 48 hours of invoice verification.

With acceptable operating history, a factoring relationship can become more open-ended. A bank borrower seeking to increase it's line of credit, for example, may inevitably be required to submit new financial documentation for subsequent review by a loan committee.

Many factors operate without formal ceilings and often issue approvals for over-advances, increased credit limits, unusual payment terms or purchase order funding. If a factoring client has a unique opportunity or emergency a factor is in a better position to respond and adjust normal operating procedures to assist the client.

Factoring is an absolute sale of an asset and therefore not a loan, it allows a business to immediately increase it's cash flow without the introduction of long term debt. This therefore improves the balance sheet and debt to equity ratio among other things.

Businesses utilize the services of a factor to immediately increase their cash flow. However, the overall services a factor can provide a client reach far beyond cash flow. The ancillary services and the partnership that is ultimately formed becomes the basis for long term client retention.

Factoring is a product with a significant amount of practical "bells and whistles," which if properly implemented and carried forward in a client's business, create a solid credit and receivables management foundation. The true ancillary benefits of factoring are:

1. **Credit Screening**. Factors employ the services of outside credit reporting agencies such as Dunn & Bradstreet, Experian or other industry specific credit agencies. Many of these tools are cost prohibitive to a small company but are critical for a factor to make a credit determination. Clients have the capability to utilize a factors credit investigation services prior to the extension of any credit. It is this investigation that can help a client establish appropriate credit levels for each individual account debtor. Proper credit extension is the first line of defense against losses and bad debt.

2. **Credit Monitoring**. Factors will monitor an account debtors credit rating on a quarterly basis. Factors are looking for significant changes in the credit status which may affect the factors ability to collect the receivable. If a significant change has occurred, the client will be notified and modifications in the clients credit limit can be made.

3. **Credit Policies & Procedures**. Factors cannot enforce account debtor credit limits. A factor reserves the right to purchase only those invoices that they deem are creditworthy. Therefore if a client extends more credit than the factor deems reasonable, the client simply will not get any availability on those invoices. Most factors share their credit rational and credit experience with their clients. This allows clients to evaluate independent data and build their own credit extension procedures.

These procedures generally model the time tested and effective methods employed by a modern factor. The ultimate result is the proper amount of credit extension to an individual customer based on their overall financial condition. Proper credit extension is the key to avoiding losses or bad debt.

4. **Invoice Support**. Factors handle thousands of invoices on a daily basis and see a wide variety of invoice quality. Those invoices that match the account debtors requirements for prompt payment and those invoices that lack sufficient information or detail. Factors often share practical information and advise to their clients. The ultimate goal is to produce an invoice that matches the account debtors requirements and the terms of sale from the client. Often times, poorly generated invoices are the cause of slow payment.

5. **Effective Receivables Management.** Factors are not a collection company, nor should they replace a receivables management program that's already in place. They may supplement or enhance, but never be a replacement. In an ideal factoring relationship, a factor will become a transparent arm of the already existing functions. The client and factor will find middle ground on the management functions and work together with the ultimate goal to improve receivable collection times.

6. **Reporting.** Factors have very sophisticated software systems for the overall receivables management functions, including credit monitoring, receivables management and posting cash collections. Many of these reports exceed capabilities usually found in prepackaged accounting software and can be considerably useful for management purposes.

Advanced Topic / Writers Point of View

> Statistically more than 90% of the motivation to enter into a factoring relationship is the need to cover payroll and associated expenses and/or the need to satisfy trade creditors.
>
> \- M. Marin

Factoring provides the desperately needed cash to perhaps the broadest spectrum of businesses today. Factoring will remain a mainstream commercial finance product due to it's broad accessibility, incredible flexibility and ancillary benefits.

Factoring is a dynamic financing tool that allows businesses to effectively make quality credit decisions, increase sales and stabilize cash flow. Ultimately business owners and executives rely on factoring for it's most powerful benefit. Consistent and improved cash flow.

Ideal Candidates

Factoring is available to perhaps the widest category of businesses today. With the wide availability of factoring and the various industries it serves, qualification for factoring has changed very little. Because of advancements in communications and therefore information, never before has a factor been more secure.

No two factors will have similar underwriting parameters when evaluating a potential factoring client. Some factors utilize similar underwriting guidelines as a cash-flow lender, others simply utilize a collateral model and some employ a combination of both. Regardless of how they determine eligibility for a factoring facility, they all look at six primary qualifications:

- Account debtor creditworthiness
- Terms of sale & invoice collectability
- Competing security interests
- Invoice verification
- Concentration
- Operational compatibility

Let's examine each preliminary qualification in detail:

1. Account debtor creditworthiness. This is a fundamental question that must be answered. A factor will determine an amount of credit that can be extended to an account debtor based on information the factor receives from an independent third party such as Dunn & Bradstreet.

   Upon receipt of the prospects accounts receivable aging report, a factor will determine if the amount open to an account debtor would be eligible for purchase.

   Microsoft is considered a highly creditworthy entity. If a prospective factoring candidate was selling Microsoft $100,000 worth of product, few factors would have any reservations about buying these invoices. If the prospect was selling to other less known companies in similar amounts, the credit extended would be scrutinized.

Often times a factor works with a prospect that has very limited or no credit policies and procedures in place. The net affect is a prospect that is blindly extending credit without being aware of the potential risk involved.

Many prospects base credit decisions on collection histories with individual customers which can be one of the worst qualification parameters in credit extension. Once a credit determination has been made, a factor will have a reasonable idea of the amount of credit they can extend each account debtor which will total a certain percentage of the prospects total outstanding accounts receivables. The higher this percentage is to the total outstanding receivables balance, the greater affect factoring will have on the business.

2. Terms of Sale & Invoice Collectability. A factor must determine if the goods or services provided have been completed and/or delivered and accepted by the account debtor. The invoices must represent a legally sustainable debt based on certain performance by the factoring prospect.

   There are five common forms of sale:

   - Straight Sale. A straight sale is where the account debtor has no rights (outside of legitimate disputes or offsets) to return the merchandise or withhold payment.

   - Guaranteed Sale: An account debtor has the right to withhold payment until a certain milestone has been met in which payment will be released to the supplier. Generally, factors will not advance on this type of sale.

   - Consignment Sale. An account debtor will only pay for what has actually sold. Generally, factors will not advance on this type of sale.

   - Bill and Hold. A prospect has sent an invoice to an account debtor without shipping goods. This is usually based on an agreement between the prospect and account debtor. Generally, factors will not advance on this type of sale.

- Billing in Advance. A prospect is billing for goods or services before any consideration has been made. Generally, factors will not advance on this type of sale.

Terms of sale should be properly supported in any documentation which is commonly referred to as the "audit trail." An audit trail is information that supports the validity of the sale and ultimately the invoice. This may be a contract, purchase order, bill of lading, proof of delivery, time-sheet, draw request, etc. The audit trail should explain where the account debtor is obligated to pay the factoring prospect upon such time that goods or services have been delivered and accepted.

As a normal course of business terms range from net 30 to net 90 days and are generally determined by a specific industry. For example, it is common in the apparel, textile and into the retail industries that net 60 days are standard terms. In temporary staffing, it is common to see terms from upon receipt to net 7 days. Circumstances may rise in which a factor will consider extended terms such as net 120 days.

Factors are careful to evaluate terms of sale as they desire to be repaid as soon as possible. Getting paid in a more timely fashion increases yield and reduces risk.

3. Competing Security Interests. A factor will immediately need to identify if there are any other secured creditors. Factors must have at a minimum a priority position on all accounts receivables. If a client has a bank loan or other obligation, a factor will need to determine if there is enough in eligible accounts receivable to retire the obligation which will give a factor a priority position.

4. Verification. A factor will need to determine a method of verifying the validity of each invoice it purchases. Factors today employ three methods of verification.

   - Review of support documents;
   - Verbal verification with the account debtors payables department;
   - Written no-offsets verification which must be signed by the account debtor(s) guarantying payment.

   Many factors rely on a combination of support documents, verbal verification or written no-offset prior to the purchase of an invoice. Factors must determine a course of action for each client which will provide adequate internal verification requirements. Consideration must also be give to ensure this process is timely to meet client funding expectations.

5. Concentration. Factors are generally concerned with a prospective clients overall concentration percentage. Concentration refers to the overall amount of credit extended to an individual account debtor. The higher the concentration, the more exposed the factor becomes. As a general rule, most factors prefer concentration limits that do not exceed 20 percent.

6. Operational Compatibility. Factors have varying appetites for clientele. For instance, some factors may have an industry niche such as third party medical billing and sub-contractors. These niches are not shared by a very large majority of the factoring industry. Other factors may have transaction size parameters. It is important for a factor to determine early if they and the prospect are operationally compatible.

Pre-qualification

It is critical to first learn and second to understand the general procedures that are employed to effectively qualify a prospect. The ultimate goal is to always bring your prospect to approval and funding.

Factoring like all other forms of financing utilizes simple yet effective methods to determine the feasibility of entering into a factoring facility. These methods are commonly practiced by business development and underwriting personnel throughout the factoring industry. There are four basic rules to remember when pre-qualifying a prospective client.

1. Work over the phone
2. Ask basic questions
3. Assess and justify needs
4. Competition

Working Over the Phone

Today, business can be conducted over the phone, fax and internet. These are invaluable tools in the pre-qualification process. There is no reason to immediately move into a presentation about factoring and all of it's benefits. First, you may consider simply informing your prospect about your role as a commercial finance consultant.

Once you have established your position as a consultant, it's time to dig deeper into the prospects situation.

Asking Basic Questions

There are several basic questions that need to be asked to determine the potential viability of a factoring relationship. Some of the most effective questions to quickly determine feasibility for a factoring facility are:

1. **Tell me about your business?**
Allow the prospect to open up about their business. If they are consumer oriented, meaning that sales are to individuals as opposed to companies, this is not a viable factoring candidate. If your prospect is providing goods or services to other creditworthy businesses, chances are favorable that factoring may be a possible solution.

   Certain industries such as apparel, temporary staffing and transportation are heavily dependent on factoring for cash flow. If a prospect comes to you from such an industry, be prepared.

2. **Who are your customers?**
Once your prospect has satisfactorily explained their business, it should become apparent whether or not factoring is a viable option. Determining the credit quality of the accounts receivables becomes important. Is the prospect selling to highly creditworthy companies (i.e. Walmart, Target, Sports Authority, etc.) or are they selling to non-listed, non-rated "mom and pop" operations? Are their any concentration issues? Where are the customers located? Are their any export sales? Are their any sales to affiliated or related companies? Are their any officer or employee sales? Are their any contra account situations?

   These questions will quickly lead you to determine if the accounts receivables could be advanced upon by a factor.

3. **What are you terms of sale?**
Many prospects will sound as if they are qualified until you discuss the accounts receivable aging report. For example, if they are giving net 30 day terms, it is reasonable to expect the receivables to turn within a certain time period. However, if the receivables are turning very slowly, say closer to 90 days, it may be cause for concern. Is the prospect giving any early payment discounts? Once you have established the terms, it's time to evaluate the aging.

You can quickly ask your customer to give you the following figures from their aging:

Example 5.

Accounts Receivable Aging Summary

Current	31 - 60 days	61 - 90 days	91 plus
$	$	$	$
%	%	%	%

It will be easy to determine why the customer is having cash flow difficulties buy utilizing this information. You will also recognize if the average turn on accounts receivable is within normal industry standards. Anytime an aging has a high percentage in the 61 to 90 day column or 91 plus days column, it should warrant additional questioning. Most factors utilize some form of a cross-age formula. A typical cross-age formula is 50 percent over 60 days or 25 percent over 90 days, will make the entire customer account ineligible.

It is necessary to ask if any of the prospects sales are of a consignment nature, guaranteed sale, bill and hold basis, billed in arrears, or straight sale. When speaking with a factoring prospect, consider the following rules:

a. Service Industries. Generally service industries are straight sales whereas the service has already been completed and payment becomes due within the specified terms.

b. Distribution Industries. Any business that distributes or resells goods may have additional caveats within the audit trail. You should always ask if the prospect is working under a vendor agreement which generally supercedes terms expressed in a purchase order.

4. **What documents support an invoice?**

The more information that supports an invoice, adds credibility to the debt. A prospect should be able to illustrate the documents or supporting evidence that leads up to the creation of an invoice. For example:

a. Contract/Vendor Agreement executed by prospect and account debtor which spells out the terms and conditions;
b. Purchase order delivered by account debtor to prospect;
c. Billing of lading or evidence of shipping;
d. Proof of delivery;
e. Time sheets executed by authorized representative within account debtors organization;
f. Invoice representing goods and services provided.

5. **What is your immediate need?**

This is a critical question, since this is where you should learn the prospects primary motivation. Are they having problems with their suppliers or in making payroll? Are they in arrears or default on their loan agreement with their present lender? Are they delinquent on any tax obligations? This is where a prospect should reveal their main motivating factor. It is common to receive a call from a prospect that is requiring funding within a very short period of time (less than 7 days). Few factors have the capability to fund a client within this short time period.

6. **How are you presently financing?**

This is equally as critical since you need to know what the prospect is currently using and what they are looking for. Are they self funded? Do they have an existing line of credit? Is the prospect currently in a factoring relationship?

Is there a problem with the existing lender? Why are they looking for new financing? This should shed additional light on the prospects overall motivation.

7. **What is your current financial condition?**

Obviously, from the tone of the conversation you will quickly ascertain how cooperative and forthcoming the prospect is. This will be a judgement call on your part. You may choose to forego any questions relating to the financial condition of the company if you determine a reluctance to divulge sensitive information about their financial condition. However, if the prospect called you, there should be little reason for a prospect to withhold any financial information.

You should ask your prospect the following questions regarding their financial condition:

- Does the company have a positive net worth? If yes, what is the net worth?
- Is the company profitable? If yes, for how long?
- What amount does the prospect have in accounts payable?

From the response, you will be in a better position to determine if further questioning is warranted. Remember that many factoring candidates do not generate financial statements and therefore do not know their true financial picture. However, they will be able to tell you if they are having problems meeting payroll or the satisfaction of trade creditors.

Justification

The assessment of the prospect's needs versus availability is where you must determine if the transaction as some degree of validity.

By now, enough preliminary information has been gathered to at least initially surmise whether this is a good candidate for factoring. Is the prospect's request sensible? If the prospect is requesting a 100 percent advance on accounts receivables or similar unreasonable and irrational requests of that nature, it may be time to set the prospect straight on what advance formulas may be realistically available. If the prospect requires funding with a certain number of days, (say within 5-7) it may be an un-achievable goal.

You will be in a position to make an assumption based on the information presented if the prospect is within the "ballpark."

If we know the basic answers to the questions, we should now have a pretty good idea if the needs expressed by the prospect can be justified and if the transaction, at least on the surface, appears to be viable.

Your primary objective is to simply get a gut feel for the overall proposed transaction in regards to it's viability and informing the prospect about realistic expectations.

Are you competing?

It is always helpful to learn if the prospect is seeking financing form other sources. If they are talking with a competitor that you know cannot offer the services the prospect is seeking or is priced higher than others, it would give you a distinct competitive advantage. Let the prospect know that you feel you can help them. Your role as a commercial finance consultant is to find the absolute best lender for each of your prospects and you would like an opportunity to package and present their factoring facility to select factors on their behalf.

However, you maybe in the situation where the prospect has already received proposals or is in dialogue with other factors. In that event, you may consider asking the following questions:

1. **Whom have you been speaking with?**
   Again, this may give you a distinct advantage to know which factor(s) the prospect is having serious dialogue with. Once this is known, it can influence the way you present the product or aid in your pricing in some instances.

2. **Do you have a term sheet or proposal?**
   If the prospect has a term sheet in hand and is willing to share the contents, it can greatly improve your position. The existing term sheet(s) will serve as a benchmark in your search. Not only will you know who you are competing against, but what rates, terms and conditions they are proposing.

Of course, you always run the risk of potentially upsetting the prospect by being too pushy. This is the appropriate point in particular analysis or discovery wherein the prospect's true interest may be determined.

3. **Is there something special you are looking for?**
   If there is something distinct about your prospects business, you will need to identify it quickly. Your prospect may be seeking a financing source with specific industry experience. For example, there are some factors that specialize in government accounts receivables, medical accounts receivables, sub-contractors, temporary staffing and trucking. If the prospect is engaged in a particular industry for example, they may better suited for certain factors with better infrastructure.

4. **What are your key issues regarding the lender you select?**
   Are there any conditions that must be considered or met for your prospect to consider or accept an offer? Is your prospect aware of a general factoring pricing structure? Is cost the primary issue or is it a service issue? It is always important to find out what key issue(s) will ultimately determine which factoring company the prospect wishes to align with.

Presenting the Product

Factoring through ignorance is known as a financing vehicle of last resort. While many start-up and turnaround entities make use of the product, it is more commonly utilized by those companies, in which sales are outstripping cash reserves and borrowing capacity. Factoring is viewed as a very powerful financing vehicle for growth.

Because factors view accounts receivables differently than all other lenders, they are in the unique position to offer facilities to a broad spectrum of companies that are unable to qualify elsewhere.

Factoring is a product that cannot be sold to a prospect. It is purely a needs driven product. If a prospect has no need to improve cash collections or solve payroll or vendor issues, factoring will not be considered.

Presenting factoring to a qualified and motivated prospect is a simple and straightforward process. Because of the unique and frankly invasive nature of the product, it is critical that you properly explain all of the "mechanical" issues involved. It is the understanding and acceptance of the mechanics that ultimately convince a prospect to utilize the tool.

Explaining the process is very simple:

Mr./Ms., prospect, the process works like this:

- You will continue to invoice your customer as normal;
- Simply provide us with a copy of the invoice and any support documentation;
- After we receive the information, within 24 hours of verification we will wire transfer a predetermined amount into your bank account;
- Your customer will continue to make checks payable to your company, but they will be redirected to a lockbox that we set-up on your behalf;
- Once we receive payment, we will remove the advance we previously gave you plus any accrued fees and rebate you the remaining balance;
- The process continues with the submission of each new invoice.

Explaining factoring can be this simple. Those prospects that recognize the necessity of this type of product look beyond many of the issues a prospect that may not be truly motivated will key on.

For a motivated prospect the true ancillary benefits will be recognized but secondary, to the immediate cash infusion the product offers. As mentioned before, factoring is a needs based product and during an initial conversation with a prospect, you should be able to immediately identify if a prospect has a genuine motivation level.

Identifying this underlying motivation should immediately position you and the prospect to dive into more of the product mechanics.

Factoring Fundamentals

Factoring has four fundamental facts regarding mechanical issues that require explanation. These issues are foundations of the factoring product and every factor has unique methods to execute these processes. It is necessary as a commercial finance consultant that you fully understand these fundamentals as they are practiced by the individual factoring companies you partner with.

Fundamental Number 1 - Notice of Assignment

The notice of assignment is a written notice to an account debtor that informs them that a secured party (a factor) has taken title to invoices for which they owe payment. Factors have a variety of notice of assignment letters depending on the clients industry or the factors individual preference. Certain actors will utilize what is considered a "soft" notice of assignment that is watered down and very client/account debtor friendly. Soft notice letters have the basic information required under the Uniform Commercial Code to perfect the assignment. Other factors utilize a stronger notice of assignment letter that may state specific Uniform Commercial Code Sections and/or state the possible penalties for payment to any other party besides the named factor.

In certain circumstances a factor may allow the client to produce the notice letter on the client's letterhead or the factor may have a pre-printed carbon copy form. These notice of assignment letters/forms may be sent via certified mail, overnight, regular mail or via fax.

Under the Uniform Commercial Code, a factor must only be able to prove that a notice of assignment was sent. Some factors may require only that they sent the notice of assignment while others may require an account debtor to acknowledge the notice of assignment in writing and return it to the factor.

Notice of assignment letters legally place the account debtor on notice that they must remit payment to the named assignee for all present and future invoices due the prospect, directly to the factor and continue to do so until otherwise notified in writing only by said factor.

Factors are required to notice account debtors for three reasons:

1. In order for a factor to be legally protected under the Uniform Commercial Code they must notice the account debtor base;

2. A factor requires the proceeds of collections to repay advances and fees earned;

3. It protects the factors overall collateral position.

Factors offer two forms of services. The first is where a client submits only certain account debtors. This is considered a selective factoring product whereby the client can choose which customers to set up and which invoices to submit. The second is where the client submits all account debtors and all receivables generated. These are considered receivables funding or full turn programs.

In discussions with a prospect, it may be premature to discuss which product would best meet both the clients and factors interest, therefore it may be appropriate to briefly explain each product and the differences in the noticing of the account debtors.

Below is an example of one way to explain the notice of assignment:

> Mr./Ms., Prospect, once you let the factor know which customers you would like to set up for funding, they are going to send them a letter on your behalf that informs them to remit all present and future payments due your company directly to the factor. Checks are still made payable to your company, but mailed directly to a lockbox they set up on your behalf.
>
> This is done for three reasons. The first is overall collateral preservation. The second is proper accounting of payments and reporting to you and the third and most important is, not to confuse your customers accounts payable department as to where they should send payments. Once they receive the notice of assignment, there will be no question as to where the remittance goes.

Advanced Topic / Writers Point of View

> Often times a prospect will think that all invoices generated from a certain account debtor must be submitted. Remember, under a selective factoring program a client can generally choose which invoices to submit. As you have already read, once an account debtor has been noticed, all payments whether factored or not will go to the factor.
>
> In selective factoring, a factor will also receive payment on non-factored invoices. These invoices are posted to the factors accounting system and are eventually released along with the normal reserve minus no fees. This is an important topic to those customers who may be a better candidate for a selective factoring product. Therefore, it is critical that you explain the process regarding non-factored proceeds.
>
> \- M. Marin

The notice of assignment is a critical issue that must be properly explained and any concerns or objections addressed immediately. If you do not fully understand a factors policies for the notice of assignment, it is recommended that your factor of choice have this conversation.

Some factors are now offering what is considered a "non-notification" factoring product. While novel in concept, it is an extremely risky practice as the major protection a factor is granted through the Uniform Commercial Code via a proper notice of assignment to the account debtors is eliminated.

Factors may offer a non-notification product to those clients that object strongly to the notice of assignment. Only long-established, large companies with a large volume of reliable debtors could be candidates for such a solution. Furthermore non-notification factoring would include a significant premium to offset the risk of operating outside the protections of the UCC. As neither the risk nor the premium is worth the cost to the respective party, less than 5% of factoring in America is classified as non-notification.

It is the writers experience that the offering of a non-notification facility is only a sales tool. The moment the client defaults or other infraction/glitch, all account debtors are immediately noticed. Therefore, if you are looking for repeat business, you may want to carefully consider offering a non-notification product.

Examples of typical soft and hard notice of assignments:

Soft Notice Letter

(On Client Letterhead)

Date

Account Debtor
Address
City, State, Zip,

Attention: Accounts Payable Manager (Via Certified Mail)

Dear Sir/Madam:

In order to accommodate the growth we are experiencing in our business, we have retained XYZ Factors to manage our accounts receivables. The availability of this service will allow us to serve our customers in a more efficient and timely manner. Accordingly, there have been assigned to XYZ Factors and XYZ Factors have purchased all rights and titles and interest in Sample Company, Inc.'s, accounts receivables. Please change remittance information to:

Sample Company, Inc. / XYZ Factors
Factors Address
City, State, Zip

This letter hereby authorizes and instructs you to remit all payments from present and future invoices due Sample Company, Inc., to XYZ Factors. We thank you for your assistance. Should you have any questions concerning this letter, please call XYZ Factors at 888-555-1212.

Very Truly Yours,	AGREED AND ACKNOWLEDGED
XYZ Factors	Sample Company, Inc.
Name	Name

Strong Notice Letter

Date

Account Debtor
Address
City, State, Zip,

RE: GENERAL ASSIGNMENT FOR YOUR VENDOR: Sample Company, Inc.

Attention: Accounts Payable Manager (Via Certified Mail)

Notice is hereby given that Sample Company, Inc., has assigned payment of your account to XYZ Factors, Inc. A copy of the Assignment is enclosed for your convenience. This letter will confirm notice and demand for your firm to make all pays, present, and future payments for above named vendor payable to XYZ Factors and send payments directly to:

XYZ Factors
2390 Easy Street
Any town, USA

Under Uniform Commercial Code Section 9406(a), your payment directed to any entity other than XYZ Factors after receipt of a Notice of Assignment is insufficient to fulfill your obligation. Payment directly to your vendor Sample Company, Inc., will not discharge the obligation to XYZ Factors. In addition, do not make any payments to any collection agency or your could be held liable for duplicate payment. Section 9046(a) provides:

(a) Subject to subdivisions (b) to (I), inclusive, an account debtor on an account, chattel paper, or a payment intangible may discharge it's obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee.

This notification and instruction will remain in effect until you are notified again by XYZ Factors, Inc., in writing of the rescinding of the notification. After receipt of the notification, the account debtor may discharge its obligation by paying the assignor. You are legally bound to pay XYZ Factors, Inc. If you choose to make any alternative payments you will be held liable for dual payment to XYZ Factors, Inc.

Please Govern Yourself Accordingly,

Fundamental Number Two - Billing

Factors require that all clients follow modified billing procedures. There are three unique areas in which this affects the client. The first is the method they submit the invoices to the factor. The second is the necessary addition of assignment language on the face of the invoice and the third is the required support or "audit trail" information.

1. Certain factors allow their client's to generate and mail out the invoices with the proper assignment language while others require original invoices in which the factor will add the necessary assignment language and mail to the account debtor. The method employed depends greatly on the factors level of confidence and/or trust in a prospect and the factors internal back office procedures.

2. Factors require that on each assigned invoice, certain language relating to the assignment be placed clearly on the face of the invoice. Some factors allow the client's to generate this language from their printer, while others provide stickers or a stamp. An example of generic language:

This invoice has been sold and assigned to XYZ Factor. Address City, State, Zip Any objections to the goods or services should be reported within 5 business days to 888-555-1212

   Additionally, many factors require that the factors remit to address supercede and/or replace the client's remit to information.

3. Most factors require that invoices be supported by necessary audit trail documents. These documents may include contracts, purchase orders, bills of lading, proof of delivery, time-sheets, draw requests, etc. This is done for a multitude of reasons, but the predominant reason is that these documents should support of the validity of the invoice. Support documentation reduces the possibility of a direct verification call to the

account debtor.
During a factors underwriting procedure, they will determine which audit trail document(s) will be required to support the validity of the invoices.

For example:

Industry	Common Support Documents
Temporary Staffing	contract, time-sheet
Trucking	rate confirmation, bill of lading, proof of delivery
Distribution	vendor agreement, contract, purchase order, bill of lading, proof of delivery
Sub-contractors	contract, purchase order, draw request, architect sign-off

Fundamental Number Three - Verification

Factors that remain in business are those that verify invoices on a regular basis. Factor very in their approach to the verification of individual receivables. A great majority of prospects become concerned with the possibility of a third party interacting with their customer base. This is normal and should be expected.

Factors generally verify invoices in one or a combination of three ways.

1. Support documentation. A factor will require that a client submit a certain amount of audit trail information for each invoice.

2. Verbal verification. A factor will generally call on behalf of the client to a selected group of account debtors on a regular or random basis. This may be done prior to the issuance of an advance or post funding. This is not a collection call, but merely a call to identify the status of the receivable within the account debtors system:

   a. Matches the information the factor has, such as the dollar amount of the invoice, terms extended, assignment language on face of invoice, remit to information, etc;

b. Identifies if the invoice is disputed or scheduled for a payment within a specified date;

c. Confirmation that payment is being directed to the factors address.

3. No-offsets verification. A no-offsets verification form is generated by a factor and is submitted to an account debtor. It is a written authorization and acknowledgment by an account debtor that the invoice as presented is due and payable to the factor within a certain period of time and without any deductions or offsets payable directly to the factor. A no-offset letter may also go as far as to notify the account debtor that the factor is relying on the accuracy of the representations made by the account debtors acknowledgment of the no-offsets.

   Many factors rely on this method before purchasing an invoice. No-offsets are generally utilized in those circumstances that pose additional risk and exposure to the factor.

Advanced Topic / Writers Point of View

No-offsets are going the way of the dinosaur! Once an incredible tool to hedge against risk, the usage, more over abuse of the no-offset letter has diminished it's effectiveness.

The no-offsets once executed by an account debtor is almost a guaranty of payment, regardless if the account debtor later claims a dispute or refuses to pay. Because of the legal ramifications of executing a no-offsets (essentially giving up any rights under a contract or purchase order which are generally favorable to an account debtor) by an account debtor, it locks an account debtor into paying the factor.

Many factors rely on the usage of a no-offsets prior to the purchasing of an invoice. While an incredible tool, it's over-usage has prompted many account debtors to set a policy that under no circumstances will they execute a no-offsets. Therefore, rendering the tool useless. Be weary of a factor that requires no-offsets on a regular basis.

- M. Marin

When communicating with a prospect, it is imperative that you understand your factor of choice's policies regarding verification. More importantly, a prospect must have absolute confidence that any interaction with their customers is handled with absolute professionalism.

Fundamental Number Four - Collection

Payments from accounts debtors received by the factor are generally posted to the factors software on the same day. The posting of the remittance closes out an individual or group of invoices. Once the factor receives payment, they generally will continue to charge "float days" until the check clears the bank. Many factors have a practice of charging between 2 and 10 additional clearing days.

With the Check 21 Laws enacted in 2005, banks are required to clear checks within 2 business days. Therefore a factor that is asking for more than 2-3 float days is making an unreasonable request. The addition of Check 21 will cost factors millions of dollars per year in lost float charge fees.

Below is an example of one way to explain the collection process:

> Mr./Ms. Prospect, once we receive payment from your customer, we post the payment to our system. Once the funds clear the bank, you are eligible to take the reserve balance.

Once you have properly explained how the product works and the necessary fundamentals, it will quickly become apparent if your prospect can work within those parameters. If the prospect has a sincere desire or need to improve cash flow, the mechanics are a mere formality for acquiring the cash.

After your presentation, one of three scenarios will take place:

- Objections and/or concerns will come quickly;
- The prospect may ask more in-depth questions;
- If the prospect is motivated, they will ask about the next step.

Common Concerns & Objections

In day-to-day factoring sales, a prospect may have various concerns or objections to the product. While a few of these concerns or objections may be valid, the truly motivated prospect will voice only four possible issues:

- Cost
- Notification
- Customer concerns
- Collection and control

It is easy to effectively overcome each objection logically once you know exactly what the prospects concern is.

Cost

In very few circumstances will a motivated prospect raise an objection to costs. For those prospects who are driven by a specific need, such as payroll or the satisfaction of trade creditors, they often view the tool as a temporary vehicle to support cash requirements. With the temporary viewpoint, many are willing to look beyond the cost, as the vehicle is an immediate cash flow fix.

Some prospects have legitimate cost concerns. For instance:

1. Thin Gross Profit Margin. Wholesale distribution is an ideal example of an industry that often operates on very thin gross profit margins. A prospect may simply not be able to afford a factors discount. A good rule of thumb to take into consideration for a factoring program is a prospect that has a minimum of a 15 percent gross profit margin.

2. Average days sales outstanding. For those prospects who extend greater than 45 or 60 day terms, or are in an industry where it is commonplace for an account debtor to pay slowly, a prospect will quickly analyze the discount schedule. If collection times cannot be improved, a prospect may realize that the discount structure they will most likely fall into, is simply to high.

Cost very quickly becomes a moot point especially when a prospect is unable to qualify for other types of financing. Certain prospects will simply object to the costs regardless of how a facility is priced. The highly motivated prospects will negotiate the fees early in the discussions with the factor and move towards a closing quickly.

Many times, the motivated prospect will quickly recognize how quickly the tool will stabilize cash flow and allow him or her to redirect resources towards managing the business as opposed to simply keeping it together.

Due to the mainstream popularity and entrance by large and international banks and financing institutions, many factors have the capability to offer rates to larger factoring prospects between 11 to 18 percent per annum. This is comparable to the most aggressive asset-based lending programs. This is an incredible value and opportunity for those companies that qualify for these rates. Very few financing vehicles are available that have the tremendous flexibility and ancillary benefits as factoring. When you add in the possibility of rates below 18 percent per annum, factoring is a very attractive tool.

Customer Concerns

Prospects that are unfamiliar with factoring always inquire about the perception of their customers. This is natural because they are considering allowing an unknown third party to interact with the life blood of their business. More over they quite possibly have never heard about factoring and the benefits seem too good to be true. Prospects that are concerned about perception should be told the following:

- Factors predominantly provide funding to up-and-coming businesses. Factors on rare occasions will provided funding to entities that are experiencing monthly cash losses, declining sales and historical net losses. Factors, like banks generally prefer to provide facilities to those companies who's sales are outstripping cash reserves or simply need greater cash availability to support the growth.

- Factoring is a mainstream financing product. Retailers such as Walmart, Target, Costco and Best Buy have internal divisions within their accounts payables to work vendors who utilize the services of a factor. In Europe, you can walk into any bank and obtain a factoring facility.

- Factors are not collection companies. Factors can become a transparent arm of the existing credit and receivables management functions. Factors generally will work closely with the existing receivables management team and share monitoring functions. The overall team goal is to proactively monitor the position of the receivable and get it to pay in a more timely fashion.

  Many factors have policies in which any interaction with an account debtor is handled with "white gloves." Most factors recognize that they do not understand their clients business or their account debtor base as well as the prospect. Therefore, if an account debtor raises a dispute or a concern, many factors have a simple policy of gathering as much information as possible from the account debtor and immediately contact the client to inform them of the situation and have them intervene to correct the issue.

  Interaction with account debtors is generally handled within lower levels in the accounts payable departments. Many prospects will interact within a sales department or senior management level. Rarely will an account debtor in a higher position learn that one of it's vendors is utilizing the services of a factor.

- Checks can generally be made payable to the client. Factors will have a provision within their legal documents allowing for a power of attorney privilege. Under this provision is the ability for a factor to endorse checks made payable to another entity and deposit them. Therefore, if checks are made payable to the client the factor still has the right to deposit them. Some factors object to this policy. If a client obtains a check that is rightfully the factors collateral, the client can deposit it without any problem. Some factors ask that checks are made payable to both entities such as: Sample Company, Inc., / XYZ Factors. Account debtors are rarely concerned about where they send the checks. They simply wish to be properly credited for their payment.

Notification

A major concern for a prospect focuses on the Notice of Assignment. It has been previously discussed why a factor is required to notice account debtors. It is unlogical for a prospect to argue with this fundamentals as it is a requirement for a factoring facility.

A prospect should take into consideration the type of factoring program that would be best suited for their business, provided they qualified. A factor may offer two distinct programs which affect the notice process:

1. Selective Factoring. Under this program a client can choose which customers to set-up. Therefore, only those account debtors will receive a notice of assignment.

2. Receivables Funding. Under this program a client is required to submit all account debtors. Therefore all customers will receive a notice of assignment.

Notification is a requirement under a factoring facility. Even the factors that offer a "non-notification" program expose a prospect to the eventual noticing of the account debtor base.

Collections & Control

Certain prospects feel that a factor simply has too much control in the relationship. They are correct. The only true control a factor has is in advancing of funds and reserve release. Prospects rarely take into consideration that a factor is simply buying a piece of paper and all efforts are made to monitor the position of the receivable and the eventual collection.

Prospects often question if the total receivables functions will be taken out of their hands. This is simply not the case as most factors are simply not equipped to monitor a clients total receivables base. All clients reserve the right to communicate with their customers as they deem necessary.

The ideal factoring relationship is a partnership in the overall receivables management functions. The collection of account debtor payments is a absolute requirement in the relationship. The shoes would quickly be reversed (which happens on a daily basis in most factoring companies) where the client receives payment from an account debtor. In the case where a client receives the advance from the factor and eventually receives payment from an account debtor, the client is truly in control of the relationship.

A factor will never prohibit who a client sells to, what dollar amount or what terms are extended. However, a factor will determine which invoices it will purchase. A factor makes daily decisions on the invoices it purchases. A factor will also determine based on collections and the overall client receivables position to release reserves.

The reserve balance after it is collected, in which it becomes a true cash reserve is a very powerful tool that the factor controls. A factors right to hold the reserve balance which is evidenced in the factors legal documents is nebulous. Often a prospect will question (after reviewing the legal documents) the right to withhold reserves. This is a question that is not easily answered simply because of the numerous reasons the reserve might be withheld.

A factor truly does have a great deal of control over a clients business. Provided the relationship performs, a client will rarely feel any serious inconveniences. However, if there are serious or numerous breaches within the relationship, a factor truly has immediate and unlimited powers to protect it's interests. These rights can cripple and mortally wound a business within days.

All of the common concerns and objections are easily explainable and are generally overcome while a prospect is being introduced to the fundamentals. Provided a prospect can become somewhat comfortable with the fundamentals but realizes the tremendous value of the overall product and it's capabilities they are often motivated to submit the necessary information required for a factor to evaluate the prospect for a factoring facility.

Information Gathering

Gathering information from a prospect will give you insight about the prospects overall motivation. This will be identified by many things, such as:

- How quickly a prospect provides the necessary information;
- The level of depth and detail in the information submitted;
- Response time to questions or requests for additional information.

The information you gather will also be an indication of the prospects overall business and it's practices. Those prospects that have excellent internal policies and procedures will be displayed via the information submitted and vice versa in the companies where those policies and procedures are laps.

It is necessary as a commercial finance consultant to take the necessary time to review a prospects application and support documentation. This is absolutely necessary to familiarize yourself with the information, but is also to confirm that you have all of the necessary information that is generally required by a factor to evaluate a prospect. Reviewing this information is a necessity because it will give you an early indication of what possible factors will have an appetite for your prospect. Therefore, it will be easier to package information and submit to the necessary factors saving you and your prospect valuable time.

Factors generally have unique information requirements when evaluating a prospect. It is important to understand what items your preferred group of factors requires and develop a "middle ground" of information necessary to support a factors individual information preferences. As a general rule of thumb, most factors will require the following:

- Application
- Accounts receivable aging report
- Accounts payable aging report
- Financial statements
- Articles of Incorporation
- Customer list
- Sample of prospects billing

1. **Application**

Although most factors have their own formal application that must be completed and returned by the prospect, a commercial finance consultant must utilize a generic application as he/she may not immediately know which factor to utilize. For that reason, many commercial finance consultants have generated a variety of applications that are acceptable to many factors.

All applications must have a location where an officer, owner or director is to execute on behalf of the company. It is important that at a minimum an application contains the following language:

> The forgoing information is true and correct to the best of my knowledge and is given to (your company) or its agents, assigns, factors, funders or lenders to induce these agent's, assigns, factors, funders to consider entering into a financing relationship with this company. I hereby do authorize (your company) agents, assigns, factors, funders to verify and investigate any and all of the foregoing statements, including but not limited to, my/our creditworthiness and financial responsibility, in any way they may choose. I/We grant (your company) or its agents, assigns, factors, funders the right to procure any and all credit reports pertaining to any party listed in this application, including, but not limited to, all principals of the applicant's company. By my signature below, I am duly authorized by all parties listed above to grant this permission on their behalf.

Factors share a similarity of the questions they ask as prospect which is reflected on the application. All questions should be completed or if they are not applicable to a prospects business should be marked as such. Blank areas on an application require further investigation as a factor may feel the prospect has chosen not to disclose information.

It is important to take the necessary time to ensure that every question has been answered. This may also lead to further questions on your part which may help you to better understand a prospects situation.

2. **Accounts Receivable Aging Report**

An accounts receivable aging report is the best snapshot of the viability of the relationship. A considerable amount of time should be spent on the evaluation of this report. Accounts receivable aging reports can come in many formats. Below are the various formats of an accounts receivable aging report:

- Detailed A/R Report. This lists all open invoices by number, customer name, days outstanding, etc.

- Summary A/R Report. This simply lists the customer and the open balance. This is an excellent report to obtain where there is a large amount of account debtors.

- Invoice or Due Date A/R Report. Prospects have the capability to set the accounting software to track the age of the invoice from two positions. The first is from the invoice or transaction date. This is where the software begins to track the age of the invoice from the date it was actually generated. The second is from due date in which the software tracks the age of the receivable only after the agreed upon terms have passed. Always attempt to obtain a transaction date A/R agin report as it truly represents the age of the receivable.

An aging report should always be within 15 days of it's most recent reconciliation. Any specific issues regarding a customer balances (high concentration, significant amount in the 60 or 90 day columns, retainage, disputes, etc.) should be highlighted and provided under separate cover.
When a prospect has a large A/R report, confirm that all pages are present.

3. **Accounts Payable Report**
The trade payable situation is always of importance to a prospective factor. A factor must insure that the prospect is in good standing with their trade creditors. If, for example, payables are seriously delinquent, the factor must address whether or not the facility will reduce the delinquency. If not, the factor may be danger of jeopardizing its collateral position. More to the point, can the business be saved with a factoring facility.

Contra accounts can also be identified against the accounts receivable aging report through analysis of the accounts payables. A payables report should always be within 15 days of its most recent reconciliation.

4. **Financial Statements**
The larger a potential factoring facility, it becomes more critical to have information of a historical financial nature as part of the application package. Many factors require at least two fiscal years of reports and

the most recent interim financial statement as part of the package. As a general rule of thumb, you should ask for a minimum of 2 years of historical financial information for any factoring facility that exceeds more than $500K outstanding.

The prospect should include the balance sheet, income statement and any or all notes or attachments that an accountant may include in a prepared statement. This may also include a breakdown on cost of goods sold, separate schedules of G&A expenses, cash flow statements, etc. It is always best to get an original bound copy of the fiscal reports, not a photocopy (no pages of the report(s) should be missing).

On an interim basis, you should expect to receive a current interim financial statement, which may be in-house prepared or done by a bookkeeping service. It should not be more than 6 months old to be of value to the factor. Many businesses running Quickbooks or Peachtree or any other common form of accounting software, should be able to provide this information with a click of the mouse.

5. **Articles of Incorporation**

Always obtain a copy of the complete organizational papers. Utilize the following guidelines:

- Corporations. Articles of Incorporation;
- Limited Liability Company. Articles of Organization;
- Partnership. Partnership Agreement;
- Trade Names. Obtain any Doing Business As (d.b.a.) or fictitious name filings;
- Foreign Corporations. Obtain Foreign Status Certificates from the State in which they have a physical location. For instance, a company may be organized in Delaware but operating in Florida. This is therefore a Delaware Corporation recognized by the State of Florida as a Foreign Corporation operating within its borders.

All information listed above should be submitted with any amendments or certifications by officers to reflect the amended structure.

6. **Customer List**
It is highly recommended that the prospect provide a complete customer. In the event that the factor is unable to obtain the necessary customer information from the aging report, they can revert to the customer list. This is especially useful for those prospects that have a large customer base.

7. **Sample Invoices**
It is recommended that you obtain a minimum of 3 to 4 sample invoices from different customers. The information reflected on the invoices should support the information given in conversations with your prospect. The method and detail in which a prospect invoices their customers will be a direct reflection of the accounts receivable aging report. If a prospect has poor billing policies and procedures, it will be reflected on the accounts receivable aging report via delinquent balances. The same is true for those prospect who have excellent polices where the receivables turn in a timely fashion.

Advanced Topic / Writers Point of View

When evaluating what information to request from a prospect, you must use your best judgement. Some prospects will be reluctant to release or disclose information. This may simply be from an inability to generate information, information supplied may be contradictory to what the prospect has disclosed or any number of other reasons.

Experience has proven that a motivated prospect will provide the necessary information and will respond to additional requests in a very timely fashion. Those prospects that trickle in information that is incomplete or is outdated rarely ever factor.

You must determine early in a conversation with a prospect not only what information they are capable of submitting, but what information you deem is necessary to evaluate them for a factoring facility.

\- M. Marin

Your goal is to identify a potential and viable candidate for factoring. The time spent on single debtor transactions or prospects that submit incomplete or trickle in outdated information is generally time wasted. Work with those prospects who are motivated to change their situation.

Preliminary Due Diligence

A factor will take many items into consideration when evaluating a prospect for a potential factoring facility. As discussed earlier a factor must evaluate many areas to determine if a prospect qualifies for a factoring facility:

- Invoice collectability
- Security interests
- Financial condition
- Officers / Owners
- Operational compatibility

1. **Invoice Collectability**

   The factors ability to collect proceeds from a factored invoice depends on a factors ability to address three basic concerns:

   a. Verification. A factor will need to determine an efficient and timely method(s) to verify the validity of an individual receivable. A factor must be able to communication directly with the account debtor base at any time the factor chooses. A factor must be able to determine if the account debtor has the willingness to pay the invoice and remit funds to a new location.

   b. Losses. Determining an account debtors ability to pay is the cornerstone of a factoring facility. Without it, there is no deal. A factor must determine a strategy in the event an account debtor is unable or unwilling to pay an invoice. This can be caused by the financial inability to pay or a account debtors refusal to pay. It is commonplace for an account debtor to refuse payment claiming a dispute which may lead to an offset or non-payment.

Factors are generally prepared to abide routine returns and merchandise credits that occur in the normal course of business. However, when disputes become widespread among the debtor base or when substantial amounts are involved it can seriously effect the factors position.

Factors have to make a “judgement call” on how well the prospect delivers their goods or services. This can be as simple as evaluating the managements industry experience or as complex as evaluating the dilution percentage over a period of time. A factor must be able to determine a worst case scenario on how it can successfully recover it’s advance and fees in the event of non payment. One reason that single account debtor transactions or high concentrations pose additional risks for a factor is the simple fact that if an account debtor is unable or unwilling to pay, the factor has very few avenues to collect out.

c. Misdirected Payments. Occasionally an account debtor will remit payment to a client as opposed to adhering to the notice of assignment. This mistake can simply be a clerical error or deliberate. Circumstances vary but it is commonplace in a factoring relationship where the client ignores the rules or is intentionally attempting to defraud the factor. A factors defense against this is to properly notice the account debtor base, confirm that accounts payable has changed the remit to address and remain in regular communication with accounts payables.

When a factor has established rapport with an account debtor, often times it is the account debtor that informs the factor that they received a written request or have been told by their vendor to change the payment location. Occasionally there is collusion between a client and account debtor where together they are perpetrating fraud and criminal offences against the factor. It takes a keen eye within a factors organization to discover collusion.

Early in a factoring relationship account debtors may have already processed and mailed payments which are destine for the client. After receiving the notice letter, it may be too late to re-route the payment. A factor expects that once the prospect has received the initial funding, that if they collect payment from an account debtor, that they immediately forward it to the factor.

Factors are vary cautious to advance on existing receivables during an initial funding for this very reason. Much of the decision to advance on existing receivables is a character judgement on the factors part of the clients management.

Factors are normally tolerant of the occasional debtor administrative check handling errors, however a factor is immediately poised to take very aggressive action against clients who deliberately attempt to misdirect payments or deposit checks without informing the factor.

d. Dilution. Dilution occurs when an account debtor regularly short pays an invoice(s). This may be from normal losses to damaged shipments, agreed upon marketing allowances, shelf spacing fees, or other unusual terms agreed upon by the client and account debtor. Generally those who sell to large retailers are subject to significant amounts of dilution. Dilution can be easily determined by a quick evaluation of the income statement as it may show up as an itemized return. Understanding dilution is critical in structuring a proper advance formula.

2. **Security Interest**

During the preliminary due diligence, a factor is quickly attempting to identify any other secured creditors. The reason is simple as there may be competing security interests. Factors require at a minimum to have a perfected interest in a clients accounts receivables.

It is commonplace to find banks, lessors, governmental agencies, trade creditors, judgement creditors, bankruptcy trustees or other secured creditors. Identifying these early are critical as they pose barriers to a transaction without an action plan to put a factor in a priority position above all other creditors on the accounts receivables.

The first place to identify if there are other secured creditors is the application. Another place is to examine the liabilities side of the balance sheet for any long term loan obligations.

If you find another secured creditor, you should ask the following questions:

- What type of loan/line is it?
- How old is the loan/line?
- What is the present balance?
- Do you know what the collateral is?
- Have you informed your lender that you are considering factoring?

The justification for asking such questions is to quickly determine if there are enough accounts receivables to buy out the existing loan if necessary. For instance, a prospect may have a line of credit for $200K but only $100K in accounts receivables.

Situations like this arise quite often and may be remedied by one of three ways or a combination of all three:

a. Buyout of existing loan. The proceeds from the initial advance (if ample) will payoff the existing secured creditor.

b. Subordination. If the proceeds from the initial advance are not sufficient to payoff the existing lender, the lender may consider subordinating their position altogether. A subordination is a position another creditor takes where they grant another creditor(s) a senior position in certain collateral. In the context of a liquidation the subordinated party will get paid secondly to the senior secured party.

c. Pay-down with Subordination. If a secured creditor is uncomfortable in subordinating their position based on an evaluation of total exposure, they may ask for a certain amount of consideration (payment). Upon receiving this consideration, they would subordinate their position.

If a prospect is subject to a State or Federal Tax lien filing then under the law, all assets of the debtor (in this case the client) are immediately subject to a lien that is superior to all other creditors. It is common in the factoring business to work with prospects that are delinquent in payroll and income tax obligations. These are commonly referred to as 941 (payroll taxes) and 940 (income tax). Both are excellent motivating factors for a prospect to seek the services of a factor.

If you have a prospect who is delinquent with either form of tax, you should ask the following questions:

- Have they received notice of intent to lien or levy?
- What amount is delinquent?
- Have they been contacted by a revenue or collection officer?
- Have they entered into an Installment Agreement (IRS form 433-D)?
- Are they current on the payments under the Installment Agreement and the ongoing deposits?

The Internal Revenue Service is a very cooperative agency if the debtor is also cooperative. The IRS is a willing participant as they are interested in collecting the delinquent taxes with the appropriate fees and penalties attached, but are genuinely interested in seeing the business survive.

The process for a revenue or collection officer to prepare the necessary subordination package can take several weeks. Once they have prepared this package, it is generally submitted to the technical services branch with eventual approval coming from a District Manager.

It is a similar process for a prospect that has an SBA backed loan product. While first the issuing bank must agree with the subordination, they are required to obtain approval from the SBA when amending the collateral. A banker is required to prepare a subordination request along with other forms and submit it to the necessary SBA section for approval.

Asking these questions early in the process may help to avoid wasted time and aggravation later.

Advanced Topic / Writers Point of View

> Many prospects will not be aware of such liens or may claim that there is no position on the accounts receivables. Any time you review an application and a bank loan or other type of loan is indicated, you must always assume that the receivables are pledged as collateral.
>
> This is a necessary and logical presumption. It is critical in the interest of time to ascertain this position. In the likely event that the accounts receivables are pledged as collateral, an action plan must be taken to identify if the secured creditor is open to discussing a possible subordination or release of collateral. I have lost numerous transactions to unidentified or hidden liens in which another secured creditor was not willing to release or subordinate.
>
> \- M. Marin

3. **Financial Condition**

Factors are generally more tolerant of companies that have a deficit net worth, operating losses or are highly leveraged. The reason factors have the ability to look beyond these issues is the simple fact that they are not relying on operating profits or cash flow as the repayment of the obligation. Factors can easily liquidate themselves in the event a business is unsuccessful. The reason for this is the careful consideration a factor places on the purchase of each individual invoice versus the overall outstanding accounts receivables.

It is not uncommon for a factor that has a client in a selective factoring program to see an cash collateral coverages of 2 or 3:1 ratios. Accounts receivables are self liquidating and are quickly converted to cash, thereby a factor can exit a relationship quickly.

Factors like all other creditors are concerned with bankruptcy as their collateral (the cash collections) can be given back to a debtor in the event a trustee determines it is in the businesses best interest. The position of the trade creditors is of paramount importance.

If a prospect has a considerable amount of it's payables in the plus 60 or 90 day column, a factor needs to consider if the prospect can continue as a going entity. Should three trade creditors get together, they can force an involuntary bankruptcy proceeding against the prospect. A factor does not to be in a defensive position regarding their collateral.

Most factors will acknowledge these operational issues and provided there is a reasonable likelihood through increased sales or other operational changes a business may turn itself around, then a factor will extend a facility. Factors will rarely entertain a business that is mortally wounded.

4. **Officers / Owners**

Like all forms of lending, great emphasis is placed on the character or lack thereof of a prospects officers or owners. A good determination of a character test is evaluating the officers or owners personal credit. Personal habits spill over into their business lives.

Past or recent bankruptcies coupled with delinquent or collection accounts may indicate an officer or owner who is also experiencing personal cash flow issues. The adage that "desperate people do desperate things" is translated by many factors to mean falsifying invoices, re-directing payments, horse-trading and the like.

Factors unlike most lenders are willing to look deeper into a officers or owners personal situation. Few factors make determinations on the viability of a facility based on a personal credit score.

5. **Operational Compatibility**

All factors have certain appetites for transactions which simply equates to a set of guidelines they will consider. Many factors look at a certain set of criteria when evaluating each prospect. Many factors share the following operational compatibility questions:

a. Industry. There are only a handful of factors that will entertain a sub-contractor or third-party medical receivables. Therefore, it is important to identify your preferred factors industry restrictions. Some factors only specialize in certain industries while others operate across a broad spectrum of businesses.

b. Size of transaction. Many factors will have a dollar minimum and maximum. It is necessary to identify your preferred factors minimum and maximum funds employed policy.

c. Workload. Workload refers to the amount of internal resources to effectively manage and monitor the account. For instance, a client that generates $500,000 per month across 20 account debtors and only 30 invoices is considerably different than an account that generates $500,000 per month across 300 account debtors with 1000 invoices per month. Workload generally includes the following:

I. Invoice submission. Some factors manually input invoices into their accounting software while others offer clients the capability to automatically upload information. There is a significant advantage for those factors who have the capability to allow clients to upload information into their system.

Not only is it an efficient method, but also reduces the possibility of human error. Having the capability to upload information allows funding to take place in a more efficient and timely manner.

II. Support documentation. Certain prospects have excellent support documentation while others have none at all. A factor may require a certain amount of this support documentation to be submitted with each invoice. Support documentation is designed simply to add validity to the invoice which supports timely funding. Many larger factors rely on the support documentation to "make the case" on an invoice.

III. Verification. If a factor determines that verbal verification is a requirement, does the factor have the necessary internal resources to handle this in an efficient manner? Some factors have realized that relying on verbal verification is difficult. It is commonplace for a factor to leave several voice messages or play phone tag with an account debtor. This does not bode well for a regular or timely funding.

IV. Days sales outstanding. All factors prefer to have the invoices pay in a timely fashion. Prospects that extend unusually long terms matched with a conservative factor will have a rocky marriage. Factors are unnerved early in a relationship where they are constantly issuing advances without the offsetting collections.

Preliminary due diligence is not an exact science, but is built from time tested experience. Factors must evaluate the necessary components of a transaction, but generally have a tendency to utilize a "gut feeling" approach to determining if extending a factoring facility is warranted.

Structuring a Facility

When a factor has completed the necessary preliminary due diligence and determined if the transaction is viable, they will execute a proposal which will detail the general terms and conditions of the proposed facility. Factors generally share the following parameters when structuring a factoring facility:

1. **Monthly Volume**

   In a factoring relationship there are two types of arrangements offered:

   a. Committed. Where a prospect is required to sell a certain amount of receivables on a monthly, quarterly or yearly basis.

   b. Expected. A prospect may sell as little or as much as they choose.

The difference between the two programs is considerable. For instance, those prospects that agree to commit for a specified period of time along with a volume commitment generally receive higher advance rates and lower fees. The reason is simple. A factor is guaranteed monthly fee income. For those prospects that are unable to commitment (a factor may refer to this as a open ended agreement) to a minimum volume without question will pay higher fees and will receive less of an advance.

Committed arrangements are better suited for the larger more established clients that are confident that they can meet or exceed the minimum monthly commitment. Expected arrangements are suited for start-up enterprises or those clients that can better forecast cash needs.

2. **Term of Agreement**

Factors that offer a prospect a committed arrangement generally also require a term agreement. It is common to find arrangements anywhere from 6, 12, 18, 24 and 30 months for these types of arrangements. The larger the facility, the longer relationship a factor will seek. As with volume, those clients that commit to longer terms may also experience reduced rate structures and higher advance percentages.

3. **Advance Rate**

Factors base an advance rate on many items, but generally take the following into consideration:

- Normal industry advances (competitive analysis)
- Dilution
- Prospect’s profit margin
- DSO
- Terms extended
- Creditworthiness of the account debtor base

In the temporary staffing or trucking industry it is common for a prospect to find factors extending advances into the 90% range. An educated prospect will be keenly aware of this fact and base future conversations on this benchmark.

Therefore, as a commercial finance consultant, you must have factors that can offer competitive advance structures.

4. **Recourse / Non Recourse**

Factors offer two types of credit products. The first is a recourse arrangement where a client remains responsible in the event for any reason of non-payment. Therefore, if a factor is unable to collect from the account debtor for reasons of dispute or financial inability to pay, the factor can seek repayment of the advance plus any accrued fees directly from the client.

The second is non-recourse. Non-recourse in it's most common form, provides protection to the client in the event an account debtor is financially unable to pay. Properly defined, this means the account debtor is insolvent or bankrupt. However, there are caveats to a non-recourse arrangement.

a. Non-recourse requires an account debtor to be approved. This is generally accomplished through the factor obtaining credit insurance. An account debtor must be credit insured by an outside credit insurance agency (some larger factors self insure). Unlike automobile insurance, where it is required by law to issue coverage, not all companies qualify to be insured.

b. Provided an account debtor is approved for credit insurance, the credit insurance issuer will only approve the account debtor for a certain dollar amount. Therefore, non-recourse coverage is only available up to this credit insured amount.

c. Payout generally occurs only in the event of an account debtor becoming insolvent and/or declaring bankruptcy (Chapter 11 or 7). It is more common for an account debtor to simply claim dispute on an invoice(s), therefore the receivable would be considered a recourse receivable and the factor would be guaranteed payment from the client.

Many prospects will ask for a non-recourse arrangement simply because they believe that they are protected in the event of non-payment. Certain industries such as those that cater to larger national retailers are better candidates for a non-recourse facility for the following reasons:

- Credit insurance is readily available;
- Clients may have greater cash exposure;
- Cost associated for the insurance is marginal.

A non-recourse facility is priced higher than a recourse facility as the factor is incurring additional expenses for the credit insurance. If a prospect considers that there is no protection in the event of a dispute, than recourse is often the very best product provided certain elements are in place.

If a factor is performing proper account debtor credit investigation and setting appropriate credit limits, prior to purchasing an invoice, they are reducing any additional exposure to the client. A good factor will only expose themselves to an amount they deem is appropriate for an account debtor. In the case where a factor ignores this simple philosophy and continues to advance above a predetermined credit limit, then they are unjustly exposing their clients to unnecessary risk. This ultimately backfires and the factor suffers.

Credit insurance is protection for both parties. More often than not, many factoring clients simply do not have the capability to repay an advance as they may be experiencing operating losses, have a deficit net worth, no liquidity available from the owners, etc. Some factors rely simply on credit insurance as a hedge against loss.

While this may be a good practice in theory, it is simply not practical. For instance, credit insurance is not available to all account debtors. If you have a client that needs maximum availability but only a portion of their account debtors are insurable, factoring provides no benefit to the client.

Concentration is a key factor in determining if a non-recourse arrangement adds additional security for both parties. If a prospect has a diverse account debtor base with an average concentration below 5 percent, there would be very few reasons to offer a non-recourse arrangement. In the unlikely event that an account debtor with a low concentration percentage declared bankruptcy, it would have a minimal effect on the clients business. However, if the client had a concentration above 15 percent and the account debtor declared bankruptcy, it may have mortally wounding effect on the prospects business.

Factors will often obtain credit insurance without offering a non-recourse arrangement. A factor is generally well aware of a clients financial inability to repay an advance plus fees in the event a large account debtor becomes insolvent.

There is no protection in the event an account debtor disputes an invoice. Generally, the only remedy is for the factor and the client to fix any possible dispute which in turn will obligate the account debtor to pay.

There is no exact science to credit. The factors that avoid problems are the ones that preform proper credit investigation up-front and properly verify the validity of a receivable prior to issuing an advance.

5. **Fee Structure**

Factors are generally limited on the fee structures they offer their clients. This is determined by the factors software. Most factors have the capability to charge their clients in one of two ways:

a. Straight discount. This is simply a fee based on a certain number of days outstanding. This fee is generally charged on the face (gross) amount of each invoice.

Example 6.

Straight Discount Fee Structure

Days Outstanding	Discount Schedule
0-31	2.50%
31-45	4.00%
46-60	5.50%
61-75	7.00%
76-90	10.00%
90+	13.00%

B. Administration Fee (may also be referred to as Monitoring/Management fee) on face and Prime-plus on advance. The administration fee is charged on the face amount of the invoice. This may be charged only one time or for a specified period. The Prime-plus charge is effectively an APR divided by 365 days which equates into a daily rate. This is generally charged only on the advance amount.

Example 7.

Administration Fee with Prime-plus on Advance Amount

	Fee Window	Rate
Administration Fee	This may be a flat one time charge or reoccur over a certain number of days. This is generally determined by DSO and factors required yield.	Price can range from .50bp on face to 1.50%
Prime Plus	Charged on the advance amount or what is commonly referred to as the net funds employed. Divide this number by 365 days and the daily rate will be determined.	Generally 1-5% above the prime rate.

Factors generally determine the pricing of a transaction on the following key factors:

- Amount a prospect intends to factor on a monthly basis;
- Number of account debtors;
- Credit quality and spread of account debtor base;
- Average DSO;
- Committed versus expected contract;
- Industry;
- Financial strength of client;
- Strength of guarantors;
- Sophistication of clients management team.

In addition to the fees associated with the purchase of an invoice, a factor may also charge:

- Invoice processing fees;
- Wire charges;
- Minimum invoice charges;
- Line origination fees;
- Concentration penalties;
- Misdirected payment penalties;
- Debtor credit investigation charges;
- Minimum monthly contract charges;
- Due diligence fees;
- Audit or field review charges (as needed).

A large majority of factors charge clients on a per invoice basis. Each individual invoice is monitored and when payment is received, the individual invoice is closed and fees stop accruing. Certain factors charge their clients on what is called a "batch" basis. Clients submit invoices to factors on what is commonly referred to as a schedule or assignment schedule.

On this form a client will list the individual invoices they are selling. Factors that charge their clients on a batch basis continue to earn fees on an entire schedule until the last invoice open gets paid.

For example, if a client submitted ten invoices from ten different account debtors and nine of the account debtors paid the invoices within 30 days but the tenth waited until the 75th day, then all invoices would be charged the 75 day rate.

Approval & Closing

Once the factor and the prospect have reached a "meeting-of-the-minds" and the necessary proposals and formal documents have been executed a factor has a few final tasks that must be completed prior to the release of funds.

1. Formal Searches. A factor will search the exact entity listed on the articles of incorporation or articles of organization in the State where the prospect is legally organized. For instance, a prospect may operate in Florida (in which they are considered a foreign corporation), but are legally recognized as a Delaware corporation. Therefore, a factor generally performs the following searches in the State in which the entity is organized:

   - UCC Search. The factor is searching for any open UCC filings on the prospect. Remember, that a factor requires a perfected priority interest on the accounts receivables.
   - Suits, Liens, Judgments Search. A factor is searching for any pending litigation, any open liens or judgements which may affect a factors ability to collect on the receivables.
   - Tax Liens. A factor is searching for any open tax liens.

   Many factors will also search the State(s) in which a prospect is operating in, as an added measure of security.

2. UCC Filing. A factor must properly file and record their security interest on the proper legal entity at the State in which the prospect is organized in.

3. Account Debtor Final Credit Review. A factor may perform additional credit investigation on the account debtor base to determine if the invoices submitted can be purchased base on the account debtors creditworthiness.

4. Noticing of Account Debtors. A factor will sent out the necessary notice of assignment letters to the account debtor base.

5. Verification of Accounts Receivables. A factor will verify through the support documentation and generally through a verbal or written verification within an account debtors accounts payable department. Many factors have a policy that they verify a minimum of 80 to 100 percent of the net funds employed on an initial funding. During this verification process a factor will generally also confirm that the account debtor has received the notice of assignment letter and has changed the remit to address within their payables system.

As a general rule of thumb, this process can take anywhere from 3 to 14 business days. Therefore, upon submission of the executed legal documents, a prospect may receive their first funding within this time period.

Day-to-Day Activities

After the client receives their initial funding they may quickly fall into a standard routine. Many factors describe the initial month of any new relationship as "tense." A factor may have to quickly adjust the advance or reserve structure if they determine they have increased exposure. Until a factor receives payment directly from an account debtor and on a regular basis, this guard may remain high.

Once a prospect has been informed on what process is required for the submission of invoices the day-to-day process may work similar to this:

- Client may seek advise from factor on the creditworthiness of a prospective customer. Credit limit will be determined;
- Client provides goods or services to customer and invoices;

- Client provides the invoice(s) along with the agreed upon support documentation on an assignment schedule;
- Factor processes the invoice(s) and enters them into their system;
- Factor performs the necessary verification process;

    a. Support documentation is evaluated;
    b. Account debtor may be contacted by phone to confirm delivery of goods or completion of services. During this conversation, the factor may inquire if payment is contingent upon further performance by client;
    c. Factor confirms that payment is routed to factors correct address;

- Factor releases the advance;
- Factor and client pro-actively monitor position of receivables. Daily dialog between factor's and client's staff is established. Best method's are established for a team approach to receivables management;
- Factor provides reports to client. This can be via internet, fax or e-mail, or regular mail;
- Factor receives payment from the account debtors on a daily basis. Factors that have online capabilities generally report collections on the same or following day.
- After the agreed upon float time, the factor will release the eligible reserve balance;
- Factoring process continues with the submission of new invoices.

Over time the relationship may mature where the factor agrees to increase the advance percentage, make seasonal over-advances, offer purchase order or trade finance or other financial accommodations.

Export Factoring

Few factors have the necessary resources or expertise to offer availability to those clients that sell internationally. Factors that have global presence generally will allow a certain percentage of export availability. Allowing eligibility on export sales is mechanically no different than purchasing domestic debt. However, a factor is not protected by the Uniform Commercial Code or the notice of assignment provisions in foreign countries. Therefore, a factor that offers export availability must take many other items into consideration when offering availability to offset the potential risk. Some of the items a factor may take into consideration are:

- Financial strength of client;
- Percentage of overall export debt;
- Country in which prospect is selling to;
- Financial strength of account debtor;
- Industry;
- Language;
- Culture;
- Conversation ratio;
- Many other items.

While the decision to offer export availability is carefully concerned, a factor must not ignore the fundamentals:

1. Country of Account Debtor. Many factors will only buy export debt from account debtors who are domiciled in countries where there are favorable trade/political relations.

2. Stability. Many factors will not give export availability to an account debtor that is domiciled in a country or region that has political, civil or monetary instability.

3. Language. Many factors have a limited language pool to draw upon. Factors must have a reliable arms-length method to communicate with an account debtor an a moments notice.

4. Currency. A factor must know if the account debtor has agreed to acquire the goods or services in the dollar. Or a factor be capable to determine the exchange rate and adjust an advance accordingly.

5. Credit Extension. The process required to obtain a foreign account debtors creditworthiness is exactly the same as a domestic debtor. However, the time in which to acquire this information generally is slower and the cost associated with the obtaining of basic credit information can be prohibitive.

6. Remittance of Funds. A factor must identify and confirm the agreed upon process of remittance of funds. If the account debtor wires payment, then a factor must successfully change the remittance instructions with the account debtor.

Factors Chain International is an organization made up of individual factoring companies in many industrialized nations. Members can (for a fee payable to the assisting party) assign the invoice/debt to a member factor within an account debtors country. The assignee will perform the necessary duties of noticing the account debtor, verifying the debt, monitoring the invoices and ultimately collecting on behalf of the assignor. This service becomes valuable for the factor that wants local representation or to ensure that their rights are protected under another countries laws.

Those factors that offer export availability generally will not offer large advances and may charge an additional premium. A factor may also choose to limit export availability to a certain percentage of the overall domestic debt thereby further reducing potential exposure.

Factoring Federal Government Receivables

Buying accounts receivables that are generated from the providing of goods or services to a Federal Agency is exactly the same as traditional factoring with a few twists. Those twists specifically revolve around the notice of assignment as a different method is required. The Federal Government has prescribed certain policies and procedures for the proper assignment of claims. Factors that advance on government accounts receivables are bound to the Assignment of Claims Act of 1940, as amended, 31 U.S.C. 3727, 41 U.S.C. 15. and (48 C.F.R. 32800-32-806).

The Assignment of Claims Act has the following condensed conditions:

- Only payments aggregating $1,000 or more are applicable;
- The Assignment must be made to a bank, trust company or other financing institution;
- The Contract does not prohibit the Assignment;
- The Assignee must send a written notice of assignment together with a true copy of the instrument of assignment with 1 original and 1 copy.

There are two additional steps that are required when noticing Federal Government account debtors. These steps supercede the traditional notice of assignment. The first involves documentation that must accompany the invoice to become a valid assignment. Those documents are:

1. Copy of the contract or purchase order;
2. Notice of Assignment (1 original and 3 copies);
3. Instrument of Assignment (1 original and 1 copy).

The second step under a Federal Assignment of Claims is that unlike traditional factoring, whereas the account debtor is put on notice only one time and therefore becomes a standing notice of assignment, a Federal Agency must be noticed for each individual invoice submitted. There is no standing notice provision.

The Notice of Assignment and Instrument of Assignment are forwarded directly to the Contracting officer and Disbursing officer or payment agency for each invoice. After receipt of this information, the Contracting officer is required to acknowledge the Notice of Assignment by executing it. This is then forwarded to the agencies designated payment center with a copy being returned to the factor.

As a general rule of thumb, most factors register with the Central Contractor Registration Database to ensure they can obtain payment in a timely fashion. Contrary to what some may believe, the Federal Government is actually a timely payor.

Instrument of Assignment

INSTRUMENT OF ASSIGNMENT

Contractor:
Sample Company, Inc.
1212 Maple Street
Lanham, MD 20706

Contract Number: 34521X883-9033

KNOWN ALL MEN BY THESE PRESENTS: For value received and in accordance with the Assignment of Claims Act of 1940, as amended, 31 U.S.C. 3727, 41 U.S.C. 15. and (48 C.F.R. 32800-32-806), the undersigned Contractor as Assignor, does hereby assign to, as Assignee, all monies due or to become due under Contract Number 34521X883-9033 dated April 15, 2005 and all delivery orders, task orders or purchase orders thereafter issued by the (Contracting Agency).

CONTRACTOR NAME	ATTESTED BY CORPORATE SECRETARY
________________	____________________
Signature	Signature
	AFFIX CORPORATE SEAL HERE

NOTICE OF ASSIGNMENT

Sample Company, Inc.
1212 Maple Street
Lanham, MD 20706

May 1, 2005

Contracting Officer
50-Building D #44
2232 Armory Road
San Antonio, TX 25561

Contract Number: 34521X883-9033

This has reference to Contract Number 34521X883-9033 dated April 15, 2005, and all delivery orders, task orders, and/or purchase orders issued thereunder, entered into between Sample Company, Inc., located at 1212 Maple Street, Lanham, MD 20706 herein after the ("Assignor") and Governmental Agency located at 50-Building D #44, 2232 Armory Road, San Antonio, TX 25561 to provide supplies and/or services according to the above referenced Contract.

Please take notice that monies due or to become due under the Contract described above have been assigned to XYZ Factors, Inc., pursuant to the provisions of the Assignment of Claims Act of 1940, as amended, 31 U.S.C. 3727, 41 U.S.C. 15. and the Federal Acquisition Regulations ("FAR") relating thereto (48 C.F.R. 32800-32-806).

Payments due or to become due under the aforementioned Contract should be made to XYZ Factors, Inc., as Assignee as follows:

Via Check

Via Wire

Please return to the undersigned, at your earliest convenience, an executed copy of the Notice of Assignment with appropriate notations showing the date and hour of receipt and duly signed by the person acknowledging receipt on behalf of Addressee.

PLEASE DISTRIBUTE A COPY TO THE APPROPRIATE PARTY(S) IN THE ACCOUNTS PAYABLE OFFICE FOR YOUR AGENCY.

ACKNOWLEDGMENT

Receipt is hereby acknowledged of the above notice and copy of the above mentioned Instrument of Assignment. These were received at ________ a.m./p.m. on_______, 2005.

PAYMENT OFFICE INFORMATION
Contact:
Title:
Phone & Extension:
Branch Name:

ON BEHALF OF:
____
Signature

YOUR NOTES:

Glossary

ABL
Acronym for Asset-based Lending.

A/R
Acronym for accounts receivables.

Account Debtor
The entity responsible for payment of an invoice. Alternatively referred to as "customer."

Advance Rate
Commonly used to describe the agreed upon up front percentage that is advanced to a client.

Advance Reserve Factoring
A type of factoring arrangement where the factor issues an initial advance to a client and remits the balance less fees upon collection from an account debtor.

Assignment
A transfer from one party to another of title and/or interest in a payment obligation such as a commercial receivable and, in the factoring industry, a term used to describe a financing transaction.

Audit Fee
Some factors charge for the time and expenses of an independent auditor to examine the books and records of a prospect. This is usually charged for the initial audit and in most cases additionally charged quarterly or semi-annually as follow-up to review collateral position and compliance.

Audit Trail
In factoring, a term used to describe the information (contracts, purchase orders, delivery receipts, etc.) that support the validity of an invoice.

Back Room
The section of an factor where the general administrative functions occur, such as invoice or sales journal processing, accounting, reporting, verifications, collections, etc.

Batch
A group of invoices prepared for submittal to a factor.

Charge-back
An invoiced amount which becomes payable by a client to a factor due to non-payment, dispute or set off by an account debtor.

Client
In the factoring industry, a seller of accounts receivables.

Concentration
Concentration refers to a certain percentage of receivables that exceed a predetermined number. Most factors prefer concentration levels not to exceed 30 percent.

Contra Account
An account in which a payable owed to a party is offset by a countervailing receivable due from the same party.

Credit Memo
1) An accounting adjustment which reflects a return, overcharge or similar event, thereby reducing or eliminating the amount of a receivable payment by an account debtor; 2) a document sent to an account debtor evidencing such an accounting adjustment.

Customer
An alternative term for "account debtor" preferred by some factors.

DBT
An abbreviation for "days beyond terms," as in the number of days beyond the due date that an invoice remains outstanding.

DSC
An abbreviation for "debt service coverage," a financial ratio measuring a borrower's ability to meet payments on a loan after paying expenses. The ratio measures the number of times loan principal and interest are covered by net (after tax) income.

DSO
Calculation utilized to determine the average number of days receivables remain outstanding before they are collected.

DTW
Debt to worth ratio and also commonly referred to as Debt to Equity Ratio. This is a measure used in the analysis of financial statement to show the amount of protection available to creditors. The ratio equals total liabilities divided by total stockholders' equity.

Debtor-in-possession ("DIP")
In a chapter 11 bankruptcy filing, a bankrupt commercial entity that retains control of its own business affairs and assets for the purpose of managing day-to-day operations, rather than relinquishing control to a court appointed trustee.

Dilution
In factoring, dilution refers to any amount of offset to an invoice.

DIP Financing
Financing that is provided to a debtor-in-possession in backruptcy.

Discount Rate
The percentage of invoice face value which a factor earns based on the number of days a receivable remains outstanding. This can also be a fee charged which is based on the gross amount of the invoice or funds employed.

Due Diligence

The process by with an factor determines the overall feasibility of a prospective client relationship. A typical due diligence procedure generally includes but is not limited to the following: (1) a search of the public records to identify existing or potential claims and filings against client assets; (2) verification of clients accounts receivables; (3) credit analysis of the client's financial situation and that of the major account debtors; (4) audit of the client's books and records, including visits to the prospective borrowers facility. Often times, due diligence is referred to as underwriting.

EBITDA

An abbreviation for **E**arnings **B**efore **I**nterest, **T**axes, **D**epreciation and **A**mortization. Another ratio analysis that is commonly used by lenders to determine the borrowers historical ability to repay debt obligations.

F**acility**

An factoring term which refers to the lending arrangement between an factor and client. Occasionally this may be referred to as "transaction facility," "arrangement," or simply the program.

Facility Fee

A fee usually expressed as a percentage of the overall loan/line amount charged by a factor as a cost of granting the facility. This is also referred to as a "line fee."

Factoring

1) to purchase accounts receivables at a discount from their face value; 2) a company engaged in the purchasing of commercial accounts receivables.

Federal Assignment of Claims Act

A Federal Law covering the rights and obligation s of parties holding invoices, contractor or other domestic trade obligations payable by the government of the U.S. Factors purchasing such invoices must comply with the procedures set forth in this act in order to enforce their collection rights against the Federal Government.

Float Days
An additional number of days that finance charges continue to accrue until payments received from an account debtor clear the bank.

Funding
Also referred to as advances by some lenders. This is a term used to describe the process of providing an advance(s) to a borrower.

Hidden Liens
Lien rights created by certain Federal or State laws that do not provide for the holders of such liens to make public notice filings. Consequently, the existence of hidden lien claims cannot be uncovered through normal due diligence procedures. An example of a hidden lien would be a lien held by a produce grower against a produce distributor under PACA laws.

Inter-Creditor Agreement
An agreement between two secured creditors setting forth their respective rights and interests in the same collateral, as in the agreement between a commercial lender, bank, factor or finance firm when providing financing to the same client or borrower.

Inventory
Merchandise or supplies on hand or in transit at a particular point in time.

Invoice
A statement of the amount due a trade creditor for completed or delivered services or goods. An invoice represents a legally sustainable debt.

Invoice Proceeds
Money actually paid by an account debtor is satisfaction of an invoice as opposed to money merely owed against invoices.

Judgement Creditor
A creditor who, having prevailed against a debtor in litigation, has thereby acquired the legal right to satisfy it's claims by attaching debtor assets.

LC

An abbreviation for a **L**etter of **C**redit. A credit instrument issued by a bank guaranteeing payments on behalf of a customer to a beneficiary, normally to a third party but sometimes to the banks customer, for a stated period of time and when certain conditions are met. There are three types of LC's

1) Irrevocable Letter of Credit
This cannot be cancelled before a specific date without agreement by all parties involved.
2) Confirmed Letter of Credit
Carries the endorsement of both the issuing bank and its correspondent, guaranteeing payment of all drafts written against it.
3) Standby Letter of Credit
This is a contingent (future) obligation of the issuing bank to make payment to the designated beneficiary if the bank's customer fails to preform as called for under the terms of a contract.

Lien

1) a legal document recording the existence of a security interest; 2) a perfected security interest in specified collateral.

Lockbox

A type of bank account set up by a lender to which payments from account debtors mail invoice proceeds. Bank personnel deposit the collections and then disburse payments pursuant to an underlying tri-party agreement.

Maturity Factoring

A factoring arrangement under which the factor does not issue up-front advances, but instead guarantees payment of a clients invoices within a certain number of days beyond terms. Maturity factoring is commonly utilized as a form of credit enhancement.

Non-Recourse

A type of factoring arrangement where the factor assumes responsibility for credit losses caused by insolvent account debtors. Under a non-recourse factoring arrangement, a factor relinquishes the right to seek recovery from it's client when an account debtor proves financially unable to pay.

Notice of Assignment
A written notice to an account debtor that a factor has taken title to invoices for which they owe payment. The notice of assignment is clearly spelled out in the Uniform Commercial Code.

Notification
1) the act of issuing notices of assignment; 2) A term used to describe a factoring arrangement which involves making notices of assignment to account debtors.

Offset
Reduction or elimination of an invoice balance due to the existence of a mitigating circumstance such as a credit or contra account balance, dispute or other objection to payment.

Over-advance
An advance which exceeds the predetermined formula percentage normally in effect between a borrower and lender.

Perfected Security Interest
A security interest, notice of which has been properly filed pursuant to RA9 of the Uniform Commercial Code and in accordance with the procedures set forth under State statutes.

Perishable Agricultural Commodities Act (PACA)
A Federal law providing priority payment to growers or producers of agricultural commodities by distributors or wholesalers of such commodities. These are generally hidden liens.

Portfolio
1) the total outstanding invoices for all clients to which a factor holds title a any given time; 2) the total invoices outstanding at any given time which have been factored by a single client.

Pre-ship Invoice
An invoice which a client generates and submits to a factor prior to delivering goods and/or services to the account debtor. Most factors consider the submission of such invoices as a breach of client representations.

Proposal Letter
A letter from the lender to the prospective borrower setting forth the general terms and conditions of the proposed lending facility.

Purchase Order
An order for goods or services issued by an account debtor.

Recourse
The typical arrangement utilized in an asset-based lending facility under which the prospective borrower retains responsibility for all non-payment or credit losses caused by insolvent account debtors. Asset-based lenders generally do not offer non-recourse arrangements which are commonly found in factoring transactions.

Reserve Account
An account set up to track funds owed to a client from the collection of factored invoices.

Schedule
Among some factors, a term used to describe a factoring transaction. See assignment and funding.

Security Interest
A legal right to recover an asset from its owner when said owner fails to fulfill obligations or defaults under a lending relationship.

Spot Factor
To factor on a one-time basis with no expectation of creating an ongoing factoring relationship.

Sweep
The act of clearing funds from a lockbox account for disbursement by a creditor who established the lockbox on behalf of the client company.

Tax Lien
A public notice of taxpayer liability which, when filed in the appropriate jurisdiction by State or Federal tax authorities, secures the taxing authority's priority claim to the taxpayers assets. This lien will automatically supercede any secured or unsecured creditors filing.

Term Sheet
See (Proposal Letter)

UCC-1
This is the necessary legal document when properly filed in an appropriate jurisdiction(s) pursuant to RA9 of the Uniform Commercial Code, perfects a security interest in a debtor's collateral.

UCC-3
A document used to terminate, assign, amend or subordinate a security interest, which has been previously perfected by a UCC-1.

Uniform Commercial Code
A body of laws governing commercial transactions, which has been uniformly adopted in all 50 States.

Verification
The process by which a lender determines the general validity and Collectability of account debtor balances prior to an initial and subsequent advances made against accounts receivables.

