

UNIVERSITY EXAMINATIONS



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Unique number of paper
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414514

MNK203-R (414514)

May/June 2005

BUSINESS MANAGEMENT (RISK) 202

Duration : 2 Hours

70 Marks

EXAMINERS :

FIRST :

MS LM MALOBOLA

MS CJ DE SWARDT

SECOND :

MR JS DE BEER

PROF GS DU TOIT

Use of a non-programmable pocket calculator permissible.

This paper consists of 7 pages plus the instructions for completion of a mark reading sheet.

This paper adds up to a total of 70 marks. This mark will be adjusted to a percentage mark.

This paper consists of TWO sections, namely A and B.

Section A is compulsory. It consists of thirty multiple choice questions that each counts 1 mark. The answers to this section must be completed on the mark reading sheet provided.

Section B consists of four discussion type questions. You must answer ALL FOUR of these questions. Each question counts 10 marks.

SECTION A: MULTIPLE CHOICE QUESTIONS

This section consists of thirty multiple-choice questions that must be filled in on the mark-reading sheet that is provided.

1. It is important to classify risks because ...
1. some risks can be managed by the enterprise while others cannot.
 2. It gives vital information on the physical/financial environment of the enterprise.
 3. It allows the risk manager to effectively manage these risks.
 4. All of the above.
2. Which one of the following statements is correct?
1. Core business risks impact directly on the organization's operating profits.
 2. Event risks offer a chance of making a gain or loss for an organization.
 3. Speculative risks concern only the possibility of loss for an organization.
 4. Incidental risks can be divided into specific risks and market risk.

[TURN OVER]

- 3 Core business risks...
1. affect the operating profits of the enterprise.
 2. arise indirectly as a result of the business activities.
 3. evolve from fluctuating financial claims.
 4. represent the downside of future events.
- 4 Uncertainty arises because of ...
1. an imperfect state of mind and objectives.
 2. an imperfect state of knowledge about the future.
 3. unclear objectives.
 4. uncertain decision-making.
- 5 If we do not define risk when we speak about it...
1. people will have different perceptions of risk.
 2. people will not have any understanding of risk whatsoever.
 3. people will tend to avoid talking about risk.
 4. people will understand what risk is and what it involves.
- 6 Which one of the following is not a category of specific business risk?
1. Sales variability
 2. Operating leverage
 3. Resource risks
 4. Compliance risks
- 7 South African enterprises should strive for good corporate governance because...
1. It is important in order to attract both foreign and domestic capital.
 2. there is an increasing demand for investment funds in developed and developing countries.
 3. investors' trust in companies has decreased while company ethics are widely criticised.
 4. All of the above.
- 8 The impact of corporate governance on business areas of the enterprise include, inter alia, the following:
- a. Employing assets effectively.
 - b. Meeting social obligations
 - c. Overall performance
 - d. Attracting lower-cost capital
- Choose the correct combination.
1. a,d
 2. a,b,d
 3. a,c,d
 4. a,b,c,d
- 9 Which one of the following is not a shortcoming of the Companies Act 61 of 1973 in terms of requirements for good corporate governance?
1. It does not address the accountability and responsibility of the enterprise to stakeholders.
 2. It does not make provision for the liability of directors and shareholders if a company acts unlawfully or in bad faith.
 3. It does not regulate non-audit services.
 4. It makes it difficult to monitor the dealings of the board of directors.

10 Which one of the following is not a basic characteristic of the concept of corporate governance?

1. Discipline
2. Transparency
3. Profitability
4. Accountability

11 Indicate the correct statement.

1. According to the traditional approach risks are managed using derivatives.
2. The traditional approach adopts a comprehensive approach to managing risks.
3. The traditional approach integrates the efforts of operating managers and risk managers.
4. The traditional approach views risk management as part of everyone's job.

12 The need for a more integrated and holistic view of risk management is emphasized by...

- a Change
- b Globalization
- c Technology
- d Increased concentration of risk
- e The increased value of tangible assets.

Choose the correct combination.

1. a,b,c,d,e
2. a,b,c,e
3. a,b,d,e
4. a,c,d,e

13 Which one of the following is not a risk identification method?

1. SWOT analysis
2. Insurance reviews
3. Personal interviews
4. "As-if" analysis

14 Which one of the following methods can be used to establish potential loss frequency?

1. Asset value
2. "Pareto" rule
3. Normal loss expectancy
4. Maximum possible loss

15 Which one of the following fire losses would you regard as the most serious?

1. R5m which occurs every ten years.
2. R3m which occurs every seven years.
3. R1m which occurs every three years.
4. R9m which occurs every seventeen years.

16 The leasing of computer equipment is an example of...

1. risk transfer
2. risk reduction
3. risk avoidance
4. risk elimination

17 A driver training programme is an example of...

1. risk transfer
2. risk reduction
3. risk avoidance
4. risk elimination

18 Indicate the incorrect statement.

1. Futures contracts are traded on a formal exchange.
2. Futures contracts are tailor-made instruments which tend to be more expensive.
3. Forward contracts are less liquid than futures contracts.
4. Forward contracts entail higher credit risk than futures contracts.

Answer questions 19 and 20 by making use of the following information:

Company A uses short-term financing by issuing banker's acceptances. The treasurer expects short-term interest rates to rise and wants to hedge the next BA-rollover. Assume the following applies:

Nominal amount	R 1 000 000
Current date	4 April
Rollover/settlement date	20 July
Spot rate on 20 July	18,6%
FRA spot offer rate	16,6%

The treasurer wants to hedge the next roll-over by buying an FRA at 16,6%.

19 In order to lock in the discount rate at 16,6%...

1. the bank will have to pay R2 712 to Company A.
2. Company A will have to pay R2 712 to the bank.
3. the bank will have to pay R4 685 to Company A.
4. Company A will have to pay R4 685 to the bank.

20 The cost (discount) of re-issuing the BA will be as follows:

1. R45 616
2. R38 219
3. R35 506
4. R 3 452

21 A six-month put option is written on a commodity at a strike price of R85. The option of the premium is R0,50. The market price of the commodity at the time the option was written was R84. Three months after the option was written the market price of the commodity has dropped to R83.

Based on the aforementioned information the buyer of the option will...

1. walk away from the option and lose the premium of R0,50.
2. walk away from the option and buy the commodity at a lower price in the market.
3. exercise the option and make a profit of R1,50.
4. exercise the option and make a profit of R2,50.

22 A fire drill practice by staff for risk control purposes is an example of...

1. physical measures.
2. procedural measures.
3. education/training.
4. legal measures.

23 The reasons for aggregating the activities directed at achieving enterprise-wide risk include:

- a The cumulative effect of risk
- b Increased efficiency and better decisions
- c Improved reporting and capital allocation
- d Simplicity

Choose the correct combination.

- 1. a,b
- 2. a,b,c
- 3. a,c,d
- 4. a,b,c,d

24 Indicate the correct statement.

- 1. Hurdle rates incorporate the riskiness of the business activities into the measurement of the expected return.
- 2. "At risk" frameworks quantify risks on the basis of the probability distributions of returns observed in historical data.
- 3. Risk-adjusted performance measures provide a means of evaluating return, risk and capital trade-offs and comparing performance across different units or activities.
- 4. Risk pooling approaches indicate how much greater the return would be at each level of risk.

25 The setting of clear goals and objectives is part of which one of the elements of the business risk management process?

- 1. Establish the process
- 2. Assess the business risks
- 3. Formulate the risk management strategies
- 4. Design and implement the risk management strategies

26 Which one of the following is not a benefit of ERM?

- 1. Increased organizational effectiveness
- 2. Better risk reporting
- 3. Improved business performance
- 4. Learning from experience

27 Indicate the correct statement.

- 1. Maximum possible loss is the maximum loss that could result from a single event under unfavourable conditions.
- 2. Normal loss expectancy describes the extent to which various risks could accumulate into a large loss as a result of the operation of a single event.
- 3. "As if" analysis takes full cognisance of the real value of an asset.
- 4. Business Interruption entails a specific analysis of the past history of an organization.

28 Which one of the following can be classified as a category 3 risk for financing the control of event risks?

- 1. infrequent small losses
- 2. intermediate small losses
- 3. frequent average losses
- 4. infrequent large losses

29 Indicate the correct statements.

- a In the case of interest rate collars, the borrower is protected against rates rising above the determined limit, while the lender is protected from rates falling below the limit.
- b In a typical interest rate swap, there are two borrowers, one paying a fixed and the other paying a floating rate.
- c As a result of an interest rate swap, both borrowers pay less interest than what they would have paid before the swap.
- d In an interest rate swap, each of the borrowers pays the other's interest.

Choose the correct combination.

- 1 a,b,c,d
- 2 a,b,c
- 3 b,c,d
- 4 c,d

30 Which one of the following is not a class of risk management objectives?

- 1. Operational objectives
- 2. Reporting objectives
- 3. Strategic objectives
- 4. Compliance objectives

[1 x 30 = 30]

SECTION B: ANSWER ALL FOUR QUESTIONS IN THIS SECTION

Question 1

- 1.1 Explain why it is important to distinguish between fundamental and specific risks. 5
- 1.2 List the five steps/tasks in establishing a basis from which to launch an ERM strategy. 5
(10)

Question 2

- 2.1 Distinguish between the narrow and broader definitions of corporate governance. 4
- 2.2 "For risk management to be effective, it is important that only incidents that actually caused damage or losses should be reported to the risk manager" Is this statement true or false? Give reasons for your answer. 6
(10)

Question 3

- 3.1 Outline the importance of a common language of risk within enterprises. 4
- 3.2 Discuss the three types of risk management objectives that can be set by enterprises when implementing ERM. 6
(10)

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Question 4

- 4.1 Discuss the benefits of the effective implementation of Enterprise Risk Management. 6
- 4.2 Explain what is meant by a perfect hedge. 4

(10)

[4 x 10 = 40]
Total marks: 70



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