KASNEB

CCP PART III SECTION 6

CREDIT PRACTICE

FRIDAY: 26 May 2017. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

CELLPHONE LIMITED

Cellphone Limited is a telecommunication company that provides telecommunication services to both local and international markets. For over 20 years, Cellphone Limited has been offering a wide array of voice and data services which are highly tailored to meet the growing expectations of customers and other users.

With the commitment to satisfy the ever changing and divergent customers' needs by offering efficient, reliable and affordable telecommunication services, Cellphone Limited continues to embrace modern technologies in each and every sector of its service provision and operations.

The company controls the largest market share in the telecommunication industry. However, increased competition from mobile telephone operators and other telecommunication providers has over the years resulted in a decline of its revenue base and profitability. The poor financial performance has further been aggravated by the huge amount of uncollected debts. Cellphone Limited has a poor track record of bad debt recovery which approximates to 15 percent of the total telephone billing.

According to the company's financial statements, accounts receivable as at 30 April 2017 stood at Sh.25.1 Billion compared to Sh.13.4 Billion for the year ended 30 April 2013. The bad debt provision amounted to Sh.14.2 Billion for the period ended 30 April 2017. On average, out of the total monthly telephone billing, approximately 15 percent of the outstanding debt is rolled over to the subsequent month thus worsening the already bad situation. The average debt collection period for the past four years has also increased from 256 days for the financial year ended 30 April 2013 to 381 days in the year ended 30 April 2017.

The due date for the credit sales rendered is clearly stated in the invoice and consequently, any customer in breach of this requirement is disconnected from receiving further services and recovery measures immediately undertaken. Despite this intervention, the company's bad debts have increased.

The dismal performance on collection of accounts receivable clearly demonstrates that the company's credit management system has not been effective in mitigating credit risks and timely follow up of debtors.

The credit management unit of Cellphone Limited is a fully-fledged unit headed by a credit manager who reports to the chief finance officer. The unit is controlled from the company's headquarters' offices located in Nairobi, Kenya and it coordinates the credit management functions of the seventeen regional offices. The main role of the headquarter unit is to set operational and policy guidelines, monitor performance through periodic reports and oversee the administrative functions of the regional offices.

The key functions of the credit management unit include credit vetting, credit rating, credit control, debt follow-up and management. Though credit vetting, credit rating, credit control and debt collection are partially-automated, they are still largely manual. The debt follow-up aspects involve correspondence through the e-mail, telephone, letters and physical visits.

To ensure continued sustainability of Cellphone Limited in the highly competitive environment and in order to cope with the demands of a rapidly changing sector, the company must intensify its efforts in debt recovery. This will provide the company with the much needed cash flow to finance its recurrent and capital budget obligations.

Required:

(a) Analyse four performance measures that Cellphone Limited could employ to monitor its accounts receivable. (8 marks)

(b) "The functions of the credit unit of Cellphone Limited though partially automated, they are still largely manual".

With reference to the above statement, argue six cases why the management of Cellphone Limited should fully automate its accounts receivable system. (6 marks)

(c) (i) Advise the management of Cellphone Limited on the relevance of average collection period. (2 marks)

(ii) Propose four ways in which Cellphone Limited could reduce its average collection period. (8 marks)

(d) Advise Cellphone Limited on eight areas that it could improve on in order to strengthen debt collection and recovery. (8 marks)

(e) Cellphone Limited wishes to restructure the credit management unit into four sub-units.

Identify four sub-units that may be considered by the company and the main function of each. (8 marks)
(Total: 40 marks)

QUESTION TWO

(a) In relation to fair credit billing regulations, describe four actions that constitute a "Billing Error". (4 marks)

(b) Discuss three stages for checking letters of credit in export credit. (6 marks)

(c) With reference to domestic credit insurance, outline five principles of credit insurance. (5 marks)
(Total: 15 marks)

QUESTION THREE

(a) Assess five features of a development bank in your country. (5 marks)

(b) One of the recommended corporate governance best practices for financial entities offering credit products is to have a board of directors with the primary responsibility of fostering the long-term business of the corporation consistent with their responsibility to the shareholders.

Required:
With reference to the above statement, examine seven other responsibilities of the board of a financial institution. (7 marks)

(c) Highlight three requirements for the licencing of deposit-taking microfinances (DTM) by your country's regulatory authority. (3 marks)
(Total: 15 marks)

QUESTION FOUR

(a) Argue five benefits that could accrue to a bank operating effective relationship banking. (5 marks)

(b) Enumerate four prudential guidelines requirements of deposit-taking SACCOs in your country. (4 marks)

(c) Discuss three rights of an unpaid seller in a sale of goods contract. (6 marks)
(Total: 15 marks)

QUESTION FIVE

(a) (i) Explain the term "credit shock". (2 marks)

(ii) Analyse four reasons why credit shocks could occur in an economy. (8 marks)

(b) Highlight five contents of a debenture trust deed. (5 marks)
(Total: 15 marks)

....