



CCP PART III SECTION 6

CREDIT PRACTICE

FRIDAY: 25 May 2018.

Time Allowed: 3 hours.

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

QUESTION ONE

SAFE WIPE ROLLS LTD.

Safe Wipe Rolls (SAWIR) Limited is a manufacturer and distributor of tissue paper. SAWIR Limited has been in this business for the last ten years. The company mainly sells to wholesalers on credit for onward distribution to retailers. They also sell to chain stores, supermarkets and hyper-markets on cash basis only.

Due to SAWIR Limited's cash only terms to the big stores, sales to these customers are in small quantities because, they only purchase to meet the demand of those customers loyal to SAWIR's products.

The company has four departments; the human resources and administration department, the sales and marketing department, the production department (which also handles all procurement functions) and the finance and accounting department.

Distribution of the goods is through sales persons who utilise the company's delivery vans although there are those customers who walk in to the company's premises to make purchases.

Due to the volume of the business expected to be transacted by the sales persons in their respective regions, the delivery vans they use act as mini-warehouses, holding the stocks required by the sales persons during the course of their duties.

Invoices, delivery notes, gate passes and all other documents with regard to sales and distribution are processed by sales clerks in the sales department and handed over to the sales staff for use in their delivery to the customers. Since the company has a reliable information management system that integrates functions of all the departments, the customer account ledgers are updated on a real time basis. Billing and any other postings are done by the sales clerks.

Collection of payments from customers is the role of sales persons. The cheques and cash collected are submitted to cashiers in the finance and accounting department for posting into the individual customer ledgers and banking. Payments made directly into the bank accounts are identified during the weekly bank reconciliation exercise undertaken by the financial accountant and are then posted into the customers' accounts.

The counterfoil copies of invoices as well as delivery notes are forwarded in daily sales report batches for filing, in the records management unit hosted by the human resources and administration department. After the copies of invoices, delivery notes and credit notes are acknowledged by the customers, filing is supposed to be done in collective files in the chronology of the dates of the transactions. Majority of these documents are not returned to the organisation since the sales persons believe that the counterfoils left at the records management unit are sufficient proof of sales and delivery. As such, they only render the ones that a few customers voluntarily choose to return to them after receipt of the goods.

The finance and accounting department has a policy of handing over due debtors to external collectors upon their debts exceeding 120 days. The external debt collectors then pursue them for payment. The sales persons visit the same customers (overdue debtors) for more orders and for the collection of debt for the recently delivered goods.

Over the last three years, there has been a conflict between the external debt collectors who are paid a commission of the amounts actually collected and the sales persons. It is worth noting that the company offers customers a credit period between 30 and 60 days. As the external collectors require proper documentation for debts referred to them for collection, the sales team can hardly provide copies of invoices and delivery notes signed by the defaulting customers. This has resulted into several disputed debts that have remained outstanding for a long time. In addition, the company's debtors' portfolio has been worsening in terms of quality, leading to a large allowance for bad and doubtful debts and bad debts write offs affecting profits.

The company has also been struggling to meet its current liabilities as and when they fall due. As such, a number of those who supply the company with raw materials have threatened to suspend the supplies and sue the company so as to recover their dues.

The company's board of directors, responding to the suppliers' threats, have constituted a credit risk management committee to look into the causes of the poor performance of the company's accounts receivables and recommend remedial strategies. The committee's preliminary report indicates that the outsourced debt collection agencies were hired on a walk-in basis and none of them were vetted as per procurement guidelines.

The external debt collectors seize the defaulting customer's collateral, dispose them casually and bring the proceeds net of their fees to the company as payment from defaulting customers.

Unfortunately, the records of the defaulting debtors whose collateral have been disposed of are never updated to reflect the money recovered. Therefore, these outstanding balances end up being written off for they are classified as uncollectable. The committee has also discovered that some debtors have letters indicating that they would be sued for default and have chosen not to pay, waiting for the litigation. Upon being questioned, the originator of these letters (the sales and marketing manager), says that they were meant for use as psychological threats to cause fear and make the particular customers pay the overdue debts.

Other debtors have complained that their debts are being followed up by both the outsourced debt collectors and the company's sales persons with both demanding different amounts. This causes confusion to the debtors. The committee also established that the outsourced debt collectors only present reports on payments made by the defaulting customers and no other report on the progress of their assignment is submitted. This is because, their terms of engagement do not require them to do so. This has made the evaluation of their performance rather difficult.

The company has a well articulated credit policy, but an audit on the credit processes reveals that the policy is never used. It was made formally to conform with the requirements of the regulators of trade credit in the industry. Even though sales persons should be paid commission based on completed sales transactions, they have been hired on monthly salaries as a motivation scheme. Their key performance indicators are however scanty and performance appraisal reports indicate that they have been recording exemplary performance, early collection of debts being one of the scoring parameters.

The committee has approached you for your professional credit management advice in their quest to help the company remedy the current state of affairs.

Required:

- (a) (i) Discuss eight areas of concern in the administration of credit sales in Safe Wipe Rolls (SAWIR) Limited. (8 marks)
- (ii) Propose eight solutions to each of the concerns identified in (a) (i) above. (8 marks)
- (b) Evaluate four factors which SAWIR Limited could consider when fixing the external debt collectors recovery rates. (8 marks)
- (c) Safe Wipe Rolls (SAWIR) Limited has poor record keeping and it is no wonder they have disputed debts that have remained outstanding for a long time in their books of account.

With reference to the above statement, explain four reasons to the management of SAWIR Limited why good record keeping is essential in debt collection. (8 marks)

- (d) At SAWIR Limited "Outsourced debt collection agencies are hired on a walk-in basis and none of them are vetted as per procurement guidelines".

With reference to the above statement, describe four characteristics of successful collection agents that SAWIR Limited could consider when engaging the debt collection agencies. (8 marks)

(Total: 40 marks)

QUESTION TWO

- (a) Discuss five benefits of Credit Default Swaps (CDS) in credit risk management. (5 marks)
- (b) Analyse five principles of social protection of consumers of microfinance services. (10 marks)

(Total: 15 marks)

QUESTION THREE

- (a) Explain seven benefits of regulating a deposit taking savings and credit cooperative society in your country. (7 marks)
- (b) Discuss five features of a valid contract of indemnity. (5 marks)
- (c) Identify three sources of information that could be of assistance to a credit analyst when undertaking credit assessment. (3 marks)

(Total: 15 marks)

QUESTION FOUR

- (a) (i) Describe five objectives of an effective loan review system. (5 marks)
- (ii) Identify five supervisory reports prepared by loan portfolio staff to ensure efficient loan review and monitoring. (5 marks)
- (b) Highlight five functions of a licensed credit reference bureau in your country. (5 marks)

(Total: 15 marks)

QUESTION FIVE

- (a) Analyse the CCCPARTS technique of credit evaluation. (8 marks)
- (b) Propose four techniques a bank could use to contain Non Performing Loans (NPLs) during widespread financial crisis. (4 marks)
- (c) Outline three cannons of good lending. (3 marks)

(Total: 15 marks)

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