

**INSTITUTE OF BANKERS IN MALAWI**

**DIPLOMA IN BANKING EXAMINATION**

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

**Date: Sunday, 3rd November 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**

1. What are the **two** special credit risks or challenges that a lending banker is faced with in the course of making a decision of whether or not to lend to a tobacco farmer? *(4 marks)*
2. Identify the **three** criteria that are used when classifying businesses and state the value of such classification to a lending banker. *(6 marks)*
3. There is a caveat that applies to bank lending officials “thou shall not overindulge in your relationship with a borrower beyond that of a professional banker-customer relationship.” Of what relevance is this caveat? *(5 marks)*

**(Total 15 marks)**

**QUESTION 2**

1. What are the **three** critical factors that must be considered when managing bank liquidity? *(6 marks)*
2. Briefly comment on **four** functions that bank liquidity performs. *(4 marks)*
3. Identify and briefly comment on **five** factors that are normally associated with bank illiquidity. *(5 marks)*

**(Total 15 marks)**

**QUESTION 3**

1. What are the problems that are associated with businesses that continue carrying too much stock? *(5 marks)*
2. Explain the **two** beneficial outcomes to a business that exercises effective control over its overheads and operational expenses? *(4 marks)*
3. What is the major advantage and disadvantage of the adoption of the Conservative Approach to the financing of Working Capital? *(6 marks*)

**(Total 15 marks)**

**QUESTION 4**

Kanengo Purewater and Mzuzu Butter Ltd are currently negotiating borrowing arrangements from your bank. The following are summaries of balance sheets and revenue accounts for the year ended 31 December, 2008.

**Balance Sheet** **Kanengo Pure Water Ltd** **Mzuzu Butter Ltd**

(K’000) (K’000)

Issued capital 75 15

Issued preference shares 10 -

Revenue reserves 20 30

8% debentures 30 25

(secured on freehold property)

Trade creditors 45 30

Bank overdraft 20 -

200 100

Freehold property, at cost 30 45

Equipment, etc less depreciation 40 15

**Stocks**

Finished goods 30 25

Raw materials 40 -

Trade debtors 60 5

Bank - 10

200 100

Revenue accounts (K’000) (K’000) K’000 K’000

Sales cash - 170

Credit 240 30

240 200

Purchases

120 150

Wages, expenses 100 35

Depreciation 10 230 5 190

Net profit (retained) 10 10

**Required:**

A succinct statement, from the viewpoint of your bank’s assessment, of the financial stability of the two companies of:

(a) **Three** ways in which Kanengo Purewater Ltd seems to be “stronger” than Mzuzu Butter Ltd. *(6 marks)*

(b) **Three** reservations that could be advanced in relation to the observations in (a) above. *(3 marks)*

( c) **Three** ways in which Kanengo Pure Water Ltd seems “weaker” than Mzuzu Butter Ltd.  *(6 marks)*

**(Total 15 marks)**

**SECTION B (40 MARKS)**

Answer **ANY TWO** questions from this section

**QUESTION 5**

Every bank lending official worth his while would try as much as possible to disassociate herself from borrowers that are caught up in a web of overtrading. However, it is always the case that discovery of overtrading takes place when the banker is already committed to the borrower.

1. From the bank lender’s perspective, what are the **five** effects of overtrading that generate so much discomfort? *(4 marks)*
2. Identify only **four** indicators of overtrading that would be smiling at you in the course performing your financial analysis. *(4 marks)*
3. What series of advices would you provide your overtrading borrower on how to arrest the situation? **Note:** Provide only **three** advices. *(3 marks)*
4. Diagrammatical representation of Type of Financing.

Kwacha

SHORT TERM FINANCING

CURRENT ASSETS

LONG TERM FINANCING

FIXED ASSETS

Time

**Required:**

(a) What type of asset financing is depicted above? *(1 mark)*

(b) (i) Briefly explain how it works. *(2 marks)*

(ii) What are its advantages and disadvantages? *(6 marks)*

**(Total 20 marks)**

**QUESTION 6**

1. Provide **three** justifications in support of the popular assertion that success of any business hinges on the effective management of its working capital.

*(3 marks)*

1. State **five** criteria that can be used in order to determine the ideal level of working capital *(5 marks)*
2. A thorough analysis of your customer’s business suggests a dire need of working capital. Due to your bank’s exceedingly alarming NPLs (Non-Performing Loans), the bank has put a stop on further lending. All the same, you are convinced that his business has the future.

**Required**

Advise your customer of four other sources/options available, apart from borrowing facilities from banks, which he might resort to in order to beef up working capital requirements. *(5 marks)*

1. **CAMPARI** is a mnemonic universally recognized and commonly used in loan applications. Briefly explain its meaning. *(7 marks)*

**(Total 20 marks)**

**QUESTION 7**

(a) Explain the significance of the following approaches to working capital and identify a merit and demerit for each.

1. Moderate/Matching maturities approach *(4 marks)*
2. The Conservative approach *(4 marks)*
3. The Aggressive approach *(4 marks)*

(b) Identify **four** sources of working capital. *(4 marks)*

(c) Mention **two** aspects that are considered crucial when managing working capital.  *(4 marks)*

**(Total 20 Marks)**

**QUESTION 8**

Ntchawaka Ltd and Kabunthu Ltd trade in the same industry but in different geographical locations. The following data are taken from the 2010 annual accounts:

Ntchawaka Ltd Kabunthu Ltd

( K'000) ( K'000)

Turnover …........................................ 40, 000 60,000

Total operating expenses …............... 36, 000 55,000

Average total assets during 2010 ….. 30,000 25,000

**Required:**

(a) Calculate the rate of return on total assets (profits as a percentage of total assets) for each company. *(4 marks)*

(b) Analyze the rates of return in part (a) into the net profit percentage and the ratio of turnover to total assets. *(6 marks)*

(c) Comment on the relative performance of the two companies insofar as the information permits. Indicate what additional information you would require to decide which company is the better proposition in the viewpoint of:

1. potential shareholders; and
2. potential loan creditors *(10 marks)* **(Total 20 marks)**

**END OF THE EXAMINATION PAPER**