

UNIVERSITY OF ESWATINI
FACULTY OF COMMERCE
DEPARTMENT OF ACCOUNTING AND FINANCE
MAIN EXAMINATION PAPER 2020/2021 SESSION

PROGRAMME : BACHELOR OF COMMERCE
TITLE OF PAPER : RISK MANAGEMENT
COURSE CODE : ACF 419
TOTAL MARKS : 100 MARKS
EXAM PERIOD : FEBRUARY, 2021
TIME ALLOWED : THREE (3) HOURS

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.

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SPECIAL REQUIREMENT: FINANCIAL CALCULATOR

Question 1 (25 marks):

(i) An organisation must identify the sources of its operational risk exposures to be able to manage them. Explain these sources of operational risk. (8 mark)

(ii) Mahala Pty has identified 1 people, 1 technology, 1 external dependency, and 1 process risks exposures with a 15%, 45%, 20%, and 20% probability of occurrence respectively. The impact of the risk exposures are \$420,000, \$125,000, \$313,000, and \$292,000 respectively, should they occur. The technology and external dependency risks are positive risks, whereas the people and process risks are negative risks. Calculate the expected monetary value required to manage Mahala Pty operational risk exposures. (12 mark)

(iii) Discuss why the total impact may be greater than the EMV. (5 mark)

Question 2 (25 marks):

Credit analysis involves ascertaining whether a potential borrower has the capacity to meet its loan obligations in accordance with the agreed terms. As the Chief credit analyst at Matsapha branch of FNB Ltd, Kwaluseni Grains Pty has sent its financial report for year ended 31st March 2020 for credit risk analysis.

Table 1: Kwaluseni Grains Pty Statement of Comprehensive Income as at 31st March, 2020

	(E000)
Sales	11500
Cost of sales	8000
Gross profit	3500
Selling expenses	1900
Interest payment	240
Earnings before tax	1360
Corporate tax (36%)	490
Net income	870
Cash dividend	320
Retained earnings	550

Table 2: Kwaluseni Grains Pty Statement of Financial Position as at 31st March 2020

	(E000)
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

Assume that the share price of Kwaluseni Grains Pty is E120, you are required to:

- (i) Outline the decision rule for the Altman's Z-score model for credit risk analysis. **(6 mark)**
- (ii) Calculate the Altman's Z-score coefficient using the financial report presented in Tables 1 and 2 to determine whether or not Kwaluseni Grains Pty has threat of financial distress in the 2021 financial year. **(16 mark)**
- (iii) Advice FNB Ltd on whether or not to grant credit facility to Kwaluseni Grains Pty based the Z-score coefficient. **(3 mark)**

Question 3 (25 marks)

Commerce Pty enters into E100 million notional amount swap with Manzini Ltd. The initiation date is December 15 2018. The swap requires Manzini Ltd to make payments to Commerce Pty based on Eswatini inter-bank offered rate (EIBOR) on 15th March, June, September and December 2019. The payment is determined by 3month EIBOR at the beginning of the settlement period. The payment is then made at end of the settlement period. Commerce Pty will pay Manzini Ltd fixed payments at a rate of 8.5% per year. If the EIBOR exceeds 8.5%, Commerce Pty will receive a payment from Manzini Ltd. If the EIBOR is less than 8.5% Commerce Pty will make a payment to Manzini Ltd. To reduce the cash flows on the swap, the two parties agree to net payment to the other. The EIBOR on December 15 2018 is 8.68%; on March 15 2019, it is 8.50%, on June 15 2019, is 8.06%, and on September 15 2019, it is 7.06%.

- (i) Determine the settlement amounts due to Commerce Pty and Manzini Ltd as well as the net amount for each of the settlement periods. **(17.5 marks)**
- (ii) What are the differences between forward rate agreement and interest rate futures? **(7.5 marks)**

Question 4 (25 marks)

- (i) Managing operational risk requires knowledge of processes, systems, and personnel as well as ensuring that duties and procedures have been clearly established, documented, and followed. What are the useful operational policies that should be implemented before managing operational risk exposures? **(10 marks)**
- (ii) Risk management has been described as a process to deal with uncertainties resulting from firm's exposures. Discuss the process of risk management. **(10 marks)**
- (iii) Highlight the rationale for risk management. **(5 marks)**

END OF PAPER