



Protecting Your Interest in Your Customer's Assets

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Certified Public Accountants

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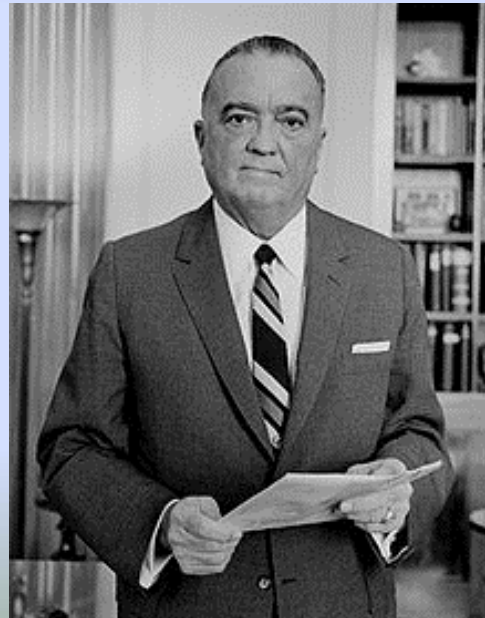
Technology



A Statistical Certainty

“At any given moment, there is a certain percentage of the population that’s up to no good”

-J. Edgar Hoover





Meet Frank

- Principal in Mercadien's Forensic & Litigation Support practice
 - Certified Public Accountant
 - Certified Fraud Examiner
 - Certified in Financial Forensics
 - Chartered Global Management Accountant

“I thrive on chaos!”



Agenda

- Protecting collateral
- Recovering from distressed loans
- When you need a forensic accountant
- Q & A session




Protecting Collateral




Protecting collateral

- The need to protect collateral comes before and after funds are committed.
- Not all borrowers are created equal!
 - Some intentionally divert or fraudulently convey assets pledged to avoid repossession in default.




Protecting collateral (continued)

- Collateral usually includes:
 - Real estate
 - Accounts receivable
 - Inventory
 - Equipment
 - Personal property (e.g., vehicles)
 - Personal guarantees (e.g., brokerage accounts)




Protecting collateral (continued)

- Obtain at least 3 years of verifiable financial data including:
 - Personal and/or company tax returns
 - Personal and/or company financial statements (including internal/external financials)
- Compare the borrower's financial ratios to specific industry standards.
- Analyze customer's current and historical accounts receivable and accounts payable activity
 - Exclude foreign A/R and other foreign assets




Protecting collateral (continued)

- Obtain and analyze growth projections and business plans to determine if repayments are realistic
 - Most are not!
- Conduct a site visit – take pictures!
- Perform an independent physical inventory count:
 - Inventory should be valued conservatively, with reserves set up for any obsolete or slow-moving items.




Protecting collateral (continued)

- Develop financial benchmarks and identify trends based on historical data and industry statistics for comparison to current and future financial performance.
- Use ratio analysis
 - current ratio, quick ratio, receivables turnover ratio, debt-to-equity ratio, etc...




Protecting collateral (continued)

- Regularly exercise the right to physically inspect and exam the borrower's books, records and collateralized assets in order to independently verify information furnished by the borrower.
 - At minimum, annually.




Protecting collateral (continued)

- Consistently monitor the borrower's compliance with the financial reporting requirements outlined in the loan agreement, such as the timely delivery of:
 - Properly completed and executed borrowing base certificates;
 - Monthly and annual financial statements;
 - Federal and state tax returns; and
 - Other schedules and reports.




Protecting collateral (continued)

- When reviewing the borrower's accounts receivable and accounts payable activities, ask the following questions:
 - Why does the borrower continue to sell products to certain customers that have significant and aged accounts receivable outstanding?
 - Does the borrower engage in business with undisclosed related-parties?




Protecting collateral (continued)

- Does the borrower's ability to operate rest on the performance of critical customers or suppliers?
- Is the borrower's business seasonal, or heavily impacted by current or foreseeable economic trends?




Protecting collateral (continued)

- How well do you know your customer and their business?
 - Conduct public record database searches on the borrower, major customers and critical vendors
 - Searches should also include bankruptcy filings, liens and judgments, sanction lists, etc.



Protecting collateral (continued)

- When real property is pledged, searches should also include:
 - Title
 - Appraisals (authentic and realistic)
 - Leases/rent rolls
 - Real estate taxes/tax liens
 - UCC searches



Protecting collateral (continued)

- Internet and subscribers databases to utilize include:
 - Google / Google Earth
 - Zillow
 - PACER
 - Lexis Nexis
 - Manta
 - Better Business Bureau
 - Boards / Associations
 - Other industry examples?



Recovering From Distressed Loans



Recovering from distressed loans

- Be prepared to act quickly!
- Consider internal and external factors:
 - The investment return objectives of the lender
 - The nature of the borrower's difficulties (financial covenant defaults vs. payment defaults)
 - Industry-specific trends
 - Liquidity in the market for distressed debt
 - Third-party pressures on the borrower




Recovering from distressed loans (continued)

- Ask and consider:
 - What is the cause of the client's problem?
 - Where is the money going?
 - How is the client working to solve these problems?
 - Client willingness to cooperate with the bank?
 - Can the client bring payments up to date?
 - Strengths and weaknesses of the bank's position
 - Other debts incurred by the borrower?
 - What can be done to avoid late payment in the future?
 - Is the loan worth restructuring?



Recovering from distressed loans (continued)

- What is the realistic likelihood that enforcement action will precipitate a bankruptcy?
 - If the answer is likely or better, consult with your counsel and financial consultants to:
 - Develop one or more bankruptcy outcome models
 - Negotiate a resolution
 - Attempt to sell the loan to an interested party
 - Other non- confrontational strategies?



Recovering from distressed loans (continued)

Banks should:

- Look to prevent the quality of their assets from deteriorating further.
- Be open to offers made by customers in light of any additional information obtained.



Recovering from distressed loans (continued)

Banks should:

- Keep minutes of all meetings and communicate in writing with clients for clarity
- Include professional advisors when appropriate
- Have a system in place for remedial action on non-performing credits and workout solutions



When you need a forensic accountant





Words of Wisdom

“ I can solve ANY case....
no matter how old
no matter how complicated,
no matter how difficult.....

If I can get someone to tell me who did it!”

-- FBI Instructor, May 10, 1976



When you need a forensic accountant (continued)

- Why are forensic investigations so important in the banking industry?
 - Mismanagement and insufficient monitoring of funds can lead to misconduct and potential losses
 - Internal/external temptations are everywhere when money is involved...
 - Employees, board members, customers and vendors



When you need a forensic accountant (continued)

- Focused testing and investigative procedures target possible irregularities/misconduct specific to troubled loans that would not normally be discovered by classic bank audit procedures
 - Conducting targeted forensic interviews yield results!
The data only gets you so far...



When you need a forensic accountant (continued)

- Borrowers in default have higher risks of intentionally diverting or fraudulently conveying assets pledged to avoid repossession
- Assist the bank in determining if the borrower has an undisclosed ownership interest in an entity with which it transacts business
- Assist the bank in identifying, tracing and recovering collateralized assets when loans go bad



When you need a forensic accountant (continued)

- To formulate damage theories and calculations resulting from borrower misconduct or other allegations
- Forensic accountants not only seek to find financial discrepancies but they'll often determine the who, what, where, why, when and how associated with your issues and allegations



When you need a forensic accountant (continued)

- If legal action is taken, the forensic accountant:
 - Acts as an independent financial expert to analyze, interpret, summarize and present complex financial and business related issues in a simple and concise manner
 - Assists corporate or litigation counsel in developing critical deposition questions and remedial actions
 - Testifies as to the results of their analysis/investigation



Questions?

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