

Credit Investigator's Handbook

Second Edition

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We extend our special thanks to several Savings and Credit Cooperatives for allowing NATCCO's Consultancy Unit to be their partner in the interventions done so that their organizations will operate even better and also for being our valuable references and inspiration in crafting the best practices in credit investigation. Hence, this Handbook contains best practices to guide those who do and are responsible for credit investigation in cooperatives.

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Lastly, but most importantly, we thank our God Almighty for giving us the wisdom that we needed in creating this Handbook.

Kristianne Aries P. Mendoza, CRA™, REA

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GLOSSARY

- Account:** record or statement of obligations, financial liabilities, receipts, subscription
- Appraisal:** act of assessment, estimation, evaluation, and judgment for the value of something
- Asset:** property owned by a person or company, regarded as having value and available to meet debts, obligations, or legacies
- Balance sheet:** a financial statement indicating the net worth of a person or company, in terms of assets and liabilities
- Cash flow:** the liquidity of a person or business, resulting from the total amount of money being transferred from and into in a period of time
- Collateral:** something of value pledged for the security in repayment of loan, subject for forfeiture in the event of default
- Credit bureau:** private or non-government credit information provider
- Delinquency:** state of default or failure to pay an obligation or indebtedness
- Detection:** act of identifying a present or future problem, or of a concealment of something
- Documentation:** a set of documents or materials prepared on paper that provides official information, evidence, or as record on file
- E-card:** electronic account card provided to a person as grantee for pension and/or benefits
- Entity:** a distinct or independent creation or existence, e.g., business, company
- Financial investigation:** process of checking the financial status and net worth of a person or company
- Mark-up price:** difference between the cost of a good or service and its selling price
- Preventive measure:** way of stopping something from happening or arising
- Profit margin:** a part of a category of profitability ratios calculated as net income divided by revenue or net profits divided by sales
- Risk:** probability or threat of damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities

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INTRODUCTION

One of the major concerns of cooperatives is managing their credit operations. Credit operation has many challenges and a number of these challenges are rather hard to surmount. Without the proper intervention in facing the challenges in credit operation, many co-ops are experiencing high loan delinquency rate. Consequently, co-ops' profitability suffers because they then need to allocate loan loss provision just to cover bad debts. And covering bad debts, in turn, affects the members of the cooperative because this action lowers the members' earnings in dividends on share capital and also disturbs the members' other privileges. All in all, without the proper management and intervention in credit operation, the co-ops suffer in the end.

The National Confederation of Cooperatives (NATCCO) was able to observe that almost all cooperatives that it had diagnosed under consultancy were troubled by loan delinquency. How the co-ops act on loans is among the major reasons for loan delinquency. Going deeper into our diagnostics, we found that, for example, much of the loan applicants' credit information supplied for evaluation had not been thoroughly validated and obtained, thus becoming one of the factors in loan delinquency. This area of concern mostly falls under the credit investigation activity. This "Credit Investigator's Handbook" thereby has the overall objective of promoting in the cooperatives the best practice in credit management and accountability that will help reduce the cost of bad debts; encourage cost-effectiveness; and promote high portfolio quality—all leading to even greater co-op development and utmost benefits for the members. The Handbook's sub-objectives are:

- to serve as a guideline for the people involved in credit investigation activity
- to identify the duties and responsibilities of Credit Investigators as well as their key performance indicators
- to suggest various ways to validate and obtain credit information according to the profile of the loan applicant.

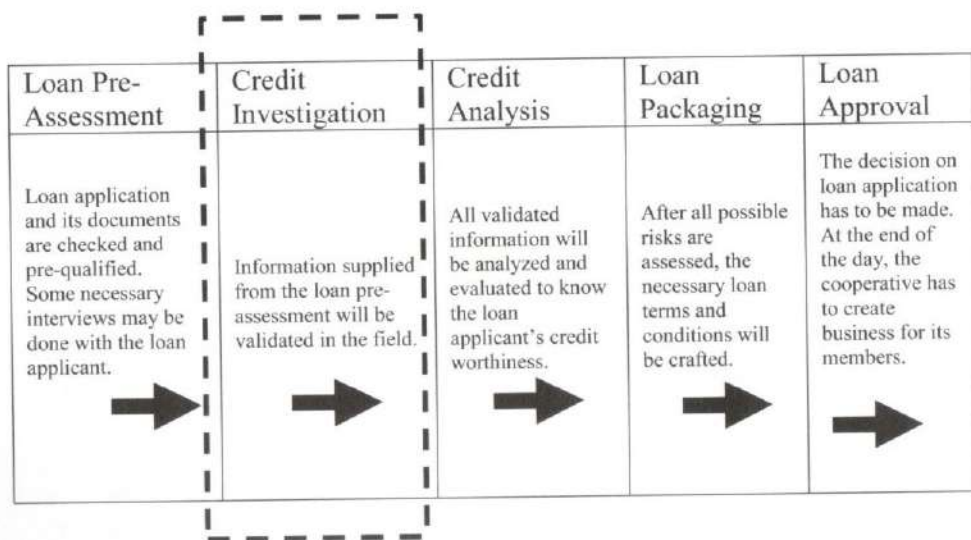
Users of the Handbook

This Handbook is for cooperative doers (Credit Investigators/Officers); implementers (managers/supervisors); policy-makers (Board of Directors and top management) who are responsible for maintaining the health of the credit operation; and other people in the co-ops whose work is related to credit investigation.

IMPORTANCE OF CREDIT INVESTIGATION IN CREDIT MANAGEMENT

Risk in credit operation is not inherently bad. At times, necessary risks have to be taken to accomplish worthy and meaningful goals. This is true in cooperatives' lending programs. Co-ops take necessary risks to run a successful credit operation. But it is important that co-ops take calculated risks. Credit risk management is the process of taking calculated risks—it reduces the chances that a loss may occur or it decreases the scale of the loss that may occur. Credit risk management offers both *preventive* and early *detection* of an actual problem that may happen such as loan delinquency. Credit investigation is one of the preventive and pre-emptive measures of credit risk management. Through credit investigation, proper loan appraisal is provided by those responsible for acting on loans.

In the usual day-to-day operation, we may look at this example of how credit investigation is done in a co-op's credit initiation process:



THE CREDIT INVESTIGATOR

Good Traits of a Credit Investigator

Aside from knowing the technicalities of credit investigation, the Credit Investigator must possess good traits to be able to do his/her tasks effectively and efficiently. Among the good traits of a Credit Investigator:

- good character—honesty, integrity
- competence and capability—skills, knowledge
- constructiveness in approach—encourages development and improvement
- consistency in decision and performance
- conscientious—thoroughness, carefulness, vigilance
- confident
- considerate—careful not to inconvenience or harm others
- congenial—can build rapport with everyone
- has common sense
- has concern: being fair
- cleanliness and hygiene—part of carrying oneself professionally
- accuracy in the thinking process
- imaginative, creative, resourceful
- has good memory
- responsible
- diplomatic—can effectively deal with different kinds of people in varying situations
- understanding of different areas related to the position (also in relation to educational, work, and competency requirements) (e.g., mathematics, economics, accounting, marketing, psychology, relevant laws, etc.)

Note: Refer to Annex 1 "Credit Investigator: Job Description and Key Performance Indicators" for more details on the Credit Investigator's tasks and requirements for task performance.

THE CREDIT INVESTIGATION

1. Definition

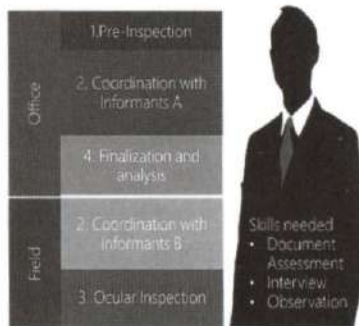
Credit investigation is the process of verifying and obtaining information supplied (mostly found in the loan application form and requirements submitted) and not supplied (mostly found in the Credit Investigation and Background Information [CIBI] form and in other activities in CIBI) by the borrower (i.e., the loan applicant/co-op member-borrower). The information will be used in making the decision on the loan application.

General procedures of credit investigation

To produce a good credit investigation report, the Credit Investigator must follow investigation procedures that are conducted through offsite (office) or onsite (field) activities.

Offsite activities are pre-inspection; analysis and finalization of reports; and, in some instances, information coordination through respondents.

Onsite activities are ocular inspection and information coordination, if the possible informant is still unknown or solicitation of information through personal interviews is necessary. However, in some cases, the cited process might change. The change will depend on either what is convenient to the Credit Investigator or what is the type of the co-op's operation. Ultimately, the credit investigation report must produce non-biased, truthful, and relevant data needed to analyze credit risks.



- Pre-inspection: Although it might be assumed that pre-inspection was already conducted, the Credit Investigator should also check the

documents and reports provided by the pre-inspection. He/She also checks the database and information accessible within the premises of the co-op

- **Information coordination:** The checking is conducted through interviews of possible respondents.
- **Ocular inspection:** The Credit Investigator conducts observations on the residence or business of the loan applicant; validates most of the cash flow data; and re-confirms the gray areas or doubtful/unfavorable/adverse information that come from the respondents, from the observation, or from the submitted documents.
- **Analysis and finalization of report:** The Credit Investigator re-checks his/her worksheets, re-analyzes the data credibility, and drafts the final credit investigation report. Also, the credit investigation herein provides initial analysis based on the report that can help the analyst do the credit analysis report.

General description of information to be validated

The Credit Investigator must learn to organize the information that she/he validates and collects during the investigation. Although *financial information* is vital to the credit investigation report, it must be noted that *non-financial information* also plays a crucial part in interpreting the financial information. Thus all of the information at the end of the day must tell the analyst the story behind the numbers.

In harvesting the needed information, the general procedures of credit investigation must be conducted.

Example

While conducting the checking of the loan applicant's source of income, the Credit Investigator asks the uses of the income in the household. A household with nine members, for instance, should not have a food expense of only PhP1000.00 for each month. Otherwise, the supposed amount of food expense for each month will be a ground to suspect that the net disposable income is somehow being overstated. The Credit Investigator must ask various questions to validate or dig into the real story. In other words, while the Credit Investigator pull outs information from the loan applicant, she/he also revalidates to come up with a justifiable data.

The Credit Investigator must gather, validate, and interpret background information and financial information to create a substantive credit investigation report.