

KASNEB

CCP PART III SECTION 6

CREDIT PRACTICE

FRIDAY: 25 November 2016.

Time Allowed: 3 hours.

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

QUESTION ONE

JIINUE MICROFINANCE

Rick Munene is the head of the credit department in Jiinue Microfinance. After attending a training programme on delinquency management, it came to his attention that many of the procedures, measures and attitudes that were discussed in the training were not being implemented at Jiinue Microfinance. This includes among others, taking measurements beyond the simple "amounts past due" formula to monitor loan portfolio quality or aging arrears.

Rick Munene has only been at Jiinue Microfinance for one year, but as far as he is aware, no non-performing loan had been written off for the past four years, nor has Jiinue Microfinance ever refinanced loans with overdue payments. Furthermore, Jiinue Microfinance does not have a clear policy on delinquency rates other than its motto "Keep it low". The microfinance also does not provide for impairment loss in its books of account. Rick Munene has further established that there is an inadequate loan tracking system which had not been updated for the last few years.

Rick Munene calculated the delinquency rate using the "portfolio-at-risk" formula for Jiinue Microfinance and it stood at forty two percent (42%) in the year 2015. There has been a steady growth in Jiinue Microfinance's loan portfolio volume which has encouraged in concealing the delinquency problem. Despite this growth, the microfinance has unused loan fund since donors keep supplying new capital. Consequently, the board of management of Jiinue Microfinance has set up a task force to carry out investigations on the status of the microfinance. Rick Munene was put in charge of the task force. A study of the credit programme revealed that the loan portfolio of a number of loan officers had lower than average repayment rates. On enquiry, the loan officers claimed that they were unaware of this low rate because of limited loan tracking system. The study found out that a sample of borrowers with delinquent loans seemed not to have any valid reason for delayed repayment and were not concerned about being in arrears.

The members of the task force made the following recommendations for improving the delinquency management in the credit department of Jiinue microfinance:

- Automatic loan refinancing to clear the arrears.
- Redefining of delinquency to improve the loan book.
- Much faster growth in the loan portfolio to address the problems.
- Immediate write-off of all loans with arrears of over one year to improve repayment rates.

Required:

- (a) Explain two types of credit risks that Jiinue Microfinance could be exposed to in its operations. (4 marks)
- (b) Delinquency in Jiinue Microfinance was caused by several internal and external factors.

Evaluate:

- (i) Four credit officer related causes of delinquency. (4 marks)
- (ii) Three institutional related causes of delinquency. (6 marks)
- (c) Analyse three types of delinquent customers that Jiinue Microfinance might have. (6 marks)

- (d) (i) Discuss the limitations of each of the four recommendations identified by the task force of Jiinue Microfinance for improving delinquency management in the credit department. (8 marks)
- (ii) Due to the limitations in (d)(i) above, the board of management rejected the recommendations made by the task force.

Suggest six actions that the board of management of Jiinue Microfinance could take in order to improve delinquency management by the credit department. (12 marks)

(Total: 40 marks)

QUESTION TWO

- (a) Describe five disadvantages of using life assurance policies as security for a loan. (5 marks)

- (b) Jabali Ltd. has annual sales revenue of Sh.60 million. All sales are on 30 days credit but customers on average take an extra 10 days to make their payments. Contribution represents 60% of total sales and the company has no current bad debts outstanding. Accounts receivable are financed by a bank overdraft which attracts an annual interest rate of 7%.

Jabali Ltd. is considering offering an early settlement discount of 1.5% for payments made within 15 days. The company also intends to extend the maximum days credit offered to 60 days. The company expects that the change in credit policy will have the following impact:

- Increase annual credit sales by 5%.
 - Additional incremental cost of 0.5% of turnover.
- The discount is expected to be taken by 30% of customers, with the remaining customers taking an average of 60 days to pay.

Required:

Using suitable computations, advise Jabali Limited on whether or not to change the credit policy. (10 marks)

(Total: 15 marks)

QUESTION THREE

- (a) During the analysis of the financial statements of a borrower, the lender analyses the cash flow and profit of the borrower.

Distinguish between "cash flow" and "profit". (4 marks)

- (b) Discuss three factors that might influence the level of trade receivables in an organisation. (6 marks)

- (c) Advancement in technology has expanded the horizon in the financial sector. Lending is now done through mobile phone platforms. This has created new challenges relating to credit risk and fraud.

With reference to the above statement, identify five steps that mobile money lenders could take to address these challenges. (5 marks)

(Total: 15 marks)

QUESTION FOUR

- (a) (i) Explain the term "surety bond". (2 marks)

(ii) Describe three challenges of using surety bonds. (3 marks)

- (b) Explain five duties and responsibilities of a SACCO credit committee. (5 marks)

- (c) Describe five responsibilities of the marketing department in the credit life cycle. (5 marks)

(Total: 15 marks)

QUESTION FIVE

- (a) Evaluate four causes of receivership in banks. (8 marks)

- (b) Argue four cases for and three cases against presenting a customer with information about their credit limit. (7 marks)

(Total: 15 marks)