
CERTIFIED ACCOUNTING TECHNICIAN (CAT)
STAGE 3 EXAMINATION
S3.5 CREDIT MANAGEMENT
PILOT PAPER

Instructions

- 1 Time allowed: **3 hours**.
- 2 This examination has **three** sections: **A, B and C**.
- 3 Section A has **10** multiple choice questions equal to 2 marks each.
- 4 Section B has **2** questions equal to 10 marks each.
- 5 Section C has **3** questions equal to 20 marks each.
- 6 All questions are compulsory.

Section A – All TEN questions are compulsory and MUST be attempted

1. Brigitte writes to Solange, her customer, offering to sell goods priced at RWF 250,000 payable within 30 days from dispatch. Solange replies in writing agreeing to buy the goods for RWF 250,000. She states that she will pay within 30 days of receiving the goods. Solange's reply was lost in the post and therefore not received by Brigitte.

Is there a valid contract in place between Brigitte and Solange?

- A Yes. Solange has accepted the offer made.
- B No. Brigitte did not receive confirmation of Solange's acceptance.
- C No. Solange's reply constitutes a counter offer for Brigitte to consider.
- D No. The contract is not binding until the goods are dispatched.
- E None of the above.

(2 marks)

2. Etienne works in credit control. One customer, Ruzindana Transport, has breached their 30-day credit limit by 15 days. Etienne is now considering the following process to recover the debt:

- (i) Telephone the customer
- (ii) Put the customer on the 'stop' list and cease supplying them
- (iii) Employ the services of a debt collection agency
- (iv) Send a reminder letter

What would be the typical order for recovering this debt?

- A (i), (ii), (iv), then (iii)
- B (iv), (i), (ii), then (iii)
- C (ii), (i), (iv), then (iii)
- D (i), (iv), (ii), then (iii)
- E None of the above

(2 marks)

3. Musoni Cosmetics Ltd allows a period of credit of one month. One customer, Karera Retail Ltd, has just purchased RWF 1.2 million worth of cosmetics. To manage working capital, Musoni Cosmetics Ltd would prefer that the purchases made are paid for immediately. Policy is to either employ the services of an invoice discounter (at an annualised cost of 25%), or to offer an early settlement discount of 2% for immediate settlement. Compound interest applies where applicable.

Which course of action would be most cost effective and why?

- A Offer the early settlement discount, as its annual cost is only 24%.
- B Employ the services of an invoice discounter, as its monthly cost is only 2.1%.
- C Employ the services of an invoice discounter, as its annualised cost is less than that of the early settlement discount.
- D Offer the early settlement discount, as 2% is significantly less expensive than the 25% cost of the invoice discounter.
- E None of the above

(2 marks)

4. Kivu's company policy is to provide 50% for irrecoverable and doubtful debts that are over three but under six months old, and 100% for debts that are over six months old.

Customer A owes a total of RWF 1.2 million and agreed to pay in instalments of RWF 100,000 a month over the coming 12 months. Customer A has just become insolvent.

Customer B owes a total of RWF 1.5 million relating to purchases they made evenly over the last ten months.

What is the total amount of the provision and write off in relation to these two customer accounts?

- A RWF 1,575,000
- B RWF 825,000
- C RWF 2,700,000
- D RWF 2,025,000
- E None of the above

(2 marks)

5. Umuhire Scaffolding Ltd are owed RWF 14.2 million by Kigali Construction Ltd, which has been declared insolvent. Kigali Construction Ltd owed the following (the amount owed to Umuhire Scaffolding is included within trade creditors):

Trade creditors:	RWF 145 million
Preferential creditors:	RWF 100 million
Secured creditors:	RWF 80 million
Ordinary share capital	RWF 125 million
Insolvency fees:	RWF 75 million

Cash available in Kigali Construction to settle debts is RWF 327.5 million.

How much is Umuhire Scaffolding Ltd likely to receive?

- A RWF 14.2 million
- B RWF 9.5 million
- C RWF 3.8 million
- D RWF 0
- E None of the above

(2 marks)

6. Manzi Pharmaceutical Ltd has credit sales of RWF 1,200 million a year. It currently offers credit terms of 30 days, although customers take an average of 45 days to pay. Manzi is considering offering an early settlement discount of 2% for payment in ten days. It is estimated that 50% of customers will take up the early settlement discount. Assume there are 365 days in a year.

What is the likely reduction in receivables as a result of offering the discount?

- A RWF 90,082,191
- B RWF 57,534,247
- C RWF 57,863,015
- D RWF 90,410,959

E None of the above

(2 marks)

7. Claude is negotiating credit terms with a customer. The customer is offered two months' credit with a credit limit of RWF 500,000 to be reviewed in six months' time. The customer replies by accepting the limit of RWF 500,000 but asks for three months' credit. Claude offers a compromise of 75-days credit which he assumes is acceptable unless he hears otherwise.

What are the agreed terms at this point?

- A The offer of a RWF 500,000 limit has been accepted and so forms a binding contract. The period of credit is still to be agreed.
- B A 75-day credit limit has been agreed with a limit of RWF 500,000.
- C No contract has yet been concluded.
- D A three-month credit limit has been agreed with a limit of RWF 500,000.
- E None of the above.

(2 marks)

8. Ruzindana Clothing is owed RWF 1.45 million by Gisenyi fashions, a retail chain, that has just been declared insolvent. The clothes were sold for a 40% profit margin on sales. 60% of the items sold by value are subject to a valid retention of title clause. The remainder will be recoverable at a rate of 25 centimes in the franc.

What is the total amount that should be provided for and written off in relation to the amount owed by Gisenyi fashions?

- A RWF 783,000
- B RWF 435,000
- C RWF 1,305,000
- D RWF 957,000
- E None of the above

(2 marks)

9. Kibuye Chemicals has a contract in place to supply chemicals to Customer A at a 10% discount to the usual list price. The agreement includes a warranty that deliveries will be made on a Monday to Thursday, as Company A does not employ warehouse staff on a Friday.

One large shipment was delivered to Customer A on a Friday. It was unfortunately spoiled by bad weather as it was left outside the warehouse. Customer A has declared this a breach of contract and considers the contract effectively terminated as a result.

Which of the following statements is true?

- A Customer A is correct. This is a breach of a key term and therefore the contract is terminated.
- B The delivery date was a warranty only, hence the contract is not terminated and Customer A is fully liable to pay for the delivery.
- C The delivery date was a warranty only, hence the contract is not terminated but Customer A is not liable to pay for the delivery and can sue Kibuye Chemicals for any consequential loss.

D The delivery date was a clear condition of trade, hence Customer A is entitled to view the contract as terminated.

E None of the above.

(2 marks)

10. Byumba Agricultural Ltd exports to European companies. As part of its supply arrangements, it agrees to comply with the European General Data Protection Regulations (GDPR). Unfortunately, a junior employee disclosed Byumba's customer list and outstanding balances by mistake.

Which of the following statements is correct?

A As there has been a breach in GDPR, the customers and the European supervisory authority must be informed immediately.

B Although customers must be told immediately of the breach of GDPR, there is no need to inform the European supervisory authority.

C There has been no breach in the GDPR so there is no need to inform anyone.

D There has not been a breach in the GDPR regulations so there is no need to inform anyone. However, it would be best practice to inform the customers affected.

E None of the above.

(2 marks)

Section B – BOTH questions are compulsory and MUST be attempted

11. Mulini Teas Ltd grows, picks and dries tea leaves. Below is an extract of the aged receivables analysis as at 31 December 2019:

<i>Customer name</i>	<i>Total amount due</i>	<i>Current Up to 30 days</i>	<i>Outstanding 31–60 days</i>	<i>Outstanding 61–90 days</i>	<i>Outstanding 91+ days</i>
	RWF'000	RWF'000	RWF'000	RWF'000	RWF'000
Manzi Exports	56,128	42,123	12,162	1,843	–
Kigali Wholesale	69,674	16,324	24,243	22,654	6,453
The Tea Company	84,356	12,232	72,124	–	–
Gisenyi Catering	14,220	14,220	–	–	–
Supplies					
Mugabo Beverages	163,874	16,171	27,342	36,127	84,234
Total	388,252	101,070	135,871	60,624	90,687

Today is 22 January 2020. The only transactions that have happened since the production of the aged receivables analysis are:

- Manzi Exports paid RWF 56,128,000 on 12 January 2020

- Kigali Wholesale made a payment on account of RWF 5,000,000 on 20 January 2020
- The Tea company paid the current balance of RWF 12,232,000 on 17 January 2020 but disputes RWF 4,123,432 of the 31–60 day balance.
- Gisenyi Catering supplies paid RWF 14,220,000 today.
- Mugabo Beverages paid RWF 120,361,000 on 15 January 2020 in payment for its oldest debts.

Mulini Teas Ltd's credit control policy is summarised below:

- 1 Credit terms are strictly 30 days from the date of invoice. All invoices are dated and sent on the last day of the relevant month.
- 2 Statements are despatched on the first working day of each month.
- 3 A telephone call to chase payment must be made when a debt is 14 days overdue.
- 4 A reminder letter must be sent when a debt is 21 days overdue.
- 5 The customer will be placed on the stop list when the amount owing is 30 days overdue and a meeting arranged with the customer to discuss the operation of the account.
- 6 A letter threatening legal action will be sent when the debt is 60 days overdue.
- 7 Legal proceedings are to be commenced when a debt is 90 days overdue subject to the agreement of the finance director.

Required

Recommend and justify a course of action for each customer given the current state of their account.

Total (10 marks)

12. You work in the finance department of Byumba Wood and Saw Mill Ltd. A major customer has ignored repeated requests for payment of a very large and long overdue amount. You are in a meeting with your manager to discuss the best course of action, including potentially starting legal action. The customer is rumoured to be struggling financially but their parent company is large, established and appears to be solvent.

Required

Recommend and explain which court should be petitioned to recover the debt. Discuss the various methods of recovery other than court action that could be used, recommending and justifying a course of action in this case.

Total (10 marks)

Section C – All THREE questions are compulsory and MUST be attempted

13. You have recently been appointed to the finance team of Byumba Cobalt Ltd as a credit management expert. The company is expanding and looking to formalise its credit policies. The industry is Cobalt mining, and customers range from large, established global steel manufacturers, to smaller ceramic and glass manufacturers. Some of the small manufacturers are habitually late payers.

Required

Prepare a short report for the finance team explaining the following:

- (a) The benefits of liquidity management and how credit management could help with liquidity management for Byumba Cobalt Ltd. **(10 marks)**
- (b) The sources of internal and external information that should be considered in the decision to offer credit to customers, and an evaluation of their usefulness to a business such as Byumba Cobalt Ltd given its customer base. **(10 marks)**

Total (20 marks)

14. Gisenyi Cosmetics Ltd (GC) has received a request for credit from Kigali Beauty Supplies Ltd (KBS), a customer who currently pays in cash.

GC has traded with KBS for 12 months on a cash basis, with cash purchases building to around RWF 1 million each month. KBS has applied for an RWF 3 million credit limit, on GC's standard 30-day terms.

KBS purchases cosmetics from GC and other companies, packages them and then sells them as KBS branded cosmetics. They have grown substantially in recent years. They plan to continue to grow and expand internationally.

You are a member of the finance team at GC and are responsible for credit decisions that are then approved by the finance manager.

The latest set of financial statements for KBS are provided below:

	20X9	20X8
	RWF million	RWF million
Sales revenue	24,000	20,000
Cost of sales	(12,000)	(11,000)
Gross profit	12,000	9,000
Distribution costs	(1,345)	(1,010)
Administration expenses	(5,412)	(4,563)
Operating profit	5,243	3,427
Finance costs	(1,004)	(651)
Profit before taxation	4,239	2,776
Taxation	(1,272)	(833)
Profit for the year	2,967	1,943
	20X9	20X8
	RWF million	RWF million
ASSETS		
Non-current assets		
Property, plant and equipment	20,000	15,213

Current assets

Inventories	3,132	1,123
Trade receivables	5,124	2,432
Cash		1,254

Total assets	28,256	20,022
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EQUITY AND LIABILITIES**Equity**

Share capital	5,000	5,000
Retained earnings	8,702	6,735
Total equity	13,702	11,735

Non-current liabilities

Borrowings	8,000	4,500
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Current liabilities

Trade payables	3,963	2,954
Taxation	1,272	833
Overdraft	1,319	

Total liabilities	14,554	8,287
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Total equity and liabilities	28,256	20,022
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Required

- (a) Write an email to your finance manager recommending and justifying whether credit should be offered to KBS. **(12 marks)**
- (b) Assuming the finance manager agrees with your recommendation, write a letter to the customer explaining your decision. **(8 marks)**

Total (20 marks)

15. Today is 31 July 2019. Nyungwe Forest Adventures Ltd (NFA) sells site-seeing and adventure trips into the national forest. They only sell business-to-business and predominantly sell to package holiday companies.

An extract from the sales ledger at 31 July 2019 is shown below:

<i>Customer code</i>	<i>Date of invoice 2019</i>	<i>Invoice number</i>	<i>RWF'000</i>
1003	14 April	Inv 093050	1,536
1001	22 May	Inv 093106	2,184
1002	28 May	Inv 093150	4,736
1001	3 June	Inv 093182	3,785
1002	10 June	Inv 093199	458
1003	15 June	Inv 093230	8,463
1001	21 June	Inv 093265	4,839
1002	25 June	Inv 093289	3,019
1001	2 July	Credit note 04623	(536)
1002	2 July	Inv 093301	999
1003	3 July	Inv 093310	1,954

1001	5 July	Inv 093321	3,146
1003	12 July	Inv 093333	2,562
1001	20 July	Inv 093346	4,267
			<u>41,412</u>

Customer 1001 (Rwandan Dreams Ltd) has a credit limit of RWF 20 million and credit terms of 30 days. The credit note issued related to invoice 093106.

Customer 1002 (Lake Kivu Cruises Ltd) has a credit limit of RWF 9 million and credit terms of 30 days.

Customer 1003 (Kiyumba Excursions Ltd) has a credit limit of RWF15 Million and credit terms of 45 days.

NFA's policy is to provide for irrecoverable and doubtful debts as follows:

- 1–30 days over agreed credit period: 25%
- 31–60 days over agreed credit period: 50%
- 61+ days over agreed credit period: 100%

All balances in excess of the credit limit (after all other above provisions relating to age of debts): 50%

Required

- (a) Present an aged receivables analysis by a customer, and, using NFA's company policy for providing for irrecoverable and doubtful debts, recommend an estimated doubtful debt provision based on the information provided. **(10 marks)**
- (b) What other information would you need to consider before deciding on a course of action to recover the amount owed by Rwandan Dreams Ltd? **(5 marks)**
- (c) Recommend whether any of the current credit terms for any customers should be amended, and if so explain and justify what they should be amended to. **(5 marks)**

Total (20 marks)

Total (100 marks)

End of question paper