

**INSTITUTE OF BANKERS IN MALAWI**

**DIPLOMA IN BANKING EXAMINATION**

**SUBJECT: CREDIT RISK ASSESSMENT 1 (IOBM – D204)**

**Date: Sunday, 12th November 2017**

**Time Allocated: 3 hours (13:30 -16:30 Hours)**

**INSTRUCTIONS TO CANDIDATES**

1 This paper consists of **TWO** Sections, A and B.

2 Section A consists of 4 questions, each question carries 15 marks.

Answer **ALL** questions.

3 Section B consists of 4 questions, each question carries 20 marks. Answer **ANY TWO** questions.

4 You will be allowed **10 minutes** to go through the paper before the start of the examination, you may write on this paper but not in the answer book.

5 Begin each answer on a new page.

6 **Please write your examination number on each answer book used. Answer books without examination numbers will not be marked.**

7 DO NOT open this question paper until instructed to do so.

**SECTION A (60 MARKS)**

**QUESTION 1**

1. Outline the difference between a registered company and a partnership along these aspects
2. Legal personality and continuity
3. Liability for debts
4. Participation in management

*(9 marks)*

1. XYZ Ltd requires capital of MK3,000,000 to run operations in the next year. The existing shareholders have already invested K1,200,000 but need an additional K1,800,000 to meet the capital requirement. The shareholders can either borrow K1,800,000 from their bank at an interest rate of 10% per annum or invite new shareholders to invest K1,800,000. At the end of the year, the company will make an operating income of K600,000 before interest and tax. Taxation will be at 30% on profit after interest payment.

**Required:**

Calculate the Return on Equity when the company borrows K1,800,000 from the bank and when new shareholders invest in the company. *(6 marks)*

**(Total 15 marks)**

**QUESTION 2**

1. Discuss the contents and use in credit assessment, any **three** of the following components of financial statements:
2. Income Statement
3. Cash Flow Statement
4. Directors’ Report
5. Auditors Report *(9 marks)*
6. State the main objective of a cash flow statement and list any **four** abilities of a company that bankers can assess from the cash flow statement. *(6 marks)*

**(Total 15 marks)**

**QUESTION 3**

1. The main adverse effect of overtrading to a business is the storage of cash. In which areas does this problem manifest itself? May 2013 *(5 marks)*

1. Explain the difference between the two ratios and their implications on credit assessment.

*(6 marks)*

1. Briefly explain the **two** most common limitations of financial statement analysis.

*(4 marks)*

**(Total 15 marks)**

**QUESTION 4**

1. Define Working Capital and discuss its importance to a business. *(5 marks)*
2. Define the Cash Cycle and identify the **two** stages in the Operating Cycle. *(5 marks)*
3. Discuss the **two** main aspects that need to be considered in managing working capital. *(5 marks)*

**(Total 15 marks)**

**SECTION B (40 MARKS)**

Answer **ANY TWO** questions from this section

**QUESTION 5**

1. From the information in Appendix 1 calculate the following ratios for the two years 2000 and 2001:
2. Debtors Turnover
3. Creditors Turnover
4. Dividend Cover
5. Interest Cover
6. Debt Ratio
7. Equity Ratio

*(12 marks)*

1. Based on the calculations above, comment on the following in respect of the company
2. Working capital management with reference to debtors and creditors turnover.
3. Capability to service debt with reference to interest cover and debt ratio.
4. Capability to pay dividends. *(8 marks)*

**(Total 20 marks)**

**QUESTION 6**

**Required:**

1. From the information in appendix 1, calculate the K-Value for 2001 using the De Lay Rey Model and interpret the result.

K = 0.01662(a) + 0.111 (b) + 0.0529 (c) + 0.076 (d) + 0.017 (e) + 0.01071 (f) – 0.06881

*(14 marks)*

1. Mention **three** advantages and **three** limitations of financial forecast models.

*(6 marks)*

**(Total 20 marks)**

**QUESTION 7**

1. Discuss the **three** approaches to financing working Capital. *(9 marks)*

1. From the information in appendix 1, calculate the Cash Turnover for the business for the year 1999. Clearly show the components.

*(11 marks)*

**(Total 20 marks)**

**QUESTION 8**

1. From the information provided in Appendix 1, calculate the following for the year 2000. Clearly show the formula:
2. Degree of Operating Leverage
3. Degree of Financial Leverage
4. Degree of Combined Leverage

*(9 marks)*

1. With reference to your results in (a) above define and discuss the following:
2. Financial Risk
3. Business Risk
4. Breakeven Point

*(9 marks)*

1. Define fixed and variable costs of a business. *(2 marks)*

**(Total 20 marks)**

**APPENDIX 1**

|  |  |  |  |
| --- | --- | --- | --- |
| **Income Statement** |  |  |  |
|  | **1999** | **2000** | **2001** |
| Sales | 2,000.00 | 2,800.00 | 3,500.00 |
| Cost of Sales | 1,120.00 | 1,350.00 | 1,750.00 |
| **Gross Profit** | **880.00** | **1,450.00** | **1,750.00** |
|  |  |  |  |
| **Expenses** |  |  |  |
| Freight Out | 35.00 | 50.00 | 60.00 |
| Audit Fees | 87.00 | 102.00 | 115.00 |
| Discount Allowed | 4.00 | 6.00 | 8.00 |
| Interest Paid | 96.00 | 105.00 | 88.00 |
| Salaries | 280.00 | 310.00 | 370.00 |
| Depreciation | 45.00 | 45.00 | 45.00 |
|  | **547.00** | **618.00** | **686.00** |
|  |  |  |  |
| **Other Income** |  |  |  |
| Rent Received | 80.00 | 120.00 | 150.00 |
| Interest Received | 65.00 | 70.00 | 85.00 |
| Discount Received | 60.00 | 90.00 | 110.00 |
| **Profit Before Tax** | **538.00** | **1,112.00** | **1,409.00** |
| Tax | 180.00 | 332.00 | 467.00 |
| **Net Profit After Tax** | **358.00** | **780.00** | **942.00** |
| Dividends | 158.00 | 280.00 | 342.00 |
| **Retained Earnings** | **200.00** | **500.00** | **600.00** |
|  |  |  |  |
| **Balance Sheet** |  |  |  |
|  |  |  |  |
| **Capital Employed** |  |  |  |
| Ordinary Share Capital | 1,200.00 | 1,200.00 | 1,200.00 |
| Retained Earnings | 200.00 | 500.00 | 600.00 |
| General Reserve | 100.00 | 200.00 | 400.00 |
|  | **1,500.00** | **1,900.00** | **2,200.00** |
|  |  |  |  |
| **Long Term Liabilities** |  |  |  |
| Mortgage Bond | 900.00 | 810.00 | 700.00 |
| Direct Loans | 600.00 | 600.00 | 600.00 |
|  |  |  |  |
| **Total Capital Employed** | **3,000.00** | **3,310.00** | **3,500.00** |
|  |  |  |  |
| **Fixed Assets** |  |  |  |
| Land and Buildings | 2,010.00 | 2,010.00 | 2,010.00 |
| **Equipment - NBV** | 600.00 | 520.00 | 780.00 |
|  |  |  |  |
| **Fixed Deposit** | 150.00 | 320.00 | 500.00 |
|  |  |  |  |
| **Current Assets** |  |  |  |
| Cash | 128.00 | 350.00 | 330.00 |
| Debtors | 330.00 | 487.00 | 520.00 |
| Stock | 260.00 | 215.00 | 170.00 |
|  |  |  |  |
| **Current Liabilities** |  |  |  |
| Creditors | 280.00 | 240.00 | 400.00 |
| Dividends Payable | 70.00 | 70.00 | 90.00 |
| Tax Payable | 128.00 | 282.00 | 320.00 |
|  |  |  |  |
| **Total Capital Employed** | **3,000.00** | **3,310.00** | **3,500.00** |

\**Cash Flow After Tax 1156*

*\*Inflation adjusted total Assets 3976*

**END OF THE EXAMINATION PAPER**