

**INSTITUTE OF BANKERS IN MALAWI**

**DIPLOMA IN BANKING EXAMINATION**

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

**Date: Sunday, 13th May 2018**

**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 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**

An unregistered farming business which operates in Kasungu is looking for a borrowing amounting to K20 million. The business is owned by two friends, Mr P Phiri and Mr K Banda and its main line of business is tobacco farming of which the product is sold through Auction floors. The business owns a farm and some farming machinery and equipment.

**Required:**

1. Explain **two** possible reasons for the borrowing.

*(4 marks)*

1. Identify **two** borrowing facilities that may be readily available to the business and their associated suitable need.

*(2 marks)*

1. Briefly describe **three** credit risks associated with this business.

*(9 marks)*

**(Total 15 marks)**

**QUESTION 2**

Your analysis indicates that Chisomo Enterprises has to be making a monthly profit of K5 million for it to be able to comfortably service the loan that it took from your institution. Chisomo Enterprises sells computers in a highly competitive market. It has made the following estimates for the forthcoming year.

Selling price per computer K500,000

Variable cost per computer K300,000

Total fixed costs per month K10,000,000

**Required:**

1. Use breakeven analysis, to calculate:
2. The breakeven point for the business per month.
3. The minimum number of computers that Chisomo Enterprises should be selling per month to comfortably service the loan. *(5 marks)*
4. Mention f**our** limitations of breakeven analysis techniques. *(4 marks)*
5. Discuss how business risk and financial risk of Chisomo Enterprises can be determined (In your discussion, include formulas). *(6 marks)*

**(Total 15 marks)**

**QUESTION 3**

Njobvu Holdings Company has presented its annual consolidated financial statements which contain among others things, an auditor’s report and directors’ report. The opinion of the auditors is that the financial statements fairly present the financial position, except for the value of debtors which they feel has been overstated.

**Required:**

1. Differentiate a qualified auditor’s report and unqualified auditor’s report. *(2 marks)*
2. State **four** duties of auditors. *(2 marks)*
3. Discuss the meaning and relevance of the opinion of the auditors over the financial statements of Njobvu Transport Services to credit risk assessment. *(4 marks)*
4. Discuss the usefulness of any **four** items contained in directors’ report to credit risk assessment exercise. *(4 marks)*
5. Explain how the consolidated financial statements of Njobvu Holdings Limited be approached when vetting its creditworthiness? *(3 marks)*

**(Total 15 marks)**

**QUESTION 4**

You have been provided with the following extracts of the income statements and balance sheets of Nyasa continental for the past three years.





**Required:**

1. Calculate the following ratios for the three years based on the financial statements of Nyasa Continental.
2. Current ratio
3. Quick ratio
4. Debtors collection period
5. Creditors payment period *(12 Marks)*
6. Based on ratio calculated in (a), analyse the liquidity of Nyasa Continental. *(3 Marks)*

**(Total 15 marks)**

**SECTION B (40 MARKS)**

Answer ANY **TWO** questions from this section

**QUESTION 5**

Balance sheet and cash flow statement are components of financial statements that are used in credit risk assessment.

**Required:**

1. Describe the balance sheet and cash flow statement. *(4 marks)*
2. Mention any **two** main contents of cash flow statement according to International financial reporting standards (IFRS). *(2 marks)*
3. Briefly describe the following items contained in the balance sheet:
4. Capital employed *(2 marks)*
5. Distributable reserves *(2 marks)*
6. Deferred expenditures *(2 marks)*
7. Current assets *(2 marks)*
8. Current liabilities *(2 marks)*
9. Investments *(2 marks)*
10. Debenture *(2 marks)*

**(Total 20 marks)**

**QUESTION 6**

Given below are the profitability ratios of one of your clients.



**Required:**

1. Briefly explain the meaning of each of the five ratios indicated above. *(10 marks)*
2. Based on the ratios provided, comment on the overall profitability of the client business over the three-year period from 2016 to 2018. *(10 marks)*

**(Total 20 marks)**

**QUESTION 7**

Typical borrowers in Malawi are: individuals, sole proprietors, partnerships, registered companies, trusts and co-operatives.

**Required:**

1. Discuss the liability to debts for each of group of borrowers *(12 marks)*
2. Identify the specific credit risks for:
3. Individuals
4. Sole proprietors
5. Registered companies
6. Trusts *(8 marks)*

**(Total 20 marks)**

**QUESTION 8**

Wongani Investments is expecting to have an opening cash balance of K30 million on 1 October 2018. The budgeted sales for different months were as given below:

**Month K’000**

September 90,000

October 75,000

November 75,000

December 80,000

Analysis of records shows that customers for Wongani Investments settle their debts in the following pattern:

60% within the month of sale

40% the following month

Extracts from the purchases budget were as follows:

**K‘000’**

September 60,000

October 55,000

November 45,000

December 55,000

All purchases are on credit and past experience shows that 70% of purchases are settled in the month of purchase and the balance a month after.

Wages of K15 million, overheads of K20 million are settled monthly.

Tax of K8 million is to be paid in November and the company will receive settlement of an insurance claim of K25 million in October.

**Required:**

1. Prepare a cash budget for three months to December 2018. *(17 marks)*
2. Explain three golden rules when drawing up a cash flow budget *(3 Marks)*

**(Total 20 marks)**

**END OF EXAMINATION PAPER**