



MNK203-R (416940)

May/June 2006

BUSINESS MANAGEMENT (RISK) 203

Duration 2 Hours

70 Marks

EXAMINERS :

FIRST :

SECOND :

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Use of a non-programmable pocket calculator permissible.

This paper consists of 15 pages plus instructions for completion of a mark reading sheet.

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

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

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. Indicate the unique number (416940) on the mark-reading sheet.

Section B consists of FOUR discussion/calculation type questions. You must answer ALL FOUR of these questions. Each question counts 10 marks. Section B must be answered in the designated areas on pages 10 - 13.

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Please note:

- 1 This is a fill-in examination paper and there is no need for any examination scripts. Students must hand over the examination paper to the invigilator before leaving the examination hall. Students must answer the questions in the spaces which have been provided in the examination paper.
- 2 Pages for rough work have been provided (see pages 14 to 15). No rough work will be marked.

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SECTION A : MULTIPLE CHOICE QUESTIONS

1. During a hailstorm the gutters of a house are blocked. This causes consequential damage to the possessions in the house.

Indicate the incorrect statement.

- 1 The hail can be considered both a peril and a hazard in this case.
- 2 The blocked gutters are a physical hazard.
- 3 The blocked gutters are a peril.
- 4 The storm is a peril.

2. The incompetence of production staff for a motor manufacturer can be considered as a ... for the specific organisation.

- 1 incidental business risk
- 2 event risk
- 3 core business risk
- 4 fundamental pure risk

3. A South African bank with a short position in American Dollar ...

- 1 will gain by a depreciation of the Rand against the Dollar.
- 2 will gain by an appreciation of the Rand against the Dollar.
- 3 has more assets in US Dollar than liabilities.
- 4 is exposed to currency risk.

4. Which of the following can be classified as moral hazards?

- a a driver of a motor vehicle driving under the influence of alcohol.
- b a worker leaving a dangerous machine unattended to talk to other workers.
- c a businessman loading insurance claims.
- d an employee who occasionally steals money from the petty cash.

Indicate the correct combination.

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

5. A probability distribution is ...

- 1 a way of expressing risk.
- 2 a collectively exhaustive list of all outcomes.
- 3 a way of expressing risk and return under certain circumstances.
- 4 none of the above.

6. Which of the following is not a risk control expenditure?

- 1 depreciation on security systems.
- 2 risk control training.
- 3 costs attached to handling of insurance claims.
- 4 management time utilised on handling insurance claims.

7. Which of the following methods can be used in the evaluation of loss frequency?

- 1 Pareto rule
- 2 Accumulation
- 3 Maximum possible loss (MPL)
- 4 'As if' analysis

8. The impact of corporate governance on business areas of the enterprise include, inter alia, the following:

- a Employing assets efficiently.
- b Meeting social obligations.
- c Improving 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. Displaying disclaimer notices in a parking area is an example of..

- 1 physical risk control
- 2 procedural risk control.
- 3 risk elimination.
- 4 legal risk control

10. Indicate the incorrect statement.

- 1 Futures contracts are traded on a formal exchange.
- 2 Futures contracts tend to be more expensive than forward contracts.
- 3 Forward contracts are less liquid than future contracts.
- 4 Forward contracts entail higher credit risk than future contracts.

Answer the next two questions by making use of the following information:

Company A uses short-term finance 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 information applies:

Nominal amount	R1 000 000
Current date	4 April
Rollover/settlement date	20 July
Spot rate on 20 July	15,50%
FRA spot offer rate	16,60%

The treasurer wants to hedge the next rollover by buying an FRA at 16.60%

11. In order to lock in the discount rate at 16.60%

- 1 the bank will have to pay R2 712,33 to Company A
- 2 Company A will have to pay R2 712,33 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

12. The cost (discount) of issuing the BA will be as follows:

- 1 R40 150,68
- 2 R38 219,18
- 3 R35 506,85
- 4 R 3,452,05

13. Which of the following are examples of alternative risk transfer (ATR) techniques?

- a Futures
- b Captives
- c Commercial insurance
- d Swaps

Choose the correct combination

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

14. Which of the following statements is correct?

- 1 Risk and uncertainty are mutually interchangeable concepts.
- 2 Uncertainty in terms of motorcar accidents can be classified as subjective uncertainty.
- 3 Only fundamental pure risks are insurable.
- 4 Investment risk refers to the risk that an organisation may lose interest income due to changes in the market interest rates.

15. Indicate the correct statements

- a In case of an interest rate collar, the borrower is protected against rates rising above the determined limit, while the lender is protected from rates falling below the limit.
- b When closing an interest rate swap deal, it is important that the net present value of future cash flows for the fixed and variable side of the deal must be equal to zero.
- c The result of an interest rate swap transaction is that the interest rate obligations as well as the risk of inherent interest rate changes are swapped.
- d American options can be exercised at any time until the expiration date while European options can only be exercised on the expiration date.

Choose the correct combination

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

16. Indicate the correct statement.

- 1 The degree of risk is calculated as the frequency with which an event occurs.
- 2 Risk is present in situations of certainty.
- 3 Risk is the deviation of actual results from expected results.
- 4 All events have a probability of between 0 and 10.

17. 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.

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

- a change
- b globalisation
- 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

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

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

20. Which of the following aspects are normally not considered when establishing the potential frequency of losses?

- 1 Incident reporting.
- 2 National and international trends.
- 3 Standing charges.
- 4 Near misses.

21. Assume the following hypothetical distribution of stock losses for a small chain of retail stores

AMOUNT OF LOSS	PROBABILITY OF OUTCOME
R40 000	0.50
R50 000	0.30
R60 000	0.20

The expected value of losses is as follows:

- 1 R37 000
- 2 R47 000
- 3 R50 000
- 4 R150 000

22. All of the following are benefits of ERM **except**:

- 1 increased organisational effectiveness
- 2 better risk reporting
- 3 improved business reporting
- 4 learning from experience

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

- 1 Establishment of the process.
- 2 Assessment of the business risks.
- 3 Formulation of the risk management strategies.
- 4 Design and implementation of the risk management strategies.

24. All of the following are classes of risk management objectives **except**?

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

25. Indicate the correct statement

- 1 When buying interest rate futures one will benefit from a fall in interest rates.
- 2 When buying interest rate futures one will benefit from a rise in interest rates.
- 3 When selling interest rate futures one will benefit from an upward move in the market.
- 4 When selling interest rate futures one will benefit from a rise in the interest rates.

26. Which of the following environmental factors are contributing to the successful implementation of an ERM framework?

- a Culture.
- b Performance management and compensation.
- c Training and communications.
- d Data and information systems.

Choose the correct combination

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

27. To ensure continuous risk management learning, the following outcomes should be pursued

- a Learning from experience is valued and lessons should be shared to create a supportive work environment.
- b Learning plans should be built into the enterprise's risk management practices.
- c The results of risk management should be evaluated to support innovation, capacity building and continuous improvement.
- d Experience and best practices should be shared – internally and across the enterprise.

Choose the correct combination

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

28. Which of the following are characteristics of good corporate governance?

- a discipline
- b responsibility
- c transparency
- d economic responsibility

Choose the correct combination

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

29. The destruction of a factory by a fire is a category two type of risk, characterised by

- 1 Low frequency and low severity.
- 2 Low frequency and high severity.
- 3 High frequency and low severity.
- 4 High frequency and high severity.

30. Which of the following are considered limitations of the Companies Act in terms of corporate governance?
- It does not address the accountability and responsibility of an enterprise to its stakeholders.
 - It does not provide for tripple bottom-line reporting; only for financial reporting.
 - It does not regulate the supply of non-auditing services by the auditing firm.
 - It is not difficult to police the dealings of boards and directors.

Choose the correct combination

- a,b
- a,b,d
- a,b,c
- c,d

SECTION B : PARAGRAPH QUESTIONS AND CALCULATIONS

Question 1

1. List and briefly explain the five steps/tasks in establishing a basis from which to launch an ERM strategy [10]

1) Establish an oversight structure

- a working group of Snc execs supported by aEC
to develop the scope of ERM

2) Define a common language : terminology

- provides a starting point for identifying, assessing source of risks in bus processes

3) Target risks + processes

focus on those areas which impact company's performance variability = losses + affecting margins, cost/turnit

4) Develop overall goals, objectives + process

defining bus risk program, vision, goals, objectives

5) Assess risk management capabilities

current state of ERM documented for areas or baseline to identify necessary improvements

Question 2

2.1 Discuss the difference between a forward contract and a futures contract. (4)

Forward contract bought over the counter.
is illiquid & has higher credit risk.
Futures contract bought on a formal exchange.
is liquid & has lower level of credit risk.

2.2 Explain what is meant by a perfect hedge. (2)

The losses & gains of the 2 positions
(long position + short position) balance each other out.

2.3 Explain why it is important to establish a common language for risk in the enterprises. (4)

The use of a common language facilitates communication.
It promotes learning.
It facilitates the aggregation of risks in the organisation.
It is a fundamental building block of CRM.

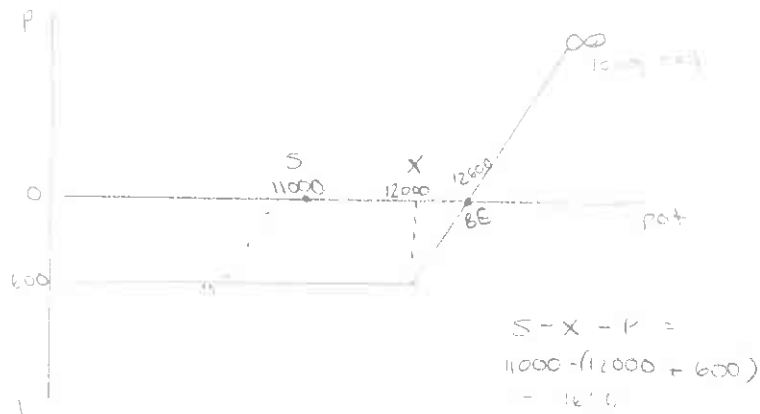
[10]

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Question 3

3.1 An organisation buys a six month option to sell an asset at a strike price of R12 000. The cost of the option amounts to R600. Two months after the transaction the market value of the asset dropped to R11 000.

3.1.1 Graphically illustrate the position of the buyer of the option at the market value of R11 000. (4)



3.1.2 Explain the profit/loss position of the buyer of the option if the option is

• Not exercised (2)

Loss is R600 premium

• Exercised (2)

Loss = R1600

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- 3.1.3 Indicate how the position of the buyer will be affected, if it is a European option. (2)

European option: can only be exercised
 expiring date. Since there are a number
 left till expiry the market price could be in favour
 of the buyer

Question 4 [10]

- 4.1 Identify and define the two categories of event risk. (4)

External Downside Risk

- external factors i.e. natural disasters + robberies
 which affect the enterprise negatively

Operational Risk

exposure of enterprise to losses resulting from
 internal failures or shortcomings of people, processes, systems

- 4.2 List six trends necessitating the development of a strategic approach to risk management. (6)

- globalisation

- change

- technology

- increased concentration of risk

- increased value of intangible assets

- New business practices

- increasingly accountable (and demanding) directors

- emergence of new RM tools + processes

- increasingly demanding investors / regulators

[10]

DO YOUR ROUGH WORK HERE.
 NO ROUGH WORK WILL BE MARKED.