MAFA : CA FINAL

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CA Final (2nd Group Pending)

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FACTORING

Introduction

Definition	A factor is a Financial institution, which provides the following services Management of Debtors Financing the Debtors
Factoring	The services provided by the Factor is known as Factoring

Types of Factoring

Non-recourse Factoring	Bad Debt loss : Borne by the Factor
Recourse Factoring	Bad Debt loss : Borne by the Company
Bulk / Agency Factoring	Financing of Debtors : Is done by the Factor Management of Debtors : Is done by the company *(The co's which have goods system of credit management but need finances, needs this type of factoring)*
Non - Notification Factoring	Customers are not informed about the Factoring Agreement

Costs of Factoring

Factoring Commission (Service Fees)	Cost due to Management of Debtors
Interest	Cos to Financing of Debtors

Benefits of Factoring

Reduction of cost	Collection / Administration department
Reduction of Baddebts	Due to factoring, bearing the bad debts losses
Other activities	Management can concentrate mare on the other activities

[Collection period = CP] CP

[Annual period = AP] AP

FORMULAS : For finding the Important terms

CP **Debtors / receivables**

$$\text{Annual Credit Sales} * \frac{\text{Average Collection period}}{365 \text{ or } 12 \text{ Months}}$$

CP **Factoring Commission**

If expressed in Amount

Factoring Commssion = Amount

If expressed in Percentage

Factoring commission = Receivables * %age

CP **Gross Advance**

Receivables - Reserve (if any)

CP **Reserves**

Reserves = Receivable * %age

CP **Net Advance**

Gross Advance - Upfront Commission - Upfront Interest

CP **Interest**

$$\text{Gorss advance} * \text{Rate of Interest} * \frac{\text{Avg Collection period}}{365 \text{ or } 12 \text{ Months}}$$

Total Cost of Factoring

	Factoring Commission	XXXXX	CP
Add :	Interest on Gross Advance	XXXX	CP
		XXXXX	CP

The answer will be for Avg collection period

Benefit of Factoring

Reduction in Bad debt loss (Credit sales * %age)	XXXXX	AP
Administration / collection cost	XXXXXX	AP
	XXXXXX	AP

(this will be for annual, which should be converted for collection period)

Factoring

Effective Cost of Factoring (NET cost of Factoring)

	Total Cost of Factoring	XXXXX	CP
Less :	Benefit of Factoring	XXXXXX	CP
	Effective cost of factoring	XXXXX	CP

Effective Cost of Factoring : In Percentage

Formula

$$\frac{\text{Effective Cost of Factoring}}{\text{Net Advance}} * 100$$

The percentage is for average collection period
Such percentage to be converted for full year

Dependency — Net Advance

Computation of Net advance *There are 4 Cases for finding Net advance*

Case 1 — Interest & Factoring commission to be paid upfront

	Gross Advance	XXXX	*(for avg collection period)*
Less :	Upfront Interest	XX	*(for avg collection period)*
Less :	Upfront Com	XX	*(for avg collection period)*
	Net Advance	**XXXX**	

Effective cost of Factoring *(for full year)*

Case 2 — No upfront payment

Gross Advance = Net Advance *(for avg collection period)*

Effective cost of Factoring *(for full year)*

Case 3 — Only Factoring commission is paid upfront

	Gross Advance	XXXX	*(for avg collection period)*
Less :	Upfront Com	XX	*(for avg collection period)*
	Net Advance	**XXXX**	

Effective cost of Factoring *(for full year)*

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Case 4 — Only Interest is paid upfront

	Gross Advance	XXXX	*(for avg collection period)*
Less :	Upfront Interest	XX	*(for avg collection period)*
	Net Advance	**XXXX**	

Effective cost of Factoring *(for full year)*