

# UNIVERSITY OF ESWATINI

## FACULTY OF COMMERCE

### DEPARTMENT OF ACCOUNTING AND FINANCE

#### MAIN EXAMINATION PAPER NOVEMBER 2019/2020 SESSION

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**PROGRAMME : BACHELOR OF COMMERCE**  
**TITLE OF PAPER : RISK MANAGEMENT**  
**COURSE CODE : ACF 419**  
**TOTAL MARKS : 100 MARKS**  
**EXAM PERIOD : NOVEMBER, 2019**  
**TIME ALLOWED : THREE (3) HOURS**

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#### INSTRUCTIONS:

1. There are four (4) questions, ANSWER ALL.
2. Begin the answer to each question on a new page.
3. Show all necessary calculations.
4. The marks awarded for a question are indicated at the beginning of each question.
5. All questions carry equal marks.

**Note:** You are reminded that in assessing your work, account will be taken of accuracy of the language and general quality of expression, together with layout and presentation of your answer.

**THIS PAPER MUST NOT BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR OR SUPERVISOR.**

**SPECIAL REQUIREMENT: FINANCIAL CALCULATOR**

**Question 1 (25 marks):**

As the Credit Officer of Standard Bank Ltd, you received the financial report of Alayi Milk Company Ltd presented in Tables 1 and 2, for credit risk analysis.

**Table 1: Alayi Milk Co. Ltd Statement of Comprehensive Income as at 31<sup>st</sup> December**

	2018
Sales	9500
Cost of sales	6000
Gross profit	3500
Selling expenses	1900
Interest payment	240
Earnings before tax	1360
Corporate tax (50%)	680
Net income	680
Cash dividend	320
Retained earnings	360

**Table 2: Alayi Milk Co. Ltd Statement of Financial Position as at 31<sup>st</sup> December 2018**

	2018
Cash and bank balances	450
Debtors	1580
Inventory	2670
Prepaid expenses	290
Total current assets	4 990
Fixed Assets	4100
Accrued depreciation	(2630)
Long term investment	660
Total assets	7120
Bank overdraft	1040
Creditors	480
Tax accruals	254
Other accruals	530
Total current liabilities	2404
Long term debt	1262
Ordinary share capital	720
Retained profits	2736
	7120

Suppose that the share price of Alayi Milk Company Ltd is E.250, you are required to:

- (i) Outline the decision rule for the Altman's Z-score model for credit risk analysis. (6 marks)
- (ii) Calculate the Altman's Z-score coefficient using the financial report presented in Tables 1 and 2 above to determine whether or not Alayi Milk Company Ltd has threat of financial distress in the 2018 financial year. (16 marks)

(iii) Advise Standard Bank Ltd on whether or not to grant credit facility to Alayi Milk Company Ltd based the Z-score coefficient. **(3 marks)**

**Question 2 (25 marks):**

Risk management has been described as a process to deal with uncertainties resulting from firm's exposures. (i) Discuss the process of risk management. **(12.5 marks)**

(ii) Highlight the rationale for risk management. **(7.5 marks)**

(iii) Outline any five principles for managing operational risk exposures. **(5 marks)**

**Question 3 (25 marks)**

(i) Pick & Pay PLC needs to borrow E.20,000,000 in three months' time. The Management is concerned that interest rates may rise, so the company buys a 3 x 6 forward rate agreement (FRA) at 5.00 percent. At beginning of FRA, the reference rate (RR) has risen to 6%. Calculate the settlement amount. **(9 marks)**

(ii) Discount the settlement amount to its present value. **(8.5 marks)**

(iii) What are the differences between forward rate agreement and interest rate futures? **(7.5 marks)**

**Question 4 (25 marks)**

(i) Futures contracts are often used to hedge risk exposure by removing the uncertainty about the future price of an asset. With the aid of an example, describe the two futures common hedging strategies. **(8 marks)**

(ii) Calculate the value of a futures contract on a non-dividend paying stock where the maturity date is in three months, the current asset price is R250, and the three-month risk-free rate is 9% per annum. **(9.5 marks)**

(iii) What are the uses of derivatives? **(7.5 marks)**

**END OF PAPER**