



**International  
Factoring  
Association**

**Presidents and  
Senior Executives  
Case Study  
And  
Factoring Discussion  
Meeting**

**October 18 & 19, 2004**

**Monte Carlo Resort & Casino  
Las Vegas, Nevada**

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## BROKE ASS VALVE AND REGULATOR COMPANY

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### I. Case synopsis

Broke Ass Valve and Regulator Company (Broke Ass) engages in the sale, repair, and monitoring of pressure regulators to major refineries, gas pipeline companies, and chemical companies in Texas and Louisiana. Invoice terms are 30 days with invoices supported by contracts or Po's further by time tickets and work orders for repair work or delivery tickets for new regulators. Two thirds of the delivery tickets are by UPS or common carrier with 1/3 by company trucks. Average turn is 38 days with spot verification and the customer has been a very good five year customer of Gulf Coast.

Recently, the account executive reported to the credit manager and chief credit officer and to the President a slow down in the companies aging. Two major customers went over 75 days with 7.5% over 90 days versus historical 2.5% with another 10% over 75 days. Gulf Coast was performing a low level of verification and was in the process of putting on several new accounts with most verification efforts on the new accounts. Over the five year life of the account, there had been instances of a slow aging where the company simply wasn't paying attention to their collection process, hence the President was not alarmed and said to concentrate on the verification of the new accounts; this was an old and valued customer.

### II. What went right or wrong

Thirty days later the account executive and credit manager met with the President and reported that the aging showed continued slowness with 10% over 90 which was charged back with another 12.5% over 75 days and 15% over 60. Several verifications came back where the company did not have a copy of the invoice. Gulf Coast was experiencing some significant new business and the President was busy calculating what his bonus would be for the year when the credit manager and account executive walked in his office. In fact, he had brochures spread out on his desk for a new 50 inch plasma television and was trying to determine which brand to purchase. He became annoyed with both the credit manager and account executive and told them to do their jobs and go back and verify more accounts.

Two weeks later, the account executive and credit manager met with the president and informed him that they had uncovered three fraudulent invoices. In fact, one invoice to Monsanto the company indicated was actually a real invoice but the invoice had occurred in the year 2001 not 2004 and had been paid by Monsanto who faxed a copy of the check for 2001. It was obvious that the 2001 invoice had been doctored and we had phony invoices. Two additional fraudulent invoices were found. With approximately \$800,000 outstanding, Gulf Coast was totally unable to verify approximately \$200,000 and determined that these could be potentially fraudulent.

The customer was called in at a meeting and admitted that approximately 150,000 of invoices were fraudulent. The other 50,000 Gulf Coast was simply unable to verify. The President had to be physically restrained from attacking the client with a baseball bat on his head and posterior and then indicated that the bank would have to report the wrongdoing to the appropriate authorities. One week later, the client gave Gulf Coast a cashier's check for \$150,000 from his IRA and personal assets. At that time, Gulf Coast continued to fund but on the basis of 100% written verification and asked the client to move his business.

Two weeks later, Commercial Capital in Baton Rouge, Gulf Coast's old nemesis and major competitor called and said that Broke Ass was talking to them about a factoring arrangement. The Gulf Coast President licked his chops. Should he stick it to Commercial Capital, those scum sucking pigs, and get rid of this problem or be forthright and protect the reputation of Gulf Coast.

Once the President of Gulf Coast became aware of the fraud and all of its ramifications, he immediately took corrective action. First, he chewed out his staff for not keeping him informed, asking them what were they thinking, where their heads were, and how they could mismanage such an account. Like a good CEO, he took none of the blame but immediately picked up the telephone to order his plasma television.

### III. What should/should not have done

- Gulf Coast was lulled to sleep about the "Good long standing customer routine"
- Gulf Coast should immediately have stepped up verifications when the aging first went out of line and this should be monitored on a weekly basis.
- After checking the file it was determined that financial statements hadn't been received for 2 quarters because of computer problems, the controller going on medical leave, excuses, excuses, excuses and this should have been a red flag.
- Never should greater attention and resources have been placed on new business than on the credit quality of existing business and the important mission of avoiding loss.
- Most of the fraudulent invoices in hindsight were the result of items delivered by company truck and not common carrier. The factor should have had policies in place to do greater verification on these items.
- The factor handled Commercial Capital properly by telling them they should use great caution and perform their own due diligence while at the same time protecting factor from any lender liability but not painting a rosy picture for a factor to take them out.
- In the final analysis, maintaining a factors reputation is more important than getting rid of a problem credit.

### IV. How to handle in the future

- Asset quality meets on a weekly basis to go over the aging of every account. With any change in the aging, the verifications should increase.
- The factor should monitor charge backed receivables to ensure that some record is kept whether those come in later as non-factored or if they are not collected so that accurate dilution is tracked.
- Red flags such as late financial statements should trigger increased verification.
- Once even the smallest amount of fraud is detected, the character issue remains paramount and the excuse "I'm sorry but I won't defraud you again" is simply not sufficient.
- Lower advance should have been coupled with increased verification once aging concerns were noted and other red flags appeared.

## SLEAZY DOG CRANE COMPANY

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### I. Case synopsis

Sleazy Dog rents cranes, cherry pickers, and other equipment on a daily fixed rate basis. They have approximately 1,200 customers with 1,000 invoices per month. This includes approximately 50 invoices for \$10,000 or more with the remainder down to \$200.00. The company has excellent paperwork, a history of low charge offs and low dilution and a good aging with over 72% or AR less than 60 days. This is a very profitable account.

When Gulf Coast first funded the account, current 941's were given to the bank along with current financial statements. Since that time the company had gone through 2 controllers and fired their outside accountant to save money and financial statements are not current. The factor runs a lien search every 30 days on all accounts hence, was comfortable that there was not a tax issue.

### II. What went wrong?

Approximately four months ago, the company had a misdirected payment totaling \$70,000 and the factor charge of a 15% misdirected pay, read them the riot act and told them that this was a mortal sin of the greatest proportion. They, of course, blamed Suzy Q the secretary who inadvertently received a check and deposited same. However, on three occasions when our account executive inquired about the past due payment, we were told that it should be mailed shortly.

The aging continued to be good with only a very slight deterioration.

Two weeks ago, factor received notice from the IRS that over \$700,000 of past due taxes had not been paid dating back to quarters in 2001 and 2002. Sleazy Dog became a client of factor in 2003.

Immediately factor began renotifying and reverifying finding another \$80,000 of misdirected payments.

### II. What should/should not have done.

The factor should have taken the following steps to avoid this situation:

1. Got 941's from previous years at inception.
2. Kept up the current 941's more closely since the missing of one quarter triggered the tax lien from prior periods.
3. Done a background check on the CEO who was an owner but had the same type of issues in a similar company years ago.
4. The factor should be congratulated on monthly lien searches on all accounts.
5. The factor immediately called the customer and indicated that they would have to discontinue funding unless subordination could be obtained from the IRS.
6. The factor did tell the customer that he would consider dip financing if bankruptcy was filed.
7. Since the equipment was all owned by another company owned by the major principal who was not CEO, the company decided to immediately start invoicing through a brand new company and not put Sleazy Dog in bankruptcy. They asked factor to provide factoring service for Newco. The factor declined.

III. How to handle in the future.

1. Special background checks could have been performed regarding previous experience of owner and CEO.
2. The factor correctly handled the re-notification process with hard notification letters and written verification on 100% of accounts immediately upon learning of the tax lien.
3. The factors refusal to factor invoices on new company was a correct decision especially in lieu of the character issue in a lack of responsibility in dealing with the IRS situation and possible piercing of corporate veil issues.

## DEADBEAT PIPE COMPANY

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### I. Case synopsis

Deadbeat Pipe Company performed pipeline inspection for major oil companies. They bill for every meter of pipe laid or bi-monthly for testing services. The paperwork was impeccable. The aging was excellent with over 60% current and 80% less than 60 days.

The aging got out of whack when 18% of receivables went past due 90 days because of a major dispute with Texaco. In order to charge back receivables of this magnitude, the factor had to lower advance rates and chargeback over a period of six weeks. At this time, the company was on a spot verification basis with an advance rate of 85% cut to 75%.

The company had approximately \$1.2 million outstanding with a \$400,000 dispute.

The factor continued to fund on new invoices with the remainder of the aging unchanged. The chargeback put pressure on the company's accounts payable but the factor appeared to be in the clear.

The factor started to receive several short pays. These were explained away by client for various reasons. The short pays continued and dilution went from approximately 2.5% to almost 15%. The client said that the major oil companies were simply putting pressure on them and they didn't want to lose good clients in a declining market hence, they were being squeezed. The factor gave the company the benefit of the doubts since they had been a good client for years.

### II. What went wrong?

As dilution increased and the over 90 day column increased, factor realized that they had a problem. With increased verification, one major oil company told factor that the invoice included both the mobilization and demobilization and neither one of these items were included in the master contract. The factor went back to look at old paperwork and discovered that this was true. However, the invoice included charges for both mobilization and demobilization.

After examining all the short pays, it was obvious that Deadbeat was padding legitimate invoices for items that client knew would not be paid by major oil companies. However, this was a method of gaining a 100% advance instead of the 75% that factor had in effect.

### III. What should/should not have done?

#### 1. Monitoring

At the first sign of a change in aging or dilution, significant increased verification must be performed.

#### 2. Paperwork Monitoring

Where PO's referred to master contracts, the contracts need to be reviewed on a continual basis to make sure that Po's and invoices are consistent with the original contracts.

#### 3. Remember that factoring for service companies always entails more risk than distribution and manufacturing and more opportunities for fraud.

4. Remember that by increasing the price and lowering the advance rate, the factor is only aiding and bedding fraud and becoming a participant in the game.

IV. How to handle in the future.

- Stick to a strict monitoring policy reviewing aging, dilution and verification weekly.
- Any short pay must be investigated thoroughly as this is a red flag.
- When it appears that a fraudulent situation exists, address it head on and don't become a player in the game.
- Increased profitability never covers increased risk when the risk is fraud i.e. (increased price is not a substitute for character.)
- Get out of a bad situation early. Remember when the music stops, there won't be enough chairs to go around.

## JAILBIRD STAFFING COMPANY

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### I. Case synopsis

Jailbird Staffing Co. (Jailbird) is a disadvantaged business providing janitorial service. The company approximately 4 ½ years old has gotten significant government contracts with revenues skyrocketing to approximately \$24,000,000. Major expense items are salaries and benefits accounting for 81% of the revenue yielding a gross margin of 19%. The company has been unprofitable for 2 ½ years. Gross margins have not increased as the company has grown. The company's explanation is that significant front end expenses are associated with securing the contracts.

Jailbird has been financed by a local bank and had been asked to move. They have internal financial statements which show a loss for the previous year as well as a negative net worth. However, internal financials show that the company is nearing break even and projections forecast a profit for the following quarter. Financial statements show slightly over a \$1,000,000 payroll tax liability and the company is on a payment plan with the IRS. No lien had been filed on their taxes. The company is seeking a factoring facility of approximately \$3.5 million and an aging shows \$3.6 million in receivables with an average pay of 48 days.

### II. What went wrong?

During due diligence the following was discovered.

- Financial statements show an incorrect tax liability. The actual liability is approximately \$5.2 million which included \$3.5 million of past due taxes, the remainder interest and penalties. The payment plan does not include earlier or subsequent periods nor the penalties and interest.
- An analysis of the financial statement revealed approximately \$1.3 in shareholder loans. In addition to his \$400,000 salary, the principal used these funds for a lavish lifestyle and to build a \$3,000,000 house. While the chief financial officer said that the President was unaware of the tax problem, it was discovered that money was taken out of the company after the date that the payment was signed by the IRS and the owner of the company.
- A study of the paperwork shows Jailbird bills on the first of the month for all services to be delivered during that month per the contract. The contract further calls for the various government agencies to perform annual audits to ensure that all aspects of the contract are being met i.e. (drug testing, no illegals, and an audit of all the expense items used in the RFP request for proposal.)
- There was a letter from Jailbird's accountant which said that he had talked with an IRS agent who agreed that they had put an internal flag on the account so that no other government entities i.e. (debtors) would utilize the right of offset.
- An analysis of current cash flows did not support the \$50,000 a month IRS payment plan.
- A comparison of the company's P&L to the RMA industry average showed that Jailbird was significantly out of line on G&A expenses.
- A further analysis showed that the company had actually never paid one dime in payroll taxes since inception and it simply used this as venture capital to grow the company.

- III. What should/should not have been done.
- Can factor get over the character issue i.e. (a deliberate predetermined plan to not pay taxes and use this as venture capital and lavish living expenses?)
  - Factor will have the risk of pre billing.
  - Inaccurate financials show either a lack of financial acumen or deliberate attempt to hide the real tax liability.
  - Without IRS subordination a lien can be filed at any time.
  - Government agencies have the right of offset on past due taxes even without a lien having been filed.
  - Difficulty of verifying and enforcing verification with government agencies.
  - The factor should quantify risk associated with annual government audit and the rights of offset for non-compliance with all contract terms.
- V. How to handle in the future.
- The factor needs a specific policy on past due payroll taxes and as to what circumstances will cause factor to fund with past due payroll taxes addressing the questions of amount, reason, length of time period, method of repayment, subordination, etc.
  - A practical policy regarding verification issues with government agency.
  - Is there a way to finance pre-billing if allowed under the government contract?
  - Pay attention to balance sheet and P&L to find all red flags.

# COMMERCIAL CAPITAL LENDING, LLC



## THE STONE CRUSHER

### **Case Synopsis**

In June 2002, we received a referral from a bank to finance a newly formed entity that was in the concrete and stone crushing business. The owner (we'll refer to him as Stone Crusher) had presented financial statements and A/R agings from several other related companies he had interest in at that time. Stone Crusher told us he was "winding down" those operations which had a partner he no longer was doing business with. In the aggregate, the other businesses did approximately \$7 - \$8 million a year in revenue. We were also told that the obligations of the other companies would be self liquidated (i.e. equipment, A/R, etc.) and that he only needed A/R financing on a go-forward basis for the new entity. All due diligence on the new entity was completed and checked out fine. Our only concern was to make sure all A/R we funded wasn't in any way associated with the pre-existing entities. In order to be absolutely certain we required that each invoice be verified in writing acknowledging that the money was due only to the entity we were financing and that there could be no offset or counterclaim against that specific invoice. After about 6 months in the relationship, we ran into several disputed invoices even though we had written confirmation as stated above. We ultimately ceased all funding and initiated collection efforts against the related Account Debtors and our customer for repayment. We obtained several judgments which we are currently collecting and hopefully we will be repaid most of what we are still owed.

### **What Went Wrong**

Approximately one year later, we were contacted by an attorney who represented Stone Crusher's ex-partner in the pre-existing companies that were "winding down" prior to us financing his new company. This attorney advised us that his client had guaranteed a number of obligations for Stone Crusher and was looking at a significant potential loss as a result of those guaranties. We expressed our sympathy for Stone Crusher's ex-partner but advised him that we had only financed the new company and had no involvement with the pre-existing entities. We were ultimately sued by the ex-partner who alleged we had somehow conspired to help create this new entity (although the entity existed prior to our contact) to somehow divert funds from the pre-existing companies. After a number of depositions, expert testimony and more legal bills, it is obvious to all parties concerned that their conspiracy claim is totally without merit. Unfortunately, this matter may still have to be litigated if the ex-partner decides to pursue it further.

### **What Should Have Been Done**

- Before you fund a newly formed entity – should you directly contact prior partners in other pre-existing entities?
- Should you contact the bank that financed other entities even though no releases or subordinations were required to finance the new entity?

### **How to Handle in the Future**

We have become more proactive in our due diligence when we are approached by a new entity that is a "spin-off" of a pre-existing company.

## Comresco Capital

**Case Synopsis:** Our “best” and most “trusted” client submitted fraudulent invoices and provided falsified supporting documentation at a vulnerable time during our company’s history. The client also collaborated with select account debtors to provide false first-line confirmations.

We were moving our office location, converting operating systems and installing new phones and computer hardware. These changes had to be managed as well as our accounts. We maintained our focus and diligently reviewed our purchases realizing the risk associated with the drain on our resources for managing the myriad of non-daily and operational demands of the move and systems conversions. However, we unintentionally lowered of guard on our “good” clients for fear we would get burned by our challenging accounts.

### Background:

- Construction-related client
- Client performed an easily verified service
- No long-term projects
- Jobs were completed in a matter of days
- Jobs were invoiced in a manner of days
- No subcontractors performed work
- Account debtors were either general contractors with an approved property owner or property owners
- Signatures required from account debtor to confirm the work was completed
- Average volume approximately \$250m-\$300m a month
- Average turnover was 43-48 days
- Dilution no more than 3% on average

**What went wrong?** In December 2003 our office moved, systems conversions were initiated and our “good” client submitted one fraudulent invoice. The invoice was charged back to ample cash reserves when verification came back negative. The client explained it was a billing error. We accepted his explanation given solid collections, ample reserves and overall good performance over the previous 12 months.

During January 2004 the system conversions continued. Verification and attention to detail lessened as resources were used for administrative changes and focus on “challenging” customers. The “good” client started a new job in February with a credit worthy account debtor. New invoices were initially verified. Random sample verifications were performed. A few inconsistencies were noted but no action was taken because we were certain this client would never intentionally defraud us. Overall collections slowed during the month as turnover moved to the mid-50s. We assumed our “good” client was experiencing slow payment because it was the first of the year. Ample reserves were still on hand.

In February 2004 our “good” client had a problem account receivable of approximately \$100 thousand. We confirmed the balance receivable on a municipality job but the account debtor was unable or unwilling to pay. Much of this month was spent on collecting this account. Reserves decreased as turnover fell to the mid-60s. During this month the client submitted about one false invoice for each account debtor for a total fraud of approximately \$260 thousand on gross receivables of \$600 thousand.

**Resolution:** At the beginning of March the results of aggressive confirmation of accounts and analysis of supporting documentation generated numerous questions the client was unable to answer. Upon confrontation, the client confessed and admitted the fraud.

Because liquidation would have resulted in a loss of at least \$200 thousand a workout was pursued. We found ourselves encouraging and supporting a client that defrauded us! The account was carefully monitored to ensure our exposure did not increase above the initial total fraud amount.

Luckily, the client had a good reputation and was able to get work. We encouraged him to eliminate cost, scale his crews back and concentrate work for those account debtors with the best margins. Moreover, we encouraged him to pursue a quick-pay program with an account debtor which accelerated his cash flow resulting in overall turnover on the account of approximately 23 days. Through a slight advance rate reduction, accelerated cash flow, reduced expenses, and focus on most profitable accounts we were able to get back in formula within 90 days.

**What should have been done:** The signs of fraud were evident and screaming at us. The slight but consistent variances in verifications, slowing turn over, billing errors, introduction of a new account debtor at the very time the client knew we were focused on moving should have been recognized as danger signs. These facets to the fraud seem very obvious now and in looking back we knew what was occurring but found ourselves making excuses for our “good” client.

**What should not have been done:** We should not have managed the risk with this client or any other client by adjusting for “trust”. The client deceived us, but no more than we deceived ourselves.

**Ramifications for the Future:** Fortunately the client had the means to continue to generate revenue. Otherwise, we would have suffered a sizable loss. We have changed in regards how we view each client and each invoice purchased. The staff asks questions and, most importantly, is not afraid to anger a “good” client. The trust factor has been eliminated and risks are managed through established operational controls and logic. The time required to access trend data, both confirmation results and account performance, was rapidly reduced. Our verification program was intensified and additional staff was hired to perform verifications.

The changes we made and lessons learned are not sophisticated. The resolution did not require unlocking a set of delicate secrets for managing a portfolio. The techniques used to detect and resolve the fraud were very simple – keep to the basics and stay the course. Instead of being the best judges of character and justifying excuses for the facts that were so evident we should have recognized the facts and reacted quickly.

## King Trade Capital

### 1. Case Synopsis:

Client is in the “fad” consumer products space. Single Debtor. King Trade Capital was asked to finance the import of goods to fill P.O.s to this single Debtor. Purchase Orders were aggressively verified in writing, verbally and, even in person at a trade show with buyer. Based on verifications, goods were imported and shipped to Debtor. Receivables related to this shipment were factored by a third party factor. Goods sold more slowly than expected by Debtor. Debtor and Client negotiated for Debtor’s return of product. Both Factor and King Trade Capital were in trouble based on these returns. Factor was repaid in full by Debtor based on aggressive negotiations.

Product was returned by Debtor to Client, who in turn resold it to another Debtor. Goods were delivered and factored by a new factoring company, KTC being paid in full. However, new Debtor now wants to return goods, putting new factor at risk.

### 2. What went wrong:

Retail Debtors, especially in the consumer goods space, seem to be getting more and more aggressive with returns, mark-downs, allowances, etc. This situation turned south very quickly. The Client, wishing to maintain its long relationship with Debtor, was willing to hurt his Purchase Order Finance and Factor companies to maintain that relationship.

### 3. What should have been done:

Purchase Orders were aggressively verified, in writing and verbally. Product was delivered on time and within quality specifications. It was a deal we would likely do 10 times out of 10.

### 4. How to handle in the future:

This is the big question. As Purchase Order Funders, we are presented with consumer products transactions constantly. How to handle the possibilities of returns, markdowns, etc.?

Case Synopsis: After many years in factoring we were surprised to find ourselves tangled up with the California Dept of Labor in regards to two of our clients within two months of each other.

The first client skipped out of town without paying the last payroll. We were aware of this, after the fact, but did not think that we were at risk. The Dept of Labor determined that the hospitals were “dual employers” and therefore had to make the payroll. The hospitals offset our invoices.

The second client, also a Nursing Registry, classified her nurses as independent contractors. Both the EDD and IRS had determined that her classification was fine. However, the Dept of Labor determined that as far as they were concerned they were not independent contractors and therefore had to be paid overtime based on California State overtime laws. The nurses working at multiple hospitals accumulating over 40 hours per week, but not over 40 hours at a particular hospital further complicated the situation. The hospital where the nurses worked when they went into overtime (over 40 hours) was now responsible along with the nursing registry to allow billing and paying of overtime. They went back 6 months and determined that \$46k of overtime was due her employees.

Right/Wrong: In the first case, what went right was, we had invoices we had not purchased, and reserve which offset most of our loss, but we did have a loss.

In the second case, what went right was our client wanted to do the right thing and also stay in business. We had an idea of the amount of the overtime due, had talked to the Dept of Labor ourselves, and then went with the client when she met with the Dept of Labor. We ended up “over advancing” our client the \$30k, made the payments to the employees ourselves on behalf of the client to insure the money was in fact used to pay the employees. We were paid back by our client through her reserve and taking a set amount from each funding and applying it to our over advance. And three years later she is still a client.

Should/Should not: We funded one more time after we heard a rumor that payroll wasn’t met on a couple employees. We should have not funded until we looked into it further.

The second case came from out of the blue. After the fact we educated all of our nursing registry clients of the possibility and required them to pay their independent contractors overtime. Even the hospital changed their contracts, which use to say they would not pay overtime, to say that overtime had to be approved. We also got rid of one client who we knew had not been paying overtime to independent contractors because the potential risk was too great.

Future: We require all nursing registries or temp agencies who classify their employees as independent contracts to pay them overtime. No exceptions.

**REXFORD FUNDING**  
**CASE STUDY**  
**IFA PRESIDENTS' MEETING**  
**OCTOBER 18, 2004**

**CASE SYNOPSIS**

This case occurred a number of years ago (prior to Patriot Act).

Client A, a wholesaler of fabric, was signed by Factor 1 in the month of March. The company had been issued a termination letter by its previous factor (a direct competitor of Factor 1). A reference was obtained from the previous factor, with whom Client A had been factored for over a year, who stated that the termination was caused by low volume and customer credit issues. The reference was clean on the subject of questionable practices.

The principals of client A provided personal guaranties, supported by personal financial statements. The principals were foreign nationals who did not own real property in the United States.

The relationship proceeded smoothly during the following two months. The only issues in regard to the quality of the accounts receivable were:

- A concentration (40%) had developed with Account Debtor A. The concentration was mitigated by a strong reference from Account Debtor A's factor (Factor 2, a competitor well known to Factor 1). The factoring story did not mention any large concentrations.
- The A/R contained a "cluster" of account debtors in the Los Angeles area. Most of these account debtors did not have Duns numbers.

Factor 1 performed heavy verifications during this time period. All verifications were satisfactory.

In the month of June, Client A's volume increased dramatically. The client continued to draw down the full 80% on all advances.

**WHAT WENT WRONG**

By mid-June, Factor 1 was suspicious. Verifications were performed on all invoices prior to funding. In addition, updated references were obtained on Account Debtor A. These references showed adequate availability and good A/R performance.

In the last two weeks of June, factored sales and funding requests again increased dramatically. At this point, Factor 1 withheld advances until a field exam was performed. The field examiner reported that the receivables were legitimate and that there were no contra accounts. All inspected invoices were accompanied by sufficient shipping evidence. The field examiner actually witnessed large outgoing shipments and proclaimed these to be legitimate. Based on these results, Factor 1 continued to fund to ever increasing cash in use levels.

By the first week of July, Client A and its principals had disappeared, having fled the country. Account Debtor A had also disappeared. Both companies, as well as numerous other fake account debtors, had been set up by a group of foreign nationals for the purpose of perpetrating

a fraud. Specifically, Client A and Account Debtor A had been shipping the same goods back and forth.

Both Factor 1 and Factor 2 suffered loan losses because of this fraud.

### **WHAT SHOULD/ SHOULD NOT HAVE BEEN DONE**

Factor 1 should have taken the following additional steps to avoid this situation:

- Should have set and maintained internal lending limits.
- Should not have made advances on any account debtors not listed in D&B.
- Should have done additional due diligence on principals (including searches now required under Patriot Act).
- Should have obtained more detailed information from Factor 2 during numerous reference calls.
- Field Examiner should have done better job identifying contra accounts.
- Field Examiner should have quantified amount of inventory on hand to see if it corresponded to the level of factored sales.

### **HOW TO HANDLE IN THE FUTURE**

The following steps should be taken in the future:

- In situations when the principals are foreign nationals and do not own any real property, special additional due diligence should be performed (background checks, references from trusted sources, etc).
- Internal lending limits should be set in accordance with the risk of the transaction. If the client's needs exceed these limits, syndication should occur.
- Advances should be made only on account debtors whose existence can be independently verified. Special attention should be given to "clusters" of account debtors in the same geographic area.
- More attention should be paid to balance sheet items (inventory/payables) to see if they correspond to rapidly increasing sales.

## **Assist Financial Services**

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## **Jencks & Jencks, P.C.**

Represented by David Jencks (Attorney) 605-256-0121

### I. Case Synopsis

Our case centers around two issues that are commonly found in a transportation related fraud. The Double Brokering of loads and the taking of undisclosed cash advances (both to be defined). With the help of another Factoring Company, we were able to come out ahead and upon settlement, actually had to refund excess monies that were recovered.

### ***What went right or wrong***

There was more than one monumental problem with this account, but the following point is where the true “experience was gained”: We were unaware that the loads that we were funding had been Double Brokered. This fraudulent activity was not apparent on the paperwork, so detection in this case was impossible at the time of funding. There was a pivotal moment (to be explained) when we held funding and started to put together a workout solution. The Double Brokering coupled with substantial offsets and the Client subsequently trying to collect on Assigned invoices led to what we call the “Circling of the Wagons”. What we did and how we did it, will be presented to the audience.

### III. What should /should not have been done

The biggest mistake that we made was allowing ourselves to believe that the initial problems were going to be remedied by our Client. During the first several weeks of this relationship, we were experiencing substantial offsets on all payments received. The Client was taking multiple cash advances on each load without noting them on the invoice. This matter was addressed, penalties were charged and we made a significant change in policy that was agreed upon in writing by our Client. Unfortunately, the red flags presented in the beginning did not lead to major concern, we thought our problem centered around undisclosed advances, not Double Brokering.

Transportation presents itself with unique circumstances, and one that we find most often is that the moment our Clients know funding will not occur, they will attempt to collect on the Assigned invoices. The Client can be quite successful at this, especially if they are lucky, threatening, or even a bit charming. Our Client possessed all three of these attributes. If a Transportation Factor chooses to halt funding, the Factor must be ready to get into a “Collections War” with the Client. With the offsets that we were already experiencing, we stood to lose some money, so it was decided that we would continue to fund at a much lower advance rate, call on each invoice funded, and send more serious Notification/Consequence letters to each Account Debtor.

### IV. How to handle in the future

This case enlightened our company on many specific defaults that either needed to be added to our existing documents or needed to be “sharpened up”. We immediately added language that addressed the taking of more than one cash advance on a load and the fees associated with the default, we wrote strong language regarding the consequences of selling Double Brokered loads, and we are quite a bit more “watchful” over every new account until our Client can be deemed trustworthy.

## **Presidents & Senior Executives Case Study: Don't drink the Kool Aid.**

### *Case Synopsis*

This example can be filed under, .Don.t drink the Kool Aid. served up by your .good. clients..Statements such as, .You.ve never lost money on one of our invoices and you never will. or .We are ok with a 90 day turn.. or .The IRS is working with us.. or .We have a great relationship with our vendors...Every statement above or ones that are meant to make you sleep better at night should be viewed as nothing more than a signal for you to aggressively clamp down.

Here is the setup back in 1999, Kool Aid, Inc. .KAI. (the name has been changed to protect the not so innocent), was factoring with another bank who previously closed their factoring operation and they were looking for a new home.

KAI had positive cash flow, good credit guarantors, one of the owners was a CPA, low A/R dilution, diversified account debtors and a growing business.

KAI was a software integrator that distributed accounting software and installed and consulted on an hourly basis per a pre-defined contract rate.

When the economy in Austin was hot, business was good. When 9/11 crashed, weaknesses in our system were uncovered.

Bottom line: we lost money by financing invoices we thought we preverified, we thought we had backup on, and we thought were aggressively collecting. Account debtors do not pay for services that are half complete and the vendors are unpaid on.

### **What went right or WRONG:**

- We were lax on verifications at the beginning of the relationship . hence we got into a problem
- When we started verifying we did the .wrong. way
- Once aware we did not act aggressively enough to get .straight.
- We wanted desperately to believe our client . blinders were firmly attached to our head - with Kool Aid in hand
- We did not pay attention to ACCOUNTS PAYABLE . this is massively important

### **What should have been done:**

- Scrutinize contracts to better understand money flow
- Proactively manage risks . when business slows know before your client knows what the pitfalls are
- Better define verification process

### **What did we learn / how to handle in future:**

- Expect that you will have TROUBLE from your .good. clients. This was the last person we expected to lose money on.
- Verification is not calling to say, .did you get the invoice?.
- Pay attention to Accounts Payable as this can have major ramifications on your client.s operations.

**Finance One  
Presidents Meeting Case Study  
Kee Hyun Kim**

I. CASE SYNOPSIS

Factor approves an order but client's employee fails to assign the invoices to the factor.

When the invoice becomes past due, client calls and demands the factor to honor the guaranty.

When factor advises the client that factor did not purchase the invoices in question, client

insists that the invoice and assignment of account were timely sent to the factor. When factor

advised the client that it cannot pay client under the factor approval due to client's failure

to assign the invoices, client gets mad and decides to sue the factor.

II. WHAT WENT WRONG?

Client fail to assign the invoice to factor. Client also fails to verify its client statement

and invoice aging report to ensure timely assignment of invoices.

III. WHAT SHOULD/SHOULD NOT HAVE BEEN DONE?

Perhaps, a better training of client and its employees would have prevented the mishap. Although

client is usually busy and thus may not be able to afford the time to learn about the factoring

procedures, it is for both parties' interest to ensure the client is properly trained.

IV. HOW TO HANDLE IN THE FUTURE

Ensure the client is properly trained for factoring procedures. Also, give them a manual to refer

to from time to time. Also, have client sign a statement that they have received proper training

and received the manual.

## TO: Strategic Planning

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- The marketing plan must be developed in accordance with the strategic plan.
- The organization should articulate its mission and then formulate a strategy and strategic objectives to achieve its mission.
- SWOT stands for strengths, weaknesses, opportunities and threats.
- SWOT is a form of management self examination to ensure that all issues facing the company have been brought to the surface. The results of this self examination should be action plans.
- SWOT analysis covers a variety of areas including management products, financial strength, market position, technology operations, distribution, and economic environment.
- SWOT is a self examination of where you are, where you want to go, and how you will get there.
- Strengths
  - What are the company's strengths?
  - What are the best opportunities available to the company?
  - Are resources being dedicated to these opportunities?
  - Are strengths translated into competitive advantages and improved profitability?
- Weaknesses
  - What are company's weaknesses?
  - What are weaknesses of the product and product mix, the 4 P's?
  - What are the issues that make the company vulnerable to loss of market share and reduced profitability?
- Opportunities
  - What opportunities are available in light of the company's strengths?
  - What actions should the company take to improve its performance and achieve its goals?
- Threats
  - What are the internal and external vulnerabilities that can damage the company's future?
  - How are competitors using the company's weaknesses to exploit opportunity and create threats?
- The future is not an extension of the past. The rate of change in the marketplace will continue to accelerate.
- Technological progress is taken place at an extraordinary rate.
- Regulatory issues require constant attention.
- Population changes and demographics and geographical shifts require constant adjustment or marketing strategies.
- Global competition is common in almost every industry.
- Business success/failure as experience is changing.
- Organizations in the workforce are becoming more complex.
- Planning goals must be quantifiable, attainable, simple to calculate and realistic.
- The planning efforts should be flexible and change as market conditions change.
- All levels in the organization must be involved in the planning process.

## **Globalization**

- Manufacturing jobs are being outsourced overseas at an accelerating rate.
- Outsourcing of manufacturing jobs creates the need for purchase order financing.
- NAFTA creates challenges dealing with cross border issues.
- Factors are increasingly dealing with issues such as XM and FCIA financing.
- How can factors finance foreign receivables?
- How can the factors finance the foreign subsidiary of an American company?
- How can a factor finance joint ventures including foreign companies?
- How can a factor finance the US area of a foreign corporation?
- Dealing with letters of credit and ensuring acceptance of goods and fulfillment of contract.

## Competition

- Competition from asset based lenders.
- Competition from small community banks.
- Competition from larger regional banks with business banking units i.e. (grid lenders).
- Competition from SBA lenders.
- Bidco's Capco's.
- Loan guarantee agencies of US state municipal governments.
- What sets factors apart?
- Advantages of factoring.

## **Changing Nature of the Industry**

- Increased competition
- Increased fraud
- Less manufacturing and more service opportunities
- Increased non-traditional factoring
- Increased litigation
- More need for TO and inventory financing
- Greater withholding tax issues
- More bankruptcy frauds
- More start-ups
- More issues are raised by outsourcing of manufacturing

## Hiring and Training

- Identifying talent
- Search firms versus do-it-yourself
- Brokers versus marketing officers
- Why people move in the industry
- Red flags when interviewing
- Cultural fits
- Will marketing person be in remote office for the first time?
- Salary versus commission
- How long should commissions be paid for new deals?
- Where to find back office talent?
- Training marketing officers
- Training back office
- Tuition reimbursement programs
- IFA and outside schools

## Benefit and Compensation

- Salary
- Commissions
  - How much?
  - Based on what how long?
  - Does salary and commissions remain the same or slide inversely?
  - Signing bonus
  - Perks
    - Car allowance
    - Cell phone allowance
    - T&E budget
    - Travel perks
    - Schools
    - Rewards
    - Recognition
    - Bonus for non-marketing officers
    - Perks for non-marketing officers
    - Health insurance
    - Dental insurance
    - Disability
    - Life insurance
    - Profit sharing/ESOP

## **Communications**

- Top down/bottom up/across division lines
- Formal versus informal
- Written versus verbal
- Communication between marketing credit and operations
- Who is umpire?
- Creating a credit and marketing culture that co-exists
- Communication channel for everyone who touches an account to talk
- Policies and procedures
- Open communication
- Dictatorship versus democracy
- Internal versus external communication