

# Field Examinations in 2022 and Beyond

BY MICHELE OCEJO

*TSL's editor-in-chief interviewed several field exam professionals as well as lenders to get an overview of what lenders should look for, the current challenges and the effects of the pandemic.*



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on Clarke, president of Asset Based Lending Consultants, summarized the importance of field exams well: “The field examination is an important management tool for the relationship manager and the lender. Its historical metrics allow the lender to preempt emerging issues and to be proactive. The field examiner is the ‘eyes and ears’ of the lender and the only person to make frequent site visits.”

## The Challenges

The challenges brought up by lenders and examiners are a mix of longstanding challenges that go along with the nature of field exams and new obstacles brought about by the pandemic. Clarke said field exams are viewed as a “necessary evil.” “No one seems to like the process as it can be rather intrusive,” he said. Field examiners must be flexible and not too sensitive if there is pushback from either party during the process, he added. One common theme mentioned by all the participants is the need for an exam to be both timely and accurate.

Aliah Lalani, managing director/COO, Hilco Diligence Services agreed, adding that clear and concise communications are a must. It’s clear, also, that in a field exam, expectations must be managed. “An overly aggressive timeline may be unrealistic. Field exams may take longer than expected,” Lalani pointed out. “We have a saying: ‘The situation on the ground is rarely better than we thought.’”

Both the field examiners and the lenders emphasized there is no “one size fits all” when it comes to the field exam process. Jason Schick of Siena, said, “I look for an examiner that is adept at identifying the pitfalls in the collateral based on the prospect’s business and operations, not just an examiner that goes in with a cookie cutter approach to identifying ineligible and reserves. I look for an examiner that can be an integral partner in my underwriting process.”

Denise Albanese, owner of Cost Reduction Solutions, added on to Schick’s thought, describing the need for each field exam to be tailored to the lender’s needs: “While there are several core challenges in the collateral field examination process that must be overcome on each assignment, there are different field examination requirements based upon each lender’s culture and credit risk appetite and policies.” She added: “There is an art to obtaining or extracting information from a prospect or borrower in order to produce the results that meet the standards of the lender.”

Another phrase mentioned by both examiners and lenders was “out-of-sight-out-of-mind” as it pertains to virtual or hybrid exams. “The examiner must be fervent in his/her pursuit of information without creating confrontation,” said Clarke.

Brian Kennedy, senior underwriter with Citizens Business Capital, provided additional input from the lender point of view: “Experience



■ **DENISE ALBANESE**  
Cost Reduction Solutions



■ **DON CLARKE**  
Asset Based Lending Consultants



■ **JAMES FOLEY**  
Bank of America



■ **RANDI HERSHGORDON**  
Gibraltar Business Capital

matters most. As a lender I need to have confidence the examination firm has the knowledge and ability to properly identify key risks across a variety of industries in multiple jurisdictions. A firm that works efficiently and communicate effectively with both the bank and the customer is likewise imperative.”

Randi Hersh Gordon, senior vice president with Gibraltar Business Capital, provided some guidance on gauging report quality: Are key findings summarized in a succinct manner and addressed appropriately with consideration for both credit and business risks? Are test results, exceptions and conclusions clearly outlined? Does the report include a detailed explanation of proposed ineligible and eligible collateral along with supporting calculations?

## What Lenders Need

Albanese explained that each lender must take the time to reflect on what they need from a specific field exam. “If a lender is short on internal operations, the borrowing base analysis may be the most





■ **ALIAH LALANI**  
Hilco Diligence Services

critical function and best time spent. Some lenders waive that analysis and want a focus on sample testing to ensure the underlying documentation supporting the collateral jives with the reporting provided. Others may be inventory centric and care more about inventory test counts, in-transit inventory analysis and the costing of inventory. Due to the variety of scope and guidelines, it is one reason we typically profess a full-scope field examination that encompasses each phase and ties together the analysis on the collateral and books and records.”

“A field exam is not a check the box exercise for lenders. It is a key piece of information, that allows lenders to make an informed decision about a given credit. Examiners should work with the borrower to clearly define scope to ensure that the field exam report meets the needs of the lender,” added Lalani. She provided the following details:

*Borrowing base:* this will provide the lender with a picture of the collateral as of the collateral date. The

footnotes to the borrowing base are just as important as the borrowing base itself.

*Scope Limitations:* Scope limitations also provide a picture of a borrower’s ability to produce and provide information to a lender for monthly reporting purposes. This could include system limitations as well as information not provided to the examiner some of which may have an impact on the risk profile of the collateral.

*Risks:* A field exam will identify risks that the lender should consider including any risks of asset/conversion/loan repayment and collectability in a liquidation scenario.

*Management responses:* The depth and breadth of management responses in a field exam will give a good indication on how a borrower will respond to a lender, particularly with borrowing base reporting. If management responses are detailed, it is likely that management will also provide detailed information to the lender.

Schick provided an overview of his firm’s needs: “Our scope



■ **JASON SCHICK**  
Siena Lending Group

generally covers a 24-month look back and includes standard A/R and inventory tests, e.g., invoice testing, verifications, credit memo and past-due review, cost and gross-profit testing, test counts, etc. However, we also will add test procedures based on the prospect’s specific business, such as reviewing maintenance logs and certification tags for aircraft and related parts, or review of PACA exposure for companies operating in the food industry. Given the profile of the deals that Siena

is working on, which includes more distressed situations, our test coverage tends to be higher than the average exam performed for a bank lender. We will also have examiners do examinations of fixed assets (in addition to what appraisal firms are doing) to validate term loan collateral being reported to us.”

For James Foley, senior underwriter with Bank of America, detailed what his team considers when outsourcing a field exam: “We consider the size of the facility, whether the facility will be syndicated, complexity of the exam, international nature (if applicable) and field exam resources available to meet the timeline. We will also consider prior experience on similar transactions.” Foley added that international deals add a level of complexity. “When there are situations where there are multiple divisions and or/countries involved, it is imperative to coordinate with the field exam team on the scope to ensure that divisions with the larger collateral value receive full and/or modified scope and smaller divisions receive lesser scope.”

Kennedy delved into what his company looks for in a recurring exam: “Recurring exams should always be more efficient from a time and cost perspective. The scope should remain the same, however, focus could change based on current trends. One area that should get more attention in a recurring exam is related to the cash testing. Now the customer is utilizing our treasury management services so a deeper dive on cash testing to make sure proceeds of collateral are flowing correctly is warranted.”

In a recurring exam, Foley said he is looking to “rollforward statistics from the survey exam to the most current period available. In addition there will be a review of the current borrowing base calculation to ensure the company is calculating the borrowing base correctly. We will request follow-up on areas from the survey field exam that were noted as requiring subsequent follow-up (e.g. consideration of credit memo lag ineligible if continued slow issuance of credit memos) and follow up on any current trends.”

When asked if the needs/scope of a field exam change from exam to exam, Kennedy said they remain largely the same, in his experience. “However as new legislation passes in different jurisdictions, it may

require deeper review of possible lien preference issues. Also, as macro events occur, additional consideration may be required. Whether it be a pandemic or supply chain disruption, there are potential impacts across the board. Having a firm that can help identify future potential issues due to a changing macro environment is a great value add to me as a lender.”

Hersh Gordon emphasized the need for the examiner to approach each exam with “fresh eyes” to ensure collateral issues are not overlooked, especially in the case of recurring exams. “We look for examiners to be thoughtful, disciplined, and exhaustive in their approach and to avoid questions that lead to responses such as ‘no changes’ or ‘same as last time’ to ensure they are not just checking a box.”

### Common Misconceptions

Misconceptions exist pertaining to the details of a field exam. The examiners took the time to clarify a few of these here.

Lalani said, “One of the most common misconceptions about a field exam is that once the initial information requests are provided and management interviews have been completed, then the exam and borrowing base can be completed very quickly. Field exam is a very iterative process and requires both management and the examiner to work together, be engaged to provide a clear picture of the borrower’s working capital cycle and collateral issues for the lender. Field exams are very labor intensive and require a lot of back and forth between the borrower and the examiner. It’s not simply a matter of getting the data and processing it. They require both the examiner and the borrower to be fully engaged in an iterative process to ensure all procedures can be fully completed, a comprehensive borrowing base can be delivered to the lender and all potential risks can be identified. It’s important to clearly outline the exam process with borrowers to ensure there are no surprises and that the borrower goes into the process knowing exactly what is required of them and what the examiner’s requests will be.”

Both Lalani and Clarke mentioned that there is a misconception among borrowers, especially new ones, that a field examination is similar to a certified financial statement exercise. Lalani clarified,

“Although there are a lot of similar information requests and procedures performed, the overall objective, the analytics, the purpose of the testing and the end product are very different.”

Albanese emphasized again the importance of recognizing that no two field examinations are the same. “Each field examination is a unique process and that includes a field examination that may take place on the same borrower within a short amount of time. Field examinations are fluid and from the field level things can change on the fly. Lenders that take that perspective are more in touch with the

reality of the workplace environment and the challenges their borrowers’ face.”



**Do the examiners think the industry will go back to 100% onsite exams again? In short, no, but this isn’t necessarily a negative. Seems the industry is finding a happy medium. “I do not think things will go back to the way they were. I think it will be client specific and fall into three rough categories: Remote, Onsite and Hybrid,” Lalani explained.**

### You Get What You Pay For

Naturally, lenders are concerned about the cost of a field exam, as this cost is paid by the borrower, but it’s also true that an efficient exam cannot be rushed. Clarke explained, “Cost and timing are driven by the timeliness and accuracy of the information received, all controlled by the borrower. The borrower can help reduce these costs by being conscious of the examiner’s time.”

Lalani agreed, stating: “Two variables that go hand in hand in a proper field exam are scope and time allotted. If either come up short, there is risk that something will be missed and the results, the risks, the borrowing base may not

be appropriate. A lender should consider what areas are important to them when weighing the balance between cost and scope of a field exam. When too much emphasis is put on price and a quick turnaround time, this can result in a lower quality work product and, as a result, risks and issues may not be identified as part of the exam.” Albanese added that if price and time are the lender’s first priorities, the lender must accept the risk.

### Is Hybrid Here to Stay?

The pandemic brought sudden and irrevocable changes to the field exam industry. Examiners, like so many others, had to quickly adapt to conducting exams remotely, something that was not done routinely prior to 2020. Examiners pointed out both the good and bad effects these changes have had.

Scott Mitchell, managing director, RedRidge Diligence Services, said, “Field exams are more challenging than ever. Every field exam and every audit performed by professionals depends on both ‘analytical review’ and ‘specific testing.’ Those are the two folders that should be in every field exam tool kit. The amount of reliance on analytical review vs. specific testing can often be the determinant for findings or the lack thereof. In the pandemic environment, where remote field exams have become the order of the day, analytical review has been greatly emphasized at the cost of specific testing. While this greater prominence in analytical review is sustainable with borrowers with strong internal controls and low collateral inherent risk, an emphasis on specific testing should be generated for those borrowers with weak internal controls and high collateral inherent risk.”

All of the examiners felt strongly that there is no substitution for being onsite. As Mitchell said, “There’s nothing like kicking the tires to see the business environment, to see people’s reactions, and being onsite with the conference door open for random comments from employees. Many of the collateral reporting issues are actually found through interactions on-site, while someone is sitting in the conference room, typing away on his/her laptop, doing the job, filling out the template, but missing the forest for the trees.”

Lalani noted another drawback of fully remote exams: “Although we were able to adapt quickly, one thing we noted was fully remote exams can take longer depending on the borrower’s responsiveness. The shift to remote exams has made exams less efficient due to the “out of sight out of mind” phenomena with remote work. The borrower may not prioritize the exam, resulting in delays and may not provide the examiners with as thorough and detailed responses as they would if an examiner was onsite.” Schick of Siena agreed that remote exams require more time. While remote exams were not ideal, we managed to be creative to sustain a robust scope, such as doing site tours and test counts over facetime, and having customers send pictures of assets. As the world has reopened, however, we have moved back to doing the crucial physical observation procedures in-person.

The examiners interviewed spoke of the importance of being able to “look in the face of the borrower.” Lalani expressed concern that there is much that can be missed when answers to questions are received via email. “The ability to see facial expressions, hear the pauses in speech, and experience the cadence of interactive Q&A and other subjective feedback is necessary to get a true picture of what’s going on,” she said.

Do the examiners think the industry will go back to 100% onsite exams again? In short, no, but this isn’t necessarily a negative. Seems the industry is finding a happy medium. “I do not think things will go back to the way they were. I think it will be client specific and fall into three rough categories: Remote, Onsite and Hybrid,” Lalani explained. She further explained that some low-risk exams, fully remote may still work just fine. For more complex or time sensitive exams, onsite exams are more efficient. And for those in-between exams, certain procedures will be performed remotely, but site visits will take place for plant tours, inventory counts as well as management interviews and, perhaps, testing follow ups.

Albanese is in favor of the hybrid approach. “We see a hybrid

approach being required on a going-forward basis. Borrowers’ accounting teams, just like so many other business groups, have been successful with a remote working arrangement, and as such a field examiner may have to match their schedule as it relates to on-site vs. desktop work.”

Clarke agreed hybrid is here to stay pointing out the convenience and cost savings associated with remote exams. “I believe we will see a hybrid emerge where surgical visits are made, for example, to see inventory, while the rest of the exam will be done remotely.”

The lenders shared their preferences concerning remote vs. onsite and their thoughts varied. While they all felt nothing can substitute for that “face to face” experience, some are more comfortable with hybrid exams than others. Kennedy said, “Our preference is that exams always be completed on site, but will certainly consider the concerns and wishes of our borrowers. Undoubtedly remote exams are less effective.”

Schick said, “While we are comfortable with a large portion of the exam being performed remotely, we require our examiners to schedule time to be on site to take a tour of the prospect to get a solid understanding of the operations, to physically observe the facilities and collateral, and to perform test counts. Also, to the extent an exam is dragging due to slow or lack of responsiveness by the prospect, we might require the examiner to go to the prospect’s location to try to help move the exam process along.”

Hersh Gordon explained that if the borrower’s personnel are working in the office, Gibraltar prefers the examiner to go on site to perform the field exam and review source documents. “At a minimum, inventory test counts should be performed on site considering the physical nature of the asset and related risks of misrepresentation,” she said.

Foley is seeing success with the hybrid method. “We are conducting hybrid field exams, which are mostly remote. For example, in the case where we used to have two field examiners in the field for five days—we now only have one field examiner on site for two to three days for the test count and review original documentation for ship test, cost test, etc.”

It’s clear that one of the keys to a successful field exam is the relationship between the examiner and the lender. Hersh Gordon pointed out the importance of creating and maintaining quality relationships with examiners. Kennedy illustrated this need by saying, “Working with a firm that you enjoy doing business with matters. I find that when I am working on a tight deadline with a complicated structure, the process flows better with the firms that seem to enjoy what they do. I know I am often pushing the examiners hard, asking tough questions and demanding a quick turnaround. Certain firms handle that pressure better than others. I enjoy when it feels more like a team process than a lender/vendor process.”

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