

**Osborne Books Tutor Zone**

# **Credit Management**

**Practice assessment 2**

**Task 1**

(a) 'Consideration' in a contract of sale for goods must:

(a) Equate to the full value of the goods being sold	
(b) Be of some value, but not necessarily the full value of the goods	
(c) Be set down in writing	

Tick the **one** correct option.

(b) An offer in contract may be terminated by:

(a) A counter offer	
(b) An invitation to treat	
(c) The price being unacceptable	

Tick the **one** correct option.

(c) The Consumer Credit Act covers:

(a) Contracts of sale issued by suppliers to other businesses	
(b) The description of goods in publicity material issued by manufacturers	
(c) Hire Purchase and hire agreements	

Tick the **one** correct option.

(d) A valid contract:

(a) Must always be in writing	
(b) Must always be in writing or agreed orally	
(c) Must always follow an invitation to treat	

Tick the **one** correct option.

(e) Which of the following constitutes an acceptance of an offer in contract:

(a) 'I agree to buy this picture from you, but I need first to confirm that it is a genuine Van Gogh'	
(b) 'I agree to buy this picture from you and will pay the £1.2 million asking price'	
(c) 'I agree to buy this picture from you, subject to contract'	

Tick the **one** correct option.

(f) The term used to describe the situation when the terms of a contract are not met is:

(a) Breach of specific performance	
(b) Breach of contract	
(c) Breach of action	

Tick the **one** correct option.

- (g) The Late Payments of Commercial Debts (Interest) Act allows small companies to charge interest to customers who exceed their credit terms and pay late. The interest charge is based on the current bank base rate.

**You are to** enter in the box below the percentage rate charged.

If the current base rate is 2%, the late payment interest rate is  per cent.

- (h) A customer owes £10,000 (excluding VAT @ 20%) and the debt is 45 days late.

**You are to** calculate the interest charge under the Late Payments of Commercial Debts (Interest) Act to the nearest penny. Enter the figure in the box below. The bank base rate is 0.5%.

£

- (i) **You are to** enter each of the following terms into the correct box within the text which follows.

**contract terms**

**disclaimers of liability**

**operation and legality**

The Unfair Contract Terms Act protects individuals and businesses by restricting the

of .

The Act covers most forms of contract and one of its most important functions is to restrict

.

**Task 2**

You work as a Credit Control Manager for Ringwood Ltd which uses a credit rating system to assess the credit status of new customers. The credit rating system is used to assess the risk of default by calculating key indicators (ratios), comparing them to the table and calculating an aggregate score.

<b>Credit rating (scoring) system</b>	<b>Score</b>
<b>Operating profit margin</b>	
Losses	-5
Less than 5%	0
5% and above but less than 10%	5
10% and above but less than 20%	10
20% or more	20
<b>Interest cover</b>	
No cover	-30
Less than 1	-20
1 and above but less than 2	-10
2 and above but less than 4	0
4 or more	10
<b>Current ratio</b>	
Less than 1	-20
1 and above but less than 1.25	-10
1.25 and above but less than 1.5	0
1.5 or more	10
<b>Gearing (total debt / total debt plus equity)</b>	
Less than 25%	20
25% and above but less than 50%	10
50% and above but less than 65%	0
65% and above but less than 75%	-20
75% and above but less than 80%	-40
80% or more	-100

<b>Risk</b>	<b>Aggregate score</b>
Very low risk	Between 60 and 21
Low risk	Between 20 and 1
Medium risk	Between 0 and -24
High risk	Between -25 and -50
Very high risk	Between -50 and -160

**Hurdle Limited: Statement of profit or loss**

	<b>20-2</b>	<b>20-1</b>
	<i>£000</i>	<i>£000</i>
Sales revenue	395	405
Cost of sales	296	223
Gross profit	99	182
Distribution costs	6	8
Administration expenses	81	19
Profit from operations	12	155
Finance costs	26	24
Profit / (loss) before taxation	(14)	131
Taxation	2	28
Profit / (loss) for the year	(16)	103

**Hurdle Limited: Statement of financial position**

	<b>20-2</b>	<b>20-1</b>
	<i>£000</i>	<i>£000</i>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment	761	693
<b>Current assets</b>		
Inventories	23	28
Trade and other receivables	108	89
Cash	–	22
	131	139
<b>Total assets</b>	892	832
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Share capital	450	400
Retained earnings	53	68
<b>Total equity</b>	503	468
<b>Non-current liabilities</b>		
Borrowing	250	300
<b>Current liabilities</b>		
Borrowing	48	–
Trade and other payables	91	64
<b>Total liabilities</b>	389	364
<b>Total equity and liabilities</b>	892	832

- (a) Complete the table below by calculating the key indicators (to two decimal places) for 20-2 and 20-1 for Hurdle Limited, and rate the company using the credit rating system.

<b>Hurdle Limited</b>	<b>20-2 Indicator</b>	<b>20-2 Rating</b>	<b>20-1 Indicator</b>	<b>20-1 Rating</b>
Operating profit margin %				
Interest cover				
Current ratio				
Gearing %				
Total credit rating				

(b) Select the type of risk Hurdle Limited's financial statements indicate for each year:

	20-2	20-1
Very low risk		
Low risk		
Medium risk		
High risk		
Very high risk		

(c) Based on the results of your credit rating and using the table below, recommend whether the requested credit limit should be given to Hurdle Limited.

Rating	Decision
Very low or low risk current year and very low or low risk previous year	Accept
Very low or low risk current year and medium risk previous year	Accept
Very low or low risk current year and high or very high risk previous year	Request latest management accounts and defer decision
Very high risk or high risk current year	Reject
Medium risk current year and medium, low or very low risk previous year	Accept
Medium risk current year and high or very high risk previous year	Request latest management accounts and defer decision

Credit decision	
(a) Accept	
(b) Reject	
(c) Request latest management accounts and defer decision	

**Task 3**

Your company has a customer, Building Times Ltd, with whom they have been trading for many years. Building Times Ltd have requested an increased credit limit from £50,000 to £75,000, despite falling behind with their payments.

The Sales Manager of your company has informed you that Building Times Ltd are considering moving overseas and will become a subsidiary of a foreign company. He has told you that this will result in much higher sales with the potential of the foreign company becoming a new customer.

Building Times Ltd have provided you with their most recent financial statements along with performance indicators:

**Building Times Ltd: Statement of profit or loss**

	<b>20-2</b>	<b>20-1</b>
	<i>£000</i>	<i>£000</i>
Sales revenue	8,927	5,685
Cost of sales	6,517	3,525
Gross profit	2,410	2,160
Distribution costs	357	227
Administration expenses	2,042	1,308
Profit from operations	11	625
Finance costs	106	31
Profit / (loss) before taxation	(95)	594
Taxation	–	110
Profit / (loss) for the year	(95)	484

**Building Times Ltd: Statement of financial position**

	<b>20-2</b>	<b>20-1</b>
	<i>£000</i>	<i>£000</i>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment	3,514	2,003
<b>Current assets</b>		
Inventories	550	541
Trade and other receivables	1,541	654
Cash	–	–
	2,091	1,195
<b>Total assets</b>	<b>5,605</b>	<b>3,198</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Share capital	1,500	1,500
Retained earnings	290	383
<b>Total equity</b>	<b>1,790</b>	<b>1,883</b>
<b>Non-current liabilities</b>		
Borrowing	2,500	1,000
<b>Current liabilities</b>		
Bank overdraft	387	15
Trade and other payables	928	300
<b>Total liabilities</b>	<b>3,815</b>	<b>1,315</b>
<b>Total equity and liabilities</b>	<b>5,605</b>	<b>3,198</b>

**Building Times Ltd**

	<b>20-2</b>	<b>20-1</b>
Gross profit margin %	27	38
Operating profit margin %	0.12	11
Interest cover	0.1	20.16
Current ratio	1.59	3.79
Trade payables payment period in days	51.97	31.06
Trade receivables collection period in days	63.01	41.99
Inventory holding period in days	30.8	56.02
Gearing %	61.73	35.02

- (a) **You are to** write notes identifying any risks associated with giving credit to an overseas customer and any further credit control procedures that should be carried out.
- (b) Write notes analysing the information given about Building Times Limited and recommend whether the increase in credit should be granted.

Use the data available to you in the financial statements and tables of financial indicators to support your comments.

**Task 4**

Ultra Ltd is a potential new customer and the Sales Department have asked for a credit limit of £25,000 to be given to them. Ultra Ltd has supplied the financial information below:

	<b>20-3</b>	<b>20-2</b>
	<i>£000</i>	<i>£000</i>
Sales revenue	995	764
Gross profit	413	413
Profit for the year (after interest and tax)	8	8
Current assets	136	215
Current liabilities (all trade payables)	157	86
Notes:		
Interest deducted	24	15
Tax deducted	–	29
Closing inventories	41	41

- (a) Complete the table below by calculating the key indicators (to two decimal places) for 20-3 and 20-2 for Ultra Ltd.

<b>Ultra Ltd</b>	<b>20-3 Indicator</b>	<b>20-2 Indicator</b>
Gross profit margin %		
Operating profit margin %		
Trade payables payment period in days		
Inventory holding period in days		
Current ratio		
Quick ratio		

- (b) Using the details from the financial information from Ultra Ltd and your answers from (a) complete the following:

Sales revenue has increased by £  or  %, this **is / is not** a strong indicator that the company may be overtrading.

Despite the increase in sales, gross profit has remained the same, this **is / is not** a good sign. The gross profit margin has **increased / decreased**.

The profit from operations has **risen / fallen / remained the same**. **This is not a problem as cash (not profits) pays liabilities / This may be a problem depending on the cash flow of the business / This is a problem because profits are needed to pay liabilities / This is not a problem as the gross profit is sufficient to pay the liabilities.**

The trade payables payment period indicates on average **the terms which suppliers offer to their customers / how long a business takes to pay its suppliers**. In this case it has increased by  days, which may mean that the company **is / is not** struggling to pay its suppliers.

The level of inventory has remained the same **but the holding period has increased which means that inventory may be slow moving / but the holding period has increased which means that inventory may run out / but the holding period has decreased which means that inventory may be slow moving / but the holding period has decreased which means that inventory may run out.**

Both the current and quick ratios have fallen, which strongly indicates **poor liquidity, which is a major concern / poor liquidity, which is not a major concern / stability**.

Based on your answers:

**I recommend that credit be given / I recommend that credit not be given.**

**Task 5**

- (a) A business has a £20,000 debt outstanding on a customer account. The situation is very complex and the case is likely to take at least two or three days. Which County Court process would deal with this type of debt?

(a) Small Claims Track	
(b) Fast Track	
(c) Multi Track	

Tick the **one** correct option.

- (b) A 'retention of title' clause in a sales contract for goods supplied will be invalidated if:

(a) The buyer mixes the goods with other material in a manufacturing process	
(b) The goods supplied cannot readily be identified as belonging to the seller	
(c) The goods are in transit at the time the claim is made	

Tick the **two** correct options.

- (c) Hobbs Ltd pays £750 per month to Dune Insurance for key account insurance.

During the year Hobbs Ltd had irrecoverable debts of £10,700, 60% of which were covered by the insurance.

Dune Insurance is offering:

Insolvency services	
Non-recourse factoring	
Invoice discounting	
Credit insurance	

The overall cost to Hobbs Ltd for the year is: £

- (d) The normal recommended order of actions taken by a seller to collect money due from a buyer is:

(a) Invoice, credit note, telephone call, statement, solicitor's letter	
(b) Invoice, credit note, telephone call, solicitor's letter, reminder letter	
(c) Invoice, statement, reminder letter, telephone call, solicitor's letter	

Tick the **one** appropriate option.

- (e) A court order is sent to a bank which holds money belonging to a business which owes an unpaid debt. The order requires the bank to pay the money to the business which is owed the unpaid debt. This type of court order is known as:

(a) A bankruptcy order	
(b) A garnishee order	
(c) A standing order	

Tick the **one** correct option.

- (f) A company that fails to repay a trade debt is said to:

(a) Be in breach of contract	
(b) Have created a voidable contract	
(c) Be in liquidation	

Tick the **one** correct option.

**Task 6**

- (a) Cleo Ltd has previously paid VAT (at 20%) on the following invoices, which are all eight months old and have been written off in the accounts of Cleo Ltd:

Customer	Total invoiced to customer £	Credit insured (75%)
Career Group Plc	12,000	Y
Highland and Co	16,800	N
Singh Ltd	6,240	Y
Tennis Times Ltd	7,080	Y

Select the correct answer:

(a) The VAT which can be claimed back from HMRC is £7,020 and the amount that can be claimed from the insurers is £15,825	
(b) The VAT which can be claimed back from HMRC is £7,020 and the amount that can be claimed from the insurers is £26,910	
(c) The VAT which can be claimed back from HMRC is £8,424 and the amount that can be claimed from the insurers is £15,825	
(d) The VAT which can be claimed back from HMRC is £8,424 and the amount that can be claimed from the insurers is £26,910	

- (b) Grundy Ltd's standard credit terms of payment are 30 days. It offers to customers a prompt payment discount of 3.5% for payment within 10 days of invoice.

The simple annual interest rate of the discount is:  per cent.

The compound annual interest rate of the discount is:  per cent.

Calculations should be to two decimal places.

(c) Select True or False about the following statements relating to liquidity management.

	True	False
(a) Liquidity management means paying suppliers as soon as invoices are received		
(b) Liquidity management means paying suppliers when the invoices are due		
(c) Liquidity management means putting procedures in place to ensure that customers pay within the correct time limits		
(d) Liquidity management means instigating court procedures as soon as a debt is overdue		

(d) Below is the expected sales revenue for Turner Ltd for the next three months:

**Sales revenue**

£

Month 1	110,000
Month 2	120,000
Month 3	100,000

Turner Ltd predicts that 95% of the sales for month 1 will be paid and 90% of the sales for months 2 and 3 will be paid. The remaining amounts are predicted to be irrecoverable and will be written off.

Calculate the amounts that Turner Ltd will receive:

£

(e) Which of the following can help to improve liquidity management:

- 1 Factoring
- 2 Gearing
- 3 Credit insurance
- 4 Invoice discounting

Select the correct answer:

(a) 1 and 2 only	
(b) 1, 2 and 3 only	
(c) 1, 3 and 4 only	
(d) 1, 2, 3 and 4	

(f) Deborah has received a letter from the liquidator of Hard Up Ltd. Deborah is owed £1,700 plus VAT at 20% by Hard Up Ltd. The letter states that all unsecured creditors of Hard Up Ltd will receive a dividend of 15.6p in the pound.

Calculate the amount that Deborah should receive:

£

**Task 7**

Teapot Treats Ltd supplies goods to the manufacturing sector. Standard terms and conditions printed on the back of all sales invoices include a retention of title clause and a statement that problems with goods must be notified to Teapot Treats Ltd within 48 hours of delivery. Goods returned are subject to a restocking fee of 5%.

Current credit control procedures once the credit limit has been agreed:

- 1 An order for goods is received by email, fax or phone (all phone calls are recorded).
- 2 Goods are delivered and a goods received note is signed by the customer.
- 3 The goods received notes are kept in a file in the accounts office.
- 4 An invoice will be issued on the day after delivery on 30 day terms.
- 5 Statements of account are sent out on the 2nd of each month.
- 6 An aged analysis of trade receivables is produced monthly.
- 7 A reminder letter is made when the debt is 7 days overdue.
- 8 When a debt is 14 days overdue a phone call is made.
- 9 When a debt is 28 days overdue the account will be put on stop.
- 10 The debt will either be placed in the hands of a debt collection company or legal proceedings could be instigated if the customer does not respond to calls or letters.
- 11 The business is credit insured, however insurance is only given for customers once they have a history of trade with the business of at least 12 months and have successfully paid for at least two invoiced amounts. Only 75% of the value of the debt is insured. VAT will be reclaimed from HMRC.

You are covering for the Credit Control Assistant and you have access to the notes he has prepared.

The date today is 30 November 20-3.

**(a) Tricky Ltd**

Tricky Ltd placed an order on 3 November 20-3 which was delivered on 5 November 20-3 and invoiced on 8 November 20-3. On 9 November 20-3 Tricky Ltd telephoned to say that the goods were not to their customers' tastes.

The action needed is:

(a) The account is not overdue so no action is required	
(b) A credit note should be issued for the value of the goods less the restocking fee	
(c) A claim should be made to the credit insurer	
(d) Tricky Ltd should be contacted to state that the problem was not notified within 48 hours of delivery	

**Meringue Ltd**

Meringue Ltd placed an order on 18 November 20-3 which was delivered on 19 November 20-3 and invoiced on 21 November 20-3. On 23 November 20-3 Meringue Ltd telephoned to say that the invoice was for the incorrect product.

The action needed is:

(a) The account is not overdue so no action is required	
(b) A credit note should be issued for the value of the goods less the restocking fee and the correct invoice issued	
(c) A credit note should be issued for the value of the goods and the correct invoice issued	
(d) Meringue Ltd should be contacted to state that the problem was not notified within 48 hours of delivery	

**Chocolate Supplies Ltd**

Chocolate Supplies Ltd is an erratic payer, but always pays eventually after reminders. There is a balance on the account of £525 which relates to one invoice dated 15 October 20-3.

The action needed is:

(a) The account should be put on stop	
(b) The account is not overdue so no action is required	
(c) The amount is small and should be written off	
(d) Chocolate Supplies Ltd should be telephoned and an immediate payment requested	

**Sugar Pie Ltd**

Sugar Pie Ltd owes a balance of £864 excluding VAT. The account is on stop. Sugar Pie Ltd is no longer trading. The account is credit insured.

Complete the sentence below:

Contact the credit insurer to make a claim for £  , make a provision for £  and claim VAT of £  from HMRC.

- (b) Review the information provided for each of the two customers below and prepare an action plan for collecting the outstanding amounts due to Teapot Treats Ltd. Your action plan should include a summary of the options available for the company to pursue and recommendations for provisions or write off of irrecoverable debts where appropriate.

**Thomas Ltd**

The sales ledger of Thomas Ltd shows a balance outstanding of £5,700, this relates to several invoices from August 20-3. Thomas Ltd has been paying £200 per week.

**Tasty Desserts Ltd**

Tasty Desserts Ltd owes £16,800 from an invoice dated 3 September 20-3, they have said they will pay as long as the invoice is reissued to Tasty Pies Ltd and dated 1 November 20-3.