



## **CERTIFIED PUBLIC ACCOUNTANT**

### **STAGE 3 EXAMINATION**

#### **S3.5 CREDIT MANAGEMENT**

**DATE: THURSDAY, 01 DECEMBER 2022**

#### **INSTRUCTIONS:**

- 1. Time Allowed: 3 hours 15 minutes (15 minutes reading and 3 hours writing).**
- 2. This examination has seven questions and only five questions should be attempted.**
- 3. Marks allocated to each question are shown at the end of the question.**
- 4. Show all your workings where applicable.**
- 5. The question paper should not be taken out of the examination room.**

## **SECTION A**

### **QUESTION ONE**

A company has a current ratio of 1.5 and an overdraft of FRW 750,000. A credit customer pays FRW 500,000 of overdue debts. Other customers pay on time.

**What is impact on the current ratio and average receivables days?**

- | <b>Current ratio</b> | <b>Receivables days</b> |
|----------------------|-------------------------|
| A Increase           | Increase                |
| B Decrease           | Increase                |
| C Decrease           | Decrease                |
| D None of the above  |                         |

**(2 Marks)**

### **QUESTION TWO**

**Which of the following would normally be required when opening a new account for a customer with an established credit status?**

- (i) Credit limit
- (ii) Credit period
- (iii) Customer bank account details
- (iv) Customer contact details

- A (i), (ii), (iv)
- B (i), (iii), (iv)
- C (ii), (iii), (iv)
- D All of the above

**(2 Marks)**

### **QUESTION THREE**

Company A offers credit terms of 60 days and a credit limit of FRW 1 million to their customer, Company B. Company B responds by saying that they would accept the offer if the credit limit was FRW 1.25 million and they would also be prepared to accept terms of 45 days as a result. Before Company A responds to the revised suggestion from Company B, Company B accepts the original offer. Company A refuses to accept this and says they accept Company B's revised offer of FRW 1.25 million and 45 days.



**Which of the following statements is true?**

- A The original terms are binding on both parties
- B The revised terms are binding on both parties
- C There is no contract in place as an offer has not been accepted
- D There is no contract in place as there is no intention to create legal relations

**(2 Marks)**

#### **QUESTION FOUR**

Cyangugu Mining Ltd has problem with two customers – Company A and Company B. The amount owed by Company A is deemed irrecoverable and so is written off. The amount owed by Company B is doubtful and so is provided for.

**Which of the following statements is/are true?**

- (i) Company A's debts will no longer form part of the receivable's ledger, whereas Company B's debts will remain on the ledger.
- (ii) There is no point financially continuing to chase Company B's debts as it has been provided for.
- (iii) Receivables days will decrease as a result of the entries being made.

- A (i) only is true
- B (i) and (iii) are true
- C (ii) and (iii) are true
- D All of the above

**(2 Marks)**

#### **QUESTION FIVE**

An organization's policy is to allow a credit account to be opened for customers who have traded successfully on a cash basis for 12 months. One month's sales are allowed on credit initially, increasing by 10% each month for the following 12 months. Sales attract VAT of 18%.

A cash customer has generated sales of FRW 3.6 million (excluding VAT) over the last 18 months and would now like a credit account.

**What would the initial credit limit be for this customer?**

- A FRW 200,000
- B FRW 418,000
- C FRW 354,312
- D FRW 236,000

**(2 Marks)**

### QUESTION SIX

Which of the following statements would be appropriate to include in a 'refusal of credit' letter?

- (i) Unfortunately, we are not currently able to trade with you
- (ii) We would welcome the opportunity to review this decision in six months' time
- (iii) If you would like to appeal this decision...

A (i) and (ii)

B (i) and (iii)

C None of the above

D (ii) and (iii)

(2 Marks)

### QUESTION SEVEN

Company policy is to report all accounts significantly in breach of credit limit to the financial controller.

The following is an extract from the aged receivables ledger:

Particulars	Total	Credit limit	Current <30 days	31–60 days	61–90 days	>90 days
	FRW 000	FRW 000	FRW 000	FRW 000	FRW 000	FRW 000
A Ltd	10,800	12,000	-	-	-	10,800
B Ltd	6,400	6,000	5,200	1,200	-	-
C Ltd	3,290	4,000	1,000	1,000	1,250	40

Standard terms are 60 days. However, C and D Ltd have extended terms to 90 days. There is ongoing dispute with A Ltd.

Which account should be reported to the financial controller?

A A Ltd

B B Ltd

C C Ltd

D None of the above

(2 Marks)

### **QUESTION EIGHT**

A company has a negative working capital cycle.

**Which statement in relation to this is correct?**

- A Its current liabilities exceed its current assets, so solvency is a concern.
- B More cash is leaving the business to pay suppliers than is coming back in from customers, depleting cash resources.
- C Cash comes in from customers before going out to pay suppliers, adding to cash resources.
- D Shareholders owe more to the company than they have contributed in share capital.

**(2 Marks)**

### **QUESTION NINE**

Kabunga Fisheries Ltd (KFL) is owed FRW 1.5 million by Net and Rod Ltd (NARL). Unfortunately, NARL have no cash to pay KFL, and holds no inventories or other tangible assets. NARL is owed significant amounts by its own customers.

**What is the most appropriate remedy to seek from the courts?**

- A Garnishee order
- B Attachment of earnings order
- C Warrant of execution
- D Charging order

**(2 Marks)**

### **QUESTION 10**

Bugarama textiles Ltd has just lost an appeal in the Provincial court to recover significant amounts owed by a government department.

**What is the next available legal course of action?**

- A Accept the result – the appeal hearing is final
- B Appeal to the High Court
- C Appeal to the Provincial court to reconsider its decision
- D None of the above

**(2 Marks)**



## **SECTION B**

### **QUESTION 11**

You work in the finance department of Nyanza Sugar Ltd (NSL). Your employer has a major European customer that is concerned some of their personal information may have been stolen from your systems in a recent cyberattack. Nyanza Sugar Ltd agreed to be GDPR (European General Data Protection Regulation) compliant as part of the Supply Agreement they have with their customer. You are soon due to attend a meeting in your department to discuss the issue.

#### **Required:**

**Write a memo for your team in advance of your meeting explaining what is meant by personal information in the context of GDPR and explain how the principles of good practice in data protection apply to Nyanza Sugar Ltd's treatment of customer data.** (10 Marks)

**(Total 10 Marks)**

### **QUESTION 12**

Your customer, Gitarama Engineering Ltd (GEL), is behind on their payments and you have heard a rumour from the sales team that they have run out of money and staff have not been paid this month.

#### **Required:**

**Clarify the difference between bankruptcy and insolvency and suggest the courses of legal action available to your company to recover the money owed if it turns out Gitarama Engineering Ltd has completely run out of money to pay their bills. Recommend and justify the most appropriate course of action to take.** (10 Marks)

**(Total 10 Marks)**

## **SECTION C**

### **QUESTION 13**

You work for Umulisa Textiles Ltd (UTL) which offers standard terms of 30 days to its customers. A cash customer, Kanza Clothing Ltd (KCL) has applied for credit. KCL make clothing to order and has been a cash customer for six months. They purchased FRW 2.5 million from UTL in the first month, rising evenly each month to around FRW 20 million last month. It has applied for a credit amount of FRW 50 million with 60-day terms, stating that the provision of this credit will allow it to increase its purchases from UTL.

You have obtained a summary set of financial statements for KCL, a bank reference and a trade reference detailed below in support of the application. You are required to assess the application for credit and communicate the decision to your manager. Assume 365 days in a year.

The bank reference responded saying 'should prove good for your figures'.

#### **The trade reference:**

We have received a request for credit from Kanza Clothing Ltd who have quoted yourselves as a referee. We would be grateful if you could answer the following questions and return in the stamped addressed envelope enclosed.

How long has the customer been trading with you? Three years and seven months

Your credit terms with customer per month FRW 40 million

Period of credit granted 30 days

Payment record Prompt/occasionally late/slow

Have you ever suspended credit to the customer? Yes/No

Any other relevant information

#### **Summary financial statements for Kanza Clothing Ltd**

##### **STATEMENT OF PROFIT OR LOSS**

<b>Particulars</b>	<b>2021 FRW million</b>	<b>2020 FRW million</b>
Sales revenue	15,000	14,000
Cost of sales	12,010	10,915
<b>Gross profit</b>	<b>2,990</b>	<b>3,085</b>
Distribution costs	1,200	1,000
Administration expenses	650	650
<b>Operating profit</b>	<b>1,140</b>	<b>1,435</b>
Finance costs	250	300
<b>Profit before tax</b>	<b>890</b>	<b>1,135</b>
Taxation	267	341
<b>Profit for the year</b>	<b>623</b>	<b>794</b>

## STATEMENT OF FINANCIAL POSITION

Particulars	2021 FRW million	2022 FRW million
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment	4,439	4,563
<b>Current assets</b>		
Inventories	300	450
Trade receivables	900	900
Cash	5	5
<b>Total Current Assets</b>	<b>1,205</b>	<b>1,355</b>
<b>Total assets</b>	<b>5,644</b>	<b>5,918</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Share capital	1,250	1,250
Retained earnings	1,377	1,077
<b>Total equity</b>	<b>2,627</b>	<b>2,327</b>
<b>Non-current liabilities</b>		
Borrowings	1,500	1,250
<b>Current liabilities</b>		
Trade payables	1,000	1,050
Taxation	267	341
Borrowings	250	950
<b>Total Current liabilities</b>	<b>1,517</b>	<b>2,341</b>
<b>Total liabilities</b>	<b>3,017</b>	<b>3,591</b>
<b>Total equity and liabilities</b>	<b>5,644</b>	<b>5,918</b>

**Required:**

**(a) Summarize any key issues or concerns noted in the three documents used in support of the credit application.** (10 Marks)

**(b) Recommend terms of credit, if any, to your manager and justify your decision with reference to UTL's company policy.** (10 Marks)

**(Total 20 Marks)**



### **QUESTION 14**

You are employed by Highlife Resorts Ltd (HRL) – a company offering high quality, prestigious accommodation for wealthy holiday makers. HRL sell their holidays via travel agents on credit terms of 30 days. You have been asked to formalize the policy for debt collection methods as up until now it has been managed informally by the financial controller.

Most customers pay in around 30 days, which means it is generally collected before suppliers need to be paid for the provision of holidays. Suppliers generally accept 60 days credit. One large customer, Rwandan Paradise Ltd (RPL) currently takes an average of five months to pay. RPL purchases approximately FRW 40 million each month. Bad debts are not generally an issue for HRL, although there are at times when it is exposed to the risk of travel agency groups who may cease trading.

#### **Required:**

- (a) Explain the advantages and disadvantages to HRL of using debt collection agencies, debt factoring, and early settlement discounts to facilitate debt collection. (12 Marks)**
  - (b) Recommend and justify an appropriate collection policy for HRL. (3 Marks)**
  - (c) Write an email to RPL explaining the impact that the change in policy recommended in part (b) is likely to have and justifying the change in policy to them. (5 Marks)**
- (Total 20 Marks)**

### **QUESTION 15**

Karera Concrete Ltd (KCL) has the following stated company policy in relation to credit accounts with customers:

#### **Debt collection policy for KCL**

- (1) Statements are sent to credit customers on the first working day of each month.**
- (2) A reminder letter is sent when a debt is seven days overdue.**
- (3) A telephone call to chase payment must be made when a debt is 14 days overdue.**
- (4) When the debt is one month overdue, the customer will be placed on the stop list and a letter sent confirming this. A meeting should then be arranged with the customer in order to discuss the account. An allowance relating to 50% of the overdue amount should be processed.**
- (5) When the debt is two months overdue, it will be placed in the hands of a debt collection agency, and the allowance will be increased to 100% of the overdue amount.**

Below is an extract from the receivable's ledger of KCL. (All amounts are in FRW million)

Customer name	Total amount	Current	O/s	O/s	O/s
		<1 month	1–2 months	2–3 months	>3 months
Kimenyi Builders	-	-5,000	1,000	4,000	-
Kicukiro Housing	7,000	7,000	-	-	-
Manzi and Son Ltd	3,000	3,000	-1000	1,000	-
Gicumbi Construction	15,000	-	11,000	4,000	-
Rulindo Civil Engineering	5,500	-	-	-	5,500

**Additional information:**

- 1) Kicukiro Housing is a new credit customer. Rumors have been circulating that they are struggling to pay their staff. They have not responded to recent phone calls from KCL.
- 2) Gicumbi Construction have recently promised that their 2–3-month balance will be paid at the end of the current month (in three weeks' time).
- 3) Rulindo Civil Engineering is insolvent and in the process of liquidation. The debt collection agency KCL charges a flat fee of FRW 75 million per account being chased plus 5% of the amount being chased. In KCL's experience, 75% of amounts that are two months overdue, do not get paid if the agency is not used. This percentage reduces to 60% when the agency is used.

**Required:**

- (a) Apply the debt collection company policy for KCL to each of its customers on the receivables ledger and recommend which debts should be passed to the debt collection agency. (10 Marks)
  - (b) Calculate the net cost or benefit of using the debt collection agency for those debts identified in requirement (a). (5 Marks)
  - (c) Recommend a doubtful debt allowance/provision for each customer if the debt collection agency is not to be used and KCL chases the debts directly. (5 Marks)
- (Total 20 marks)**

**End of question Paper**