

# How do you know if a collateral exam is needed?

As the saying goes hind sight is 20-20. This is probably why many lenders have found it prudent to employ an audit schedule that borrowers may be subject to. Depending on the risk profile of a borrower, a company may be on a 360, 180, 120 or 90 day cycle, with audits once, twice, three or four times a year.

Other lenders perform audits on an as needed bases. When this is the case, the following pages provide early **warning** signs. If one or more of these items is present in any relationship, the lender may want to consider sending in an audit team.

# Warning Signals

- **Delay in receipt of external financial statements**
  - Possible reasons include:
    - Management is in discussion with its auditors over **negative adjustments required by the CPA**
    - The financial statements are at risk of being issued with an **“un-clean” opinion.**
- **Delay in receipt of internal financial statements**
  - Possible reasons include:
    - Management **delaying bad news**
    - Management is trying to **mask results by keeping accounting periods open longer.**
- **Going concern opinions** issued in conjunction with audited financial statements



# Warning Signals - cont'd

- Decrease in level or frequency of services performed by outside accountants
  - Possible reasons include:
    - **Lack of liquidity**
    - Desire to **avoid the “scrutiny” of an audit** and possibly an unfavorable opinion
- Frequent changes in accountants
  - Possible reasons include:
    - Management is **shopping for results**
    - Internal controls are such that **accounting firm requires drastic changes**



# Warning Signals - cont'd

- Inability to “cleanup” seasonal working capital line
  - Possible reasons include:
    - **Lack of liquidity**
    - **Disappointing sales**
    - **Unexpected expenses**
- Requests to waive covenants
  - Possible reasons include:
    - **Lack of liquidity**
    - **Disappointing sales**
    - **Unexpected expenses**
- Resistance to sending in lender auditors or representatives
  - Possible reasons include:
    - **Lack of liquidity**
    - Desire to **avoid the “scrutiny” of an audit** and possibly an unfavorable opinion



# Warning Signals - cont'd

- Large fluctuations in financial ratios
  - Possible reasons include:
    - **Income manipulation** by increasing/decreasing various reserve accounts
    - **Variability in results** making the predictability of the business difficult
- Collateral deterioration (increasing dilution, deteriorating turnover, increased aging)
  - Possible reasons include:
    - Poor business performance
    - **Overstatement of collateral**
- A/P and/or taxes payable deterioration
  - Possible reasons include:
    - **Lack of liquidity**
    - **Poor financial results**



# Warning Signals - cont'd

- Persistent overdrafts
  - Possible reasons include:
    - **Lack of liquidity**
    - **Poor financial results**
    - **Poor internal controls**
- Books and records not supporting financial statements
  - Possible reasons include:
    - **Poor internal controls**
    - **Managements desire to mask/hide results**
- Inconsistent expenses
  - Possible reasons include:
    - **Lack of liquidity**
    - **Poor internal controls**
    - **Inappropriate expenses**



# Warning Signals - cont'd

- Increase or undisclosed related party transactions
  - Possible reasons include:
    - **Lack of liquidity**
    - **Poor internal controls**
    - **Inappropriate expenses**
- Poor management information systems
- Cash profit vs. accrual basis loss



# ECG Enterprises, Inc.

## info@ecgenterprises.com

Please feel free to contact ECG Enterprises to arrange for a collateral examination.

ECG is a new and young company, built on Greg Isenberg's extensive experience in the commercial finance industry.

ECG specializes in **protecting lenders by designing and implementing audit programs** that:

- Identify collateral risk lenders may not be aware of
- Identify favorable and unfavorable trends in a borrower's financial and/or collateral performance
- Provide relationship managers with strategic information not readily available elsewhere.