

ACCOUNTING AND FINANCE

LEVE-II

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Introduction of the module

This module covers the knowledge, skills and attitudes required to understand basic knowledge and awareness of understanding debt and consumer credit as they apply to account transaction of debit, Criteria of debt and critical understanding the behavior of debt.

This module covers

- Identifying and discussing the role of credit in society
- Identifying and discussing the range of credit options available
- Identifying costs of using credit
- discussing effective use of consumer credit
- personal credit rating and history

Learning objectives of the Module:

At the end of this session, the students will be able to:

- Identify and discuss the role of credit in society
- Identifying and discussing the range of credit options available

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- Identifying costs of using credit
- discussing effective use of consumer credit
- personal credit rating and history

Module Instruction

For effective use this modules trainees are expected to follow the following module

1. Read the information written in each unit
2. Accomplish the Self-checks at the end of each unit
- 3 .Perform Operation Sheets which were provided at the end of units
4. Read the identified references book for Examples and exercise

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UNIT ONE: Identifying and assessing the role of credit in society

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Discussing concepts and terminology of Credit
- Identifying historical and current role of consumer credit
- Discussing advantages and disadvantages of credit
- Discussing the impact of consumer debt on the national economy

This unit will also assist you to customer attain the stated objective. Specifically, upon completion of this learning guide line, you will be able to:

- Discuss concepts and terminology of Credit
- Identify historical and current role of consumer credit
- Discuss advantages and disadvantages of credit
- Discuss the impact of consumer debt on the national economy

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1.1 discussing concepts and terminology of Credit

1.1.1 Definition of credit

Credit is part of your financial power. It helps you to get the things you need now, like a loan for a car or a credit card, based on your promise to pay later. Working to improve your credit helps ensure you'll qualify for loans when you need them. Credit refers to your borrowing capacity. It's based on your history of paying back your debts, and it defines how much you are able to borrow cash or access goods and services.

For example, good credit signals to lenders that you are "creditworthy" or likely to be able to repay money you borrow. It instills confidence in lenders that they will get the loan principal plus any interest back from you, which makes you more likely to get approved for new credit (for example, a loan) with favorable terms, such as low interest rates or higher limits.

Credit is something you build up over time as you borrow money and pay it back. These records are tracked by the three major credit bureaus and available to lenders in the form of your credit report and credit score

1.1.2 Reason of credit for business

The reason of credit for business include in the following ways.

- A. To increase of capital for business or increase of investment
- B. To receive tax advantage of business
- C. To expand of business
- D. To increase of capital for business

1.1.3 Criteria of credit for business

The criteria of credit for business are as follows in accounting treatment (5cs).

A. Character

Character refers to your credit history, or how you've managed debt in the past. You start developing that credit history when you take out credit cards and loans. Those lenders may report your account history to credit bureaus, which capture it in documents called credit reports.

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Lenders use credit scores and your credit reports to determine whether you qualify for a loan or credit. But each lender has different criteria for assessing your credit history. When pulling your credit reports, they'll look at the details of your payment history and how much you've borrowed. They'll also check for things like late payments, foreclosures and bankruptcies.

B. Capacity

Your capacity refers to your ability to repay loans. Lenders can check your capacity by looking at how much debt you have and comparing it to how much income you earn. This is known as your debt-to-income (DTI) ratio. You can calculate your own DTI ratio by adding up all your monthly debt payments and dividing that by your pre-taxed monthly income. Then multiply that number by 100.

C. Capital

Capital includes your savings, investments and assets that you are willing to put toward your loan. One example is the down payment to buy a home. Typically, the larger the down payment, the better your interest rate and loan terms. That's because down payments can show the lender your level of seriousness and ability to pay back the loan.

Your household income is often the primary source for paying off your loans. But if anything unexpected happens that could affect your ability to pay them off, like a job loss, capital provides the lender with additional security.

D. Collateral

Collateral is something you can provide as security, typically for a secured loan or secured credit card. If you can't make payments, the lender or credit card issuer can take your collateral. Providing collateral may help you secure a loan or credit card if you don't qualify based on your creditworthiness. The asset you provide as collateral, and whether you need it, depend on the type of credit you're applying for. For auto loans, the car you buy usually acts as collateral. On a secured credit card, you'd put down a cash deposit to open the account.

Secured loans and secured credit cards are considered less risky for lenders, and they could be useful for people who are establishing, building or rebuilding their credit.

E. Conditions

Conditions include other information that helps determine whether you qualify for credit and the terms

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you receive. For instance, lenders may consider these factors before lending you money:

1.1.4 Factor affecting credit

The factor that affecting credit is as follows based on the accounting treatment.

A. Payment history

Your payment history is one of the most important credit scoring factors and can have the biggest impact on your scores.

Having a long history of on-time payments is best for your credit scores, while missing a payment could hurt them.

B. Credit usage

Credit usage is also an important factor, and it's one of the few that you may be able to quickly change to improve (or hurt) your credit health.

C. Length of credit history

Having experience with different types of credit, like revolving credit card accounts and installment student loans, may help improve your credit health.

Since your credit mix is a minor factor, you probably shouldn't take out a loan and pay interest just to add to your credit mix. But if you've only ever had installment loans, you may want to open a credit card and use it for minor expenses that you can afford to pay off each month.

D. Recent credit

Creditors may review your credit reports and scores when you apply to open a new line of credit. A record of this, known as a credit inquiry, can stay on your credit reports for up to two years.

1.1.5 Source of consumer credit

We all have short-term or long-term needs for money or credit. You'll want to familiarize yourself with your options when your needs for credit arises.

A. Commercial Banks

Commercial banks make loans to borrowers who have the capacity to repay them. Loans are the sale of the use of money by those who have it (banks) to those who want it (borrowers) and are willing to pay a price (interest) for it. Banks make several types of loans, including consumer loans, housing loans and

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credit card loans.

Consumer loans are for installment purchases, repaid with interest on a monthly basis. The bulk of consumer loans are for cars, boats, furniture and other expensive durable goods.

B. Savings and Loan Associations (S&Ls)

As depicted in Wonderful Life, savings and loan associations used to specialize in long-term mortgage loans on houses and other real estate. Today, S&Ls offer personal installment loans, home improvement loans, second mortgages, education loans and loans secured by savings accounts.

S&Ls lend to creditworthy people, and usually, collateral may be required. The loan rates on S&Ls vary depending on the amount borrowed, the payment period, and the collateral. The interest charges of S&Ls are generally lower than those of some other types of lenders because S&Ls lend depositors' money, which is a relatively inexpensive source of funds.

C. Credit Unions (CUs)

Credit Unions are nonprofit cooperatives organized to serve people who have some type of common bond. The nonprofit status and lower costs of credit unions usually allow them to provide better terms on loans and savings than commercial institutions. The costs of the credit union may be lower because sponsoring firms provide staff and office space, and because some firms agree to deduct loan payments and savings installments from members' paychecks and apply them to credit union accounts.

D. Consumer Finance Companies (CFCs)

Consumer finance companies specialize in personal installment loans and second mortgages. Consumers without an established credit history can often borrow from CFCs without collateral. CFCs are often willing to lend money to consumers who are having difficulty in obtaining credit somewhere else, but because the risk is higher, so is the interest rate.

E. Life Insurance Companies

Insurance companies will usually allow you to borrow up to 80 percent of the accumulated cash value of a whole life (or straight life) insurance policy. Loans against some policies do not have to be repaid, but the loan balance remaining upon your death is subtracted from the amount your beneficiaries receive.

Repayment of at least the interest portion is important, as compounding interest works against you. Life

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insurance companies charge lower interest rates than some other lenders because they take no risks and pay no collections costs. The loans are secured by the cash value of the policy.

1.2 Identifying historical and current role of consumer credit

1.2.1 Definition of Consumer credit

Consumer credit is money that consumers can borrow to pay for goods or services. Access to credit allows consumers to make purchases today and then pay for them over a period of time. Banks, financial institutions, and businesses make credit available to consumers.

Examples of consumer credit

- Credit cards
- Student loans
- Mortgages
- Auto loans

Federal and state laws govern consumer credit to protect consumers from unfair lending practices and prevent businesses from discriminating against them based on non-financial factors.

1.2.2 Types of Consumer Credit

Consumer credit is offered to individuals through retailers or through larger institutions like credit card companies and banks. It covers any type of personal debt allowing a shopper to make an immediate purchase and pay the cost off over time, usually with interest. There are two main types of consumer credit:

Consumer credit is offered to individuals through retailers or through larger institutions like credit card companies and banks. It covers any type of personal debt allowing a shopper to make an immediate purchase and pay the cost off over time, usually with interest. There are two main types of consumer credit:

1. **Installment credit:** The customer spreads the cost of a specific purchase over time. Payments are typically made weekly or monthly in equal installments, with low interest rates. In some cases, like Buy Now Pay Later (BNPL) plans, repayment plans are interest-free as the loan is paid off quickly.

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Installment credit is often secured because the purchased item (like a house or car) usually serves as collateral in case of default.

2. **Revolving credit:** This type of consumer credit includes credit cards, which don't need to be used for a specific purchase. Instead, the consumer has access to a revolving line of credit up to a maximum limit. This is refreshed as the borrower pays off their debts with minimum monthly payments. Because the loan is unsecured with collateral, interest rates are higher.

1.2.3 Current role of consumer credit

The role becomes an indispensable part of our lives, with its ease of use and convenient pay-back options. The discounts, offers, and deals that a credit card offers are unmatched by any other financial products and spell a bonanza for the wise user. However, credit cards can become debt traps if not used correctly, or if you spend more than you can repay when the bill comes around.

It enabling approved applicants the ability to purchase items (goods and/or services) where the cost of the item exceeds current savings available.

1.3. Discussing of advantages and disadvantages of credit

1.3.1 Advantage of credit

The roles of consumer credit are as follows in the following ways.

- A. **Emergency preparedness:** A revolving line of credit comes in handy if you face unexpected expenses like a broken-down car or appliance.
- B. **Convenience:** There's no need to carry around large wads of cash when shopping.
- C. **Flexibility:** Rather than saving for years to cover the cost of each purchase in full, you can choose payment plans that give access to products and services immediately. Consumers can also avoid putting off expenses that could grow more costly over time, like home repairs.
- D. **Customer rewards:** Many credit card companies and retailers offer special discounts, perks, and rewards for purchasing large items on credit. Additional benefits include cash-back offers and frequent flier miles.

1.3.2 Disadvantage of Credit for society

The disadvantages of consumer credit are as follows.

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- may increase cost of items purchased due to interest accrued
- usually attracts other fees such as account servicing fees
- can lead to compulsive buying habits
- Creates a false sense of wealth.

1.4 Discussing the impact of Consumer Debt on the National Economy

The personal effect of struggling to repay debt can be far reaching.

A. Lack of financial awareness can lead to stress, depression, anxiety, mental health problems, relationship breakdown and even suicide.

B. The financial cost of debt is not only on an individual level, but there is also a cost to society in general.

People who have had homes repossessed need to be re-housed, generally by the local Council. Those who seek legal aid due to debt issues also incur a cost to the taxpayer.

- C. break of customer with institution with when occurrence of default risk
- D. decrease the country economic development and infrastructure
- E. decrease the contrary growth domestic product

Self-check-one

Part I: True or False Questions

Instruction Read the following sentences carefully and writes TRUE if the statement is correct or FALSE if the statement is not correct on the space provided before each question number:

1. Many credit card companies and retailers offer special discounts,
2. The customer spreads the cost of a specific purchase over time.
3. Consumer credit is money that consumers can borrow to pay for goods or services
4. break of customer with institution with when occurrence of default risk
5. Collateral is something you can provide as security, typically for a secured loan or secured credit card.

Part II: Short answer

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1. Write the definition of credit
2. Why people credit business
3. What are the role of credit
4. Write the disadvantage of credit?

Answer sheet for writing essay

1. _____

2. _____

3. _____

4. _____

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UNIT TWO: IDENTIFY AND DISCUSS THE RANGE OF CREDIT OPTIONS

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Comparing the types of credit facilities used by business and individual
- Discussing the differences between unsecured and secured loans
- Explaining implications of default on secured loans

This unit will also assist you to customer attain the stated objective. Specifically, upon completion of this learning guide line, you will be able to:

- Compare the types of credit facilities used by business and individual
- Discuss the differences between unsecured and secured loans
- Explain implications of default on secured loans

2.1 Comparing types of credit facilities used by business and individual

2.1.1 Credit Facilities

A credit facility is a type of financing businesses use to finance ongoing capital needs. Credit facilities

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can be revolving, allowing businesses to draw from a line of credit on an as-needed basis, or a conventional term loan. A credit facility is a type of financing businesses use to finance ongoing capital needs. Credit facilities can be revolving, allowing businesses to draw from a line of credit on an as-needed basis, or a conventional term loan. Credit facilities are one of the most common and mainstream financing solutions for businesses, so it can be worthwhile to understand how they work and their requirements. Alternative financial products are included as well. A credit facility is a funding solution that businesses can use to finance various expenses during a predetermined term. Credit facilities can be revolving, which means the borrower can withdraw some or all of a predetermined amount until the end of the term. Credit facilities can function as conventional term loans as well.

2.1.2 Types of Credit facility

There are three main types of credit: installment credit, revolving credit, and open credit. Each of these is borrowed and repaid with a different structure.

A. Installment credit: Installment credit is a type of loan in which you borrow one lump sum and repay it with interest in regular fixed payments, or installments, over a certain amount of time. Once an installment credit loan is paid off in its entirety, the account is considered closed. Examples of installment credit accounts include mortgages, auto loans, personal loans, and student loans.

B. Revolving credit: Revolving credit accounts allow you to repeatedly borrow and repay amounts from a single line of credit up to a maximum limit. You're in control over how much you borrow (and ultimately need to pay back). Interest is charged on any balance remaining after each statement's due date, so it's possible to avoid ever paying interest if you pay your balance in full each month. As long as you make all your payments on time, the account will remain open indefinitely until you choose to close it. Credit cards are the most common type of revolving credit, but HELOC (home equity line of credit) is another example.

C. Open credit: Open credit is unique in that monthly payments vary, and balances are due in full at the end of each billing cycle. Your electricity bill is a great example of open credit; the amount due depends on how much electricity you used that month. You're expected to pay the entire bill within a certain number of days after receiving it. Many utility bills — such as gas, electricity, water, cable, and cell service — are considered open credit accounts.

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Consumer credit facilities:

Fixed: the types of credit facility that personal for real interest rate by considering time value of money.

- personal loans

Many consumers opt for a **personal loan** at some stage, whether it's to cover the likes of a new car, a wedding or a family getaway, or to consolidate debt into a single payment. However, it's essential that anyone thinking about taking out a loan is well informed. There are many loans on the market designed for various purposes and people in different circumstances, and understanding how they work is the first step in borrowing responsibility.

A loan is a financial contract in which one party – the lender – agrees to give another party – the borrower – a specific amount of money, to be paid back monthly over a set period of time. There will also be interest payments at an agreed rate, and sometimes additional charges for the administration of the loan. The terms and conditions of a loan will vary from lender to lender, but will be specified in the contract. The borrower must adhere to the repayment terms stated in the contract – especially repayment dates and interest rates.

Loans come in all shapes and sizes, but, overall, there are two main types: secured and unsecured loans.

Example of personal loan

DW company Wants to establish a business enterprise with an initial capital of birr 100,000. The investor has 60,000 birr deposit and borrows the remaining amount from Dashin bank with an interest rate of 10% that will be repaid after a year.

Calculates the cash and interest to be collected from Hyrax plc. After a year.

Answer

The borrowed amount that is cash that will be collected after a year

$$\text{Borrow} = 100,000 - 60,000 = 40,000$$

$$\text{Interest} = 40,000 \times 10\% = 4000$$

$$\text{Total amount} = 40,000 + 4,000 = 44,000$$

Example two: The accounting records of Xyz shows the following accounts as of January 1, 2012.

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Prepaid rent 40,000, Supplies, 6,000 Prepaid insurance, 2,000 Equipment .80, 000, Building 70, 000 A/P .12, 000 N/P. 9,000. Assume that the company wants to introduce a new product with the required capital of birr 360,000. The company applied for credit at Addis international bank Share Company in order to finance the required capital. The bank accepted application and agreed with 12% interest semiannually with equal installment semi-annually for five years. The bank charged birr 2500 for facilitating the loan. The company estimates a profit of Br 90,000.

- calculates the amount of borrowing financed by Addis international bank?
- Determine the total expense related to the credit?
- record the amount of borrowed on the book of the company?
- Record the final disbursement of principal and interest on the books of the company?
- Calculates the estimated rate of return?

Answer

Task A. from the above mentioned data we can calculate assets and liability of DH PLC.

Asset = prepaid rent + supplies + prepaid insurance + equipment + Building

$$A = 30,000 + 6,000 + 2,000 + 80,000 + 70,000$$

$$A = 198,000 \text{ birr}$$

Liability = Account payable + Note payable

$$L = 12,000 + 9,000 = 21,000 \text{ birr}$$

From simple accounting equation Asset = Liability + Capital

We can find the amount of capital then the formula of capital as follow

$$\text{Capital} = \text{Total Asset} - \text{Total Liability}$$

$$= 198,000 - 21,000 = 177,000 \text{ birr}$$

So the amount of borrowing financed by AIB = $360,000 - 177,000 = 203,000$ Birr

Task 2.2 required total expense related to the credit

Given

Borrowed amount = 203,000 birr Interest rate = 12%

Time = 5 years semi-annually = $5 \times 2 = 10$ service charge = 2,500

Installment paid amount = $203,000/10 = 20,300$

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1st installment interest = $203,00 \times 12\% \times \frac{1}{2} = 12,180$

Outstanding loan balance = $203,000 - 20,300 = 182,700$

2nd installment interest = $182,700 \times 12\% \times \frac{1}{2} = 10,962$

Outstanding loan balance = $182,700 - 20,300 = 162,400$

Unless time is restricted we should continue calculating in the above ways 10 times and the total sum amount of interest (+) service charge is our answer.

C. Cash----- 203,000

 Note payable----- 203,000

D. Note payable -----203,000

 Cash -----203,000

Interest expenses----- 22,002

 Cash -----22,002

E. Rate of return on investment = Estimated profit /required capital x 100

= $90,000/360,000 \times 100 = 25\%$

- leases including mobile phones, cars, business premises, office equipment including personal computers
- hire purchase

A revolving loan facility is a line of credit often extended to businesses that a borrower can draw from and pay back multiple times. It differs from a term loan in that it comes with a maximum credit amount, and borrowers can repeatedly withdraw money and repay the loan.

A revolving loan facility is a line of credit often extended to businesses that a borrower can draw from and pay back multiple times. It differs from a term loan in that it comes with a maximum credit amount, and borrowers can repeatedly withdraw money and repay the loan.

This flexible form of financing allows borrowers to access funds as needed. That makes a revolving loan facility a good option for businesses that have ongoing working capital needs. Learn more about how revolving loan facilities.

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A revolving loan facility is a variable line of credit generally used by businesses. It's a flexible form of credit that allows borrowers to withdraw funds on an as-needed basis. A revolving loan facility may have multiple terms and limits within its lifespan, and may cap the number of outstanding balances you have at any one time. Because of this, a revolving loan facility may come with higher interest rates than what you'd receive on a fixed-rate loan.

A revolving loan facility is a popular option for businesses because it can help with cash flow problems. The company will often draw funds to cover a working capital need. It's beneficial during times of the year when businesses experience inconsistent revenue.

For example, a business might use a revolving loan facility to cover payroll or other operating expenses during a slow season. When the company receives payment from its client or customers, it can repay the loan.

Types of Revolving Credit

The term revolving credit refers to a type of account that allows a customer to borrow and repay money on a repeated basis. The most common examples of revolving credit are as follows.

A. Credit cards: Is perhaps the most recognizable form of revolving credit. Both consumers and businesses may qualify for credit card accounts. In general, better credit scores lead to better interest rates and borrowing terms.

B. business line of credit is a type of revolving credit that's available for business purposes. This borrowing option can be secured or unsecured, with varying credit limits, loan terms, and interest rates based on the creditworthiness of the business and other factors.

C. commercial building equity line of credit is a type of financing where the borrower receives a line of credit based on the amount of equity that's available in their commercial property. The property serves as collateral.

D. home equity line of credit or HELOC is another type of revolving credit in which a borrower's property serves as collateral to secure the account. However, in this scenario the borrower is an individual consumer, not a business.

Reason of revolving Line Of Credit

There are numerous reasons your business may want to consider opening a revolving line of credit.

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- Access to a flexible source of funding.
- Working capital on a periodic or seasonal basis.
- A non-specific amount of funding for an upcoming project or investment.
- The ability to borrow money quickly in an emergency.
- A way to build better business credit history and credit scores for the future



Figure 2.1: Revolving Credit Facilities

The lender may calculate your interest based on a whole year and display it as a percentage. From there, the revolving line of credit interest formula is the principal balance multiplied by the interest rate, multiplied by the number of days in a given month. This number is then divided by 365 to determine the interest you'll pay on your revolving line of credit.

Revolving Line of Credit Interest Formula

(Principal Balance X Interest Rate X Days In Month) / 365

What is installment debt?

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Installment debt, or term debt, is a loan you take out and pay back using a payment schedule. Each payment you make goes toward the original loan plus interest. There might be additional charges, like a setup fee and processing fees.

With each payment you make, the balance decreases. After using the loan amount, you cannot continue to borrow more money, which is different than revolving debt.

There is a set length of the loan. Your lender tells you when the loan term ends. Installment debt is predictable because your month-to-month payment liability typically does not change.

Example ABC trading plc. Is a business enterprise engaged on rental of construction machineries The Company import different kinds of construction machineries in order to rent thorough a bay bank. In the year 2013 muffin engineering plc. Imported roller machine at a cost of 5,000,000 birr, 60% of the cost of machine is covered by credit facility from Abay bank. The loan will be repaid within five years at equal installment quarterly at a cost of 12% interest rate, the total service charge and the cost related with credit facility is 2000 for the first year of the loan period and 2500 the second year of the loan period. Assume that the bank interest policy is simple interest rate on outstanding loan and advances.

A. calculate principal repayment and cost of loan related with first year loan period

B. what is the outstanding balance of loan at the end of three year loan periods

Given

Borrowed = 5,000,000 x 60% = 3,000,000

Time = 5 x 4 = 20

Interest rate = 12%

Service charge

1st year = 2000

2nd year = 2500

Solution A.

Installment paid amount = 5,000,000 / 20 = 150,000

First year principal repayment = 150,000 x 4 = 600,000

B. Outstanding balance = 150,000 x 8 = 1,200,000

Revolving credit vs. installment credit

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Determining when to use revolving credit vs. installment credit doesn't have to be difficult. When you need to make smaller purchases on short notice, it's best to use revolving credit. For large expenses, installment debt is the better option.

Interest rates are higher for revolving debt than installment debt. In fact, interest rates for revolving debt can be **15-20%** more than installment debt. Try to pay off revolving debt quickly and stay away from accumulating too much debt.

Table 2.1: difference between installment debt and revolving debt

	Revolving Debt	Installment Debt
Definition	Line of credit you can continue borrowing from as long as you don't surpass limit	Loan you take out and pay back using a payment schedule
Example	Credit card	Car loan
Interest Rate	Higher	Lower
Payment Plan	No	Yes
Type of Purchase	Smaller	Larger
Dangerous Debt Level	Higher	Lower
Future Credit Opportunities	Yes	No

2.1.2 Types of Credit Facilities

A. Short term credit facilities

Short term credit facilities are designed to only last for a while, and can be further divided into the

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following:

Cash credit and overdraft: This type of short term credit facility allows you to withdraw more than the fund present in your deposit account. However, you would also pay interest on the amount you overdrew.

Trade finance: Trade finance is a type of short term credit facility that is generally essential to the efficient cash flow of a company. It could come in different forms including supplier's credit, export credit, letters of credit, and factoring.

B. Long term fixed credit facilities

They design long-term credit facilities to appeal to corporations looking at obtaining long-term loans. The different types include:

Bank loans: This is a very common long term credit facility that comes with a definite tenor and repayment schedule. Also, banks thoroughly assess lenders before giving out a loan to address their credit risk. The lower the better, and a higher chance of you getting loan approval from the bank. You can read more on how you can get a bank loan.

Notes: This is an unsecured credit facility that is mostly raised from private or capital market. Therefore, it is usually only considered when banks are not willing or have reached their lending limit.

Mezzanine debt: This credit facility is only provided by private equity

2.1.3 Credit Facility Work

Credit facilities can operate as a revolving line of credit—the business that gets the line of credit withdraws up to a certain limit when the situation demands it—but this is not always the case. A credit facility can also function as a term loan, where the funds are disbursed in a single advance, and amounts repaid can't be re borrowed.

2.2 Discussing the differences between unsecured and secured loans

2.2.1 Secured loans

A secured loan, you need collateral. Just as a house is held as collateral in the case of a mortgage loan and auto for an auto loan, you need some type of collateral for a secured personal loan. Your collateral might be money in a traditional savings or credit union share account, share certificate or CD. If you are

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approved for a secured loan, a lender will put a lien on an asset until the loan is paid off. Secured personal loans typically have lower interest rates than unsecured loans. Makes sense, right? A lender is taking a bigger risk with an unsecured personal loan, so it seems logical that the interest rate would be a bit higher on a riskier loan. As with any type of loan, your credit score and payment history also come into play when qualifying for a lower interest rate.

Secured personal loans may have a higher borrowing limit or longer repayment terms than unsecured personal loans. Again, this is dependent on the lender and also the collateral used for the loan.

Secured debts are tied to an asset that's considered collateral for the loan. Lenders place a lien on the asset, giving them the right to take the asset if you fall behind on your payments. If the Secured debts are tied to an asset that's considered collateral for the loan. Lenders place a lien on the asset, giving them the right to take the asset if you fall behind on your payments. If the lender has to take your asset because of you've become delinquent, the asset will be sold. Lender has to take your asset because of you've become delinquent, the asset will be sold.

2.2.2 Unsecured loans

Unsecured loans attract higher interest rates due to increased risk to the lending institution

With unsecured loans, lenders don't have rights to any collateral for the loan. If you fall behind on your payments, they don't have the right to take any of your assets. However, the lender may take other actions to get you to pay. For example, they will hire a loan collector to coax you to pay the loan. If that doesn't work, the lender may sue you and ask the court to garnish your wages, take an asset, or put a lien on another your assets until you've paid your loan. They'll also report the delinquent status to the credit bureaus so it can be reflected on your credit report.

Credit card loan is the most widely-held unsecured loan.

Other unsecured loans include student loans, payday loans, medical bills, and court-ordered child support. Unsecured loans attract higher interest rates due to increased risk to the lending institution

2.3 Implications of default on secured loans

Breaching a loan contract comes with consequences. Defaulting sends a red flag to other financial entities that you are not a reliable borrower, and may not be trustworthy in other aspects as well.

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Some lenders report delinquencies if you're late on a bill. For the first 30 days after a payment is due, you're probably in the clear, but missed payments that lead to default will be reported to credit bureaus, resulting in lower credit scores.

A. Low credit scores can impact several areas of your life. You might have a harder time renting, finding a job, signing up for utilities and mobile phone service, and buying insurance.

B. Increased Costs

Defaulting can also increase your debt. Late payment fees, penalties, and legal costs might .

In fact, considering the effects of compound interest, outstanding debt grows quickly. When you miss payments, your monthly interest charges are added to the principal balance of the loan; future interest is then charged on this greater balance, which can quickly snowball.

Certain events, conditions, or circumstances may be considered a breach of contract and, therefore, an event of debt default. Events of default include, but are not limited to:

- Non-payment or late payment of interest and/or principal
- Covenant breaches
- Changes in ownership or control

Self-Test two

Part I: Matching

Instruction: match column A with column B in real appropriate instructions.

A	B.
1. Implications of default risk	A. higher risk
2. Secured loans	B. collateral
3. Unsecured loan	C. unsecured
4. Types of credit facility	D. installment sale
5. Default risk	E. Credit risk

Part II: short answer

1. write the types of credit facility
2. what are consequence of default risk

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3. Write the major Principal advantage of secured loan?

Operational sheet 1

1. Muffin engineering plc. Is a business enterprise engaged on rental of construction machineries The Company import different kinds of construction machineries in order to rent thorough a bay bank. In the year 2013 muffin engineering plc. Imported roller machine at a cost of 5,000,000 birr, 60% of the cost of machine is covered by credit facility from Abay bank. The loan will be repaid within five years at equal installment quarterly at a cost of 12% interest rate, the total service charge and the cost related with credit facility is 2000 for the first year of the loan period and 2500 the second year of the loan period. Assume that the bank interest policy is simple interest rate on outstanding loan and advances.

A. calculate principal repayment and cost of loan related with first year loan period

B. what is the outstanding balance of loan at the end of three year loan periods

2. The accounting records of ABC shows the following accounts as of January 1, 2015. Cah 80,000, Supplies, 16,000 Prepaid insurance, 4,000 Equipment .80, 000, Building 70, 000 A/P .22, 000 N/P. 19,000. Assume that the company wants to introduce a new product with the required capital of birr 360,000. The company applied for credit at Addis international bank Share Company in order to finance the required capital. The bank accepted application and agreed with 12% interest semiannually with equal installment semi-annually for five years. The bank charged birr 4,500 for facilitating the loan. The company estimates a profit of Br 80,000.

A. calculates the amount of borrowing financed by Addis international bank?

B. Determine the total expense related to the credit?

C. record the amount of borrowed on the book of the company?

D Record the final disbursement of principal and interest on the books of the company?

E. Calculates the estimated rate of return?

Answer sheet for writing skill

1. _____

2. _____

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3. _____

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UNIT- THREE: DISCUSSING COSTS OF USING CREDIT

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- comparing Fees, costs and profit
- Assessing of non-interest bearing loan (consider Islamic Bank)
- Comparing features fixed versus variable interest rates
- Discussing ways to compare advertised interest rate

This unit will also assist you to customer attain the stated objective. Specifically, upon completion of this learning guide line, you will be able to:

- compare Fees, costs and profit
- Assess of non-interest bearing loan (consider Islamic Bank)
- Compare features fixed versus variable interest rates
- Discuss ways to compare advertised interest rate

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3.1 Comparing Fees, costs and profit

3.1.1 Definition of Fee, Cost and Profit

Fee: charge or payment for professional services a sum paid or charged for a privilege:

An admission fee, charge allowed by law for the service of a public officer.

Fees and costs associated with different credit options may include:

- **Account servicing fees:** the receipt of company due to render of service by business or individual.

For example: individual is deposit of money in bank

- **Credit purchase fees;** is the amount fee that receive by individual for purchase when early payment in of product.

For example; Assume that ABC company purchase inventory 4,000 2/10,n/30 in jan1,2001.

Assume the purchase jan6, 2001.

Credit purchase fee: $4,000 \times 0.02 = 80$

Example: Almaz retail store made two purchase of merchandise from XYZ Whole sale Company.

Almaz purchase \$ 30,000 of merchandise on account on May 4,& on May21, purchase \$ 20,000 of merchandise on cash. The required journal entries are:

May4	Purchase.....\$ 30,000
	Account payable\$ 30,000
	(To record credit purchase)
May 21	Purchase\$ 20,000
	Cash\$ 20,000
	(To record cash purchase)

Purchase Discounts

The arrangements agreed up on by the buyer and the seller as to when payments for merchandise are to be made is called **credit terms**. If payment is required immediately upon delivery, the terms are said to

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be “**cash**” or “**net cash**”. Otherwise, the buyer is allowed a certain amount of time known as the **credit period**, in which to pay. It is usual for the credit period to begin with the date of the sale as shown by the date of the invoice or bill. If payment is due within a stated number of days after the date of the invoice, for example 30 days, the terms are said to be “**net 30 days** “, which may be written as “**n/30.**” If payment is due by the end of the month in which the sale was made, it may be expressed as “**n/eom.**”

As a means of encouraging payment before the end of the credit period, the seller may offer a discount for the early payment of cash. Thus the expression “2/10, n/30” means that, although the credit period is 30 days, the buyer may deduct 2% of the amount of invoice if payment is made within 10 days of the invoice date. Such discounts taken by the buyer for early payment of invoice are called **Purchase discount**. They are recorded by crediting the purchases discounts account and are usually viewed as a deduction from the amount initially recorded as purchases. In this sense, the purchase discounts account is a contra (offsetting) account for purchases.

Example: Assume the credit term for Almaz retail store on May 4 purchases are 2/10, n/30, and if the merchandise is paid on May 14 a 2% discount may be taken .Thus, only \$ 29,400($30,000 - (30,000 \times 0.02)$) must be paid to settle the \$ 30,000 accounts payable. Here, the entry to record the payment of the invoice on May 14 will be:

May 14	A/P..... \$ 30, 000 Cash.....\$ 29,400 Purchase discounts \$ 600
--------	--

(To record the payments after deducting discounts)

From the buyer’s stand point, it is important to take advantage of all available discounts, even though it may be necessary to borrow the money to make the payment. Assume that the May4 purchase of the invoice, with term of 2/10, n/30 is to be paid within the discount period with money borrowed for the remaining 20 days of the credit period. If an annual interest rate of 12% is assumed, the net savings to the buyer is \$ 406.69, determined as follows:

Discount of 2% on \$ 30,000	\$ 600.00
Interest for 20 days at rate of 12% on \$ 29,400	
($29,400 \times 20 / 365 \times 0.12$).....	\$ 193.31

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Saving effected by borrowing\$ 406.69

- **Late payment fees:** is the type of receive fee that receive by individual due to penalize of payment.
- **Loan establishment fees:** - Also called 'application', 'up-front', 'start-up' or 'set-up' fees. An establishment fee is a one-off payment when you start your loan. If you are not charged an establishment fee, you may pay higher on going fees.
- **Withdrawing from a foreign Automatic Teller Machine** (i.e. the ATM of a lending institution other than your owns. This types of payment that receive by company due to receive of service charge of the bank.

When comparing different loans, check the fees so you know exactly how much the loan is going to cost you.

You must be told about any fees or charges before you sign up for a loan. Most credit providers publish fees and charges in their product booklets, on their websites and in their credit contract.

Different credit providers charge different fees. The same fee might also be called different names by different providers.

Cost: A cost is an expenditure required to produce or sell a product or get an asset ready for normal use.

In other words, it's the amount paid to manufacture a product, purchase

Inventory, sell merchandise, or get equipment ready to use in a business process.

Profit is defined as the amount gained by selling a product, which should be more than the cost price of the product. It is the gain amount from any kind of business activity. In short, if the selling price (SP) of the product is more than the cost price (CP) of a product, then it is considered as a gain or profit. It describes the financial benefit obtained if the revenue from the business activity exceeds the taxes, expenses, and so on, which are involved in sustaining Profit Formula if the selling price of the commodity is more than the cost price, then the business has gained its profit. Therefore formula to calculate the profit is;

Profit or Gain = Selling Price – Cost Price

But, when the product is sold at selling price lesser than the cost price, it is termed as loss business activities.

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Fees and costs may be analysed and compared using:

Calculations' tools

- manually, comparing fees and costs drawn from tables and charts provided by financial institutions and analysed using a tool
- online, web-based, calculation tools
- Software applications such as spread sheets.

A claim supported by a note has some advantages over a claim in the form of an account receivable. By signing a note, the debtor recognizes the debt and agrees today it according to the terms listed. A note is therefore a stronger legal claim if there is a court action. A **promissory note** is a written promise to pay a sum of money on demand or at a definite time. It is payable to the order of a person or firm or to the bearer or holder of the note. It is signed by the person or firm that makes the promise. The one to whose order the note is payable is called the **payee**, and the one making the promise is called the **maker**.

Notes have several characteristics that affect how they are recorded and reported in the financial statements. These characteristics are briefly described as follows;

Due Date: The date a note is to be paid is called the **due date** or **maturity date**. The period of time between the issuance date and the due date of a short-term note may be stated in either days or months. When the term of a note is stated in days, the due date is the specified number of days after its issuance. To illustrate, the due date of the 90-day note receivable dated March 16 is determined as follows:

From March (31-16).....15 days
 From April-full month30 days
 From May-full month31 days
 June-remaining14 days
 Total..... 90 days

Therefore, the due date of the note is June 14.

The term of a note may be stated as a certain number of months after the issuance date. In such cases, the due date is determined by counting the number of months from the issuance date. For example, a three-month note dated June 5 would be due on September 5. A two-month note dated July 31 would be due on September 30.

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Interest: A note normally specifies that interest be paid for the period between the issuance date and the due date. The interest rate on notes is normally stated in terms of a year, regardless of the actual period of time involved. The basic formula for computing interest is:

$$\text{Interest} = \text{Face Amount (or Principal)} \times \text{Rate} \times \text{Time}$$

The Time can be expressed in days, month or year.

To illustrate this, a business received a 3-month note with face value of Br20,000. The note earns annual interest rate of 5%. Then the interest is computed as;

$$\text{Interest} = \text{Br}20,000 \times 5\% \times 3/12 = \text{Br}250$$

Had the note be a 90 days note, the interest is computed as;

$$\text{Interest} = \text{Br}20,000 \times 90/360 \times 5\% = \text{Br}250$$

Maturity Value

Maturity Value is the amount that is due at the maturity or due date. It is the sum of the face amount and the interest. For example the maturity value of the above note is Br20,250 (Br20,000+250).

Accounting for Notes Receivable

A business may receive a note when sales are made or to renew the accounts receivable. When businesses receive a note at time of sale, it should be recorded at the face value, i.e.

Notes receivablexxx

Sales.....xxx

A note may be received from a customer to replace an existing account receivable. To illustrate, assume that a 30-day, 12% note dated November 21, 2006, is accepted in settlement of the account of ABC Co., which is past due and has a balance of Br6,000. The entry to record the transaction would be;

Notes Receivable6,000

A/Receivable 6,000

When the note matures, the entry to record the receipt of Br6,060 (Br6,000 principal plus Br60 interest) would be:

Cash6,060

Notes Receivable..... 6,000

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Interest Revenue..... 60

If the maker of a note fails to pay the account on the due date, the note is a dishonored note receivable. When a note is dishonored, the face value of the note plus any interest due is transferred to the accounts receivable account. For example, assume that the Br6,000, 30-day, 12% note received from ABC Co. and recorded on November 21 is dishonored at maturity. The entry to transfer the note and the interest back to the customer's account is as follows:

Accounts Receivable	6,060
Notes Receivable	6,000
Interest revenue.....	60

3.2 Analyzing non-interest bearing loan(consider Islamic bank)

Non-Interest Bearing Loan. Operator agrees to make a non-interest bearing loan to Owner in an amount equal to five hundred thousand dollars (\$500,000) in cash subject to the conditions set forth below.

There are times in life, despite how hard you try to keep on top of things, when unexpected expenses pop up. According to Accounting Tools, a non-interest-bearing loan is a loan or debt on which the borrower is not required to pay interest. With this type of loan, the only amount due is the principal, or actual amount borrowed, as long as the borrower meets all other requirements of repayment. The source notes that this can also be referred to as a non-interest-bearing note.

Investopedia notes that a non-interest-bearing loan may be called a non-interest-bearing current liability, depending on the issuer of the debt. Examples of a non-interest-bearing current liability include accounts payable, taxes due and current income taxes with repayment amounts that do not increase due to fees, interest or penalties. Typically, a non-interest-bearing loan of this type is due for full repayment within one year of the date the debt was incurred.

3.3 Features and Associated Risks of Fixed Versus Variable Interest Rates

3.3.1 Definition of Fixed and Variable interest rate

Fixed rate and variable rate—also referred to as an adjustable rate—are the two means by which interest

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can be figured on a monetary loan. If you are seeking a loan, you may be given the option to choose between the two. The rate best for your needs can depend on several factors as both have advantages and potential drawbacks. A fixed rate loan has the same interest rate for the entirety of the borrowing period, while variable rate loans have an interest rate that changes over time. Borrowers who prefer predictable payments generally prefer fixed rate loans, which won't change in cost. The price of a variable rate loan will either increase or decrease over time, so borrowers who believe interest rates will decline tend to choose variable rate loans. In general, variable rate loans have lower interest rates and can be used for affordable short term financing.

Variable interest Rate

A variable interest rate means that the interest you are charged changes as whatever index your loan is based on changes. Loans can be based on the rate of the one-year T-bill or the prime lending rate among other factors. The prime lending rate as defined by the Federal Reserve is the rate set by the majority of the top 25 U.S. banks and is used "to price short-term business loans." These results in fluctuations in the amount you have to repay to keep current. Depending on the terms of your loan, it could change as often as monthly.

Fixed interest Rate

A fixed interest rate means that the interest rate that you will be charged over the term of your loan will not change, no matter how high or how low the market may drive interest rates. Your payment will remain the same on your last payment as it was on your first payment.

A variable interest rate loan is a loan in which the interest rate charged on the outstanding balance varies as market interest rates change. As a result, your payments will vary as well (as long as your payments are blended with principal and interest).

Fixed interest rate loans are loans in which the interest rate charged on the loan will remain fixed for that loan's entire term, no matter what market interest rates do. This will result in your payments being the same over the entire term. Whether a fixed-rate loan is better for you will depend on the interest rate environment when the loan is taken out and on the duration of the loan.

When a loan is fixed for its entire term, it will be fixed at the then prevailing market interest rate, plus or minus a spread that is unique to the borrower. Generally speaking, if interest rates are relatively low, but

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are about to increase, then it will be better to lock in your loan at that fixed rate. Depending on the terms of your agreement, your interest rate on the new loan will remain fixed, even if interest rates climb to higher levels. On the other hand, if interest rates are on the decline, then it would be better to have a variable rate loan. As interest rates fall, so will the interest rate on your loan.

N.B In general, variable rate loans tend to have lower interest rates than fixed versions, in part because they are a riskier choice for consumers. Rising interest rates can greatly increase the cost of borrowing, and consumers who choose variable rate loans should be aware of the potential for elevated loan costs. However, for consumers who can afford to take risk, or who plan to pay their loan off quickly, variable rate loans are a good option.

3.4 Ways to Compare Advertised Interest Rates and the Effects of Fees

3.4.1 Ways to compare advertised interest

Informing the client of the 'comparison rate' which includes all associated fees and charges.

The Comparison Rate on a mortgage is higher than the interest rate because the Comparison Rate takes into account some of the costs that you pay when getting the mortgage. The purpose of a Comparison Rate is to give you an indication of the real cost of your borrowings over the life of your loan so that comparisons can be more easily made. You see, sometimes you may be offered a special discount or an attractive start up rate for a fixed period at the beginning of your loan agreement and once the fixed period has expired the rates may increase. So the rate you pay at the outset doesn't actually tell you the annual percentage interest rate that you may have to pay in the future. A comparison rate is a tool to help consumers identify the true cost of a loan. It is a rate which includes both the interest rate and fees and charges relating to a loan, reduced to a single percentage figure. For example, a bank's advertised interest rate may be 5.49% and its comparison rate 6.75%.

3.4.2 Reason of advertised interest rates

1. Credit score is less than excellent

Unless your credit score is near perfect, a low (or even good) score will be the biggest reason you aren't offered the lowest advertised interest rate. While those stellar rates are available, lenders usually don't quote them to borrowers with credit scores below. Other aspects of your financial life, such as a high

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debt-to-income ratio or a shaky employment history with inconsistent income, can prevent you from getting the advertised interest rate. Ultimately, anything that makes a lender feels you're a higher risk.

2. Shopping for a vacation home

Mortgage loans aren't created equal, and it's not just your information that affects the rate the lender quotes. The property you want to purchase can also impact the rate and the terms of your loan.

3. Lender doesn't want to get competitive

Did you receive a quote for an interest rate from a large, corporate bank and get a little bit of sticker shock when the numbers came back much higher than you expected? Remember that lenders make profits from the interest they charge on money they let people borrow. If, for whatever reason, an institution or lender

Self-check three

Part I : Multiple Choice Questions

Choose the best answer and write the capital letter of your best choice in the space provided before each question number

1. Which one of the following is an incurred something in order to get asset?

- A. Expense B. cost C. fee D. none

2. among the following one account service fee income

- A. fee earned B. service revenue C. sale revenue D.A&B

3. Which one the following is an elements of cost?

- A. rent revenue B. Sunk cost c. interest income

4. _____rate loan is a loan in which the interest rate charged on the outstanding balance varies as market interest rates change.

- A. variable charge B. fixed charge C.A&B D. none

Part II: Short answer

1. Write the difference between cost and expense?
2. What is difference between fixed rate and variable rate?
3. What are the elements of fixed rate?
4. How company used variable rate?

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Operational sheet

1. Lale Hotel present loan proposal to Abay bank and bank providing three credit option shames to the loan the first option is to borrow birr 430,000.00 home mortgage to be paid with 16 year at equal installment at the rate

Of 10% semiannual the second option at borrow 500,000.00 for 30 months at equal installment at rate of 13% semiannual and birr 400,000.00 for a year equal installment at rate of 12% semi annual respectively. The bank agreed with the company and the loan disbursed with additional service charge of birr 37,500.00

/One time borrowing cost for the three loan/

A. calculate interest expense and other service charge at the end of first year

B. calculate total loan repaid at the end of second year

Short answer writing

1. _____

2. _____

3. _____

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UNIT FOUR: DISCUSSING THE EFFECTIVE USE OF CONSUMER CREDIT

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Discussing ways to avoid excessive or unmanageable debt
- Discussing strategy to minimize fees on credit
- Discussing importance of meeting minimum payments on credit cards
- Discussing ways to avoid credit card fraud

This unit will also assist you to customer attain the stated objective. Specifically, upon completion of this learning guide line, you will be able to:

- Discuss ways to avoid excessive or unmanageable debt
- Discuss strategy to minimize fees on credit
- Discuss importance of meeting minimum payments on credit cards
- Discuss ways to avoid credit card fraud

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4.1. Discussing Ways of avoid Excessive or Unmanageable Debt

4.1.1 Definition Unmanageable Debt

Unmanageable debt generally means having more debt payments than you can keep up with and a monthly basis. More specifically, it means the total of your monthly expenses and debt payments exceeds your monthly net income. Having unmanageable debt is difficult, but there are options to simplify your struggles if your debt hasn't gotten completely out of control.

4.1.2 Ways of avoid unmanageable debt

There are Five ways avoid unavoidable risk

With a little dedication and prior planning, it is possible to reduce your debts on your own. Why pay debt counselors and consolidation agencies fees for things you can do yourself? Credit.com shows you the tricks of the trade and the fastest way to reduce your debts on your own.

Step 1: Evaluate Your Debts

Collect all of your financial documents and print out your free annual credit reports. Use Credit. Com's free credit report card to see exactly where you stand to see exactly where you stand. This is an important step toward debt recovery and one that people are often scared to take. On a piece of paper, write down the balances, interest rates, and monthly amount due for each of your debts. Include your auto loans, personal loans, payday loans, credit cards, and other debts. You should also make note of any annual fees on your credit cards. You don't need to include your mortgage loan or student loans at this time. These loans have relatively long terms and low APRs so it is better to focus on paying off your other debts first.

Step 2: Look at Your Budget

After you have collected the information about your debts, you should take a look at your monthly budget. Write down your monthly income after taxes and subtract your rent/mortgage payment from this amount and other monthly expenses such as childcare, student loan payments, insurance, utilities, and groceries. Once you have subtracted all of your expenses, calculate how much you have left to pay off your debts. If this amount is too small, look for ways to reduce your spending. Consider turning off

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your cable subscription or carpooling as ways to cut back temporarily. The more you can pay towards your debts each month, the sooner you will be debt free.

Step 3: Make a Plan

Now that you know all about your financial situation, it's time to create a plan for reducing your debts. Use your information from Step 1 and 2 to fill in the following chart. Subtract your minimum debt payments (Step 1) and monthly expenses (Step 2) from your monthly income after taxes. The remaining amount should be used to pay off the debt with the highest interest rate and the highest balance.

Step 4: Start Negotiations

While you are starting to follow your repayment plan from Step 3, you should contact your creditors and lenders to see if you can improve the terms on your debts. You may be able to lower your interest rates or negotiate a reduced settlement on some debts by speaking with the customer service department. It is especially easy to negotiate the terms of debts that are charged off (dismissed) by the creditor or in collections already. Also think about moving some of your credit card debts to new accounts with lower interest rates. Moving a balance to a credit card with a 0% introductory rate for 6-12 months can help you save a lot on interest. Just be sure to keep each of your credit card balances below 35% of the credit limits to avoid damaging your credit score.

Step 5: Follow-Through Your Debt Reduction Plan

- Do your best to meet your repayment goals each month. It's okay if the amount you put toward your most expensive debt each month varies. Just try to consistently put as much as possible toward your debts. Signing up for an automated payment system and keeping a chart of your progress on the refrigerator can help.

4.2 Strategies to Minimize Fees on Credit

Strategies to minimize fees on credit

- consolidating savings and credit facilities with the one institution where account servicing fees can be cancelled out
- knowing how many free transactions come with the card
- Paying the minimum monthly installment on time.

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Basically, there are seven Strategies to Minimize Fees on Credit

1. Your accounts stay out of collections.

More credit card companies are turning to debt collection agencies when their customers don't send credit card payments on time. Even the smallest credit card balance can get sent to a collection agency if it goes unpaid for several months. Pay on time and you can avoid dealing with debt collectors.

2. Enjoy a lower interest rate.

Credit card issuers are allowed to increase your interest rate if you're more than 60 days late on your credit card payment.

3. Avoid late fees.

Thanks to technology, you might be charged a late fee just minutes after your credit card payment is due.

4. Improve your credit score.

Thirty-five percent (35%) of your credit score is based on whether your credit card payments are made on time.

5. Get lower insurance rates.

Insurance companies increasingly use your credit score to determine your insurance rate. When late credit card payments lower your credit score, your insurance rates could subsequently increase.

6. Keep your monthly payments low.

When you make a late credit card payment, your next minimum payment will be more than double what it would have been had you not missed a payment. That's because your next credit card payment will include two minimum payments and a late fee. If you have trouble making your credit card payment, putting it off won't make it easier to pay. Instead, the opposite happens.

7. Keep your credit card in good standing.

You risk having your credit cards cancelled when you miss your credit card payment, an action that could hurt your credit score, especially if you have a credit card balance.

4.3Importance of Meeting Minimum Payments on Credit Cards

The important minimum payment credit card is:

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1) **Save money**

When you only cover the minimum every month, you end up paying more in interest. The minimum payment exists to ensure that interest fees are covered, with only a small amount going toward the actual balance.

2) **Get to debt-free faster**

The more you pay, the quicker you'll be debt-free.

3) **Raise your credit score**

The ratio of your balances to your credit limits is called "credit utilization." This

Making the total minimum payment each month means you avoid a late payment fee and ensures you can keep using your card.

4.4. **Ways to Avoid Credit Card Fraud**

Ways to avoid credit card fraud include:

- not disclosing Personal Identification Number (PIN) to anyone
- selecting a PIN only the card holder would know
- Signing the back of the credit card.

Your credit card information is always at risk for theft. Take steps to keep it safe and don't be fooled by scammers who try to trick you.

1. **Keep your credit cards safe.**

Keep your credit cards in a purse or wallet close to your body where it can't easily be snatched away. Ladies, make sure your purse is zipped. If you're shopping in a high traffic area, carry a smaller purse. For both men and women, carry only the one or two credit and debit cards you'll be using that day. Leave all your other credit cards at home.

Thieves can take pictures of your credit card with a camera or cell phone, so don't leave your credit card exposed any longer than necessary.

After you make a purchase put your credit card away immediately. Confirm you have your credit card back in your possession before you leave the store or restaurant.

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2. Shred anything with your credit card number on it.

Rather than toss your credit card billing statements directly into the trash, shred them to keep dumpster divers from getting their hands on your credit card number. The same thing applies to old credit cards that have expired or been cancelled. You might even put the shredded pieces in different trash bags to thwart clever thieves who can put shredded pages back together.

3. Don't sign blank credit card receipts

To avoid credit card fraud, always verify the amount on your credit card receipt before signing it. If you get a credit card receipt that has blank spaces in it, write \$0 in those spaces or draw through them before putting your signature on the card. Otherwise, the cashier could write in an amount and send the purchase to your credit card issuer.

4. Avoid giving out your credit card information.

Only give out your credit card number or other sensitive information on calls you initiate to customer service using the number on the back of your credit card. Don't return calls to a phone number left on your answering machine and don't give your credit card number to anyone who calls you requesting the number. Credit card thieves have been known to pose as credit card issuers and other businesses to trick you into giving out your credit card number.

5. Be safe with your credit card online.

Don't click on email links from anyone pretending to be your bank, credit card Company, or other business who uses your personal information, even if the email looks legitimate. These links are often phishing scams and the scammers want to trick you into entering your login information on their fake website.

6. Report lost or stolen credit cards immediately.

The sooner you report a missing credit card the less likely it is that you'll have to pay for any fraudulent charges made on your credit card. Write down your credit card companies' customer service number now so you'll have it if your credit card is ever missing.

7. Review your billing statements each month.

Unauthorized charges on your credit card are the first indicator of credit card fraud. If you notice a charge you didn't make, no matter how small, report the charge to your credit card issuer immediately.

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Your credit card issuer will tell you whether you should close your account to avoid credit card fraud.

Self-check- four

Part: I matching

Instruction match the following question in most writing a select of A with B

A

1. Ways avoid credit card risk
2. Default risk
3. Unauthorized charge
4. Strategies to minimize fee
5. Fee

B.

- A. use PIN
- B. credit risk
- C. first indicator of credit card risk
- D. consolidation of saving
- E. Charge

Part II: short answer

1. What are the strategy of minimize default risk?
2. What are the ways of credit card risk?
3. Explain about the strategy minimize of risk?
4. What are the factors of unauthorized charge?

5. Explain what mean by fee?

Answer sheet for writing essay

1. _____
_____ 2. _____

3. _____

4. _____

5. _____

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UNIT FIVE -MANAGE PERSONAL CREDIT RATING AND HISTORY

This unit is developed to provide you the necessary information regarding the following content coverage and topics:

- Discussing role of credit reference agencies
- Discussing purpose and use of credit reference reports
- Discussing implications of establishing a poor credit history
- Discussing methods of obtaining own credit reference file

This unit will also assist you to customer attain the stated objective. Specifically, upon completion of this learning guide line, you will be able to:

- Discuss role of credit reference agencies
- Discuss purpose and use of credit reference reports
- Discuss implications of establishing a poor credit history
- Discuss methods of obtaining own credit reference file

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5.1 □ Discussing role of credit reference agency

5.1.1 Definition of credit reference

Credit reference agencies act like data libraries, receiving information from your lenders and the public bodies (such as the electoral register)

Credit reference agency is to collect information over the last six years from public bodies and lenders. This information is then used to create your credit report which can be viewed by lenders to help them make decisions on applications.

Lenders will view this information as it can help lenders to make more confident decisions. This is because they can see if a customer is using credit sensibly and making all their payments on time or highlighting if a customer might be struggling, such as missing payments on the debt they already have. Customers are also able to view the information held by the credit reference agencies to check the information being provided by their lenders is correct

Need credit references

Credit references are requested when an individual requests to borrow money from a lender or to use a service. There are several situations when a credit reference may be requested. Some of the most common situations include:

- Loan applications.

When an individual or business applies for a loan, lenders almost always require a credit reference. These references let a lender know whether or not the applicant will pay back the money that has been borrowed from the lender.

- Rental applications.

Landlords often request credit references with rental applications. The information presented on the credit history allows property owners to determine if rental applicants will make timely payments.

- Utility services.

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Credit references are also often requested for utility services such as electricity, gas, cable, or phone services. Companies that provide these services may require a credit reference prior to activating accounts to determine whether or not you have a history of making timely and appropriate payments for similar services.

5.1.2 Role of Credit Reference Agency

1. provides you with a chance to review the information and, if required, dispute the data in your credit report before making any applications for credit, this may help an application to be accepted where it may have been declined.
2. Customers are also able to view the information held by the credit reference agencies to check the information being provided by their lenders is correct.
3. Lenders will view this information as it can help lenders to make more confident decisions. This is because they can see if a customer is using credit sensibly and making all their payments on time or highlighting if a customer might be struggling, such as missing payments on the debt they already have
4. To collect information over the last six years from public bodies and lenders. This information is then used to create your credit report which can be viewed by lenders to help them make decisions on applications.

5.2. Purpose and Use of Credit Reference Reports

A credit report is a summary of your credit history, including the types of credit accounts you've had, your payment history and certain other information such as your credit limits.

Credit reports established and maintained by credit reference agencies which record all negative events (i.e. defaults) listed by creditors against debtors.

Purpose of Credit reference

It is used documents that describe your credit history background and creditworthiness to potential lenders. You may need these if you're looking to borrow money, like a loan, or rent from a landlord. If you're familiar with a job resume referral, these are pretty similar — credit references allow lenders to base your credit approval off of a trusted source and verify your income.

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Credit references will give insight as to whether or not you were able to make payments on time, or if you have any debt. If you have a low credit score and haven't paid off your debts in a reasonable time, your credit application may be more likely to get rejected. On the other hand, if your credit history shows that you've been making timely payments and paying off any debts, the lender will be more likely to approve your application.

A credit reference can be a report from a credit agency for either a business or an individual. The term can also be used to mean a letter from a bank or other financial institution with which a company has done business, confirming to third party that the company or individual is known to the financial firm as a good client. Credit references are generally used to determine the creditworthiness of a person or individual. Credit agencies are used most often for this purpose, although individual letters of reference are sometimes necessary. For example, an overseas business wishing to establish its credentials in the United States may obtain a number of credit references from other businesses, banks, vendors and customers.

Credit reports are a gold mine of information about consumers. They contain your Social Security number, date of birth, current and previous addresses, telephone numbers (including unlisted numbers), credit payment status, employment information and even legal information.

5.3 Implications of Establishing a Poor Credit History

The Implications of establishing a poor credit history may include:

- Higher interest rate penalties: it refers to the amount of interest rate is higher.
- Inability to obtain finance in the future: it implies that poor obtain of fiancé of business.
- may disadvantage applications for rental accommodation
- Necessity to obtain guarantor in future loans.

Here are some of the most common side-effects of bad credit.

1. High interest rates on your credit cards and loans

Creditors and lenders see bad credit applicants as riskier than applicants with better credit scores. They make you pay for this risk by giving you a higher interest rate. Over time you'll end up paying more in interest than you would if you have better credit and a better interest rate. The cost is higher with

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big credit card balances or major loans.

2. Credit and loan applications may not be approved

Because creditors and lenders think your bad credit is a risk, they might not want to lend to you at all. You may find that your applications are being denied.

3. Difficulty getting approved for an apartment

Who knew that landlords checked credit before allowing you to sign a lease? It's true. Having bad credit can leave you homeless or close to it.

4. Security deposits on utilities

Utility companies – electricity, phone, and cable – check your credit as part of the application process. If you have a bad credit history, you may have to pay a security deposit to establish service in your name, even if you've always paid your utility bills on time.

5. You can't get a cell phone contract

Yep, cell phone companies check your credit too. They contend that they're extending a month of service to you, so they need to know how reliable your payments will be. If your credit's bad, you may have to get a prepaid cell phone, a month-to-month contract where phones are typically more expensive, or go without one at all.

6. You might get denied for employment

Certain jobs, especially those in upper management or the finance industry, require you to have a good credit history. You can actually be turned down for a job because of negative items on your credit report, especially high debt amounts, bankruptcy, or outstanding bills.

7. Higher insurance premiums

Insurance companies check credit too. They say that lower credit scores are linked to higher claims filed. Because of this theory, they check your credit and charge a higher premium to those with lower credit scores, regardless of the number of claims you've actually filed.

8. Calls from debt collectors

Bad credit itself doesn't lead to debt collection calls. However, chances are if you have bad credit you also have some past due bills that debt collectors are pursuing.

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9. Difficulty starting your own business

Many new businesses need banks loans to help fund their startup. A bad credit history can limit the amount you're able to borrow to start a new business, even if you have the greatest idea and the data to prove it.

5.4 Methods of Obtaining own Credit Reference Report

Methods of obtaining own credit reference file may include:

Writing, emailing or telephoning the relevant agency requesting a copy of your file, having provided relevant details to identify self.

- **Asset documentation**

Asset documentation can also serve as a credit reference. These documents are issued by the financial institution that manages an individual's assets like savings accounts, retirement funds, stocks and bonds. Assets can illustrate the creditworthiness of a prospective applicant. For example, individuals who possess substantial assets are likely to manage their money effectively, and therefore will likely be responsible borrowers. You will need to ask the financial institutions who manage your assets to furnish records and supply them to prospective lenders.

Asset documentation is considered a highly effective credit reference.

- **Financier support documentation**

Financier support documentation can also serve as a credit reference. This type of documentation is similar to asset documentation; however, instead of illustrating the assets of an individual, it highlights the assets of a business entity. For example, those who financially support a business can provide documentation that illustrates its access to capital.

Business owners applying for loans or services that require credit references can ask their investors to furnish statements that showcase the amount of capital available to the business.

Financier support documents are considered highly effective credit references.

- **Character references**

Lastly, character references can be used as credit references. While these types of credit references are not as effective as credit reports, asset documentation, and financier support, they can be useful.

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Character references are documents issued by reliable resources such as past landlords, previous employers, and utility companies that an individual has had accounts with, for example. A character reference highlights the experiences the individual or entity has had with the applicant. It can offer information about the character of the applicant and how responsible he/she is with regards to managing important tasks. While they do not provide detailed information about an individual's past financial obligations, those who supply character references can illustrate whether or not an applicant has successfully managed various responsibilities, including debt payments.

Self-check five:

Part I: True or False Questions

Read the following sentences carefully and write TRUE if the statement is correct or FALSE if the statement is not correct on the space provided before each question number

1. Everyone's financial activities are stored in what's known as a credit file
2. With bad credit you might get denied or you might get approved with a high interest rate.
3. Creditors and lenders see bad credit applicants as riskier than applicants with better credit scores.
4. Credit reports are a gold mine of information about consumers.
5. Reports established and maintained by credit reference agencies which record all positive events (i.e. defaults) listed by creditors against debtors.

Part II: Short answer essay

1. What are the key credit files?
2. Discuss the over aspect of credit own reference in your understanding?
3. What mean by credit reference?
4. Describe in detail about report of creditor?

Answer sheet for short answer essay

1. _____

2. _____

3. _____

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4. _____

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