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CCP PART III SECTION 6

CREDIT PRACTICE

MONDAY: 30 November 2020 **Time Allowed: 3 hours.**

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

QUESTION ONE

MKULIMA IMARA BANK (MIB) LIMITED

Mkulima Imara Bank (MIB) Limited is a bank whose membership is drawn from farmers. The bank has been operational since the year 2000. Its initial customer base was dairy farmers. The bank has credit facilities suitable for this group of customers to aid them in the purchase of dairy farming inputs among other needs.

Five years ago, the government conducted a research and identified a variety of potatoes that take three months to mature. After an evaluation, the government selected MIB Limited for a partnership so as to promote the growth of this crop across different parts of the country. The government financed the initial outlay to the interested farmers.

The first year of the trial went on well and the farmers, depending on the weather patterns managed three seasons of the harvest. The senior management of the bank is comprised of close relatives who are among the founders and the board of directors is composed of veteran dairy farmers.

The potato farmers have been recording poor repayments of their facilities due to the seasonality of their income. Further, the government's potato board (GPB) pays the farmers after three months from the date of submission of the produce into their stores for export. The interest rate charged on the initial outlay to the farmers was 9% per annum on a reducing balance since it was a subsidy from the government. So as not to lose the farmers, the bank chose to maintain this rate of interest.

Since a lot of work came about as a result of the new clients, the bank carried out a massive recruitment and hired graduates from all fields of study with the aim of giving them training on agriculture lending to bridge any skill gap. Most departmental heads lack requisite knowledge and experience in the respective professions but were endorsed to the positions owing to their connections with the board.

As a result, financial reporting has major issues and the regulators have issued warnings on several irregularities on quarterly bank reports, capital adequacy maintenance, liquidity ratio thresholds among other regulatory matters.

The loans are appraised by marketing officers while the accounts team maintains the farmers' accounts. The accounts team is charged with contacting farmers who are in arrears for payment follow ups before referring them to auctioneers for external recovery processes. The main criteria for granting loans to the farmers was the successful initial project as subsidised by the government, ownership of the farm and ownership of some farm and household assets.

The bank was certain that upon harvest, sufficient income would be generated to repay the loans in full. However, this has not been the case due to the effect of crop diseases and other adverse farming conditions including unstable weather patterns.

A review of the bank's lending process reveals that little has been done with regard to assessment of customer's credit worthiness. This explains why the bank has been recording increased delinquent loans and poor profitability. The interest spread also seems to give a negative margin since the government withdrew from the project. A sample of the delinquent loans has been linked to the bank's staff who took advantage and used unsuspecting farmers as conduits to get financing from the bank only to default and leave the customers under the bank's pressure to repay. The bank's performance has been on a downward trend and the regulator has threatened to place it under receivership unless the board of directors make the recommended changes within one year with the view of reviving it to meet the minimum performance indicators as laid out in the regulations. One of the board's resolution is now to hire a loan's management expert to turn around the bank's loan management as well as a corporate governance expert to advise on overall sound management of the bank, in line with prevailing best practices.

Required:

(a) You have been hired by the management of MIB Limited as the loans management expert:

(i) Assess five practices by the bank that have contributed to its dismal performance in loans management. (Support your answers with evidence from the case study). (10 marks)

(ii) Propose appropriate remedies to the practices identified in (a) (i) above. (10 marks)

(b) One of the most important ways MIB Limited could ensure its loans meet regulatory standards and are profitable is to establish a written loans policy. In line with this, discuss ten important elements that should be included in the loans policy document. (20 marks)

(Total: 40 marks)

QUESTION TWO

(a) (i) Explain the term "debt restructuring". (2 marks)

(ii) Examine five ways that debt restructure could benefit a business. (10 marks)

(b) Explain three steps for setting up an accounts receivable management system. (3 marks)

(Total: 15 marks)

QUESTION THREE

(a) Analyse three drivers of credit risk that a bank should consider in credit portfolio risk management. (6 marks)

(b) Describe three sources of financing temporary working capital needs. (6 marks)

(c) Enumerate three indicators of overtrading in a business. (3 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Explain three uses of Capital Adequacy Ratios in management of banks. (6 marks)

(b) Argue three cases against the use of Univariate Models in prediction of corporate failure. (6 marks)

(c) Describe three challenges of credit risk modeling in banks. (3 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Arriving at a workable solution among competing interest of commercial defaulters requires an understanding of dynamics of negotiation and agility of negotiators.

With reference to the above statement:

(i) Analyse three dimensions of negotiation. (3 marks)

(ii) Explain six principles of the interest-based strategy in commercial debt negotiations. (6 marks)

(b) In relation to the Central Bank of your Country's Regulatory Framework:

(i) Explain the meaning of the term "Risk-Based Supervisory Framework". (2 marks)

(ii) Assess four principal benefits of Risk-Based Supervisory approach adopted by central bank. (4 marks)

(Total: 15 marks)

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CCP PART III SECTION 6

CREDIT PRACTICE

THURSDAY: 28 November 2019. **Time Allowed: 3 hours.**

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

QUESTION ONE

HABARI MEDIA GROUP (HMG)

Habari Media Group (HMG) is a Kenyan media group that is listed on the Nairobi Securities Exchange. HMG was founded in 1969 and is the largest media house in East and Central Africa. The company has invested in media and entertainment with businesses in television and print media.

Despite its enormous success in the media business, HMG has been experiencing an increase in outstanding debtors. Prior analysis have revealed that the company's debt level has been increasing with the company's growth in terms of turnover. Between years 2016 and 2018, total turnover increased by Sh.1.126 billion while credit sales increased by Sh.901.5 million, leading to the increase in debt level from Sh.351.2 million in year 2016 to Sh. 603 million in year 2018. The company's debt position has been worsening over the years in terms of value and number of days' sales in receivables.

The Board of Directors of the company is concerned about the debt's position and believes that if the trend is not reversed, the company will soon or later find itself in cash flow difficulties. As a result, they have approached you as a credit specialist to advice on why there is an increasing level of outstanding debtors in HMG. As part of your assignment you have conducted a research on the company's credit operations and discovered the following:

1. The credit control department is headed by a revenue accountant who is in charge of all revenue activities of the company.

2. Despite enormous growth in sales over the last few years, the company's credit policy has remained the same without review.

3. HMG's credit control staff and sales staff have never had any training on credit management.

4. The company's major customers are newspaper distributors and advertising agencies.

5. A significant percentage of credit customers do not provide the necessary financial documents for credit assessment purposes.

6. Advertising agencies are the main debtors of HMG, currently the amount due from them is 60% of the total outstanding debt. HMG directors are reluctant to request the agencies to provide additional security because they fear by doing so they could lose them to competition.

7. Some clients notably the distributors have problems in understanding the company's financial documents. For instance some have difficulty in differentiating invoices from credit notes.

8. Appointment of distributors and advertisers is not done by way of clear evaluation and interview procedures but instead they are freely appointed.

9. The current commission structure is not motivating enough to ensure early collection of the receivables by the sales staff.

10. HMG is a member of a Credit Reference Bureau. However, it does not make use of the available services.

11. HMG, operations are mainly manual and as such financial documents like invoices, credit notes and statements are not promptly processed by HMG to facilitate payment as quickly as possible. Thus, 80% of the distributors and advertisers do not receive the necessary financial documents on time.

Required:

(a) Describe five practices in credit management of HMG that could be a source of credit risk. (10 marks)

(b) Describe four types of services that the management of HMG could seek from Credit Reference Bureaus (CRB). (8 marks)

(c) Analyse five benefits that would accrue to HMG as a result of automating accounts receivable management. (10 marks)

(d) Propose six measures that the management of HMG could put in place to reduce their debt level. (12 marks)

(Total: 40 marks)

QUESTION TWO

(a) (i) Explain the meaning of the term "credit enhancement" as used in credit management. (2 marks)

(ii) Evaluate four types of credit enhancement. (8 marks)

(b) Highlight five internal factors that could lead a company into financial distress. (5 marks)

(Total: 15 marks)

QUESTION THREE

(a) Examine four effects of delinquency on credit portfolio. (8 marks)

(b) Describe seven strategies employed by a firm in managing delinquent loans. (7 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Discuss four limitations of using financial statements to assess the creditworthiness of a customer. (8 marks)

(b) Enumerate four qualities of a good collateral. (4 marks)

(c) Explain three determinants of the level of working capital in a company. (3 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Propose four warning signs of bad and doubtful debts. (8 marks)

(b) (i) Explain the term "syndicated loan". (2 marks)

(ii) Enumerate five features of a syndicated loan. (5 marks)

(Total: 15 marks)

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CCP PART III SECTION 6

CREDIT PRACTICE

FRIDAY: 24 May 2019. **Time Allowed: 3 hours.**

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

QUESTION ONE

EDEN VILLE SACCO (EVS) LIMITED

Eden Ville Sacco Limited (EVS Ltd.) is a sacco that is at the brink of collapse and this is after being in operation for twenty five years. In the first fifteen years, EVS Ltd. was initially registered as a group composed of members from the metal works section of Gulubu, one of the major towns in the country.

These members were dedicated blacksmiths who had chosen to come together and pull together their savings so as to advance credit to their own for business growth among other financial needs and purposes.

Initially, members were using table banking but with the help of financial literacy from the Chamber of Commerce and Industry, they got encouraged to take the organisation to the next level and that is how the sacco came into being.

Among the pioneer sacco members were the metal works investors. The metal works investors were very learned entrepreneurs who were identified by the guiding committee from the chamber of commerce for pioneering the transformation of the registered group into the current sacco.

Registration of the sacco met all regulatory requirements and was duly licensed with licence renewals being done annually as per the regulatory guidelines.

The sacco's activities picked up well but due to the growth prospects, the common bond for members' pool was opened to cater for all businesses provided a track record of performance could be proved for at least three years. The loan demand has increased over time and as a result collateral requirements have been enhanced from members' guarantees to include the conventional securities on a need basis. The sacco has been advancing large loan amounts to businesses provided the collateral so provided is adequate.

A member applying for a loan using collateral, is advised to undertake a valuation report for the collateral. Recently, the sacco has been recording poor performance and as a result the regulator has sent its supervisors on an investigation so as to have an independent report as regards the sacco's operations in addition to the external audit reports and recommendations. Preliminary working papers of the supervisors indicate a number of issues that could easily be associated with the saccos declining profitability and dismal performance. Due diligence on a sample of the assets taken by the sacco as security, has revealed that the values of most of the assets taken as security were exaggerated at the time of booking the loans. The values used to book the loans were far much less compared to what was reflected in the valuation reports. Further investigations point to collusion between the assets valuers, borrowers and lending officers.

Collections on loan repayments are done by the loan officers. The loan officer's primary duty is to grow the loan book via disbursements of new loans. The sacco has no credit officers charged with loan recovery. Report on the debt recovery is generated one week past the due dates and the customers are reminded of their instalments arrears via phone text messages, calls and dunning letters. A scrutiny of this exercise indicates that track sheets for these follow ups are not maintained both in the sacco's information system and on the manual collection files. As such there is no co-ordinated loans review system since the only exercise that is a kin to this is the monthly reporting of the past and due accounts.

Further, the information contained in the borrowers' files, especially for the defaulted cases, is not reliable as most of the contact information is not correct. This indicates lapses in information verification at the onset of the credit provision for use in future correspondences with borrowers.

The investigators also interviewed a couple of former employees whose services were terminated on the grounds of fraudulent lending, so as to find out the motives and causes behind their fraudulent activities. Nearly all of them cited stretching targets leading to too much work with unmatching remuneration as the main reasons that pushed them to the misconduct. At the conclusion of its investigation, the supervisors have recommended to the regulator that your firm, which does credit management consultancy, be appointed to guide the sacco's management in managing its delinquent portfolio of loans so as to improve its performance.

Required:

(a) (i) Citing evidence from the case study, evaluate four areas that EVS Ltd. has failed in its management of delinquent loans. (8 marks)

(ii) Propose four remedies to the failures identified in (a) (i) above. (8 marks)

(b) Loans review is a process that if regularly conducted could be of immeasurable aid in a lender's quest for proper management of delinquency. With reference to this statement and looking at EVS Ltd.'s situation:

(i) Discuss the five principles of loan review. (5 marks)

(ii) Advise on five features that EVS Ltd. should consider when structuring the loan review process. (5 marks)

(c) Evaluate six features of troubled loans that the management of EVS Ltd. should note in its loans portfolio for timely remedial actions to be taken. (6 marks)

(d) Discuss the steps involved in loan work-outs, the process of recovering funds from problem loans situation, so as to help the management of EVS Ltd. to better its loans recovery strategies. (8 marks)

(Total: 40 marks)

QUESTION TWO

(a) Examine five disadvantages of inadequate working capital. (5 marks)

(b) Explain three legal documents used in loan work-out agreements. (6 marks)

(c) Outline four indicators of a company in financial distress. (4 marks)

(Total: 15 marks)

QUESTION THREE

(a) Identify five types of risks inherent in a loan facility. (5 marks)

(b) Discuss three Pillars of Basel III Accord. (6 marks)

(c) Describe four benefits of undertaking credit portfolio risk analysis. (4 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Describe four implications of International Financial Reporting Standard (IFRS) 9 "Financial Instruments" on the business model of financial institutions. (4 marks)

(b) Analyse three components of the Altman's Z-score insolvency prediction model. (6 marks)

(c) Identify five internal factors that could cause delinquency in a firm. (5 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Discuss three approaches to the credit evaluation process. (6 marks)

(b) Enumerate four types of credit events. (4 marks)

(c) Propose five mechanisms a commercial bank could use to reduce the risk of loan delinquency. (5 marks)

(Total: 15 marks)

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CCP PART III SECTION 6

CREDIT PRACTICE

FRIDAY: 30 November 2018. **Time Allowed: 3 hours.**

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

QUESTION ONE

AA MICROFINANCE BANK LTD.

AA Microfinance Bank Ltd. was the first of its kind in the Middle East and North Africa region. Founded in the year 2008, AA Ltd. was created based on the principle of financial inclusion for all, particularly for the region's unbanked population (including young people and women). As part of its institutional charter, AA Ltd. specifically targets the youth and women market segments.

AA Ltd. entered into a partnership with Sila Technology (Sila-Tech), an institution that devices solutions for youth employment in the Northern region. Together, the two institutions created a youth fund which aims to provide the youth, aged between 18 years and 30 years with sustainable financial services. In addition to the fund, Sila-Tech also provides entrepreneurship training to these youth.

Initially, AA Ltd. aimed to reach 800 youth within the first year of the project. However, less than a year later, AA Ltd. had already disbursed 5,200 loans through the youth fund, 63% of which went to women. By the end of 2010, AA Ltd. had 6,317 youth loan clients, which accounted for 43% of AA Ltd.'s total loan client base, with a youth loan portfolio of US $ 1.3 million.

In addition to youth friendly savings and insurance products, AA Ltd. has four distinct loan product offerings for its young clients.

All four of AA Ltd. youth loans, carry same terms as those of its other loan products. The primary differences in product design for youth credit products include among others; start up funding, fewer collateral requirements, special staff training and unique delivery.

Recognising that youth are a unique market segment that requires additional support in starting and growing business, AA Ltd. has adapted its lending requirements to make loans more accessible to start up entrepreneurs. Through partnerships with Sila-Tech and other external organisations, AA Ltd. offers its youth clients, supplemental non-financial services through training courses such as: Entrepreneurship Education - Know Your Business for the region and Financial Education Program - designed specifically for female clients in preparation for running a business of their own. Existing youth clients are also given opportunity to participate in training courses on financial management, marketing and sales.

Since its inception in 2008, AA Ltd. has been challenged for distinguishing itself from traditional banks because its target clientele, youth and women, traditionally have been excluded from the financial services sector. AA Ltd. has focused on finding new ways to communicate its message of financial inclusion of these groups. As a result, AA Ltd. coined its slogan "The bank for the unbanked". Another marketing challenge AA Ltd. is facing is low levels of literacy in the region. This has made it difficult to use conventional print marketing materials. AA Ltd. uses word-of-mouth as its most effective tool of marketing, with loan officers focusing efforts on door-to-door promotion.

In order to effectively reach the youth, AA Ltd. also targets its marketing campaigns to young people's interests, while adapting its services to meet the needs of the population. For example, AA Ltd. reaches out to youth at universities and colleges where young people often spend time and has partnered with vocational training institutions, television networks, radio stations and lottery campaigns.

Despite perceived risk in lending to the youth, AA Ltd. reported a minimal 0.03% portfolio at risk >30 days. The bank attributes this success to a few key factors including tailoring financial services to suit the youth and women, marketing and delivery mechanisms according to needs of the youth market and training staff on how to effectively serve young clients and manage risks.

AA Ltd. continues to explore a number of additional methodologies to increase their youth special products and services including the use of technology such as mobile banking and short message service (SMS), partnerships with higher education institutes and focusing on significantly disadvantaged groups including persons living with disabilities and orphans.

In spite of the above effort by AA Ltd. to empower the youth, a spot check in some areas shows a low uptake of the fund.

Required:

(a) AA Ltd. was created based on the principle of financial inclusion for all.

With reference to the above statement, propose three benefits that could accrue to the unbanked population as a result of financial inclusion. (6 marks)

(b) Analyse six credit monitoring procedures that AA Ltd. could adopt to assist in effectively managing its portfolio risk. (6 marks)

(c) Discuss five factors that might have contributed to the slow uptake of the fund by the youth in some areas. (10 marks)

(d) Explain five benefits that could accrue to AA Ltd. as a result of the introduction of mobile banking. (10 marks)

(e) Describe four categories of services provided by AA Ltd. (8 marks)

(Total: 40 marks)

QUESTION TWO

(a) In relation to Fair Credit Billing Regulations and Fair Debt Collection Practices Act:

(i) Explain the term "vulnerable person". (2 marks)

(ii) Describe six categories of persons who could be considered vulnerable in enforcement of debt collection action. (6 marks)

(b) With reference to microfinance loans and delinquency management, describe four ways in which a pipeline report is used to monitor loans. (4 marks)

(c) Highlight three items to be included in the SACCO by-laws in regard to loans and advances. (3 marks)

(Total: 15 marks)

QUESTION THREE

(a) Examine four key ratios that are used in the assessment of creditworthiness by credit analysts. (4 marks)

(b) Identify three objectives of a credit audit. (3 marks)

(c) Propose four drawbacks of mortgage loan modification. (8 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Discuss the early signs of a company's financial warning under the following headings:

(i) Income statement. (3 marks)

(ii) Receivables aging. (3 marks)

(b) (i) Explain the term "credit concentration risk". (2 marks)

(ii) Analyse seven methods of managing credit concentration risk. (7 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Discuss four objectives of the Basel proposal. (8 marks)

(b) Explain seven benefits of sound management of working capital in an organisation. (7 marks)

(Total: 15 marks)

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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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CCP PART III SECTION 6

CREDIT PRACTICE

FRIDAY: 1 December 2017. **Time Allowed: 3 hours.**

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

QUESTION ONE

SOFTCASH LTD.

Softcash Ltd. specialises in providing auto loans to consumers with low incomes and poor credit records. Most of the company's loan applicants have an average monthly household income of Sh.28,000. Almost a third of the applicants have no bank account, and only 4% of the applicants own their own home.

The lending process of Softcash Ltd. begins with customers filling an application form when they arrive at a dealership. They work with a sales representative and the dealership manager to select a vehicle and discuss financing terms. Buyers are then required to make a down payment of 10% and the 90% balance is financed by Softcash Ltd.

Buyers are expected to make regular payments to the dealership for a fixed period of three years. The loan attracts high interest rates reflecting the risk of the borrowers pool. Defaults during the repayment period are common and tend to occur relatively early in the repayment period. About 35% of loans are defaulted during the first year of repayment and only 40% are paid in full.

Due to the high default rate, Softcash Ltd. has adopted credit scoring in order to determine the creditworthiness of each applicant. Employees at the dealership are responsible for collecting information from applicants during the sales process, and much of this information is not formally recorded. Prospective buyers are asked for basic information about their income, family, work status and scheduled debt payment.

With the adoption of credit scoring, the company has started to pull information from the major credit bureau and is using a proprietary algorithm to assess each applicant's risk profile. The scoring algorithm achieved impressive risk stratification. The loan repayments made in the first year after credit scoring was put in place, have shown great improvement.

Softcash uses the assigned credit score to establish a schedule for minimum down payments. Each applicant is required to make a down payment. The amount of the down payment depends on the applicant's credit score but not on the type of car being purchased. An applicant deemed as low risk is eligible to obtain financing for a larger range of vehicles, in particular, newer, lower-mileage cars that are more expensive.

The adoption of credit scoring allows the company to make systematically different offers to loan applicants with different risk profiles. Profits per transaction increased by over 20% for each risk category.

One of the members of the Board of Softcash Ltd. strongly feels that in as much as the loan recovery has improved, the management of Softcash Ltd. should consider outsourcing debt recovery activities. The other members of the Board are non-committal on the issue, but have tasked the credit manager to develop an outsourcing policy for consideration.

Required:

(a) Explain four challenges that Softcash Ltd. could be facing in lending to its customers. (8 marks)

(b) Analyse four sources of information that Softcash Ltd. could use to assess credit risk of its customers. (8 marks)

(c) Justify the adoption of credit scoring by Softcash Ltd. (8 marks)

(d) Suggest six types of information about a customer that a credit score model should consider. (6 marks)

(e) Highlight ten areas that might be incorporated in the proposed outsourcing policy. (10 marks)

(Total: 40 marks)

QUESTION TWO

(a) Virtually any person, including an evasive debtor, can be located because there is always a "paper trail".

Required:
With reference to above statement:

(i) Explain the term "skip tracing". (2 marks)

(ii) Explain three main objectives of skip tracing. (3 marks)

(b) "Every applicant seeking to engage in agent banking business shall, on a one off basis, submit the required information to the central bank".

Required:
With reference to the above provision:

(i) Propose five contents of the required information. (5 marks)

(ii) Enumerate five reasons why an agency contract could be terminated. (5 marks)
(Total: 15 marks)

QUESTION THREE

(a) Describe five assets of a debtor which cannot be taken over under the warrant of execution. (5 marks)

(b) Highlight five objectives of the Consumer Protection Act in your country. (5 marks)

(c) Janet Lendi is considering various sources of finance to raise additional capital for her business.

With reference to the above statement, assess five factors that might influence Janet Lendi's choice of source of finance. (5 marks)
(Total: 15 marks)

QUESTION FOUR

(a) With reference to bank credit, distinguish between the following terms, "time liability" and "demand liability". (4 marks)

(b) Describe four faults in lending procedures which could lead to poor quality loans in lending institutions. (4 marks)

(c) Examine seven matters that might be addressed by a deposit taking Savings and Credit Co-operative Society (SACCO) when reviewing its liquidity policy. (7 marks)
(Total: 15 marks)

QUESTION FIVE

(a) Explain the term, "seasonal datings" as used in trade receivables management. (2 marks)

(b) Memphis soft drinks palour is currently offering trade credit of "net 35 days". Its credit sales amount to Sh.50 million with an average collection period of 50 days. In order to increase the demand for its products, the company reviewed its credit terms to "net 45 days", with an expected 10% increase in sales. Under the new terms, the average credit period is expected to be 60 days.

For every Sh.1.00 of sales, the company incurs Sh.0.70 in variable costs and the company's pre-tax required rate of return on investment in receivables is 18%.

Required:
(i) Analyse the impact of the change in credit terms to the management of Memphis soft drinks parlour. (11 marks)

(ii) Advise the management of Memphis soft drinks parlour on whether to implement the change in credit period. (2 marks)
(Total: 15 marks)

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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)

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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)

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KASNEB

CCP PART III SECTION 6

CREDIT PRACTICE

FRIDAY: 27 May 2016. **Time Allowed: 3 hours.**

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

QUESTION ONE

Kujikuza Sacco Society Ltd. has been in existence for the last ten years. It has a current membership of 45,000 comprising of traders from diverse businesses in the informal sector. The sacco started as a rotating savings and credit association (ROSCA) with membership being drawn purely from second hand clothes sellers in one small town. With a view to expand their businesses and create more personal wealth, the ROSCA members resolved to make their savings grow by avoiding the annual distribution of the accumulated fund and instead choosing to pay a certain percentage on the amount each member had saved. By so doing, they were able to accumulate a substantive amount of permanent capital within the ROSCA. With permanent capital available, the members of the ROSCA who at that time were 3,000 resolved to convert the ROSCA into a Sacco society by the name Kujikuza Sacco Society Ltd.

With the help of Katiba Company Advocates, by-laws were set out to govern the savings and lending of money among members as well as rules governing the operations of the sacco, which at this time were yet to be registered with the regulator as it had failed to meet the required minimum capital. Nevertheless, the members strongly agreed to continue carrying on their operations as a sacco, collecting monthly contributions from members and granting credit at an interest rate of 9% per annum with a maximum loan of three times one's shares.

The security of the loan advanced to a member was the members shares and a guarantee from three other members whose shares could cover the required loan amount.

Two years into the business, Kujikuza Sacco Society Ltd. suffered its worst setback when the government imposed punitive excise duty on imported second hand clothes so as to promote the local textile industry. This move by the government made the cost of running second hand clothes' business unbearable. Consequently, the sacco started experiencing reduced savings and defaults on loans including getting absolute losses from members who could not cope with the business conditions brought about by the government's directive.

To cope with the sudden change of legislation by the government, the sacco management agreed to open their common bond to other sectors of the economy, provided a member had a stable business anywhere in the country. This was informed by some great losses suffered in the immediate last four years.

To facilitate the expansion upon opening of the common bond to other sectors of the market, the sacco opened branches in all major towns and recruited credit officers and other staff for the running of the branches. With the opening of branches, strategic decision making became very difficult since all the members of the senior management were the large savers in the sacco and opposed any strategic move which was considered unfavourable to them. This led to setting of goals customised to meet the desires of a few members of the Sacco.

Every manager wanted his or her person to get employed within the branches. As a result, nepotism hit the sacco with the result of recruitment of staff just because they were related to the senior savers in one way or the other. There was no oversight body like a board of directors because the large savers believed that they could manage the funds of the sacco in a sound manner.

In order to beat competition from other established saccos, the management changed the loan capping to a maximum of six times a member's share. As a result of the new loan policy, funds are no longer sufficient to satisfy loan demands. Members have to wait for more than two months for their applications to be processed since the sacco has to wait for funds from repayments and savings which are inconsistent due to the nature of the pool from where members are drawn.

Collection of loans is merely dependent on the members own volition to remit loan repayments and share contributions. Members have not received dividends for two years now and some members are threatening to file a petition in court to have the sacco wound up.

The management, in response to this threat from members, has approached your firm for advice on how to change things for the better. Your firm has selected you as the lead credit management consultant of the team assigned with this task of helping the sacco out of its woes.

Required:
Advise the management of Kujikuza Sacco Society Ltd. on the following:

(a) (i) Six credit management and other related issues facing the sacco. (12 marks)

(ii) Six remedies to the credit management and other related issues identified in (a)(i) above. (12 marks)

(b) With reference to the sacco's situation, discuss the main agency problem surrounding the sacco and the necessary remedy. (9 marks)

(c) Explain adverse selection as one of the information asymmetry element in the sacco's woes and how the same could be minimised. (7 marks)

(Total: 40 marks)

QUESTION TWO

(a) You have been appointed to a taskforce tasked with the preparation of a draft Consumer Credit Act. The Act will be tabled before a conference of the relevant stakeholders for deliberations and further reading before being forwarded to the country's legislative body for enactment.

Required:
Analyse five aspects that you consider as important contents of the draft Consumer Credit Act. (10 marks)

(b) Explain the process of perfecting title to land as collateral in your country. (5 marks)

(Total: 15 marks)

QUESTION THREE

(a) Credit crunch is an economic condition in which investment capital is difficult to obtain.

With reference to the above statement, explain a four step process that a firm could follow to manage risk under credit crunch conditions. (8 marks)

(b) A credit memorandum should accompany all commercial loans to help lending institutions measure objective and subjective risk characteristics and to understand the borrowers probability of default.

With reference to the above statement, summarise the contents of a credit memorandum. (7 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Microfinance institutions (MFIs) often operate in disaster-prone environments, both of the human and natural varieties. Consequently, MFIs should prepare for such events and have disaster management schemes ready to pull off the shelf as soon as a crisis occurs.

You have been tasked by the Board of directors of Badilisha MFI to head a team that will develop a credit management disaster scheme policy.

Required:
Examine five key considerations that your team should take into account in designing the credit disaster management scheme. (10 marks)

(b) Discuss five credit management costs that could be accurately planned for and measured on a monthly basis in the credit department. (5 marks)

(Total: 15 marks)

QUESTION FIVE

The National Credit Act Steering Commission of your country has been tasked with coming up with rules and regulations governing best practice and conduct of debt collection. The commission liaison officer has approached you with a request that you become one of the commission resource person(s) in developing the Act since you are a credit professional.

Required:

(a) Categorise parties that might be contacted other than for the purpose of obtaining information concerning the debtor's location when trying to follow up on a debt. (5 marks)

(b) Summarise five prohibited acts of debt collection that could amount to harassment of a debtor. (5 marks)

(c) Analyse five sources of information that is used for the evaluation of a customer's creditworthiness. (5 marks)

(Total: 15 marks)

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KASNEB

CCP PART III SECTION 6

CREDIT PRACTICE

FRIDAY: 27 November 2015. **Time Allowed: 3 hours.**

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

QUESTION ONE

Denkmann Oluoch is a sole proprietor dealing in the sale of second hand clothes. He has been in this business for five years. To finance his business, he relies heavily on the use of credit cards, overdraft facilities from his bank and loans from Jijenge Co-operative Society in which he is a member. He holds an account with Uwezo bank and Jitegemee bank.

Denkmann Oluoch has defaulted in payment of most of his accounts for at least 120 days. As a result, his name has been forwarded to the credit reference bureau (CRB) as a defaulter. He is worried about the possibility of losing his house and car through foreclosure. This is not the first time his name has featured in the CRB. Two years ago, he had defaulted on the repayment of a loan from Jijenge Co-operative Society and he was listed as a defaulter in the CRB.

Denkmann Oluoch has approached Duke Mumo, the credit controller of Uwezo bank, from where he had acquired the mortgage facility and the car loan, to find out if the bank would be willing to allow him to restructure his debt.

Duke Mumo advised Denkmann Oluoch to seek the services of Christopher Roos, a registered debt counsellor and owner of Debt Counselling Experts Ltd. who could offer professional debt counselling advice on how to organise his finances and ultimately control his "huge appetite for debt". Denkmann Oluoch contacted Christopher Roos as advised by the credit controller of Uwezo bank. He filled in his debt counselling application form and left it with the debt counsellor.

Christopher Roos agreed to review Denkmann Oluoch's application form and developed the following new repayment plans for Denkmann Oluoch with lower monthly payments and interest rates and sent these to the credit providers for their agreement:

Proposed repayment plan for Denkmann Oluoch

Credit provider	Original annual interest rate %	Industry rate %	Monthly instalment before review USD	New agreed annual interest rate %	New monthly instalment USD
Home loan	10	7	7,703	7.5	4,970
Vehicle finance	15	6.5	1,605	7.5	1,050
Credit card 1 (Uwezo Bank)	23	4	1,610	5.5	480
Credit card 2 (Jitegemee Bank)	22	4	905	4.5	270
Overdraft 1 (Uwezo Bank)	18	4.5	1,580	5.0	430
Overdraft 2 (Jitegemee Bank)	20	6	1,760	7.0	1,150
Total			15,163		8,350

All the credit providers agreed with the new repayment schedule but raised the following questions:

1. How was it possible that even after Denkmann Oluoch defaulted on his Jijenge Cooperative Society loan, he was able to acquire a mortgage facility plus additional credit facilities?
2. With credit information sharing, how did Denkmann Oluoch access different credit products from different financial institutions?

As a partner at Debt Counselling Experts Ltd., you have been appointed by Christopher Roos to be in charge of Denkmann Oluoch account on debt restructuring.

Soon after your appointment, you held a meeting with Denkmann Oluoch so that you could take him through the process of debt restructuring. At the end of the meeting you realised that lack of information sharing among the financial institutions was one of the major reasons that encouraged Denkmann Oluoch's huge appetite for debt.

Required:

(a) Discuss the six stage process of debt restructuring that Denkmann Oluoch's repayment schedule would be subjected to. (12 marks)

(b) With reference to Denkmann Oluoch's situation, argue three cases in favour of debt restructuring. (6 marks)

(c) (i) One of the functions of credit providers is to price credit correctly.

Required:
Analyse the above statement in relation to Denkmann Oluoch's case. (6 marks)

(ii) Denkmann Oluoch seems to be suffering from the problem of "moral hazard".

Required:
Explain the term "moral hazard" with reference to the default made on the Jijenge Cooperative Society Loan. (5 marks)

(iii) Justify the following statement: "credit information sharing among the financial institutions would have been the solution to Denkmann Oluoch's huge appetite for debt". (6 marks)

(d) Apart from the information provided in the repayment plan, describe five additional sources of credit information that the debt counselling expert could have requested from Denkmann Oluoch for consideration under debt restructuring. (5 marks)

(Total: 40 marks)

QUESTION TWO

(a) The following particulars were extracted from the books of Biashara Faida Bank Ltd. as at 30 June 2015:

Assets particulars	Amount Sh."million"	Provision %
Standard	2,900	0.25
Sub-standard assets	1,080	10
Doubtful assets categories (secured)		
Up to 1 year	420	20
1 – 3 years	210	30
More than 3 years	180	50
Loss assets	90	100

The proportion of security available for the doubtful assets is 65%, 40% and 25% for the three categories respectively.

Required:
Assess the amount of provision the bank should make for each of the assets above. (6 marks)

(b) Highlight four disadvantages of using a bank overdraft facility to finance a business. (4 marks)

(c) Analyse five drawbacks of the informal credit rating approach. (5 marks)

(Total: 15 marks)

QUESTION THREE

(a) With reference to asset finance, evaluate four factors that could affect the validity of title deeds in your country. (8 marks)

(b) Discuss seven advantages of sale and lease back as a source of finance. (7 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Describe five principles of microfinance. (5 marks)

(b) ABC Ltd. makes annual credit sales of Sh.1,500,000 and offers credit terms of 30 days. Debt administration has been poor and the average collection period has been 45 days with 0.5% of sales resulting in bad debts written off. As a result, ABC Ltd. has sought the services of a factor who is willing to take on the task of debt administration and credit checking, at an annual fee of 2.5% of credit sales. The company could save Sh.30,000 a year in administration costs. The payment period could be reduced to 30 days.

The factor will also provide an advance of 80% of invoiced debts at an interest rate of 14% per annum (3 % over the current bank rate). The company can obtain an overdraft facility to finance its accounts receivable at a rate of 2.5% per annum over the current bank rate.

Required:

As the credit controller of ABC Ltd., advise the management on whether to engage the services of the factor. Assume a constant monthly turnover. (10 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Explain four reasons why there is a global trend to migrate both credit and debit cardholders from magnetic strip to chip technology cards. (4 marks)

(b) Loan defaults eventually lead to non-performing loans (NPLs) which in turn erode the profitability of banks and endanger their shareholders funds. To this end, banks have set up risk management departments to monitor credit quality and take early preventive measures to control NPLs.

One of the methods of monitoring credit quality is to identify early warning signs, commonly known as red flags.

Citing relevant examples, identify two red flags in each of the following categories:

(i) Account operations. (2 marks)

(ii) Business operations. (2 marks)

(iii) Environment. (2 marks)

(c) Outline five disclosures of interest rates that a lending institution should make to the customer prior to signing the contract. (5 marks)

(Total: 15 marks)

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KASNEB

CCP PART III SECTION 6

CREDIT PRACTICE

PILOT PAPER

September 2015. **Time Allowed: 3 hours.**

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

QUESTION ONE

LOAN STRUCTURING AND COLLECTION METHOD

Uwezoni DTM is a financial institution with a wide branch network across the country. It has been in operation for five years now and although it started well with the aid of donor financing, its financial viability and economic sustenance is at stake due to a non-performing loan portfolio now at 55%.

The founders were to come up with strategies of lending to the vulnerable segment of the community to help them improve their living standards as well as boosting economic growth by bringing up sustainable and viable economic activities.

The strategic plan for the first five years presented to the donors before inception was acceptable and met the standards regarding financial viability. The donors were to get annual reports regularly for monitoring purposes. After staffing and laying down of all the processes and regulatory requirements, the communities targeted were sensitised across the country as this was a crucial part of the programme.

Lending began with individual and group applications. The loans were designed to be payable from within six to thirty six months at a favourable low rate of 9% per annum on a reducing balance. The borrowers were mainly casual workers who were contracted depending on their employers' needs. A considerable percentage of the rest were wheat farmers with two harvests each year. Every customer is given a loan with a maximum of ten times their savings with the microfinance and repayments on a monthly basis.

The first beneficiaries had challenges in repaying their loans but Uwezoni DTM continued advancing loans to more members. The field officers were very aggressive on reaching more members and growing the loan portfolio which eventually hit the limits as set by management and donors. At this point, the financial control and literacy were not given priority.

There has been no collection section as collections are done by the same field officers who are also the lending officers. There is no real time information system for the programme. The savings and loan repayment information is sent from field officers via ordinary mail where the information and date is posted in batches by the back office officers.

The field officers are not well remunerated commensurate with their responsibilities and set targets. The groups have started complaining due to poor leadership and favouritism in lending by the officers.

Collection calls and visits are not recorded and it is only the field officers who know the status of the defaulted accounts. The farmers whose only source of income is received twice a year have started losing focus on the programme and they look for other sources of finance to enable them meet their commitments. The casual workers have been defaulting and they move to other areas to look for employment. As there has been poor filing of documents at the head office it has been difficult to retrieve documents for reference in pursuing the debts. The securities for the loans were mostly the group savings and guarantees.

Required:
As the Head of Credit at Uwezoni DTM, identify where the company could have gone wrong and propose recommendations to convince the management and donors to revive the microfinance. (40 marks)

QUESTION TWO
Upendo Supermarket Limited is a large chain of retail stores with branches in all major towns across the country. Upendo Supermarkets Limited purchases 80% of its merchandise from Uzuri Wholesalers Ltd.

This year, there has been delayed payments by Upendo Supermarkets Limited to Uzuri Wholesalers Ltd. The payment terms given by Uzuri Wholesalers Ltd. are net 30 days for all credit customers.

The Chief Finance Officer of Uzuri Wholesalers Ltd. has tasked you as the credit controller to hold a meeting with the management of Upendo Supermarkets Limited to discuss the matter of delayed payments with a view to normalising the account.

Required:

(a) Prepare a checklist of the agenda of the meeting for which you will use as a guide in your deliberations with the finance manager of Upendo Supermarkets Limited. (5 marks)

(b) Identify the triggers of predicting corporate failure. (5 marks)

(c) The sales ledger is a critical record of unpaid sales. Explain six benefits of a sales ledger. (5 marks)

(Total: 15 marks)

QUESTION THREE

ABC Ltd. is a newly incorporated company that operates in the horticulture market. The five directors are not professionals and do not have any skills in credit. The company has been operating in the domestic market but is planning to venture into the export market.

You have been appointed as a consultant to give advice on how the company should enter into the new export market.

Required:

(a) Discuss the types of letters of credit that the company can use in financing the export business. (8 marks)

(b) Recommend the sources of finance for export made available to ABC Ltd. (7 marks)

(Total: 15 marks)

QUESTION FOUR

There has been a lot of focus on credit reference in the market where providers of credit, employers and other institutions ask for credit certificates as a basic requirement.

Required:

(a) Propose the key areas that should be included in a Credit Law in line with the above trend. (10 marks)

(b) Explain why consumer credit has not taken off fully in your country. (5 marks)

(Total: 15 marks)

QUESTION FIVE

(a) You are the credit manager of S.G.R Transporters Ltd. whose board of directors have approved your proposal to have funds allocated for acquisition and implementation of a credit management information system.

Required:

Describe the features of a well designed computer software that will serve S.G.R Transporters Ltd. (5 marks)

(b) Discuss five key ratios that are used in risk assessment. (10 marks)

(Total: 15 marks)

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