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Why Accountants Should Know about Credit Scores

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Credit scores have become a major factor for consumers and businesses that seek financing ranging from mortgages, car and student loans to business credit lines and bank loans.
Accountants who understand how credit scores work and what they mean can help consumers and businesses qualify for hard-to-get loans and credit, save hundreds, thousands, and, in many cases, millions of dollars in interest rates and closing costs, and, in the case of businesses, remain attractive to potential customers.

There are many different scores used for various reasons. Some are for educational purposes and are sold directly to consumers. Others are indices used by mortgage lenders or insurers, including government agencies, such as Fannie Mae, Freddie Mac, and the Federal Housing Administration, to determine a borrower's creditworthiness.

To arrive at a score number that represents each applicant, various factors are taken into account, such as an individual's or business's bill-paying habits, open credit accounts, age of the accounts, activity on the accounts, variety of credit, amount of debt-to-limit ratio, and delinquency records. Even the number of credit inquiries over a period of time can affect a score.

Consumers can find their scores by going online. The most common consumer scores found online are Fair Isaac Corporation (FICO), whose scores range from 300 to 850; Plus, whose scores range from 300 to 830; Equifax, whose scores range from 280 to 850; and Vantage, whose scores range from 501 to 990 with letter grades from A to F.

For consumer loans and mortgages, accountants should be aware that most banks use FICO as the provider of credit scores. This is important because other credit score providers, such as Plus, Vantage and Equifax, can be 40 to 150 points higher than FICO. Borrowers who rely on score providers other than FICO can be grossly misled as to their loan qualifications and their ultimate loan costs.

A 720 FICO is considered a good score for a mortgage, and a 740 and above is excellent. Below a 620 is poor. To buy a FICO score, consumers can log onto www.myfico.com.

Factors Affecting Consumer Credit Scores
Opening and closing credit can drop a score up to 60 points for a year. The higher the score, the more it will drop.

Balances over 10 percent of revolving credit limits decrease credit scores. Revolving credit is defined as any account where consumers can make the minimum payment, or pay more and choose what amount of the credit line they will use. If the balance is over 10 percent of the limit even by $1, the score can drop over 100 points. The closer the balance is to the credit limit, the more it will drop.

A credit score is affected less by negative information as the information ages. Most negative information will remain on a credit report for seven years, and bankruptcies remain for 10 years. Making an account current will not take away the negative impact of any late payments or delinquency.

When a third party reviews a consumer's credit profile (called a "pull" or inquiry), the score can drop up to five points for each inquiry. However, mortgages, student loans, car loans and leases have a window of time where third-party inquiries will be grouped in batches and viewed as one.

During this period the score will drop only five points for each type of loan as if only one inquiry were made. Such windows usually last for 14 to 30 days. For example, a consumer shopping for a mortgage, student loan and car loan at the same time might have their credit pulled 10 times within each of the three categories. As long as the "pulls" take place during one window of time, the score will decrease only up to five points for each category of loan.

Inquiries by third parties for credit other than for mortgages, student loans or car loans will reduce a score up to five points each time, as there is no window for such inquiries.

When consumers pull their own credit reports and credit scores, the inquiry will not affect the score.

How Business Credit is Determined

As with consumers, credit scores play a big part in determining business credit. The right business credit score is of great value when negotiating lower lease payments, approval for business loans, or when a potential client is deciding which company to use for business-to-business services.

The sad fact is that one late payment or a collection account for a specific amount related to the debt owed for each vendor listed on the individual's report can drop a score such as Paydex by 40-plus points. This will immediately place a business into the high-risk category.

D&B Credit Score and Rating

Dun & Bradstreet is the best-known provider of business credit scores and credit ratings. Businesses with poor D&B scores can have loans denied or credit extensions cut or closed. They can be rejected for bids and services by prospective customers, or have their products removed by stores like Wal-Mart.

The D&B rating can quickly help assess a firm's size and composite credit appraisal, based on information in a company's interim or fiscal balance sheet and an overall evaluation of a firm's creditworthiness. In this economic environment, D&B credit profiles are viewed more often and used to sway B2B decision-making.

These days it is common for lenders and companies to check D& B reports when making decisions on credit and services. Having the wrong vendors listed on a D&B report, or too much or too little information given, or a new late payment at the wrong time, could mean the difference between approval and rejection of a much needed credit line or request for services or products by potential clients.

Paydex Score

This score is based on payment patterns and is dollar weighted by the creditor and vendor accounts listed on a business's report. Paydex scores range between one and 100 (100 is a rarity).

An 80 signifies a high score and indicates all bills are being paid promptly. On the other end of the spectrum, a low 60 score means late payments, judgments or collections.

Below a 60 could mean many defaults or very little credit history. In this case it is likely a business will have problems being approved for loans or credit extensions. At best, it may need to pay much higher rates on leases. A strong Paydex score gives a business access to financial tools that can help it land bigger clients and earn higher revenues.

Financial Stress Score

This score was designed to help predict a business's potential for failure. It indicates the likelihood that a company will obtain legal relief from creditors or cease operations without paying all creditors in full over the next year.

The score uses the full range of D&B information, including financials, comparative financial ratios, payment trends, public filings, demographic data and more.

Commercial Credit Scoring System

This scoring model is based upon the observed characteristics of hundreds of thousands of businesses in D&B's database and the relationship of these characteristics to the probability of a company experiencing severe delinquency over a period of 12 months.

The amount of information processed into consumer and business credit scores is large and complex. While accountants cannot be expected to master all of the intricacies of the system, they should have sufficient knowledge to be able to properly advise clients and know where and when to seek expert help from credit score experts and firms that specialize in the restoration and monitoring of credit scores and credit.

Tracy Becker is president and founder of North Shore Advisory Inc., a New York-based credit restoration and education company that works with CPAs, bankers, realtors and attorneys helping their clients by improving credit scores. A credit industry leader for two decades, Becker published "The Credit Solutions Kit" and the soon-to-be released "Credit Score Power." She also created Elite Credit Services, a specialized credit-monitoring program She can be reached at ***tracy@northshoreadvisory.com****.*

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