The Basics of Accounts Receivable Factoring

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Introduction

Over the past fifteen years, growing numbers of small and mid-sized companies have begun to explore factoring as a practical source of working capital. Unfortunately, the availability of accurate, up-to-date information has not kept pace with the mounting interest in this much under-utilized form of commercial financing. We therefore present the following discussion for those seeking a broader understanding of this dynamic alternative to traditional debt/equity funding.

What is Factoring?

The term "factoring" refers to the outright purchase and sale of accounts receivable (A/R) invoices at a discount from their face value. The structure, terms and conditions of such a transaction may vary in any number of ways, as evidenced by the array of factoring programs currently available throughout the United States.

Companies engaged in the business of buying accounts receivable are called "factors." Factors often exhibit a flexibility and entrepreneurial awareness rarely demonstrated by banks and other secured lenders, whose activities are more generally restricted by regulation and prevailing law.

Companies selling their receivables are typically referred to as "clients" or "sellers" (not "borrowers"). The client's customers, who actually owe the money represented by the invoices, are generally known as "account debtors" or "customers."

Characteristically, there seems to be no industry-wide term of art to describe the actual event that occurs when a factor accepts invoices for purchase. Common terms for this event include: "schedule," "funding," "advance," "assignment" and "transaction."[1]

The cash which a factor issues to a client as initial payment for factored invoices is typically called an "advance."

Factoring differs from commercial lending because it involves a transfer of assets rather than a loan of money. In assessing risk, therefore, factors look primarily to the quality of the asset being purchased (i.e. the ability to collect client receivables), rather than to the underlying financial condition of the seller/client. This focus makes factoring a suitable vehicle for many growing businesses when traditional commercial borrowing proves either impractical or unavailable.

Defining Accounts Receivable

In the factoring industry, the term "accounts receivable" normally refers to short-term commercial trade debt having a maturity of less than 90 or, at the outside, 120 days. To be sure, factors sometimes receive offers to purchase longer-term debt obligations, such as leases or commercial notes. The purchase of such debt instruments, however, does not fall within the meaning of the term "factoring" as it is most commonly used.

Factors are universally quick to distinguish between invoices (which represent legally enforceable debts) and purchase orders (which do not). Most factors refuse to advance money against purchase orders under any circumstances. A few, however, have developed separate purchase order financing programs.

Similarly, factors generally refuse to purchase "pre-ship" invoices that clients sometimes generate prior to shipping goods or providing services to account debtors. Many factors will immediately terminate a factoring relationship if they discover that their clients are attempting to factor "pre-ship" invoices.

Factoring vs. Accounts Receivable (A/R) Lending

Although factoring is occasionally confused with A/R lending, it differs both legally and operationally.

Legally, a factor takes immediate title to the invoices it purchases. The A/R lender, on the other hand, never takes title to invoices unless and until the borrower defaults on its loan agreement.

In connection with the transfer of title, the factor purchases the right to collect payments directly from account debtors, who thus become legally obligated to the factor. An A/R loan, however, does not legally obligate account debtors to pay the lender directly, except when the lender notifies them of a default by the borrower.

Operationally, the factor differs from the A/R lender because the factor concentrates on the aging, collection, and posting of each factored invoice. By contrast, the A/R lender does not track the payment status of every individual invoice generated by the borrower in the normal course of business.

Further, while an A/R lender will have virtually no interaction with individual account debtors, the typical factor will find it necessary to contact them directly as a matter of course.

A/R lenders do not normally take an active role in collecting invoice payments, although they may sometimes set up a "lockbox account," to which a given borrower's entire invoice proceeds must be initially directed and deposited. Under this arrangement, the lender (or designated trustee) then "sweeps" the lockbox on a regular basis, deducts for the benefit of the lender any outstanding loan payments, fees or other charges due from the borrower, and deposits the remaining balance in the borrower's operational account. This system enables the lender to monitor general cash flow, ensure immediately available funds covering the borrower's obligations to the lender, and preserve access to the collateral if the borrower defaults.

A factor, however, must directly collect the proceeds of specifically purchased invoices in order to recover its advances and fees. General administration of a lockbox requires relatively little operational effort compared to the myriad processing, collection and reporting activities which factors routinely perform (see "The Factoring Process," below). The fact is, unless they also provide factoring services, most secured lenders lack the necessary operating capability to collect and manage an invoice portfolio of even moderate size.

Since many financial service companies offer more than one type of financing it is not unusual to find factors also engaging in A/R lending. In general, A/R lending programs tend to be somewhat less expensive than factoring (although not always). A/R loans can be more difficult to obtain, however, since lenders normally expect greater financial strength from borrowers than factors do from clients.

Sometimes the distinction between factoring and A/R lending becomes less clear. For example, recourse factoring, which is discussed below, has certain features that make it legally comparable to A/R lending in some states, even though it is operationally dissimilar.

Assuming Credit Risk: Non-recourse vs. Recourse[2]

What happens when an account debtor becomes financially unable to make payment for an outstanding invoice that a factor has purchased? The answer depends on whether the factor operates on a non-recourse or recourse basis.

In a non-recourse transaction, the factor purchases the underlying credit risk associated with each factored invoice. The client therefore incurs no liability to the factor if the account debtor proves financially unable to make payment. In such an event, the factor must either absorb the loss or take direct enforcement action against the account debtor.

A recourse transaction, however, allows the factor to make claims against the client in order to recover losses caused by account debtor insolvencies. Recourse factoring agreements generally require the client to repurchase any invoices that remain unpaid after a certain number of days (typically 60 or 90).

How Does Factoring Work?

Factoring occurs in a variety of forms, which are briefly described below.

Advance/Reserve.

This type of factoring is by far the most widely practiced. Upon taking title to invoices, the factor immediately pays to the client a percentage of their total face value. This payment (called the "advance") typically falls between 70% and 85%, but may go as low as 50% or less (for example, in the case of construction or third-party medical invoices), or as high as 90%. After successful collection of payment from the account debtors, the factor subsequently remits the balance of the invoice amount(s) (usually called "the reserve") to the client, minus the factor's earned fees.

The reserve provides the factor with available funds from which to draw its fees, and furnishes a buffer against defaults by clients and/or account debtors.

Some factors do not hold back a reserve balance, but rather advance the entire invoice face value, less maximum factoring fees, at the time of purchase. This practice is not widespread, however, since most factors of this type prefer to retain the protection that reserves offer.

Advance/reserve factors generally structure their fees as an initial discount rate (typically ranging between 1.5% and 5% of invoice face value), followed by subsequent increases scheduled over the length of the actual collection period.

The collection period begins on the day that the factor advances funds to the client (which is not always the same as the invoice date), and is normally divided into "windows" or "time bands" of equal duration. Windows most typically occur in 15-day increments, although 7-, 10- or 30-day increments are not unheard of. The initial discount normally increases by one or two percentage points at each new window. A typical advance/reserve transaction, therefore, might be structured as follows:

Example of Rate Schedule for Advance/Reserve Factoring Transaction

Face Value of Invoice(s)	$ 100,000
Initial Funds Advanced (80%)	$ 80,000
Reserve Balance (20%)	$ 20,000

Payment Collected in:	Factoring Fees/ Discount rate:	Reserve Rebated to Client:	Total Payment to Client[3]:
Day 1 - 15	$ 2,000 / 2%	$18,000	$98,000
Day 16 - 30	$ 4,000 / 4%	$16,000	$96,000
Day 31 - 45	$ 6,000 / 6%	$14,000	$94,000
Day 45 - 60	$ 8,000 / 8%	$12,000	$92,000
Day 61 - 75	$10,000 / 10%	$10,000	$90,000
Day 76 - 90	$12,000 / 12%	$ 8,000	$88,000

We provide the above figures only for the purpose of illustration. While the fees shown here are by no means unusual, many advance/reserve transactions can carry significantly lower rates. (See "What Factors Look For," below).

Flat-fee Plus Interest[4].

This approach is common among large factors but occurs less often among smaller firms. In this type of factoring, the client pays a flat processing fee (typically around 1% of face value) on all factored invoices. The client then draws advances as needed against the factored invoices, up to a preset limit (typically in the range of 80%-90%). The factor charges the client interest on the advances at some number of points over prime.

Upon collection of payment from the account debtors, the factor remits the outstanding reserve balance to the client after first deducting earned fees.

Maturity Factoring.

Something of a cross between the flat fee plus interest approach and credit insurance, maturity factoring enables clients to establish a reasonably predictable cash flow at a relatively low cost. Instead of issuing an advance, the maturity factor simply guarantees payment of a client's invoices. If the account debtors become insolvent, or fail to pay for some reason other than a dispute with the client, the maturity factor pays the invoice within a certain number of days beyond terms. For this service, the factor charges a flat fee, typically around 1% of invoice face value. Additionally, clients have the option to draw advances at some number of points over prime.

Consumer (Retail) Factoring.

The major credit cards, such as MasterCard, Visa and American Express offer the best example of this type of factoring, although they do not appear in the Individual Main Listings. There are, however, a small number of private credit card companies that specialize in purchasing consumer debt from narrow segments of the retail industry such as apparel stores, or from service suppliers such as dentists. Most commercial factoring companies, however, avoid purchasing consumer debt entirely.

The vast majority of factors in the United States conform to one or more of the foregoing models, which have in common that they provide clients with continuing access to predictable cash flow. Factoring occasionally appears in other forms, however, including the following:

Bankruptcy Factoring.

This type of factoring activity has developed in response to the "famous name" bankruptcy filings of the past several years, as in the case of Federated Department Stores, Childworld and Macy's. Bankruptcy factors solicit suppliers holding allowed trade claims against such companies and purchase these debts at a discount. For clarity, we distinguish between "bankruptcy factoring" as it is defined here and DIP (debtor-in-possession) factoring, which refers to more traditional types of factoring services provided to clients in bankruptcy under Chapter 11 of the U.S. Bankruptcy Code.

Guaranty Factoring.

In this approach, the factor does not make advances. Rather, it simply enables the client to obtain goods or raw materials by furnishing credit guaranties to the client's suppliers. Upon collecting payment from the account debtors, the factor deducts its fees, issues payment to the suppliers, and forwards the balance directly to the client. This type of factoring is not very common.

Invoice Liquidation.

We use this term to describe the one-time purchase of distressed (i.e. largely uncollectible) receivables for some small number of cents on the dollar. Although this activity involves the purchase of accounts receivables, it does not play a role in true commercial financing. Consequently, virtually no one ever thinks of it as any type of factoring. We mention it here only for the purpose of drawing the distinction.

Assessing the Costs of Factoring

As mentioned, the cost of factoring depends on a variety of specific circumstances, including the type of program, the volume factored, invoice terms, etc. In fact, when one considers the extra fees and closing costs charged by commercial lenders, the costs of some factoring programs almost compare favorably with conventional bank credit.

Generally, however, factoring will cost more than other forms of commercial financing. [For example, assuming factoring for a 30-day discount rate of 3% and a collection period of 30 days the cost of factoring is 37% APR (annual percentage rate). However, the APR in the above example compares more favorably with the standard 2%-net-10 discount that many vendors offer their customers as an inducement to early payment. That incentive enables the vendor to get paid 20 days earlier than the standard 30-day term, while the customer is effectively borrowing money for 20 days. When annualized out, the cost to the customer ends up being 37% APR.]

In preparing a cost/benefit analysis of factoring, therefore, prospective clients need to look at more than just the APR. If, for example, the factoring relationship significantly increases a client's sales and generates a net increase in profit, the bottom line results will more than justify the factoring fees. Moreover, the value added services usually provided by the factor can often reduce a client's direct expenses, improve collections and reduce credit losses. (See below).

Inevitably, factoring fees reflect the increased risk posed by companies that cannot meet the more restrictive criteria imposed by traditional commercial lenders.

Comparisons with alternative forms of commercial financing therefore become moot unless such alternatives are realistically available.

To some extent, the fees a factor charges reflect its own cost of funds. One reason why factors are able to obtain access to purchasing capital is that they can provide a higher return to their financing sources than can other types of investments. In so far as factors can obtain capital at lower rates, their fees tend to reflect this fact. Still, many factors maintain that their operating overhead, which can be substantial, ultimately has the greatest impact on their fee schedules.

Why Businesses Factor

Businesses most frequently factor in order to finance sales growth. Additionally, many companies turn to factoring as bridge to future debt or equity financing.

To be sure, factoring is still widely misunderstood by many business people, who continue to view it as a tool of last resort for companies with terminal financial problems. In reality, however, the opposite is true. Companies on an inexorable downhill slide make poor factoring candidates because they present a level of risk that most factors strive to avoid.

Factoring is therefore best seen as a dynamic financial tool that enables growing companies to accelerate and stabilize cash flow. As an alternative to bank financing or venture capital, factoring can address a wide range of business situations. The most common reasons why business turn to factoring appear below.

Availability

During the past fifteen years, factoring has become more readily available to small and medium-sized businesses than traditional bank lending.

To obtain bank financing today, companies generally need to:

1) produce audited financial statements demonstrating a minimum of three to five years of profitable operating experience;
2) possess a strong collateral base including equipment, real estate and other hard assets; and
3) maintain a debt/equity ratio of approximately 2:1 or better, depending on the industry. Although banks expect to see a strong receivables portfolio, they generally will not be comfortable relying on receivables as the only available collateral.

Many growing enterprises fail to meet bank lending criteria for one reason or another. For example, bank financing often remains unavailable to service companies with no real assets other than receivables, and to younger companies with short operating histories.

By contrast, a commercial business becomes a reasonable factoring prospect as long as it can demonstrate the following:

1) that it has an unencumbered portfolio of collectable accounts receivables which are payable by credit-worthy account debtors without dispute or offset;
2) that it has the margins necessary to absorb the factoring discounts;
3) that factoring will, in fact, improve the company's cash position and enable it to accommodate increased sales.

Very few factors require prospective clients to submit audited financial statements and most do not even impose any minimum net worth requirements. For a more detailed discussion of factors' purchasing criteria, see "What Factors Look For," below.

Flexibility

As a rule, factoring executives exercise a greater degree of decision-making autonomy than banking executives. Even among giant factors, which are often subsidiaries or divisions of large banks, factoring executives managers often seem more responsive than their counterparts on the commercial lending side.

This autonomy generally allows factors to respond rapidly to business opportunities and client needs. While a bank might take months to process and approve a commercial loan application of any size, factors routinely execute sizable transactions within ten days (or less) of an initial prospect meeting.

Moreover, factoring relationships tend to be more open-ended. A borrower seeking to increase a bank credit line, for example, will inevitably have to submit new documentation and financial statements for subsequent review by a lending committee. Factors, on the other hand, frequently operate without formal ceilings, and often issue immediate approval for larger-than-normal advances based solely on the performance of the client's current portfolio and the quality of submitted receivables.

Lastly, to accommodate good clients in emergency situations, factors may be more likely than banks to modify normal operating procedures.

Balance Sheet Considerations and Equity Preservation

Because it represents the sale of an asset, factoring enables companies to obtain working capital without taking on new debt or giving up equity.

Collateral Preservation

As a condition of issuing a loan, commercial lenders typically secure their position by taking all of a borrower's business assets as collateral. Even if the collateral value greatly exceeds the potential loss exposure, lenders rarely display any flexibility on this issue.

Factors, on the other hand, usually limit their collateral to client accounts receivable, leaving other assets unencumbered. A discussion of factoring collateral requirements appears later in this article.

Refinancing and Bridge Financing

Factoring provides a practical transitional tool for restructuring long-term financial arrangements. It is therefore particularly useful for companies seeking to extricate themselves from unfavorable or overly restrictive bank relationships. Its use in this manner became especially common during the late 1980's and early 1990's, when many established companies lost access to previously available business credit.

Numerous young businesses rely on factoring to help them reach the point where they become viable candidates for less expensive bank financing or equity funding.

Lastly, factoring sometimes plays a role in acquisition financing by supplying the necessary "gap" funding to make the acquisition workable.

Debtor-In-Possession (DIP) Financing

Most factors welcome the opportunity to work with clients operating under Chapter 11 bankruptcy protection[5] because the court's oversight can provide factors with increased operational security.

DIP factoring agreements require the specific approval of the bankruptcy court. As a condition of entering into such an agreement, the factor will most likely insist that the court grant the following stipulations:

1) a super priority lien on all post-petition[6] client receivables and proceed; and

2) a relief from the "automatic stay" provision of the bankruptcy code.

Should the client subsequently convert to Chapter 7, a factor lacking this protection could be barred from immediately collecting invoice proceeds and might instead have to wait for the court to appoint a liquidating trustee. In a worst-case scenario, secondary lien holders might express concerns about the factor's willingness to settle with account debtors for less than full invoice face value(s). Consequently, the factor could be forced to wait for months thereafter while the trustee attempts to collect the receivables directly.

In connection with obtaining the requisite court approval, the factor will incur additional legal expenses, which it will pass on to the client.

Value-added Services

A factor's value to its clients frequently goes beyond advancing funds. Most factors typically provide such critical A/R support services as customer credit analysis and approval, invoice handling, collection, posting, accounting and reporting. For many businesses, even those with access to long-term commercial credit, the desire to obtain these services actually drives the decision to factor. It is not unusual, therefore, to find instances where a client regularly factors all of its receivables but only rarely draws advances from the factor.

Preferences: What Factors Look For

In considering a new relationship with a prospective client, the factor's principal concerns may be broadly summarized by four key questions:

1) How collectable are the client's invoices?
2) Are there any outside parties who could interfere with collection of proceeds arising from the client's invoices?
3) How can advances and fees be recovered if the client's invoices turn out to be less collectable than anticipated?
4) Is the client company operationally compatible with the factor's invoice processing, tracking, collection and accounting capabilities?

A factor answers these questions by conducting an in-depth analysis of the client and its receivables portfolio. This process is known as "due diligence." Obviously, it behooves the client to become actively involved in the due diligence process, so that the factor may more easily achieve the necessary comfort level regarding these issues, as discussed below.

Invoice Collectibility

Operationally, the factor's collection of proceeds from factored invoices depends on its ability to effectively address three basic concerns:

1) **Credit losses:** where account debtors prove financially unable to pay their invoices.

Factors assess the creditworthiness of account debtors through the use of standard commercial credit analysis techniques. Besides subscribing to major national credit reporting agencies, (D&B, TRW, etc.) and trade-specific reporting agencies (i.e. the Jeweler's Board of Trade), many factors rely on in-house databases which detail their own previous experience with individual commercial debtors. In the case of larger factors, these databases can be quite extensive.

2) **Debtor disputes:** where account debtors refuse to issue invoice payments, claiming offsets or non-performance by the client.

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 a given client's debtors, or when they involve substantial sums, these disputes may jeopardize the factor's ability to recover advances and fees.

Nearly all factors address this concern by directly contacting account debtors in order to verify the validity of invoices prior to issuing advances. Such contact is typically made by telephone, although in certain instances factors may insist on a written verification signed by the debtor. (See "The Factoring Process").

Companies exploring the factoring option for the first time sometimes express reservations about having their customers contacted by a factor. Such concerns generally prove to be misplaced, however. Professional factors recognize the delicacy of the relationship between clients and account debtors, and generally take great pains to ensure that direct contact always remains cordial, courteous and businesslike.

That said, the prudent client will nonetheless take steps to forestall unnecessary confusion by giving customers advance notice of the factor's pending contact.

3) **Direct payments to client:** where account debtors remit invoice payments directly to the client.

Factors generally find this occurrence extremely worrisome, since it creates an opportunity for the client to dissipate the proceeds before they can be forwarded to the factor. For this reason, most factors will not allow clients to receive factored invoice payments directly from account debtors.

It is, therefore, standard operating procedure among factors to notify account debtors in writing regarding the establishment of a factoring relationship with a given client. Such notification always includes revised remittance instructions indicating that payment must henceforth be made directly to the factor. This notice is legally binding on the account debtors. Should they thereafter make direct payment to a client, they become potentially liable to reimburse the factor for any losses arising from the client's dissipation of proceeds.[7]

Direct payments may occur because account debtors fail to update their records to reflect the factor's remittance address. Sometimes, however, clients deliberately attempt to divert account debtor payments by issuing contrary payment instructions. Experience has shown that such fraudulent behavior is, sadly, not uncommon.

Accordingly, factors tend to be extremely diligent about monitoring payment flow. While they are normally tolerant of occasional client administrative check-handling errors, they will usually take aggressive action against clients who intentionally deposit factored invoice payments into their own operating accounts. In serious cases, such action may include:

- immediate termination of the factoring relationship;
- notification to customers (whether or not they represent factored accounts) of the client's default;
- a legally binding demand to all customers that they remit payment directly to the factor for all currently outstanding invoices, whether factored or not and/or
- litigation.

Although potentially a risk with any client, direct payment problems are more likely to occur in some industries than others. For example, local area printers and food wholesalers often employ drivers who routinely collect checks as they make customer deliveries. Because it is so difficult to adequately control payment flow under such circumstances, many factors make it a policy to avoid prospective clients in these fields.

Unencumbered Receivables

Prior to establishing a new client relationship, the factor will conduct an independent search of public records to identify existing interests or claims by third parties with respect to the client's assets, including accounts receivable.

Such third parties might be secured lenders, judgment creditors, bankruptcy trustees, the IRS, and/or state/local tax authorities. Searches generally cover UCC-1[8] financing statements (see below), tax liens, bankruptcy records and judgment records in selected jurisdictions.

For simplicity in this discussion, we refer to all such third parties as "secured parties" although, strictly speaking, that term normally covers only those parties whose interests are evidenced by the existence of a UCC-1 financing statement (as opposed to bankruptcy trustees, the IRS, etc.).

If a search indicates the existence of prior interests covering client receivables, a factor will not enter into a factoring agreement without first obtaining subordinations, terminations and/or releases from the appropriate secured parties.

Because they are often unconcerned about third party interests in client assets other than receivables, most factors will not typically seek subordinations from equipment leaseholders.

Third party inventory interests do present a problem, however, since claims against inventory generally include the proceeds arising from the sale of such inventory. In the normal course of business, proceeds from the sale of inventory are the same as accounts receivable. Consequently, the factor will face exposure unless it can obtain proper subordinations from all parties holding secured positions in inventory.

If it enjoys a positive relationship with prior secured parties, the client may find it useful to assist the factor in obtaining the appropriate subordinations. This process often requires negotiation, since secured parties generally want something in return for giving up a portion of their collateral position to the factor. Very often, the client is in a position to foster productive discussion or resolve differences.

Throughout the course of its relationship with a client, factors typically conduct periodic update searches to protect against competing future claims from unanticipated sources.

First Priority Collateral Interest

Once it has ensured that the receivables are free and clear of potential competing claims, the factor must secure its own position. It accomplishes this end by filling out a one-page form known as a UCC-1 Financing Statement (UCC-1), and filing it in the public location(s) dictated by the laws of the individual state(s) where the client does business.[9] Assuming it has been properly filed under applicable law, the UCC-1 (which must be signed by the client)[10] creates what is called a "perfected security interest" in collateral.[11]

The level of required collateral protection can vary, not only from factor to factor, but even between different clients of the same factor. The various levels are:

1) factored invoices only;
2) all accounts receivables, whether factored or not;
3) accounts receivables plus some or all other business assets.

A factor's collateral requirements in a given situation will depend on its perceived level of risk, the availability of suitable client assets, and the factor's usual operating standards. As a rule, most factors prefer to take a first position on both factored and unfactored receivables. This way, they maintain a reasonable recovery alternative in the event that factored invoices become uncollectible due to client defaults under individual factoring agreements. At the same time, by restricting their interest to receivables only, they leave other client assets unencumbered.

Prospective clients sometimes attempt to limit the factor's security position so that it covers factored invoices only. The difficulty with this arrangement, from the factor's perspective, is that it provides no alternative collateral protection against uncollectible invoices. For example, if a factor buys an invoice with a face value of $100,000 and the account debtor subsequently declines to pay because of client non-performance, the factor is left with only a security interest in a worthless piece of paper. Accordingly, it would suddenly find itself holding an unsecured claim for $100,000 against the client. Most factors would find this position intolerable. Nevertheless, provided that they are especially confident about their ability to collect in a given situation, there are some factors that will consider limiting their collateral interests to factored invoices only.

Personal Guaranties

Unsurprisingly, factors differ widely in their approach to the issue of personal guaranties by client principals. To be sure, there are some whose policies on this point are as stringent as any bank's. Most are much less exacting. A few require no personal guaranties of any type.

Policies regarding such guaranties fall into four categories:

1) No personal guaranty required.
2) Personal guaranties required only against client malfeasance (i.e. deliberate misrepresentations or fraudulent behavior).
3) Personal guaranties required against all factoring losses, except where such losses result from the financial insolvency of account debtors.
4) Personal guaranties required against all factoring losses, regardless of the cause.

The factoring industry appears to be pretty evenly divided over the latter three approaches. It is somewhat unusual for factors to forego personal guaranties entirely.

As a practical matter, guarantors often lack sufficient personal assets to cover the factor's risk. Nevertheless, most factors insist on these guaranties in order to ensure that client principals retain a personal stake in the favorable conduct of the factoring relationship.

Factors often display some flexibility towards personal guaranties and may adjust their requirements depending on the availability of alternative business collateral and/or other mitigating circumstances.

Operational Compatibility

A factor needs relatively little operational sophistication to manage a transaction consisting of a single $100,000 invoice. On the other hand, a $100,000 transaction consisting of 500 separate $200 invoices is quite a different matter. The tasks associated with processing, verifying, tracking, collecting and reporting a sizable batch of invoices can be extremely labor intensive, especially when that batch represents only one of many submissions made by different clients on any given day.

Some clients expect to submit invoices and draw advances only once or twice a month, while others need to make submissions several times each week. To accommodate the needs of different clients, the factor must employ a well-planned combination of trained personnel, administrative systems and computing capacity.

In evaluating a prospective factoring relationship, therefore, a factor will always consider the operational effort necessary to properly service the client. This evaluation will cover the following:

- The quantity of invoices generated by the client;
- The number of account debtors serviced by the client;
- The average amount of client invoices;
- The amount and complexity of invoice back-up documentation;
- The legibility, clarity, accuracy and completeness of the client's invoices;
- The frequency of the client's invoice submissions;
- The volume of routine credits, chargebacks or other payment exceptions likely to be taken by the client's account debtors; and
- The accessibility and cooperation shown by the account debtors with respect to verification and collection.

Factors will generally reject a potential client relationship if they foresee undue operational complications. Prospective clients also need to be concerned about operational compatibility. When factors and clients cannot adjust to each other's operating requirements, the results can be disastrous. Miscommunication and procedural blunders can lead to funding delays, disputes, accounting errors and, in extreme cases, disgruntled account debtors.

Additional Considerations

In addition to the foregoing concerns, other issues also enter into a factor's ultimate decision to accept or reject a prospective factoring client.

Invoice Aging and Turnover.

Factors exhibit different degrees of flexibility regarding the age of invoices they purchase. Some will factor only current invoices (i.e. not yet due for payment). Others will routinely buy invoices that remain unpaid as of 30 or 60 days beyond terms (dbt), or even longer.

In making their assessments, factors will usually compare the invoice aging to the general paying habits of the applicable debtor industries. They will not typically purchase invoices that have aged significantly unless special circumstances indicate that payment will be forthcoming within a reasonable time thereafter.

Industry Preferences.

As they discover individual niches and gain experience with particular types of clients, factoring companies often develop preferences for working in certain industries. The giant factors, for example, have traditionally concentrated on manufacturers and wholesalers of textiles, apparel, furniture and other consumer goods. Consequently, they are especially comfortable factoring invoices payable by large retail chains.

Other factoring companies find such large retail account debtors less attractive due to the difficulty of obtaining adequate invoice verifications and the ever present risk of merchandise returns and credits. These factors may instead prefer clients who provide non-retail account debtors with such services as temporary personnel, janitorial work or consulting. Some factors only buy invoices payable by state or federal governments, while others make it a policy to avoid such transactions altogether. At the same time, many factoring companies take a more general approach by courting clients throughout a wide range of industries.

Certain fields, however, present unique risks which factors cannot adequately manage without specialized knowledge or operating capabilities. Most factors therefore avoid such areas, which include the following:

- Construction and building trades;
- Third-party medical receivables payable by insurance companies, Medicare and Medicaid;
- Trucking/transportation;
- Fresh produce and other agricultural commodities.

These fields are generally subject to laws, regulations and industry payment practices that may, in certain circumstances, jeopardize factors' collection rights. On the other hand, these areas also provide attractive niche opportunities for those factors who have developed the appropriate systems and expertise to manage the risk.

Nationality of Account Debtors.

Because they have access to solid international banking affiliations, virtually all of the giant factors will purchase foreign receivables. Due to the difficulty in enforcing payment rights against foreign account debtors, however, most small and mid-sized factoring companies remain exclusively interested in domestic invoices.[12]

Still, the developing global economy does encourage some smaller factors to purchase foreign invoices. The formation of international factoring networks, such as *Factors Chain International*, indicates that this practice is likely to become more widespread over time.

Other considerations, such as an exceptionally strong account debtor, or the amount of the factor's exposure relative to the client's overall factoring volume, may prompt an otherwise reluctant factor to advance funds against a foreign invoice.

Potential Factoring Volume.

Whether or not they explicitly impose such requirements by contract, most factors expect client relationships to yield some minimum annual (or at least monthly) level of factoring volume and/or fees.

Sometimes, factors will work with young clients that initially offer little realistic prospect of meeting such expectations. In such cases, the factor will enter the relationship in the belief that factoring can help the client grow into a more profitable account.

Anticipated Duration of the Factoring Relationship.

Factors most commonly prefer to establish relationships lasting a year or longer, during which time they generally expect to purchase the client's invoices on a regular basis. Accordingly, factoring contracts often set specific term lengths. While numerous factors do forgo such formal requirements, they nevertheless tend to prefer clients whose demonstrated factoring needs are likely to persist for longer than a few months.

Some factors will consider entering into shorter-term relationships, or even one-time transactions offering no prospect for repeat business (a practice known as spot factoring). Such transactions, however, can be difficult to consummate for two reasons:

1) unless the proposed purchase is relatively large, the return on a single transaction is unlikely to justify the factor's administrative, legal and due diligence expenses; and

2) if the proposed purchase is large enough to provide an attractive return, the factor's risk exposure will be significant. The short-term nature of the relationship provides little margin for error, and may jeopardize the factor's ability to recover its funds in the event of a collection problem.

To understand this point, consider the factor's position in a spot transaction with a face value of $1 million. If the factor advances 80% at a 4% discount rate, then the factor is risking $800,000 to earn a $40,000 profit. Compared with other types of commercial financing, this may seem a healthy return. However, the risks associated with a one-time purchase are substantial since there is always a reasonable possibility of default by either the client or the account debtor(s) on any single transaction. A factoring executive faced with such a purchasing decision understands that in the event of a mistake, he or she will have to write $20 million in new business to make up an $800,000 loss. When measured against the potential exposure, the prospect of adding $40,000 to the factor's annual bottom line on a "one-shot deal" may not seem so attractive.

We do not mean to suggest in the foregoing discussion that spot factoring does not work. On the contrary, many factors do engage in one-time transactions, although such transactions usually entail especially intensive discussion, planning, and due diligence.

Client Financial Condition.

Although factors tend to be less demanding than secured lenders when evaluating the financial condition of prospective clients[13], they cannot afford to be entirely indifferent to the issue.

At a minimum, the client should expect to demonstrate: 1) that it enjoys sufficient margins to absorb the factoring discounts; 2) that factoring will enable it to expand sales or reduce expenses; and 3) that factoring will enhance its over-all financial position.

Above all, factors generally want assurance that clients will remain solvent during the factoring relationship because the collectibility of factored invoices often deteriorates rapidly when a client ceases operations.[14]

In connection with this concern, factors are likely to pay special attention to the issue of outstanding trade debt. To be sure, well-aged payables are not uncommon among the cash-strapped growth companies most likely to benefit from factors' services. However, the client must show that factoring can successfully address such problems within a reasonably short period of time. Otherwise, as dissatisfied suppliers become less cooperative and more demanding, the factor risks being swept up in the client's growing cash flow pressures.

A factor will, of course, also evaluate the client's long-term debt obligations. Such debt, even if it is delinquent, will not necessarily preclude a factoring relationship so long as the factor can effectively negotiate its priority security position with the other creditors.

Outstanding state and federal tax obligations, however, are a source of continuing concern to all factors. Some will not do business under any circumstances with prospective clients carrying liabilities for back taxes. Others will work with such clients only to the extent that initial factoring advances can bring the client completely current. In some cases, at the client's request, factors may actively become involved in negotiating a long-term payout agreement with the appropriate tax authority.

Most factors will immediately cease issuing advances to clients who become delinquent in taxes during the factoring relationship, especially if the delinquency leads to the filing of a state or federal tax lien. Otherwise, the factor risks becoming subordinated to the taxing authority. This subordination will apply to all client invoices generated after the lien filing date, regardless of whether the factor has advanced funds against them.[15]

Client Management and Administration.

At the risk of stating the obvious, it bears mention that factors place a great deal of importance on their assessment of clients' executive management. The quality of management's experience, industry knowledge, organizational abilities and personal integrity all influence a factor's willingness to enter into the relationship.

The factor will also consider the client's ability to effectively manage the factoring program on a day-to-day basis, including the availability of solid support personnel to interact smoothly with the factor's operating staff.

The Factoring Process

Once the factor and the client have executed a formal factoring agreement, and the factor has perfected its security interest, the day-to-day factoring relationship begins in earnest. The specific process by which a client submits invoices, draws advances and receives reports will depend on the type of factoring program, the size of the factor's operation, the quantity of client invoices, etc. Still, in most cases, the process will entail the following sequence of events:

1) ***Factor approves account debtors' credit*.**

Factors often encourage advance notice of pending orders so that they can establish account debtor credit limits before clients generate actual invoices. In this way, clients can know prior to shipment whether the factor will approve a given invoice.

2) ***Client submits invoices.***

In the vast majority of cases, factors require clients to generate invoices with the factor's remittance address already on them. Usually, the factor will provide the client with a stamp or labels containing the remittance instructions and a statement that the invoice has been assigned to the factor.

The client batches the stamped invoices with the necessary support documentation attached and submits them to the factor. The submission package always contains an adding machine tape or computer printout showing the batch detail and totals.

About half of the factors insist on mailing the invoices directly to the account debtors, and so require clients to submit only original invoices. Other factors allow the client to handle the mailing chores, however, and will therefore accept invoice copies.

3) *Factor receives and processes invoices.*

Upon receipt of a client's batch submission, the factor typically enters each invoice into its computer system and generates a printout listing the specific invoices.

4) *Factor verifies invoices.*

As mentioned, direct telephone contact is the most common method for verifying invoices. Where total verification proves impractical due to an excessive number of account debtors, factors may elect to perform random spot checks.

During verification, a factor seeks to satisfy itself that: 1) the account debtor has received and accepted delivery of the goods and/or services indicated on the invoice(s); 2) the debtor's payment is not contingent on the fulfillment of any additional conditions; and 3) the account debtor intends to make payment in full, without asserting any offsetting claims or credits. In addition, the factor may attempt to determine the extent of the account debtor's willingness to remit invoice payments directly to the factor.[16]

There are instances where factors find it impractical to contact debtors prior to advancing funds. For example, certain high-volume retailers (such as Wal-Mart) will not discuss the status of individual invoices until they are more than a certain number of days past due. The sheer volume of invoices processed by such account debtors renders any other policy unworkable.

In these cases, many factors depend on alternate means of verification such as examination of shipping/delivery documents. Other factors simply refuse to purchase invoices from such debtors altogether.

Factors often cut back their verification activities for long-standing clients whose receivables consistently perform well. Some factors, especially the giants, have come to rely entirely on after-the-fact collection efforts and auditors' letters to uncover disputes or other collection problems. Consequently, they rarely contact account debtors prior to issuing advances.

5) *Factor disburses advances.*

Once the factor has processed the invoices and completed verification, it will normally issue an immediate advance to the client. Depending on the factor's procedures, it may require the client to execute some type of transaction document prior to making a disbursement. In all probability, this document will list the factored invoices, and state the amount of the factoring advance. Disbursements are most commonly made by wire, with the client paying the fees.

Factors generally try to disburse advances as soon as possible after receiving client invoice submissions. Many pride themselves on providing same-day turnaround. Others promise disbursements within 24-48 hours. Sometimes, turnaround can take longer, especially if the factor runs into difficulty with invoice verification.

6) *Factor notifies debtors.*

In order to preserve its collection rights against the account debtors, a factor must first notify them that it has taken title to client invoices.

This notification usually occurs in two ways. As mentioned, most factors provide clients with notification stamps or labels, which the client routinely affixes to its invoices. In addition, the factor may send separate notification letters to the account debtors. Quite often, these letters go out on the client's own letterhead and carry the signatures of both a client officer and a representative of the factoring company.

Factors usually send notification letters only once to each account debtor. The letters usually carry a warm, upbeat tone and explain how the factoring relationship will enable the client to serve the account debtors even more effectively than in the past.

While notification letters usually state that an assignment of invoices has taken place, they normally avoid making reference to the term "factoring."

7) *Factor tracks invoice performance and collects payment.*

Factors normally track the aging of client invoices and place follow-up inquiry calls to account debtors as invoices become due. If standard industry paying habits typically exceed invoiced terms, factors will usually time their inquiry calls to reflect that fact.

8) *Factor deposits and posts payments.*

Most factors deposit debtor checks immediately upon receipt and complete posting of payments within one or two days.

9) *Factor disburses rebates to client.*

Under most factoring arrangements, clients accrue reserve account balances as the factor collects account debtor payments. After first deducting its factoring fees and other charges[17], the factor remits these reserve account balances back to the client in the form of "rebates."

Factors generally follow one of three different policies with respect to issuing rebate payments:

a. The factor pays rebates as individual invoices are collected, subject to a processing lag. In some cases, factors make such payments periodically, such as once each week.

b. The factor pays rebates only after collecting sufficient amounts on individual invoice batches to recover advances and fees.

c. The factor pays rebates only after collecting full payment for all invoices in individual batches.

Regardless of which policy they employ, many factors impose a standard waiting period to allow for clearing of account debtor checks. In some cases, the factor may continue to accrue fees during this period.

10) *Factor reports to client.*

Reporting occurs continuously throughout the factoring relationship, since the client must have accurate information in order to properly manage the program.

Certain reports are triggered by specific events, such as the collection of invoice payments and the generation of rebates. Others are issued periodically to keep clients aware of their overall account performance and costs.

Most factors rely on internally developed proprietary software to generate reports, with the result that there are no standardized industry-wide reporting formats.[18] Regardless of the form in which data is presented, however, a client should expect the factor to provide the following information on a regular basis:

1) Detailed aging of all currently outstanding factored invoices;
2) Reserve account balances showing detailed charges and credits;
3) Balance of outstanding advances;
4) Factoring fees paid by the client and accrued fees currently due the factor;
5) Collection reports detailing invoices collected, collection dates, and including breakdowns (by invoice) of funds advanced to client, fees earned by the factor and rebates due the client; and
6) Detailed "cash out" reports showing the net amount which would be due the factor if all outstanding invoices were paid off on a given day.

In addition, the factor should have standard and timely procedures for keeping clients informed regarding disputes, unexplained payments (checks from account debtors that do not correspond to any readily identifiable invoice) and other routine anomalies.

Working with Brokers and Referring Advisors

Companies often come to factoring through the involvement of independent advisors such as brokers, management consultants, accountants or other referring parties. If they are knowledgeable about factoring in general, or if they have an in-depth understanding of a particular client's operating and/or financial situation, such professionals can help businesses establish suitable factoring relationships.

Independent advisors normally receive compensation for their efforts either through consulting fees paid by the client or through referral commissions paid by the factor.[19] Regardless of who pays them, however, such advisors do not become parties to the executed factoring agreement.

Clients therefore need to remember that a factoring broker's statements will not usually be binding on the factor. Accordingly, the client should not rely on a broker/advisor to act as a permanent intermediary once the initial introduction has been made. For the same reason, the factor will most likely move to establish direct primary contact with client staff and management in the early discussion phase.

Most factors pay broker commissions to individuals or companies that refer clients. These commissions usually represent either a percentage of the factor's earned fees (typically around 10%), or a percentage of the client's gross factoring volume (typically less than 1%). In either case, the payment of such commissions will most likely be contingent on the factor's successful collection of the referred client's invoices.

Factoring brokers exhibit varying degrees of sophistication and involvement in the factoring industry. Some work full-time to actively identify suitable factoring candidates and help prepare detailed presentation packages before making the factoring introduction. These brokers generally have developed working relationships with one or more factors to whom they refer business on a regular basis.[20]

Others are simply business professionals who, in the course of their own activities, may occasionally come across a business that turns out to be a likely factoring prospect. Such referring brokers may or may not have previous knowledge of factoring, and may locate potential factors simply by asking around or checking other resources such as *The Edwards Directory* or the *Yellow Pages*.

Lastly, when a factoring prospect proves unsuitable for a given factor's portfolio, the factor may earn a broker commission by referring the prospect to a different factor.

Commissions typically remain payable to the referring broker throughout the life of the factor's relationship with the referred client.

Changing Factors

Sometimes a factor and client will discover that they no longer meet each others' needs. Significant changes in a client's overall factoring requirements, unanticipated operating difficulties, or the availability of alternative financing at lower rates are among the reasons why factors and clients may terminate an existing relationship.

In many cases, the client will need to secure the services of a different factor. Making this change requires some thoughtful financial and operational planning.

When a client changes factors, the new factoring company usually buys out the old factor's interests in the client's portfolio. The old factor will therefore need to provide the client with an exact "cash out" figure, backed by a detailed accounting. This task is not always as clear cut as it may seem, since the client's overall account balance may vary from day to day. Accordingly, the "cash out" figure may change several times during the discussion period immediately preceding the execution of a title transfer.

Once the "cash out" figure is agreed upon as of a given date, the new factor will typically wire full payment directly to the old factor. Simultaneously, the old factor will execute a UCC-3 Financing Statement to either terminate its security interest or assign it to the new factor. The two factors will also execute other documents in connection with the transfer of title.

The buyout transaction itself will entail double costs for the client, who will not only pay the fees accrued by the outgoing factor, but will also incur fees due the new factor for the funds advanced to execute the buyout. In addition, the new factor might find it necessary to issue some type of over-advance to make the buyout work.[21]

When switching factors, the client must also take active steps to ensure that the transition does not cause undue confusion among its customers, who will need to be advised of the new remittance address. During the period immediately following the switch, some customers may continue to send payments to the old factor, who will then forward them on to the new factor. Check processing delays caused by such "detours" may occasionally cause increased factoring fees, if the extra time in transit pushes the invoice aging into a new collection window. Consequently, it behooves the client to do everything feasible to keep its customers informed of the change.

In rare cases, a more aggressive factor may simply consider "coming in on top" of an existing factor's position. In this scenario, the new factor simply starts buying invoices generated after a certain date, on the assumption that the invoices held by the old factor will be paid off in the reasonably near future. Once that happens, the basis for the old factor's security interest disappears, at which point it can reasonably be expected to terminate its existing UCC-1 filing. This approach enables the client to avoid paying double fees and can eliminate the need for the new factor to make over-advances.

The problem, however, is that a significant portion of the old factor's invoices may subsequently prove uncollectible, thus causing it to enforce its prior security position against the client (and, therefore, the new factor). In that event, the new factor will likely find itself having to relinquish proceeds of invoices against which it has previously advanced funds. Understandably, factors generally prefer to avoid such potential exposure, unless special circumstances indicate that this risk can be effectively mitigated.

Establishing a Productive Factoring Relationship

Companies enter into factoring relationships to achieve certain goals, such as accelerating cash flow to increase sales, buying time to permit an orderly search for more conventional financing, weathering a start-up period, etc. Factors enter these relationships to earn fees by helping clients achieve these goals. Neither the factor nor the client expects the relationship to last any longer than is legitimately necessary, and both parties have strong motivation to minimize problems and avoid disruptions.

Clients can do much to ensure that their factoring relationships proceed smoothly and productively. In this regard, we offer the following [12] suggestions for those seeking to advance their companies' financial position through the use of factoring.

- ✓ Be very clear about your objectives and how you expect the factor to help you achieve them.
- ✓ Talk to a number of factors to determine which one has the program that best suits your company's needs.
- ✓ Once you have selected an appropriate factor, make sure you clearly understand how the factoring program works, both operationally and financially.
- ✓ Be sure that you can comply with the factor's program and that you will not find it continually necessary to ask for policy exceptions once the relationship has commenced.
- ✓ Designate at least one competent staff member to manage day-to-day interaction with the factor's administrative personnel. Make sure that this staffer clearly understands invoice submission procedures and requirements, and knows how to read the factor's operating reports.
- ✓ Ensure that you do not prematurely submit invoices for work that has not been completed unless you have first informed your factor to that effect.

- ✓ Closely monitor the performance of your portfolio. Do everything possible to facilitate timely payments by your customers. Be sure that your invoice documentation is complete and accurate in order to prevent processing delays and confusion in the customers' accounts payable departments.

- ✓ Respond in a timely fashion to the factor's request for information and assistance regarding invoice disputes, unidentified payments or other anomalies.

- ✓ Inform the factor immediately whenever account debtors incorrectly send payments for factored invoices directly to your company. Be prepared to forward such payments immediately to the factor, unless otherwise instructed. To the greatest extent practical, be sure that your accounting staff learns to recognize checks issued in payment for factored invoices so that such checks will not be inadvertently deposited in your company's bank account along with other receipts.

- ✓ Avoid crisis cash flow management. Communicate with your factor regularly to avoid last minute surprises involving extraordinary cash flow demands. Most factors are professionals and will do everything possible to work with you, so long as they have time to help develop appropriate strategies. Do not try to "blackmail" the factor into making inappropriate last-minute advances by threatening disaster, such as missed payroll.

- ✓ Use the funds obtained through factoring wisely, to accomplish your stated objectives.

- ✓ Above all, remember that factoring is a mutual relationship in which both parties have much to gain as well as much to lose. It is wise to remember that the Golden Rule works as well in factoring as it does in any other relationship where two parties depend on each other.

Endnotes

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[1] For purposes of clarity and consistency, we use the term "transaction" throughout this article.
[2] [omitted with permission]
[3] When a single advance/reserve transaction covers multiple invoices, fees are usually calculated for each invoice based on its individual collection period. Accordingly, the total fees actually incurred in a given factoring transactions will reflect a blended average of aggregate invoice performance.
[4] Many factors prefer to avoid the term "interest," since the term most often connotes a loan of money.
[5] A company in Chapter 11 is known as a "debtor-in-possession" because it retains operational control of its own assets, rather than having such assets turned over to the

control of a court-appointed bankruptcy trustee. The appointment of such a trustee is rare in a Chapter 11 case. Instead, all of the powers and duties of a bankruptcy trustee remain with the debtor-in-possession.

[6] The term "post petition" refers to events occurring after the filing of the client's bankruptcy petition.

[7] As a practical matter, the costs of enforcing legal claims against account debtors, especially when they are out-of-state, will prove prohibitive unless the amounts in question are substantial.

[8] The initials UCC refer to the Uniform Commercial Code, which is a body of law that has been more or less uniformly adopted by all states except Louisiana. [The UCC has been nationally adopted beginning in 2002.] Article 9 of the UCC, which is more than 150 pages long, defines the rights of secured parties in financial transactions and establishes the procedures by which secured interests are perfected. Since the individual states are responsible for administering the UCC with respect to their particular jurisdictions, there is a degree to which filing and enforcement procedures vary from state to state.

[9] Under Article 1 of the Uniform Commercial Code, a sale of accounts receivable can be deemed invalid if it is not secured by a perfected filing.

[10] In UCC terminology, the party granting a security interest (the factoring client) is actually referred to as the "debtor". [In the current version of the UCC Revised Article 9, it is no longer necessary for the debtor's signature. All that is needed is a security agreement, between the parties, which grants authorization to file a UCC-1.]

[11] The proper filing of a UCC-1 does not "grant" a security interest. The client grants the security interest by signing the factoring agreement, which describes the collateral and specifies the events of client default which would trigger the factor's right to claim the collateral. The filing of a UCC-1 simply "perfects" the factor's rights with respect to other parties who might also attempt to claim rights to the collateral.

[12] Many factors who generally reject foreign receivables may consider factoring invoices payable by Canadian account debtors.

[13] Some factors, especially the giants, require clients to meet more stringent financial criteria, and also to produce audited financial statements.

[14] Factors also face jeopardy when clients unexpectedly file for Chapter 11 bankruptcy protection, because the factor's security interest in receivables does not apply to new invoices generated after the date of filing. Moreover, the court may even move to restrict a factor's exercise of its security interest in pre-petition invoices, citing disruption to the client's operation.

[15] The Federal Tax Lien Act of 1966 contains a provision known as the "45-day" rule. Under this rule, a secured party's perfected priority interest on any collateral remains ahead of an IRS lien, based on subsequent advances under a commitment of up to 45 days. However, in a dispute with the IRS over client proceeds, factors attempting to invoke this rule may face an argument that their factoring relationship does not constitute a "commitment" to make advances.

[16] Although the Uniform Commercial Code obligates account debtors to remit payments to the factor, some occasionally prove reluctant to do so. Factors generally prefer to

avoid purchasing invoices payable by such uncooperative account debtors, rather than engage in subsequent legal battles.

[17] In addition to factoring fees, deductions usually cover discounts, offsets or other events of non-payment by account debtors, as well as wire fees, Federal Express charges and other administrative costs which the factor passes on to the client.

[18] Off-the-shelf commercial factoring software has become more common in recent years, with the result that many factors now generate the same reports.

[19] Although some may attempt to collect fees at both ends, most reputable professionals regard such "double dipping" as inappropriate.

[20] In some cases, the factor may require the client to reformat certain material in the presentation package or transcribe it onto the factor's own forms. Such a requirement does not mean that the broker has failed to do his or her job properly.

[21] Factors have developed various accounting mechanisms to address over-advances. In some cases, the amount of the over-advance may be treated as a simple loan. Other times, the factor will need to create a "dummy" invoice, which will be paid out of the client's reserve account balance. Regardless of how it is handled, the new factor will obviously expect to recoup its over-advance, plus fees.