

Chapter 16

Credit

Answer Key

Part 1: Content Review

Matching

1. J
2. D
3. C
4. H
5. G
6. A
7. B
8. E
9. F
10. I

Multiple Choice

1. B
2. A
3. A
4. C
5. D
6. C
7. D
8. A
9. C
10. B

Completion

1. open-end
2. installment
3. amortization table
4. annual percentage rate (APR)
5. proprietary
6. FICO
7. accounts receivable
8. Capital
9. Capacity
10. trade

Part 2: Concept Review

Open Response

1. Four benefits of credit are (1) the ability to use goods and services as they are being paid for, (2) the opportunity to buy costly items, (3) a source of funding for emergency or unexpected expenses, and (4) the convenience of carrying a credit card instead of cash or a checkbook. However, using credit is not always helpful. Consumers who overuse credit run the risk of not being able to make payments on time. Businesses that overuse credit run the risk of cash flow problems.
2. The APR includes both interest and all fees and charges that otherwise may be hidden from the borrower. The APR reveals the true cost of credit and helps to compare different loans and other sources of credit.
3. Potential benefits of extending customer credit include increased sales, customer loyalty, and income from interest and finance charges. Potential costs include transaction fees, bad debts, tying up cash while waiting for payments, and additional paperwork.
4. A credit policy is a written set of guidelines used by an organization to determine how many and which customers will be approved for credit. A credit policy establishes limits for the amount of credit that will be extended for installment loans and trade credit. Specific terms of repayment are included, as well as interest rates, late fees, penalties, and actions for nonpayments.
5. The five determinants of a FICO score include (1) payment history, (2) amounts owed, (3) length of credit history, (4) new credit, and (5) types of credit used. Student explanations will vary.

Part 3: Math Skills

Interest

1. $P \times R \times T = \text{Interest}$
 $\$15,000 \times .08 \times 1 = \$1,200$
 $P + \text{Interest} = \text{Repayment Amount}$
 $\$15,000 + \$1,200 = \$16,200$
2. $P \times R \times T = \text{Interest}$
 $\$5,000 \times .06 \times .25 = \75
 $P + \text{Interest} = \text{Repayment Amount}$
 $\$5,000 + \$75 = \$5,075$
3. $P \times R \times T = \text{Interest}$
 $\$20,000 \times .10 \times .5 = \$1,000$
4. The length of time of the loan is $1/12 = .0833$
 $P \times R \times T = \text{Interest}$
 $\$40,000 \times .05 \times .0833 = \166.60
5. RJ will not collect interest for two months, or $2/12$ of a year.
 $P \times R \times T = \text{Interest}$
 $\$50,000 \times .05 \times .167 = \417.50

Part 4: Communication Skills

Writing

Section I

1. far
2. garage
3. sweet
4. baseball
5. watch
6. swim
7. dog
8. night
9. write
10. mother

Section II

1. Student answers may vary.
2. Student answers may vary.
3. Student answers may vary.
4. Student answers may vary.
5. Student answers may vary.
6. Student answers may vary.
7. Student answers may vary.
8. Student answers may vary.
9. Student answers may vary.
10. Student answers may vary.