Invoice Discounting and Factoring

CASHFAC SECTOR LITERATURE

Introduction

Invoice discounting is the practice of using a company's unpaid accounts receivable (i.e. invoices) as collateral for a loan, which is issued by a finance house. The amount of debt issued by the finance company is less than the total amount of outstanding receivables (typically 80% of all invoices fewer than 90 days old).

Factoring is also a type of debtor finance in which a business sells its accounts receivable to a third party (called a factor) at a discount.

With factoring, the provider takes the role of managing the sales ledger, credit control and chasing customers for settlement of their invoices. With invoice discounting, the company retains control of its own sales ledger and chases payment in the usual way. These types of borrowing are intended to be short-term, so that borrowed funds are expected to be repaid as soon as the associated accounts receivable are paid by customers.

However, factoring and invoice discounting arrangements typically roll over. As clients raise new invoices and the existing invoices are paid, the invoice discounter or factor issues new funds to the borrower. This means a borrower may have a base level of debt that is always present as long as it can sustain an equivalent amount of receivables.
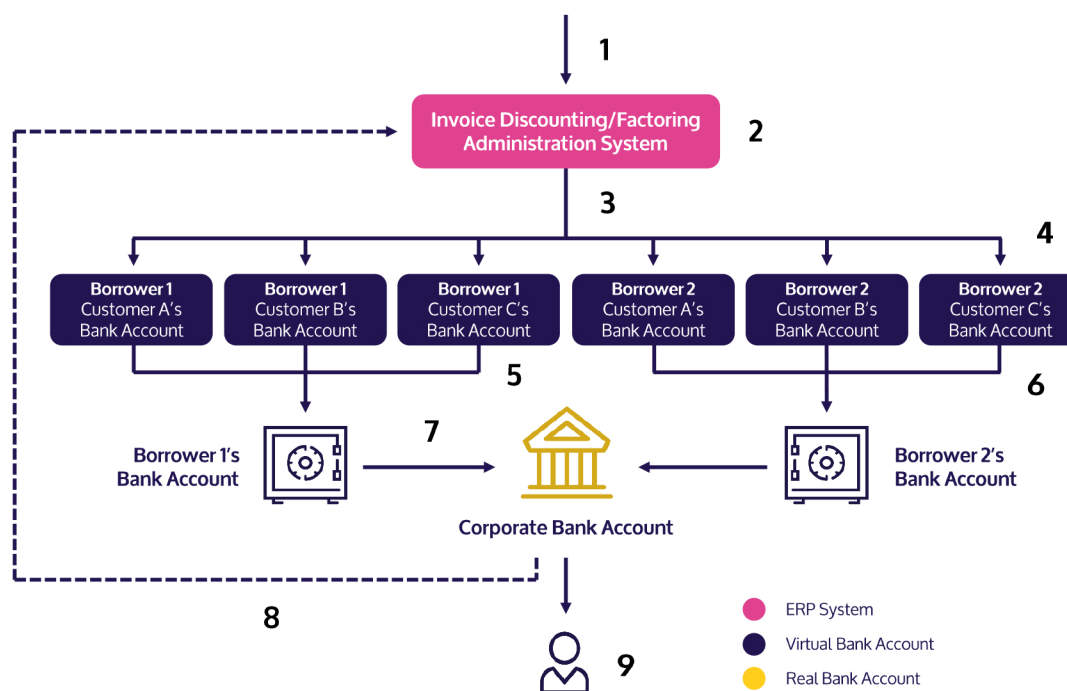
Configuration for an Invoice Finance Firm

1. New invoices extracted from borrowers' ERP systems and sent to lender's invoice discounting system.

2. New invoices loaded onto the borrower's customers' accounts to:
   a. Create expectations/open debtor positions to be matched to the cash receipts when they arrive to help identify them and drive the accounting for them.
   b. Create future dated accounting records for calculation of funding available to the borrower
   c. Project future cash positions for risk monitoring and control purposes.

3. Funds can be swept from the borrower's existing bank account to the invoice discounter/factors account.

4. Funds received by direct debit or bank transfer from the borrower's customers (possibly via the borrower's bank account) routed to virtual bank account setup for that customer alone.

5. Funds received also accounted for at borrower level.

6. Borrower account can also hold invoices outstanding/funding available figure for the borrower. This allows Cashfac to calculate and/or record additional funding available to the borrower and either:
   a. Allows the borrower to draw it down using the Cashfac web portal, or
   b. Sweeps it to borrower automatically.

7. Funds received are automatically swept to corporate account under clearing hold, if required.

8. Cashfac updates the invoice discounting administration with the cash receipts. Cashfac can also automatically generate full double entry accounting for transactions under its control, either in Cashfac's general ledger or your existing ERP.

9. New funding, triggered by the cash receipts or the uploading of new invoices or credit limits for the borrower, is automatically paid out to the borrower.

How Can **Cashfac** Help?

The Cashfac solution provides invoice financing companies with a proven solution to the challenges of cash processing, including:

Taking Control of the Borrower's Bank Account

When the borrower enters into a factoring/invoice discounting arrangement, sales invoices/receivables are sold by the borrower to a lender. Ideally thereafter, the borrower's customers would pay the lender directly for these invoices. However, in practice, this may not happen due to the terms of the financing agreement, customer error or simply because the borrower does not want their customers to be aware of any factoring arrangements they have with a lender as they can sometimes be regarded as finance of last resort.

Using innovations in the banking industry driven by Open Banking regulation, the lender can allow customers to continue paying the money for the invoices into the borrower's bank account. Using Cashfac's solution, the lender can take control of the borrower's collections account. It can monitor the borrower's bank account in real time and, as soon as the funds arrive in the borrower's bank account, the solution sweeps it to the lender's bank account.

Cashfac is regulated by the FCA as an Account Information Service provider (AISP) and a Payment Initiation Service Provider (PISP). Once the correct contract has been put in place between the borrower and the lender, the lender can be authorised to access the borrowers account and instruct a payment of the balance on the account to itself. This gives greater transparency and security over repayments to the finance house while causing minimum inconvenience to the borrower.

Identifying, Allocating and Applying Cash Receipts

Cashfac takes the lender's single cash receipts bank account and virtualises it into thousands of fully functional bank accounts, one for each customer of the borrower.

Each customer can then pay funds directly to its virtual bank account through the banking network, or the lender can process collection to that virtual account using direct debits or cheques. This banking arrangement can greatly reduce or, if we can use Virtual IBANs* from your bank, remove the possibility of not being able to identify the payer. As only one customer can use that virtual bank account, all receipts in that virtual account must belong to that customer.

As the banking industry develops, banks are making intraday statements available at much more frequent intervals during the day. Some banks already allow Cashfac to take a statement every 15 minutes, enabling us to allocate cash as soon as it arrives throughout the day.

Cashfac integrates seamlessly with the lender's existing administration and ERP systems. Invoices and credit notes purchased or held as security can be loaded into our solution and posted as non-cash expectation transactions on the customer's virtual bank accounts. When a cash receipt is posted to the virtual bank account, our solution will apply the receipt against the invoice expectations thereby settling the invoice. This settlement can be used to update the invoice finance firm's existing systems.

Cashfac's application functionality is smart enough to handle many-to-one applications and deal with tolerance differences in a highly automated fashion.

If the lender would prefer to do the application of cash on its existing systems, each Cashfac virtual bank account is simply paired with the customer's existing receivable account on the existing systems. When cash is received in the virtual account, Cashfac automatically posts the cash to the existing systems from where they apply it.

Fully Automating Clearance Management

Best practice is to hold all direct debits or cheque receipts for a clearance period before processing them onto your ERP or administration system. To do this manually requires significant manual effort and reconciliation.

If a clearance hold is required, Cashfac completely automates the process. It holds funds received by direct debit or cheque for a clearance period before making them available to trigger new finance to the borrower.

* Virtual IBANs. The Cashfac virtual bank accounts can be given their own virtual IBAN to make the account "externally addressable". This in turn allows customers to lodge funds directly to their own virtual bank account through the bank clearing network, either by bank transfer or direct debit, rather than requiring the client to quote a reference or invoice number in the bank narrative.

Reconciliation and Accounting

Cashfac's virtual banking solution can deliver full double entry accounting for cash transactions. The lender's existing ERP or administration systems may be able to fully account for all its transactions, and if so, Cashfac updates the ERP with details of cash transactions and/or clearance either through the Web Service API calls or File Transfer.

However, if the company's existing systems do not have sufficient accounting functionality, Cashfac posts the accounting entries to the operational general ledger that Cashfac maintains for all the activities under its control.

As the system accounts for the cash transactions, it also reconciles the accounting records to the company's bank statement, delivering a full external bank reconciliation.

Calculation and Accounting for Credit Limits

Invoices and credit notes purchased or held as security can be loaded into Cashfac and posted as non-cash expectation transactions on the customer's virtual bank accounts. These future-dated transactions can be used by Cashfac to calculate the credit facility available to the borrower or to store a credit limit calculated elsewhere.

# Making New Credit Instantly Available to the Borrower

When cash is received from the borrower's customers, it is rapidly credited to the borrower's Cashfac account. Taking account of this receipt and/or new invoices purchased, Cashfac, in real-time, can determine the new credit available to the client.

Cashfac can then either sweep the new finance directly to the borrower or place it in a new virtual bank account where it is available for the borrower to drawdown using the Cashfac web portal. To do this, the borrower logs onto their Cashfac account and initiates a payment to themselves or directly to a supplier using the Cashfac payment functionality. The Cashfac virtual bank account is a fully functioning bank account allowing the invoice discounting firm the option of offering a full payment banking service to its borrowers.

If the lender's bank can make statements available on an intraday basis, Cashfac can allocate cash receipts in real time throughout the day. This in turn can automatically trigger the release of new finance on a near real-time basis, improving the lender's customer service and increasing its turnover.

Managed Services

Cashfac Managed Service offers a single point of contact for all support issues, removing the need for employing dedicated customer staff to operate the virtual banking platform and thereby minimising change management and specialist training.
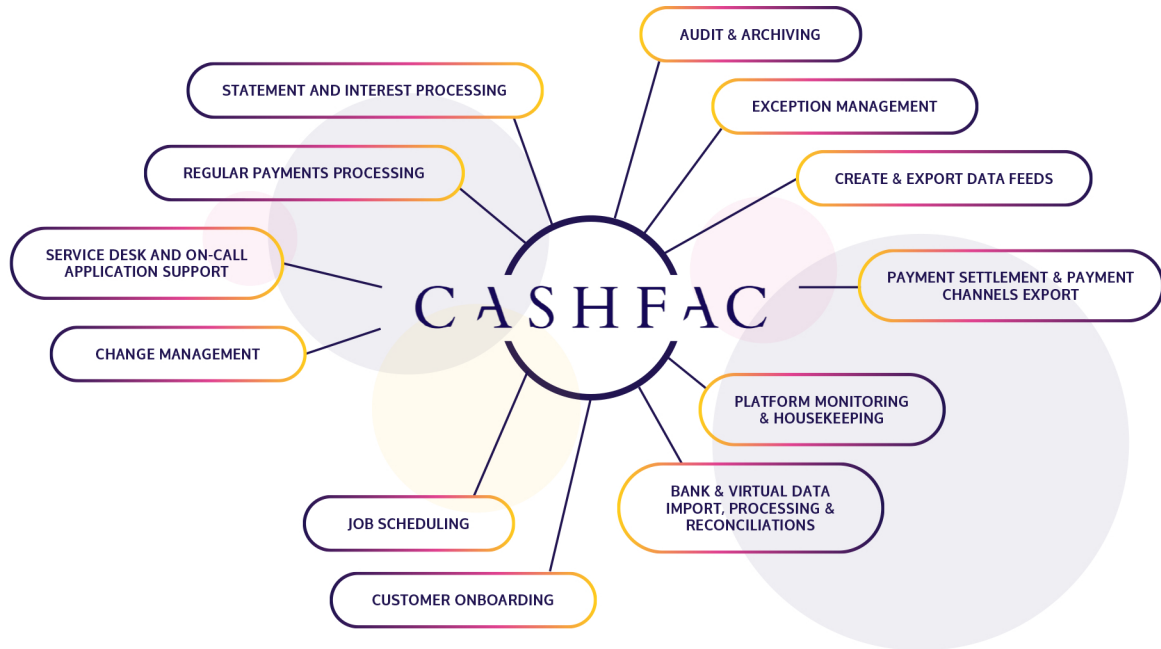
Hosted Services

Cashfac hosts the service via Microsoft Azure infrastructure and manages the entire release and upgrade process, including platform testing before release, and will assist you with your own testing.

Our deep knowledge of our product and a detailed understanding of the features that have been enhanced in each release, combined with proximity to the development team, ensure this process is executed with accuracy, knowledge and expediency.
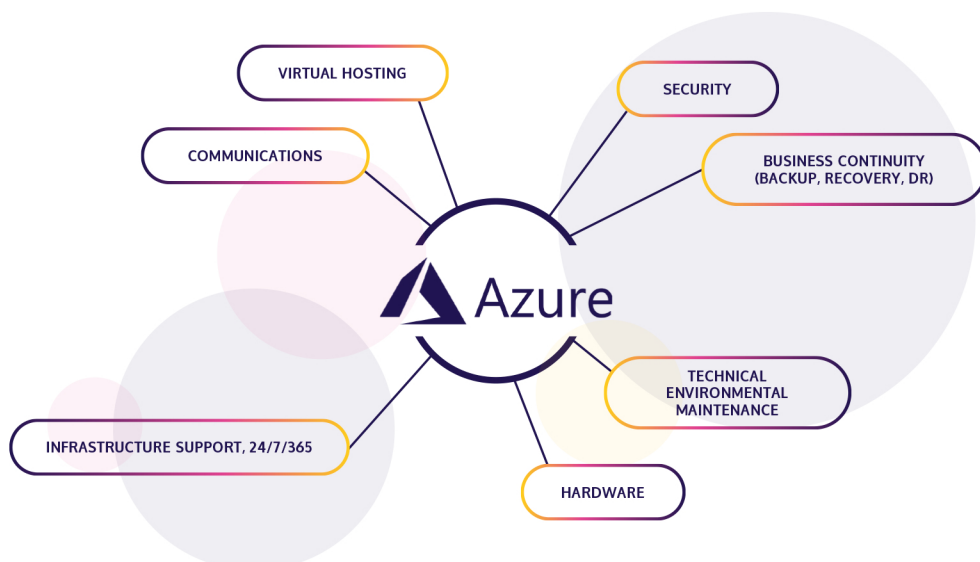
For product information, to request a demonstration or to speak to us about your business needs, please contact us at
www.cashfac.com/contact

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