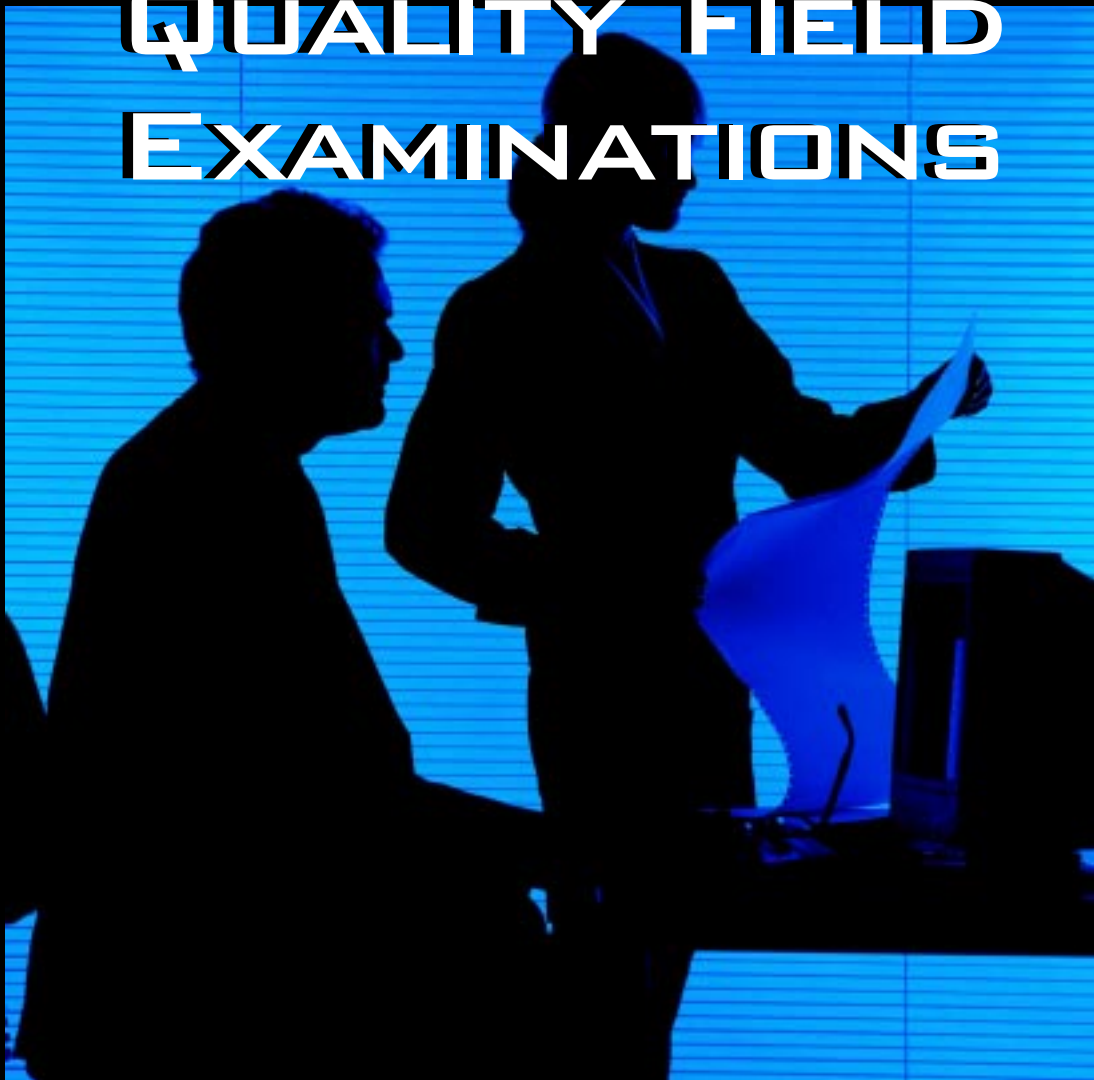


ACCOUNTANTS CORNER

QUALITY FIELD EXAMINATIONS



by Steven M. Rosenberg

Field examinations are performed primarily to provide the lender with nonbiased, factual information about a current or prospective borrower in order to help the lender manage the relationship. Managing the borrower relationship can include, but is not limited to, accepting or declining a new loan, making an overadvance, adjusting advance rates or changing reserve amounts. A field exam is not a witch hunt. Good news or bad news, the information should be reported in a clear and factual manner.

Most financial institutions require the same core procedures, which include certain accounts receivable analysis, inventory analysis, accounts payable analysis, payroll taxes analysis and cash analysis. The core procedures are an industry standard and are performed by most internal field examiners, independent accounting firms and outside contractors. The depth and intensity of the procedure varies at each institution. Borrowers with higher leverage generally require more in-depth procedures, due to the thinner assets available to repay an outstanding loan or advance.

By performing the core procedures, a field examiner should have the ability to generate a quality field examination. The difference between a poor field examination and a quality field examination lies mainly in:

- the approach by the field examiner,
- the way the information is communicated to the lender,
- how the field examiner evaluates the results of its procedures,
- the report turnaround time, and
- the intuitiveness of the field examiner.

The approach (shifting certain responsibilities to the borrower)

A field examiner should make immediate contact with the borrower to schedule an appointment and send a document request list. This puts the responsibility on the borrower to gather the information and be ready for the scheduled field examination. Any delays with the scheduled date should be immediately communicated to the lender.

Once at the borrower, the field examiner should obtain a brief understanding of the business, its operations and the flow of the “collateral” accounting records. The examiner should first always attempt to perform procedures that involve the borrower supplying supporting documents (i.e.: shipping test, credit memo test, inventory cost and gross profit tests). This allows the borrower to work simultaneously with the field examiner. The field examination should not be a one-person show. The borrower should assist with the preparation of schedules (nobody knows the borrower’s business better than the borrower). The field examiner’s function is to verify the information, not create the information.

By shifting certain responsibilities to the borrower, such as retrieving credit memos or preparing slow-moving inventory schedules, the field examination should take less time. Having the borrower perform certain functions is similar to having a free assistant, since the borrower is already paying the employee. Again, it must be stressed that all schedules must be verified for accuracy.

One of the best compliments a field examiner can receive from the borrower is “we (the borrower) were really busy gathering information for the examiner”. This lets the borrower, as well as the lender, know that the field examiner was not wasting time and was analyzing the proper information while at the borrower.

Communication

On either a new transaction or an existing relationship, the lender does most of its business over the telephone or may make occasional borrower visits. Depending on the borrower’s size, field examinations can range from one day to two weeks. In general, the field examiner is the lender’s on-site connection.

According to Richard Assaf, vice president of MTB Bank, a good field examiner immediately communicates unresolved issues to a lender. This gives the lender the ability to take immediate action with the relationship or request the examiner to perform additional procedures that may mitigate the issue or determine the depth of the problem.

According to Mr. Assaf, the worst field examinations generate more questions than answers. He indicated that it is frustrating when he receives a final field examination that includes

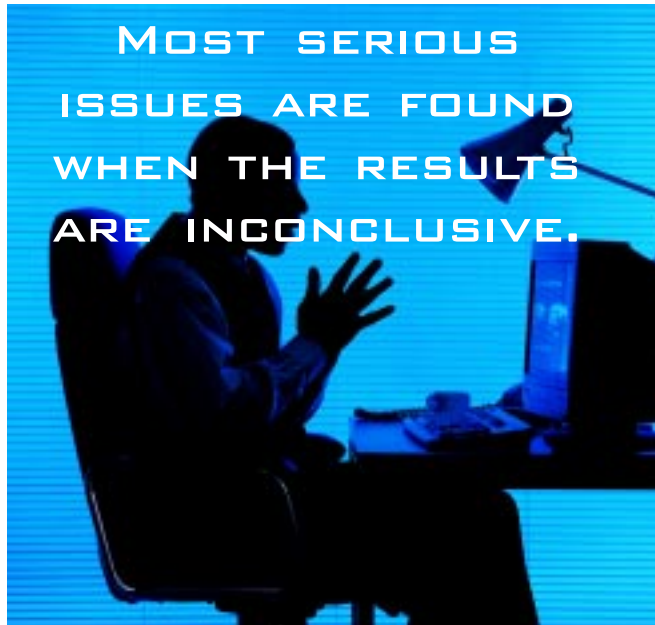
one or more major issues (such as unpaid payroll taxes, excessive dilution, significant unissued credits, obsolete inventory) that were not earlier communicated to either him or the borrower.

Major issues should always be brought to the attention of the borrower during the field examination. Many times circumstances mitigate a potential major issue, such as: 1) a pending, open, customer order for older inventory, 2) a one-time major return that was rebilled to the same customer, or 3) a subordination agreement for delinquent payroll taxes.

If the major issue cannot be resolved at the borrower’s premises, it should be communicated to the lender. This gives the lender the ability to terminate the transaction and avoid embarrassment as well as incurring additional time and expense of a dead deal.

Common sense approach to field examinations


A quality field examiner is able to recognize issues that may affect a lender’s position. Most serious issues are found when the results are inconclusive. Most borrowers don’t come right out and say, “We haven’t paid our payroll taxes this quarter” or “We assigned invoices that won’t be shipped until next month”. The field examiner should never accept an unverified explanation for a potentially serious issue. When faced with a problem area, examiners should refocus their efforts on the problem area and complete the



balance of the field examination after the problem has been resolved.

According to Joseph Elias, vice president and audit manager for Fleet Bank, the most important attribute of a quality field examination is a common sense approach to an engagement. According to Mr. Elias, anyone with an accounting or banking background can do the numbers. He indicated that quality field examiners interpret and communicate their findings to the lender in an unbiased and readable report. A common thread of poor field examinations are reported numbers without explanations, which generally results in an examiner returning to the field, he added. Poor examiners also pass over issues in order to complete a report. Good examiners know when to expand their procedures based on inconclusive results, Mr. Elias noted.

Part of Mr. Elias' job is to prepare a summary of the field examination with recommendations regarding the borrower. The summary generally includes a discussion regarding the quality of the collateral, the borrower and the related advance rates. At the bottom of every summary report to the relationship managers he includes the comment, "Remember, there is no substitute for common sense".



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Reporting in a timely manner

It is very important to complete the field examination and provide a report to the lender quickly (completion time varies significantly based on the quality of the records, the quality of the collateral, the number of locations and companies involved). In general, field examiners are scheduled to quickly move onto other engagements, shortly after exiting a site. If most of the procedures and report write-up are not completed in the field, the exam may require many calls and faxes to finish incomplete procedures. This may cause even a greater delay or the examiner may need additional information to support certain conclusions. The field examiner should always communicate to a lender when he experiences delays at the borrower.

According to Paul Mehring, senior vice president of Access Capital, Inc., delayed field examinations can have a

much greater impact on prospective transactions than recurring field examinations. Mr. Mehring indicated that the field exam is generally performed in later stages of the transaction and the prospect is eager to close. A return to the prospect to complete the examination may delay the closing and start the relationship on a negative tone.

Mr. Mehring also has had to send field examiners back to the prospect since the information from the initial field examination report was stale. In addition, he indicated that delayed field examinations may cost a prospective transaction since there may be other lenders bidding on the deal.



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Intuitiveness (talking to the people without the suits)

One of the most difficult parts of a field examination is to analyze the value of inventory. In general, the examiner attempts to determine that the inventory exists and is valued properly. Critical is determining the quality of the inventory. For example: How old is the inventory? Is it marketable or when was it last shipped to a customer? The people in the accounting department may not know the answer or may not be willing to share the information. The people who definitely know are the ones in the warehouse.

According to Robert W. Blodorn, vice president and audit manager for Bank of America Commercial Finance, a good field examiner builds a relationship with the borrower and generally gets the nonnumber information that is important to understanding the borrower's collateral. For example, field examiners who build a relationship with warehouse personnel may get certain answers that they would otherwise not get if they just counted the inventory. Mr. Blodorn indicated that just "shooting the breeze" with the warehouse people might help build a comfort level. With a level of trust, the warehouse personnel may either volunteer information, such as slow-moving inventory, or may innocently answer important questions, such as "Has any of the inventory been returned lately?"

Obtaining certain nonnumber information can be vital to the overall quality of a field examination.

The role of the field examiner

The role of a field examiner is not to be a hero and to find something wrong with a borrower. A quality field examiner should communicate nonbiased facts to the lender in a clear and concise manner on a timely basis to allow the lender to make an educated decision regarding its relationship with the borrower. ▲