Contingent Liability Risk Management

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Friday, 22nd September 2017

Theme

The Role of Trade Credit as an alternative Financing Solutions in the Post Capping Era.

Cost and risk characteristics of many financing options have changed, requiring re-evaluation of existing Debt Management Strategies.

RISK

RISK


A LESSON FROM WALL STREET...
DON'T PUT ALL YOUR EGGS IN ONE BASKET!
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Definition: Contingent liability

- **Contingent Liability**: A contingent liability is a potential liability that may occur, depending on the outcome of an uncertain future event. A contingent liability is recorded in the accounting records if the contingency is probable and the amount of the liability can be reasonably estimated.

Bad Debt as a Contingent Liability

- Credit services given to clients who are not creditworthy, results to debtors that qualify to be listed as contingent liabilities:-

Credit worthiness check: 5Cs

1. Capacity: (FS)-No money, cant pay, wont pay. Check liquidity and profitability.
2. Capital: gearing ratios, ownership of the land to be developed, deposit to mortgage.
3. Collateral: Fall-back position for Asset Financing, car loan, mortgage, electronics, guarantors etc.
4. Character: Credit History, media, CRB
5. Conditions: What is the interest rate, any penalties, What is the loan meant for, development, business, Luxury.

Definition: Risk Management

Risk management is the identification, assessment, and prioritization of risk, followed by coordinated and economical application of resources to avoid, share, minimize, monitor, and control the probability and/or impact of unfortunate events or to maximize the realization of opportunities.

Credit Risk Management

- Risk-taking is an integral part of management in an enterprise. If a business decides to sell only on cash basis, it is likely to have less sales and profit margins However, Certain risks should not be taken even if there is a likelihood of major gains or profits.
- If likelihood to default is high and the impact is also high, then avoid the risk by declining the request for credit.

Credit Risk Management Cont

- If a bank decides to only lend against deposits, its margins are bound to be very slender. Transactions with sizeable risk content should be transferred to professional risk institutions like Insurance and bank guarantees. Share The Risk
- Credit is an important component for every business that wants to be successful. Extending goods and services on credit comes with a risk which should be properly managed. Mitigate/Minimize
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Credit Risk Management Cont

- One way of managing credit Risk is to spread it by lending to various types of borrowers, that is, to individuals, private businesses, Government corporations, different regions different age groups
- The main tool used to manage credit risks is however the Credit Policy and Procedure Manual.
- Whether to use a liberal or a conservative Credit policy will depend on the type of business/industry, the level of business growth, the kind of clients and the risk they impose.

Importance of Credit Policy and Procedure Manuals.

- A credit Policy sets standards of operations and has therefore to be endorsed at the highest level.
- Establishment of an appropriate credit risk environment/culture.
- Operating under sound and independent credit approval process
- Ensuring adequate controls over credit risk
- Maintaining appropriate credit administration, measurement and monitoring processes.

Importance of Credit Policy and Procedure Manuals cntd.

- Leading to objectivity in credit decisions, avoiding double standards and protecting the credit decision maker.
- Instilling risk return discipline at all times.
- Acting as the reference guide applicable to the majority of issues that the credit department will face.
- A training/Induction tool for new credit officers.

Interactive Session