

KASNEB

CCP PART III SECTION 6

CORPORATE LENDING

FRIDAY: 26 May 2017.

Time Allowed: 3 hours.

Answer ALL questions. Marks allocated to each question are shown at the end of the question. Show ALL your workings.

QUESTION ONE

- (a) In use of a company's assets as collateral for financing, lenders evaluate impairment on the assets so as to have a fair approximation of their value.

In relation to the above statement, discuss five indicators of impairment considered by lenders. (10 marks)

- (b) Abuse of credit rating in lending is associated with adverse economic impacts in the financial sector as witnessed during the 2007/2008 financial crisis.

With reference to the above statement, analyse five credit rating challenges that might have led to the financial crisis. (10 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Outline four warning signs of problem loans. (4 marks)

- (b) The following are the statements of financial position for Heifer Ltd. as at 30 April 2017 and 30 April 2016:

	2017 Sh. "000"	2016 Sh. "000"
Non-current assets	1,300	1,000
Accumulated depreciation	(600)	(400)
	700	600
Investments	100	400
	800	1,000
Current assets:		
Inventory	400	800
Accounts receivable	3,100	2,700
Cash and bank balance	-	200
Total assets	<u>5,300</u>	<u>4,700</u>
Financed by:		
Ordinary share capital at Sh. 1 each	1,500	1,000
Share premium account	400	300
Retained earnings	1,060	1,340
	2,960	2,640
Current liabilities:		
Bank overdraft	120	-
Accounts payable	1,840	1,600
Taxation	380	460
Total equity and liabilities	<u>5,300</u>	<u>4,700</u>

Additional information:

- During the year ended 30 April 2017, some non-current assets which were purchased at Sh.50,000 were sold for Sh.40,000 in cash.
- The accumulated depreciation on the disposed non-current assets as at 30 April 2016 amounted to Sh.20,000.
- Investments costing Sh.300,000 were sold at their book value during the year ended 30 April 2017.
- The taxation balances in the books of accounts represent the actual amount agreed with the revenue and customs authority. All taxes were paid on their due dates.
- A dividend of Sh.260,000 was paid during the year ended 30 April 2017.

6. During the year ended 30 April 2017, the company made a rights issue of 1 share for every 2 shares held. The rights issue was made at Sh.1.20 per share.
7. Earnings before tax for the year ended 30 April 2017 was Sh.360,000.

Required:

Cash flow statement for the year ended 30 April 2017 using the indirect method.

(16 marks)

(Total: 20 marks)

QUESTION THREE

(a) With reference to predatory lending, explain the following types of lending:

- (i) Loan sharking. (2 marks)
- (ii) Loan flipping. (2 marks)
- (iii) Loan packing. (2 marks)

(b) On 1 May 2017, Mega Ltd. applied for a loan of Sh.50 million from TLD Bank. TLD Bank in their offer letter, gave the following requirements that Mega Ltd. must have met for the years 2015 and 2016:

- Operating profit should be above 35%.
- Net profit margin should be above 20%.
- Current ratio should be above 1.2.
- Total liabilities should not exceed 65% of total assets.
- Annual revenue growth should be above 10% per annum. The 2014 revenue was Sh.650 million.
- For the application to pass the appraisal stage, three of the five conditions above must be met.

Below are the extracts from the books of accounts of Mega Ltd. for the years 2015 and 2016:

Income statement extract:

	2015 Sh. "million"	2016 Sh. "million"
Revenue	710	725
Gross profit	515	520
Operating profit	275	260
Profit before tax	235	205
Profit for the year	185	160

Balance sheet extract:

	2015 Sh. "million"	2016 Sh. "million"
Non-current assets	515	975
Current assets	165	140
Capital and reserves	460	635
Non-current liabilities	20	85
Current liabilities	200	395

Required:

Analyse whether Mega Ltd.'s application passed the appraisal stage.

(14 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Jazzi Ltd. was incorporated in Kenya in 2004. The company's main line of business is the sale of computers. The company has received a foreign purchase order from the Rwandan government. The management of Jazzi Ltd. is worried about the foreign currency transaction involved. They have approached you as a credit consultant to advise the management on foreign transactions.

Required:

Advise the management of Jazzi Ltd. on four methods they could use to mitigate foreign exchange risk.

(8 marks)

- (b) ABC Ltd. is a wholly owned subsidiary of DEF Ltd. DEF Ltd. is 60% owned by GHI Ltd. and 25% by JKL Ltd. Taratibu Consortium is the sole shareholder of GHI Ltd. and JKL Ltd., giving it an overall 85% indirect stake in ABC Ltd.

Taratibu Consortium has applied for a loan in your bank. As a credit analyst, you are aware that lending to a group requires special consideration of risk.

Required:

Analyse six areas of special consideration before lending to Taratibu Consortium.

(12 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) Highlight four advantages of e-billing. (4 marks)
- (b) Describe how the following techniques could be used to detect a fraudulent credit card transaction in an e-payment infrastructure:
- (i) Address verification system (AVS). (2 marks)
 - (ii) Card verification number (CVN). (2 marks)
- (c) The prudential guidelines issued by central bank have categorised some loans as non-performing. Enumerate two classifications of non-performing loans. (4 marks)
- (d) Discuss four precautions that a bank might take when lending long-term to a corporate. (8 marks)

(Total: 20 marks)

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