

**INSTITUTE OF BANKERS IN MALAWI**

**DIPLOMA IN BANKING EXAMINATION**

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

**Date: Sunday, 3rd may 2015**

**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 20 multiple choice questions, each question carries 2 marks. Answer **ALL** questions.

3 Section B consists of 5 questions, each question carries 20 marks. Answer **ANY THREE** questions.

4 You will be allowed **10 minutes** to go through the paper before the start of the examination when 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 sheets without examination numbers will not be marked.**

7 All persons writing examinations without payment will risk expulsion from the Institute.

8 If you are caught cheating, you will be automatically disqualified in all subjects seated this semester.

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

**SECTION A (60 MARKS)**

Answer **ALL** questions from this section.

**QUESTION 1**

Briefly discuss **three** characteristics of each of the following personalities that have an effect on the credit assessment conducted by banks. The characteristics should be on legal status, liabilities for debt and borrowing needs.

1. Individual
2. Sole Proprietor
3. Partnership
4. Registered Company
5. Trusts Co-Operative **(Total 15 marks)**

**QUESTION 2**

In July 2014, Mr Gianopolis a Greek Tobacco farmer in Thuchila approaches your bank for advice on financing programs that can be availed to him for his farming business.

1. Provide a concise outline of the financing facilities available.

Discuss the benefits of each and the specific use of each in his business. *(6 marks)*

1. Outline **three** basic requirements and **three** security arrangements for Mr. Gianapolis to obtain financing. *(6 marks)*
2. In light of the recent heavy rains and flooding in the country, mention **three** of the credit risks impacting Mr. Gianapolis and their effect on the facility extended to the bank. *(3 marks)*

**(Total 15 marks)**

**QUESTION 3**

1. Define fixed and variable costs providing **two** examples for each. *(4 marks)*
2. Define Break-even point. *(2 marks)*
3. Calculate the break-even point for a business with fixed costs amounting to MK250,000, variable costs MK45 per unit, and each of its units sell for MK65.

*(4 marks)*

1. Discuss the importance of break-even analysis to credit risk assessment.

*(5 marks)*

**(Total 15 marks)**

**QUESTION 4**

1. Define the following items in the Financial Statements:
2. Current Assets and Current Liabilities
3. Debtors and Creditors
4. Leverage
5. Stock Turnover –
6. Liquid Assets  *(5 marks)*
7. Mr. Dimba has operated his stationery business for the past 12 months since inception. In the first year he had turnover amounting to MK0.5 million and capital of MK0.1 million. However, of late he has experienced a large increase in orders amounting to MK7.9 million without a growth in capital. He has since gone to the bank to apply for a loan to finance his business and Ms. Ntere, the Credit Analyst at NBH, has advised him that the loan may not be granted as the bank has concerns of overtrading on the part of Mr. Dimba.
8. With reference to the case, define overtrading. *(2 marks)*
9. Mention the **three** causes of overtrading. *(3 marks)*
10. What are **five** effects caused by overtrading? *(5 marks)*

**(Total 15 marks)**

**SECTION B (40 MARKS)**

Answer **ANY TWO** questions from this section

**QUESTION 5**

1. Briefly explain **four** components mentioned below of working capital that requires managing and how each one of them should be managed.
2. Cash or Bank overdrafts
3. Debtors and Creditors Control
4. Stock Control
5. Overheads and Operating Expenses *(12 marks)*
6. Discuss the **three** different approaches of financing working capital. *(8 marks)*

**(Total 20 marks)**

**QUESTION 6**

**Balance Sheet as at 30th September 2014**

**Non-Current Assets**

Plant and Machinery 84,500

Office Equipment19,200

**103,700**

**Current Assets**

Inventory 53,000

Recievables 30,400

Prepayments 5,000

Petty Cash 1,000

**89,400**

**193,100**

**Capital and Reserves**

Equity Shares of 50t each 100,000

General Reserves 25,000

Retained Earnings 21,500

**146,500**

**Current Liabilities**

Payables 30,400

Accruals 8,600

Bank Overdrafts 3,600

Income Taxes Payable 1,000

Final Dividend proposed 3,000

**46,600**

**193,100**

**Income Statement for year to 30th September 2014**

Sales Revenue 3,536

Cost of Sales (2,290)

**Gross Profit 1,246**

Selling and Distribution Costs (221)

Administration (252)

Interest Payable (85)

Income from Investments 24

**Profit Before Tax 712**

Income Tax Expense (210)

**Profit After Tax 502**

Using the above information, calculate the following ratios:

1. Return on Assets
2. Return on Equity
3. Debtors Period
4. Creditors Period
5. Current Ratio
6. Quick Ratio
7. Stock Turnover
8. Gross Profit Margin
9. Earnings Per Share
10. Debt Ratio  **(Total 20 marks)**

**QUESTION 7**

1. Define the operating cycle? *(2 marks)*
2. Discuss the key differences between the operating cycles of a retailing business and manufacturing business. *(6 marks)*
3. Malambe Co buys raw materials from suppliers that allows Malambe 2.5 months credit. The raw materials remain in stock for a month, and it takes the business 2 months to produce goods. The goods are sold soon after production and customers take on average 1.5 months to pay. Calculate the operating cycle for Malambe Co. *(8 marks)*
4. A statement of financial accounts (Financial Statements) is one of the key documents required in the assessment of a client’s credit risk. Specify the meaning of a qualified and unqualified auditor’s report.

Discuss how these reports would impact on the credit assessment of the client.

*(4 marks)*

**(Total 20 marks)**

**QUESTION 8**

Compare the business risk of XYX Bank and Shoprite in light of their cost structures. Your discussion should highlight why cost structure is important in the discussion of business risk, and how different cost structures increase or decreases business risk.

1. Elaborate with examples from the two institutions. *(15 marks)*
2. Explain **five** assumptions and limitations of break-even analysis. *(5 marks)*

**(Total 20 marks)**

**END OF THE EXAMINATION PAPER**