RSK2601 TEST BANK

Question 1
Which one of the following is a benefit of effective risk and opportunity management?

1) Improved profit certainty
2) Increased shareholder value
3) Increased stakeholder confidence **Correct option 3**
4) Lower economic returns

Explanation

Improved **cost** certainty, **sustainable** shareholder value, increased stakeholder confidence and **higher** economic returns are all benefits of effective risk and opportunity management.

Question 2
The board's role should be to steer the corporation towards corporate governance policies that support …

1) long-term sustainable growth in shareholder value **Correct option 1**
2) short-term sustainable growth in shareholder value
3) short-term sustainable growth in stakeholder value
4) long-term sustainable growth in stakeholder value

Explanation

The board's role should be to steer the corporation towards corporate governance policies that support long-term sustainable growth in shareholder value.

Question 3
Which one of the following statements is not considered a benefit of Enterprise Risk Management (ERM)?

1) Minimise operational surprises and losses.
2) Enhance corporate governance.
3) Comply with relevant legal and regulatory requirements.
4) Align return appetite and strategy. **Correct option 4**

Explanation

Benefits of Enterprise Risk Management (ERM) include minimisation of operational surprises and losses, enhancing corporate governance, complying with relevant legal and regulatory requirements and aligning **risk** appetite and strategy**. The determination of the risk appetite of a business is vital in the ERM process because it shows how much risk the business is willing to take on.**

Question 4
The King II report moved away from the … bottom-line principle to a … bottom-line principle.

1) double - triple
2) single - triple **Correct option 2**
3) single - double
4) double – single

Explanation

The King II report moved away from the **single** bottom-line principle to a **triple** bottom-line principle.

Question 5
As of June 2010, companies listed on the JSE are expected to comply with …

1) King I
2) King II
3) King III **Correct option 3**
4) King IV

Explanation

As of June 2010, companies listed on the JSE are expected to comply with **King III**.

Question 6
King III applies to …

a) All listed companies on the JSE
b) Banks
c) Financial institutions
d) Insurance institutions

Choose the correct option.

1) a, b, c, d
2) a, b, c
3) a, b, d **Correct option 3**
4) a, b

Explanation
King III applies to all listed companies on the JSE, banks, financial and insurance institutions.

Question 7
In financial ratio analysis, efficiency ratios …

1) measures the degree of success of the management in achieving their primary purpose of creating wealth for their owners
2) are also known as activity ratios **correct option 2**
3) examine the relationship between liquid resources held and creditors due for payment in the near future
4) assess the returns and performance of shares held in a particular business

Explanation
In financial ratio analysis, efficiency ratios are also known as activity ratios.

Question 8
A GAP analysis …

1) is used to list all the risks that were identified on previous projects within the business
2) is a list that categorises each risk into a type of area
3) can be used to identify the main risks linked to a certain activity or project of the business **Correct option 3**

4) is a structured checklist to breakdown the risks and opportunities into manageable components

Explanation

A **GAP analysis** can be used to identify the main risks linked to a certain activity or project of the business. A **risk checklist** is used to list all the risks that were identified on previous projects within the business.

A **risk prompt list** is a list that categorises each risk into a type or area.

Risk taxonomy is a structured checklist to breakdown the risks and opportunities into manageable components.

Question 9

Pareto analysis is used to …

1) identify those risks that will have a dramatic impact on business projects/activities and objectives **Correct option 1**
2) determine the expected return of an asset in relation to its risk or risk profile
3) structure decisions, uncertain events and values of outcomes
4) identify the causes of any risk

Explanation

Pareto analysis is used to identify those risks that will have a dramatic impact on business projects/activities and objectives.

The **CAPM model** is used to determine the expected return of an asset in relation to its risk or risk profile.

Decision analysis is used to structure decisions, uncertain events and values of outcomes.

Casual analysis is used to identify the causes of any risk.

Question 10

The attitude towards risk that requires an increase in the return for an increase in the risk is known as risk …

1) neutral
2) seeking
3) averse **Correct option 3**
4) impartial

Explanation

The attitude towards risk that requires an increase in the return for an increase in the risk is known as risk **averse**.

Question 11

The … is a method used by a business to evaluate the effect of uncertainty on a planned activity in a range of situations and uses random numbers to sample from a probability distribution.

1) scenario analysis
2) simulation
3) Monte Carlo Simulation **Correct option 3**
4) latin hypercube sampling

Explanation

The **Monte Carlo simulation** is a method used by a business to evaluate the effect of uncertainty on a planned activity in a range of situations and uses random numbers to sample from a probability distribution.

Question 12
The … is used to re-create the probability distributions specified by distribution functions accurately.

1) scenario analysis
2) simulation
3) Monte Carlo Simulation
4) latin hypercube sampling **Correct option 4**

Explanation
The **Latin Hypercube sampling** is used to re-create the probability distributions specified by distribution functions accurately.

Question 13
Which of the following are inputs for the risk treatment process?

a) Risk register
b) Industry betas
c) Description of the business risk appetite
d) Risk response actions

Choose the correct option.

1) a, d
2) a, b, d
3) a, b, c **Correct option 3**
4) a, b, c, d

Explanation
Inputs for the risk treatment process include the risk register, industry betas and description of the business risk appetite. The outputs for the risk treatment process will be the risk response (i.e. remove, reduce or transfer) actions.

Question 14
Which one of the following is a process **output** in the risk analysis process?

1) risk identification
2) risk recording
3) risk register **Correct option 3**
4) profit and loss account assessment

Explanation
Risk identification is done in the second stage of the risk management process. Risk is identified and recorded during this stage. Risk recording is a process input in the risk analysis process. The risk register is a process **output** of the risk identification and risk analysis process. One of the tools (process inputs) used to identify risk is the analysis/assessment of the profit and loss account.

Question 15
Risk appetite can defined as ...

1) a reduction of risks by distribution
2) the amount of risk a business is prepared to tolerate at any point in time **Correct option 2**
3) the elimination of a risk when a negative outcome or high-risk exposure is anticipated
4) the strategy used to transfer a risk to another entity, business or organisation

Explanation

Risk appetite can defined as the amount of risk a business is prepared to tolerate at any point in time.

Use the following information to answers Questions 16 and 17.
Afrika Company's total current assets, total current liabilities, and inventory for each of the past 4 years are as follows:

Item	**2009**	**2010**	**2011**	**2012**
Total Current Assets	R 16 950	R 21 900	R 22 500	R 27 000
Total Current Liabilities	R9 000	R 12 600	R 12 600	R 17 400
Inventory	R 6 000	R 6 900	R 6 900	R 7 200

Question 16
The firm's current ratio for the year ended 2011 is ...

1) 1.24
2) 0.56
3) 1.79 **Correct option 3**
4) 3.26

Calculation
The firm's current ratio for the year ended 2011 is 1.79.
Calculation of current ratio: Current Assets / Current Liabilities
= R 22 500 / R 12 600
= 1.7857 ≈ 1.79

Question 17
The firm's quick ratio for the year ended 2012 is...

1) 1.55
2) 1.14 **correct option 2**
3) 2.42
4) 1.79

Calculation
The firm's quick ratio for the year ended 2012 is 1.14.
Calculation of quick ratio (acid test ratio): (Current Assets – Inventory) / Current Liabilities
= (R 27 000 – R 7 200) / R17 400
= R 19 800 / R17 400
= 1.137 ≈ 1.14

Question 18
Effective corporate governance…

1) promotes the inefficient use of resources
2) attracts higher cost of capital
3) retards overall performance
4) ensures adherence to legislation **Correct option 4**

Explanation
Effective corporate governance promotes the efficient use of resources, attracts lower cost of capital, enhances overall performance and ensures adherence to legislation (laws and regulations).

Question 19
Key Risk Indicators must be …

1) linked to a loss
2) qualitative
3) quantitative **Correct option 3**
4) indicated by means of probability distributions

Explanation
Key Risk Indicators must be **quantitative**.

Question 20
Mr. A Lucky has been appointed as the risk manager for A-Z clothing Ltd. Mr. A Lucky must implement a risk management process for the business. Which of the following risk management stages should Mr. A Lucky implement?

a) establish the context, monitor and review
b) risk identification, risk analysis and risk evaluation
c) design and improve the process
d) risk treatment, communication and consultation

Choose the correct option.

1) a, d
2) a, b, d **Correct option 2**
3) a, b, c
4) a, b, c, d

Explanation
The **stages** in the risk management process include establishing the context, monitor and review, risk identification, risk analysis, risk evaluation, risk treatment, communication and consultation. The design and improve process is an **ongoing** process which takes place at commencement and throughout the risk management process.

Question 1
The risk that a counterparty to a contract will not live up to its contractual obligations is known as:

1) Liquidity risk
2) Credit risk
3) Counterparty risk **Correct option 3**
4) Default risk

Explanation
Counterparty risk is the risk that a counterparty to a contract will not live up to its contractual obligations.

Question 2
The uncertainty linked to the recovery of outstanding amounts due is known as:

1) Recovery risk **Correct option 1**

2) Exposure risk
3) Default risk
4) Credit risk

Explanation
Recovery risk is the uncertainty linked to the recovery of outstanding amounts due.

Question 3
Which one of the following is not a benefit of operational risk management?
1) Improving ability to achieve business objectives.
2) Maximising day-to-day profits. **Correct option 2**
3) Providing management the opportunity to focus on revenue generating activities.
4) Minimising day-to-day losses.

Explanation
Benefits of operational risk management include improving ability to achieve business objectives, minimising day-to-day losses and providing management the opportunity to focus on revenue generating activities.

Question 4
Information technology consists of the following:
1) E-commerce using the internet
2) Network Systems
3) Intranets **Correct option 3**
4) 4.Broadband

Explanation
Information technology consists of Intranets and **communications** technology consists of broadband, network systems and E-commerce using the internet.

Question 5
The determination of the probability and impact of the identified risks and opportunities is referred to as risk …
1) identification
2) analysis
3) evaluation **Correct option 3**
4) review

Explanation
The determination of the probability and impact of the identified risks and opportunities is referred to as risk **analysis**.

Question 6
The sources of risk embraced under economic risk include the following:
a) Fall in demand
b) Government policies
c) Exchange Rates
d) Fall in Supply

Choose the correct option.
1) a, b, c, d

2) b, c, d
3) a, b, d
4) a, b, c **Correct option 4**

Explanation
The sources of risk embraced under economic risk include fall in demand (a shift in the aggregate demand curve), government policies (including interest rates and trade protectionism) and exchange rates.

Question 7
Macro-economic policy is influenced by government through the …
a) Fiscal policy
b) Econometric policy
c) Monetary policy
d) Competing theories

Choose the correct option.
1) a, b, c, d
2) a, c, d **correct option 2**
3) a, b, d
4) None of the above.

Explanation
Macro-economic policy is influenced by government through the fiscal policy, monetary policy and competing theories.

Question 8
Which one of the following factors influences the aggregate supply curve?
1) Consumer spending
2) Increased investment in education **Correct option 2**
3) Government spending
4) Exports and imports

Explanation
Increased investment in education is a factor that affects aggregate supply.
Consumer spending, government spending, exports and imports are factors that affect aggregate demand.

Question 9
Which of the following is an example of a political risk factor for the South African government?
1) Fiscal policy **Correct option 1**
2) Monetary policy
3) Monetary-economic policy
4) Inflation policy

Explanation
Political risk is defined as “the uncertainty that stems, in whole or in part, from the exercise of power by government actors and the actions of non-government groups”. The political environment of overseas countries will always have an impact on the threats and opportunities of a business wanting to expand business overseas for example the tax regime (fiscal policy) may change, contract

risk events, pressure groups, terrorism and blackmail. All of these factors can impact on the political risk a country or business can face.

Question 10
"The exposure to a potential loss arising from diminishing sales or margins as a result of changes in market conditions, outside of the control of the business" is known as…

1) interest rate risk
2) environmental risk
3) market risk **Correct option 3**
4) social risk

Explanation
"The exposure to a potential loss arising from diminishing sales or margins as a result of market conditions, outside of the control of the business" is known as **market risk**.

Question 11
Which one of the following methods is used to calculate Value-at-risk?

1) Monte Carlo **Correct option 1**
2) Pest Analysis
3) Economic value added
4) Economic simulations

Explanation
The **Monte Carlo** method is used to calculate Value-at-risk.

Question 12
Graham Capital is in the process of obtaining a loan from XWX Bank. Which of the following factors must Graham Capital take into consideration?

a) Interest rate at commencement of the loan
b) Interest rate at the end term of the loan
c) Duration of payment
d) Nature of the interest rate

Choose the correct option.

1) All of the above.
2) a, b, c
3) a, c, d **Correct option 3**
4) None of the above.

Explanation
When a company borrows money, it needs to know the interest rate at the commencement of the borrowing, the nature of the interest rate (fixed or variable), the duration of the payment and the basis of interest rate determination.

Question 13
Expropriation of corporate assets without prompt and adequate compensation is an example of…

1) economic risk
2) political risk **Correct option 2**
3) legal risk
4) cultural risk

Explanation
Expropriation of corporate assets without prompt and adequate compensation is an example of political risk. This example can also be seen as a macropolitical risk.

Question 14
A country's ability or intention to meet its financial obligations determines it's…

1) economic risk **Correct option 1**
2) financial risk
3) political risk
4) country risk

Explanation
A country's ability or intention to meet its financial obligations determines its **economic risk**. The fiscal and monetary policy of the government determines it financial obligations which can have an influence on economic risk.

Question 15
Which one of the following statements is correct?

1) Current ratio is the relationship between non-current assets and non-current liabilities.
2) The current ratio is more conservative than the quick ratio.
3) The current ratio excludes inventory.
4) A higher quick ratio means a better liquid current position. **Correct option 4**

Explanation
The correct statement is "A higher quick ratio means a better liquid current position".
Current ratio is the relationship between **current** assets and **current** liabilities. The **quick** ratio is more conservative than the current ratio. The **quick** ratio excludes inventory.

Question 16
In implementing operational risk management in a business, external events which can occur outside of the business must be taken into consideration. These events may require a business to have response strategies in the form of:

1) change and knowledge management
2) project and knowledge management
3) change management and business contingency plans **Correct option 3**
4) project management and business contingency plans

Explanation
In implementing operation risk management in a business, external events which can occur outside of the business must be taken into consideration. These events may require a business to have response strategies in the form of **change management and business contingency plans**.

Question 17
Control technology can be defined as…

1) the collection, storage and processing of information by electronic means
2) specific computer-based production control systems **correct option 2**
3) network systems in which computers are linked to one another over a network
4) IT governance to manage the risks and constraints of IT

Explanation

Control technology can be defined as **specific computer-based production control systems.**

Question 18
Which one of the following is seen as a common challenge for businesses in implementing project risk management?

1) Lack of a risk maturity model. **Correct option 1**
2) **Clear** definition of roles.
3) Lack of responsibility assignment matrix.
4) Lack of team structure.

Explanation
A common challenge for businesses in implementing project risk management is a lack of risk maturity model.

Question 19
Which of the following risks are seen as internal micro influences to a business?

1) Project, market and legal risks
2) Economic, political and environmental risks
3) Social, ethical, health and safety risks
4) Ethical, project and technological risks **Correct option 4**

Explanation
Ethical, project and technological risks is seen as internal micro influences to a business.

Question 20
Credit insurance …

1) eliminates uncertainty over the likely recovery of outstanding amounts due
2) mitigates action for credit risk to protect a business against bad debt **Correct option 2**
3) prevents that a customer may default on its payment
4) relates to an uncertainty surrounding the payment of future amounts

Explanation
Credit insurance **mitigates action for credit risk to protect a business against bad debt.**

Essay questions: The following represents an extract of the compliance statement of Vodacom. Read through the extract and answer **question 1** below.

Statement of compliance

Vodacom is committed to the highest standards of business integrity, ethics and professionalism.

The Board recognises the need to conduct the business in accordance with the principles of the King Code of Corporate Practices and Conduct ('King III').

These principles include discipline, independence, responsibility, fairness, social responsibility, transparency and the accountability of directors to all stakeholders.

A number of these principles are entrenched in the Group's internal controls and policy procedures governing corporate conduct.

The Board is satisfied that every effort has been made in the financial year to 31 March 2013 to

comply in all material aspects with King III. Where we do not comply, this is stated and explained.

Question 1

1.1 In the extract, Vodacom's statement of compliance is referring to the principles of the King Code of Corporate Practices and Conduct (King III). Discuss the **principles** listed in the compliance statement of Vodacom? **(7)**

Answer

Principle:	**Definition based on the King Code of Governance Principles for SA 2009**
Discipline	Each company should demonstrate its commitment to its code of ethics by constantly enforcing appropriate discipline. **√**
Independence	Independence is the absence of undue influence and bias which can be affected by the intensity of the relationship between the director and the company. **√**
Responsibility	The state or position of having control or authority and being accountable for ones actions and decisions. **√**
Fairness	Free from discrimination or dishonesty and in conformity with rules and standards. **√**
Social responsibility	Is an important and critical component of the broader notion of corporate citizenship. **√** One is a good corporate citizen, inter alia, by being socially responsible. Corporate responsibility is the responsibility of the company for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour that: contributes to sustainable development, including health and the welfare of society; takes into account the legitimate interests and expectations of stakeholders; is in compliance with applicable law and consistent with international norms of behaviour; and is integrated throughout the company and practiced in its relationships. Activities include products, services and processes. Relationships refer to a company's activities within its sphere of influences.
Transparency	Easy to understand or recognise; obvious; candid; open; frank. √
Accountability of directors to all stakeholders	Being responsible and able to justify and explain decisions and actions. **√**

1.2 Identify any three (3) **additional principles** included in the King III report not specifically listed by Vodacom. **(3)**

Answer

Any three of the following additional principles included in the King III report can be discussed:

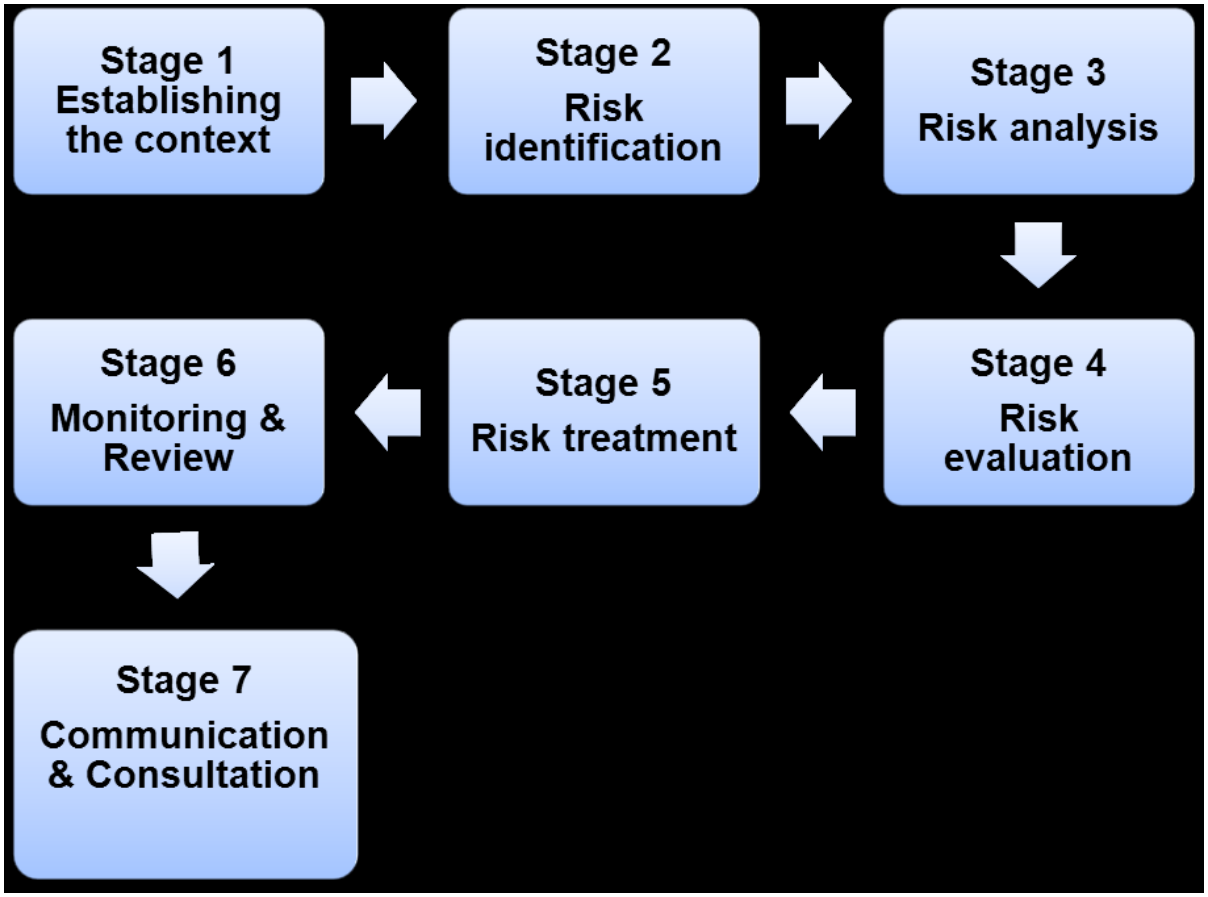
- Management should be responsible for the risk management process. Management is accountable to the board for designing, implementing and monitoring the process of risk management and integrating it into the day-to-day activities of the company.
- All staff should practise risk management.
- The board should be responsible for the process of risk management.

- The board should approve the company's chosen risk philosophy.
- The board should adopt a documented risk management plan.
- The board may delegate the responsibility of risk management to a dedicated risk committee.
- Risk assessment should be performed on an on-going basis.
- The board should approve key risk indicators for each risk, as well as tolerance levels.
- Risk identification should be directed in the context of the company's purpose.
- The board should ensure that key risks are quantified and are responded to appropriately.
- Internal audit should provide independent assurance on the risk management process.
- The board should report on the effectiveness of risk management.
- The board should ensure that the company's reputational risk is protected.
- The board should determine the extent to which risks relating to sustainability are addressed and reported on.
- The board should ensure that information technology (IT) is aligned with business objectives and sustainability.
- The board should consider the risk of the unknown as part of the qualitative and quantitative risk assessment process.
- Compliance should form part of the risk management process.

Question 2

With reference to the seven (7) **stages** in the enterprise risk management (ERM) process explain how a business might design and implement an ERM approach to risk. **(15)**

Answer



The diagram is given for explanation purposes only. If the question had asked to illustrate the stages in the ERM process you would have been required to illustrate your answer by drawing this diagram.

Stage 1 of the ERM process is establishing the context. It forms the foundation for all the other stages in the ERM process. **√** Establishing the context deals with the business as a whole as well as the business activities, processes and projects. **√** This stage is used to acquire accurate data and information about the whole business. **√**

Stage 2: Risk identification is a crucial step in the ERM process. It is important to be able to identify the risks in the business and understand how they fit into the overall business context. **√** Through risk identification, the business will be able to identify the key risks and risk events associated with the business. **√** The business will constantly change and grow as well as the risks associated with the business. The business will need to identify risks on a constant basis and identify the opportunities that may arise in order to enhance its objectives as well as risks that may reduce the likelihood of the business achieving its objectives. **√**

Stage 3: Risk Analysis. The risk analysis stage will provide information on the likelihood of risks and opportunities occurring **√** and the impact of them to aid in the decision making process. **√** The risk analysis process will assess all the risks identified in the risk register. **√**

Stage 4: Risk Evaluation. The risk evaluation stage will evaluate the results obtained in the risk analysis stage. Stage 4 will focus on both the risk exposure and opportunity that may arise from a business activity. All the information gathered in the risk analysis process is integrated into the risk evaluation process. **√** The risk evaluation stage will evaluate the financial impact (loss or gain) of a risk in a business in numerical terms. The risk evaluation stage is essential as it assists the business to understand the combined effect of a group of risks and opportunities. This stage will assist the

business in its decision making process. **√** Risk evaluation is the only option available to the business for assessing the organisation's exposure to risks and opportunities and it must be implemented properly. **√**

Stage 5: Risk Treatment. The risk treatment stage will assist the business to design a specific action plan **√** and produce strategic responses to address the risks and opportunities identified in the business to secure business objectives. **√** This stage is vital in the risk management process because the risk strategy responses and action plan must be prepared and implemented effectively into the business. **√**

Stage 6: Monitoring and Review. The risk monitoring and review stage is a key stage in the ERM process.**√** It may become necessary for a business to review all the previous stages in the risk management process because new information became available or circumstances changed in the business. **√** The monitoring and review stage must be carried out in order to increase the success of the implementation of the entire ERM process. **√**

Stage 7: Communication and consultation. The risk communication and consultation stage will be used across all the other ERM process stages. **√** It is essential for a business to understand how effectively the process outputs of each stage is communicated and understood by decision makers. Risk communication and consultation form a link with all the other stages in the ERM process. The business risk management process must be effectively communicated to all levels of employees in the business. **√** This step is vitally important because every employee may be involved in an activity that might have a direct impact on the ERM process and if the employee does not understand the risk management culture in which the business functions it can have disastrous consequences. **√**

All the stages are interrelated and must be implemented effectively and communicated in the business to manage its risks and opportunities. **√**

Question 3

3.1 Argue the **value of good corporate governance** to business enterprises. (Hint: refer to the four business areas corporate governance might impact on). **(10)**

Answer

Corporate governance adds value to an enterprise in the following manner:

Employing assets efficiently

Effective corporate governance promotes the efficient use of resources within a firm and the economy at large. **√** When an efficient corporate governance system is in place, debt, equity and capital flow to enterprises that are capable of investing these resources efficiently in order to produce goods and services that are most in demand and have the highest rate of return. **√** In this regard, effective governance helps to grow and protect scarce resources and to ensure that societal needs are met. Effective governance should make it possible to replace managers who do not put scarce resources to efficient use or who are incompetent in what they do. **√**

Attracting lower-cost capital

Effective corporate governance helps enterprises to attract lower-cost capital by improving the confidence of domestic and international investors and by assuring them that the assets are used in the form agreed upon, whether the investment is in the form of debt or equity. **√** This has a positive impact on both debt and equity. For enterprises to succeed in competitive markets, corporate managers must innovate relentlessly and efficiently, and constantly evolve new strategies to meet changing circumstances. **√**

Meeting social obligations: complying with laws and regulations
To succeed in the long term, enterprises must comply with the laws, regulations and expectations of the societies in which they operate. Most corporations take their corporate citizenship seriously. **√** They contribute to civil societies' needs while some are opportunistic and have no regard for social or environmental issues. Good corporate governance is essential to ensure adherence to legislation as well as corporate social responsibility principles. **√**

Overall performance
If corporate governance is effective, it gives managers a holistic view of the organisation and holds managers and the board accountable for the management of corporate assets. **√** Such accountability contributes to the efficient use of resources, attraction of lower-cost capital and an increase in the responsiveness of the enterprise to society, and will therefore lead to the improvement of corporate performance. **√** Effective corporate governance may not guarantee improved corporate performance at the individual firm level, but it should increase the likelihood of managers focusing on improving the performance of enterprises and of their being replaced when they fail to do so. **√**

3.2 Define operational risk and briefly explain each of the **main underlying risk factors** comprising operational risk management. **(10)**

Answer
Operational risk is defined as "the potential for loss due to failures of people, processes, and technology and external dependencies". **√** The main underlying risk factors comprising operational risk include the following:

- Business risk – includes adverse changes to a firm's market, customers or products, changes to the economic and political environments in which the firm operates and strategic risk which a firm faces if business plans, supporting systems and the implementation of these plans adversely affect the firm. **√**
- Crime risk including potential theft, fraud and computer hacking. **√**
- Disaster risk such as fires, floods and other natural disasters. **√**
- Information technology risk, including unauthorised access and disclosure, and data corruption.**√**
- Legal risk including loss arising from legal action against it and from inadequate, incomplete or otherwise unsound legal documentation and practices. **√**
- Regulatory risk relating to the lack of observance of rules set by a regulatory body. **√**
- Reputational risk from negative publicity about its business practices or internal controls. **√**
- Systems risk loss as a result of failure caused by the breakdown of business procedures, processes or systems and controls. **√**
- Outsourcing. **√**

Question 1
Indicate the **correct** statement.

1) Risk is the deviation of the expected from the actual result.
2) Risk implies the presence of certainty.
3) The probability of an event refers to its long-term frequency of occurrence. **Answer: 3**
4) Uncertainty arises from a person's perfect state of knowledge about future events.

Explanation
The probability of an event refers to its long-term frequency of occurrence.
Question 2

Motorcar accidents are an example of subjective uncertainty. Which of the following characteristics best describes subjective uncertainty?

1) Outcomes can be predicted with precision.
2) Outcomes are identified and probabilities are known.
3) Outcomes are identified but probabilities are unknown. **Answer: 3**
4) Outcomes are not fully identified and probabilities are unknown.

Explanation
Subjective uncertainty applies where an outcome is identifiable but the probability of the outcome is not known outcomes are identified but probabilities are unknown.

Question 3
For a given firm, 50 of the 90 employees are union members. Of those who are union members, 35 belong to union A and 15 belong to union B. The probability that any member selected at random belongs to a union is …

1) 0.56 **Answer: 1**
2) 0.66
3) 1.66
4) 2.56

Calculation
Total number of members = 90
Members belonging to a union = 50
The probability that any member belongs to a union = 50/90 = 0.555
= 0.56 (to 2 decimal places)

Question 4
The … is a measure of relative dispersion used in comparing the risk of assets with differing expected returns.

1) coefficient of variation **Answer: 1**
2) expected mean
3) standard deviation
4) average

Explanation
The **coefficient of variation** is a measure of relative dispersion used in comparing the risk of assets with differing expected returns.

Question 5
The risk of not being able to repay its depositors on demand or, when the terms of the deposit require it, on expiry of the agreed period of notice or on due date is known as ….

1) investment risk
2) credit risk
3) liquidity risk **Answer: 3**
4) interest rate risk

Explanation
Liquidity risk: For a deposit-taking institution like a bank, the risk is not being able to repay its depositors on demand or, when the terms of the deposit require it, on expiry of the agreed period of notice or on due date. For other type of enterprises it is the risk of not being able to meet its cash commitments when required.

Investment risk refers to the possibility of negative variation in the value of financial instruments owing to market changes. **Credit risk** refers to the possibility of counter-party to a financial transaction failing to meet the financial commitments stemming from a credit agreement on time. It is the risk that a debtor will fail to service the interest payments or to repay the capital when it falls due either because of bankruptcy or for any other reason, thereby causing the asset holder to suffer financial loss. **Interest rate risk** for a lender of money is the risk of loss of interest income that is caused by changes in market interest rates. For a borrower of money, it is the risk of having to pay more for debt as a result of changes in market interest rates.

Question 6
Interest rate volatility is an example of a … risk to financial institutions.

1) systematic core business **Answer: 1**
2) incidental businesses
3) operational
4) downside

Explanation
Interest rate volatility is an example of a systematic core business risk to financial institutions.

Question 7
Thabo was late for work. As he drove around a curve, he hit a patch of oil that had been spilled on the road. He slid across the road and hit a guard rail. Thabo was not hurt; however, his car was severely damaged. The presence of oil on the road is best described as a (n):

1) peril
2) objective risk
3) moral hazard
4) physical hazard **Answer: 4**

Explanation
Thabo was late for work. As he drove around a curve, he hit a patch of oil that had been spilled on the road. He slid across the road and hit a guard rail. Thabo was not hurt; however, his car was severely damaged. The presence of oil on the road is best described as a physical hazard.

Hazard relates to the environment surrounding the cause of loss (the presence of oil on the road).

Question 8
In the preceding question, the collision between Thabo's car and the guard rail is an example of a …

1) peril **Answer: 1**
2) physical hazard
3) fundamental risk
4) speculative risk

Explanation
The collision between Thabo's car and the guard rail is an example of a peril. The peril is the source of risk but is not a risk in itself.

Question 9
Corporate governance is defined in its narrowest sense as …..

1) a formal system of accountability of the board of directors to shareholders **Answer: 1**
2) a formal system of accountability of the board of directors to stakeholders
3) an informal system of accountability of board of directors to its stakeholders

4) an informal and formal relationship between the corporate sector and its stakeholder

Explanation
Corporate governance is defined in its narrowest sense as a formal system of accountability of the board of directors to shareholders.

Question 10

In terms of good corporate governance …

a) risk identification should be directed in the context of the company's purpose
b) the CEO should approve the company's chosen risk philosophy
c) the Chief Risk Officer should be responsible for the process of risk management
d) risk assessment should be done periodically

Choose the correct combination.

1) a, b, c, d
2) a, d **Answer: 2**
3) b, c, d
4) a, b, d

Explanation
Options **a** and **d** are **correct**. In terms of good corporate governance, risk identification should be directed in the context of the company's purpose and risk assessment should be done on an on-going basis.

Question 11
The business approach to risk management …

1) focuses on insurable and financial risks
2) adopts a holistic approach to managing risks
3) adopts a proactive approach to managing risks **Answer: 3**
4) is process driven

Explanation
The business approach to risk management adopts a more proactive approach to managing risks than the traditional approach. Although it looks further than insurable and financial risks, the focus however remained on managing individual risk and groups of risk thus function driven.

Question 12
Alternative risk transfer techniques (ART) …

1) resulted from a need for a less sophisticated approach to risk financing **Answer: 1**
2) do not apply to large catastrophic risks
3) involve the transfer of risk from capital markets
4) exclude derivative instruments

Explanation
Alternative risk transfer techniques (ART) resulted from a need for a **more** sophisticated approach to risk financing, **apply** to large catastrophic risks, involve the transfer of risk **to** capital markets and **include** derivative instruments.

Question 13
The most important drivers towards an enterprise risk management approach include the following:

a) increased value of tangible assets
b) increased concentration of risk
c) decline of insurance and development of ART
d) new business practices

Choose the correct combination.
1) a, b, c, d
2) b, c, d **Answer: 2**
3) a, b, c
4) c, d

Explanation
The most important drivers towards an enterprise risk management approach include increased value of **intangible** assets, increased concentration of risk, decline of insurance and development of ART; and new business practices.

Question 14
The following factors contribute to the successful implementation of Enterprise risk management (ERM):

a) Treating ERM as a stand-alone process.
b) Strong and visible support from senior managers.
c) Proceeding incrementally and leveraging early wins.
d) Learning from experiences

Choose the **correct** combination.
1) a, b, c,
2) b, c, d **Answer: 2**
3) a, c, d
4) a, b, c, d

Explanation
The factors that contribute to the successful implementation of enterprise risk management (ERM) include strong and visible support from senior managers, proceeding incrementally and leveraging early wins; and learning from experiences.

Question 15
Which of the following evolving tools enable enterprises to ensure that returns are adequate for the risk undertaken and that capital is allocated optimally?
1) Risk-adjusted return on capital (RAROC) **Answer: 1**
2) Alternative risk transfer (ART)
3) Enterprise risk management (ERM)
4) Value added tax (VAT)

Explanation

Risk-adjusted return on capital (RAROC) is an evolving tool that enables enterprises to ensure that returns are adequate for the risk undertaken and that capital is allocated optimally.

Question 16
Enterprise risk management is characterized by a …

1) narrow focus on hazard risks
2) comprehensive, inclusive and proactive approach to risk management **Answer: 2**
3) functional approach to risk management responsibilities
4) lack of consistency in terms of level of detail and reporting formats

Explanation
Enterprise risk management is characterised by a comprehensive, inclusive and proactive approach to risk management.

Question 17
Which of the following is not a category of risk management objectives?

1) Compliance
2) Operational
3) Reporting
4) Strategic **Answer: 4**

Explanation
Incorrect: Strategic objectives serve as yardsticks for tracking the enterprise's performance in the long term.

Question 18
Internal factors that may influence the corporate and risk management objectives of an enterprise include the …

a) technology used
b) infrastructure
c) economic environment
d) employees

Choose the correct combination.

1) a, b, c, d
2) a, b, d **Answer: 2**
3) b, c, d
4) a, b, d

Explanation
Options **a, b** and **d** are correct. Internal factors that may influence the corporate and risk management objectives of an enterprise include the technology used, the infrastructure of the enterprise and the personnel (employees) the enterprise has at its disposal.

Question 19
Which of the following is an example of systems risk?

1) Fraud and theft
2) Security breaches **Answer: 2**

3) Negligent staff
4) Stock taking

Explanation
Systems risk refers to the risks resulting from systems failures and they are therefore primarily based on enterprises' reliance on technology. Examples include systems failures, security breaches, implementation failure and poor data integrity. Fraud and theft, and negligent staff are examples of people risk.

Question 20
The following share prices of Ayoba Holdings over the past five months were taken from the business section of a newspaper.

March R23.50
April R24.00
May R24.20
June R24.50
July R25.10

The squared deviation for June is…
1) 0.2400
2) 0.0576 **Answer: 2**
3) 0.3450
4) 0.5700

Explanation
When probability is not given, we assume that the probability of the given set of outcomes is the same. Therefore, the mean = the expected value.

The mean for the given set of outcomes = Total share price/Number of outcomes
= R121.30 / 5
= R24.26
Therefore the expected value = R24.26

Month	**Price**	**Expected Value**	**Deviation**	**Squared deviation**
June	R24,50	R24.26	0.24	0.0576

Therefore the squared deviation for June = 0.0576

Question 1
A (n)… is a graphic representation of any form of flow within and to the enterprise.
1) organisational chart
2) flow chart **Answer: 2**
3) fault tree analysis
4) SWOT analysis

Explanation
A flowchart is a graphic representation of any form of flow within and to the enterprise.

Question 2

The term associated with the worst loss that could happen to a firm is …

1) Accumulation
2) "As if" analysis
3) Normal loss expectancy
4) Maximum possible loss **Answer: 4**

Explanation
Maximum possible loss is associated with the worst loss that could happen to a firm.

Question 3
Which of the following is an example of standing charges?

1) Bank charges
2) Leasing charges **Answer: 2**
3) Raw material prices
4) Distribution expenses

Explanation
Standing charges concern those costs which are incurred irrespective of whether or not the business operates. Typical examples include rent, certain salaries and expenses, leasing charges and a portion of services and facilities.

Question 4
Type 3 losses include losses that occur regularly, but which are trivial. These losses are characterised by …

1) low frequency and low severity
2) low frequency and high severity
3) high frequency and high severity
4) high frequency and low severity **Answer: 4**

Explanation
Type 3 losses include losses that occur regularly but which are trivial (e.g. loss of stationery). These losses are characterised by high frequency and low severity.

Question 5
Lesedi Pharmacy would like to market a new hypertension drug. While the Department of Health was testing the drug, it discovered that the drug produced a harmful side effect. When Lesedi learnt of the Department's test result, Lesedi abandoned its plan to produce and distribute the drug. Lesedi's reaction illustrates risk …

1) avoidance **Answer: 1**
2) assumption
3) transfer
4) elimination

Explanation
Lesedi Pharmacy would like to market a new hypertension drug. While the Department of Health was testing the drug, it discovered that the drug produced a harmful side effect. When Lesedi learnt of the Department's test result, Lesedi abandoned its plan to produce and distribute the drug.

Lesedi's reaction illustrates risk **avoidance**.

Question 6

Which of the following is a procedural risk control measure?

1) Erecting a security wall around a property.
2) Having a back-up facility at a distant location.
3) Emergency procedures such as recovery plans following a fire. **Answer: 3**
4) A disclaimer delivered with the products marketed by a company.

Explanation
Emergency procedures such as recovery plans following a fire are a procedural risk control measure.

Question 7
The process of establishing or offsetting long and short positions in order to diminish the portfolio's risk that could result from an adverse price movement is known as …

1) speculation
2) hedging **Answer: 2**
3) interest rate swapping
4) insurance

Explanation
The process of establishing or offsetting long and short positions in order to diminish the portfolio's risk that could result from an adverse price movement is known as hedging.

Question 8
Indicate the **correct** statement.

1) Risk managers use insurance reviews to counter risk exposure.
2) The price of a stock is inversely related to the market rate. **Answer: 2**
3) The long buyer expects the price of the asset to fall.
4) A short position entails the buying and keeping of an asset.

Explanation
The price of a stock is inversely related to the market rate.

Question 9
Indicate the **correct** statement.

1) Swaps may be used to increase the effective interest cost of borrowing.
2) Parties to interest rate swaps exchange the capital sums involved, adjusted for the differences in interest rates.
3) The result of a swap is the swapping of interest obligations as well as the risk of inherent interest rate changes. **Answer: 3**
4) Swaps may be used to decrease the realised yield on an investment.

Explanation
The result of a swap is the swapping of interest obligations as well as the risk of inherent interest rate changes.

Question 10
Which of the following is responsible for articulating and communicating an enterprise's risk appetite to different constituencies?

1) Methodologies

2) Limits and controls **Answer: 2**
3) Volume or notional limits
4) Risk-sensitivity limits

Explanation
Limits and controls are responsible for articulating and communicating an enterprise's risk appetite to different constituencies.

Question 11
Which of the following are key strategic considerations that need to be evaluated when determining the risk appetite for an enterprise?
a) Capital at risk
b) Internal constraints
c) Process
d) Strategy

Choose the correct combination:
1) a, b, c
2) a, b, d **Answer: 2**
3) a, c, d
4) a, b, c, d

The key strategic considerations that need to be evaluated when determining the risk appetite for an enterprise include capital at risk, internal constraints and strategy.

Question 12
… is an attempt to provide a single number which summarises the total risk in a portfolio of financial assets
1) Cash flow at risk
2) Risk adjusted return
3) Earnings at risk
4) Value at risk **Answer: 4**

Explanation
Value at risk is an attempt to provide a single number which summarises the total risk in a portfolio of financial assets.

Question 13
The risk limit framework of an organisation is a combination of its … limits.

a) notional
b) risk-sensitivity
c) stop-loss
d) stress

Choose the correct combination.
1) a, b, c
2) b, d
3) c, d
4) a, b, c, d **Answer: 4**

Explanation
The risk limit framework of an organisation is a combination of its notional, risk-sensitivity, stoploss/ advisory and stress/scenario limits.

Question 14
Reporting on the risk profile, business performance and risk implications usually forms part of the … risk report.

1) daily
2) monthly **Answer: 2**
3) quarterly
4) annual

Explanation
Reporting on the risk profile, business performance and risk implications usually forms part of the **monthly** risk report.

Question 15
Monitoring processes are generally applied to...

1) keep up to date with regulatory requirements
2) identify emerging risks **Answer: 2**
3) demonstrate management leadership
4) foster an environment that motivates people to learn

Explanation
Monitoring processes are generally applied to identify emerging risks

Question 16
Which of the following is a method of monitoring a risk management process?

1) Internal audit **Answer: 1**
2) Insurance reviews
3) Statutory records
4) Fault tree analysis

Explanation
Internal audit is a method of monitoring the risk management process.

Question 17
Hurdle rates are used to …

1) measure performance, taking into account the risks inherent in a portfolio
2) facilitate the allocation of capital based on risk
3) screen capital projects when using discounted cash flow techniques **Answer: 3**
4) strengthen the links between performance, accountability and established risk thresholds

Explanation
Hurdle rates are used to screen capital projects when using discounted cash flow techniques.

Question 18
Bank regulators use … to determine the capital a bank is required to keep to reflect the market risk it is bearing.

1) earnings at risk
2) value at risk **Answer: 2**

3) cash flow at risk
4) risk-adjusted return on capital

Explanation
Bank regulators use value at risk (VaR) to determine the capital a bank is required to keep to reflect the market risk it is bearing.

Question 19
Indicate the **correct** statement.
1) Aggregation methods provide a qualitative means to transfer, avoid and securitise risk.
2) Aggregation is a way to summarise an extremely simple set of rules.
3) It is less-effective to manage pooled risks than individual risks.
4) An aggregate index can be used with the hedging of pooled risks. **Answer: 4**

Explanation
An aggregate index can be used with the hedging of pooled risks.

Question 20
Which of the following steps/tasks is essential in the establishment of a basis from which to launch an enterprise risk management (ERM) strategy?
1) Assessing risk management capabilities. **Answer: 1**
2) Evaluating risk management performance.
3) Aggregating multiple risk measures.
4) Cultivating a continuous improvement disposition.

Explanation
Assessing risk management capabilities is an essential task in the establishment of a basis from which to launch an enterprise risk management (ERM) strategy.

Question 1
Indicate the **correct** statement.
1) The area under a curve of a continuous process is equal to 10%.
2) The most widely used measure of central tendency is the variance.
3) When the probabilities of all the possible outcomes are exactly the same, the mean and the expected value will differ.
4) If all possible outcomes and associated probabilities are known, a continuous probability distribution can be developed. **Answer: 4**

Explanation
A continuous probability distribution can be developed if all the possible outcomes and associated probability distributions are known.

Question 2
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. **Answer: 2**
3) Only fundamental event 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.

Explanation
Uncertainty in terms of motorcar accidents can be classified as **subjective** uncertainty

Question 3
Which of the following is an example of a core business risk for a motorcar manufacturer?

1) Interest rate changes on borrowed funds.
2) The incompetence of production staff.
3) The cost of components and raw materials. **Answer: 3**
4) Failures of systems.

Explanation
The cost of components and raw materials impact directly on the manufacturer's operating profits.

Question 4
A company has a fleet of 1000 cars and, on average, 250 cars are damaged annually in accidents. The probability of such damage to a car is …

1) 0,15
2) 0,25 **Answer: 2**
3) 0,50
4) 0,20

Explanation
The probability of damage is the number of occurrences divided by the total number of possible outcomes (250/1000) = 0.25.

ANSWER THE NEXT THREE QUESTIONS BY MAKING USE OF THE FOLLOWING INFORMATION:

The following share prices of Glenfair Enterprises over the past seven months were taken from the business section of a newspaper.

Month	**Price**
March	R23,50
April	R24,00
May	R24.20
June	R24.50
July	R25.10
August	R25.40
September	R24.90

Question 5
The first step in calculating the standard deviation of the above prices entails …

1) calculating of the square root
2) calculating of the expected value **Answer: 2**
3) dividing of the sum of the expected values by the total number of outcomes
4) calculating the sum total of squared differences

Explanation

The first step in calculating the standard deviation of the share prices entails calculating of the expected value.

Question 6
The squared deviation for August is …

1) 1,0201
2) 0,7921 **Answer: 2**
3) 0,3481
4) 0,2601

Explanation
When probability is not given, we assume that the probability of the given set of outcomes is the same. Therefore, the mean = the expected value.

The mean for the given set of outcomes = Total share price/Number of outcomes
= R171.60 / 7
= R24.51
Therefore the expected value = R24.51

Month	**Price**	**Expected Value**	**Deviation**	**Squared deviation**
March	R23,50	R24.51	-1.01	1.0201
April	R24,00	R24.51	-0.51	0.2601
May	R24,20	R24.51	-0.31	0.0961
June	R24,50	R24.51	0.01	0.0001
July	R25,10	R24.51	0.59	0.3481
August	R25,40	R24.51	0,89	0.7921
September	R24,90	R24.51	0.39	0.1521
Total				2.6687

Variance = 2.6687/7
= 0.3812428

Therefore standard deviation = $\sqrt{0.3812428}$ = 0.6174486 =0.6174 (to four decimal places)
Question 7
The standard deviation of the above set of prices is …

1) 0,3812
2) 2,6687
3) 0,1521
4) 0, 6174 **Answer: 4**

Explanation
Refer to the calculation above.

Question 8
A devastating tsunami in an area where a manufacturing plant is located can be classified as ... risk.

1) resource
2) financial
3) particular event
4) fundamental event **Answer: 4**

Explanation
A devastating tsunami in an area where a manufacturing plant is located can be classified as **fundamental** event risk because it is impersonal in origin and it arises from a purely physical occurrence. **Resource risk** is an example of specific business risk that causes fluctuations in the operating profits of the company. **Financial risk** is the risk involved in transactions in financial assets and those that may emanate from fluctuating financial claims. A **particular event risk** has its origin in discrete events which have an essentially personal cause.

Question 9
A security guard on duty falls asleep during his shift. During this time period the business is robbed of R100 000.
In the light of the aforementioned, indicate the **correct** statement.

1) The robbery is regarded as a peril. **Answer: 1**
2) The sleeping security guard is regarded as a peril.
3) The sleeping security guard is regarded as the risk.
4) The robbery is regarded as the hazard.

Explanation
The robbery is regarded as a peril. The loss was caused by the robbery. The sleeping security guard increased the probability of a possible robbery. The risk is the possibility of loss due to one or other peril.

Question 10
Probability distributions …

a) can be developed for risky events by using simulations
b) involve underlying concepts such as central tendency and variation
c) can be depicted as bar charts
d) is a model that relates probabilities to the associated outcomes

Choose the **correct** combination:

1) a,b,c
2) b,c,d
3) d only
4) a,b,c,d **Answer: 4**

Question 11
An underlying factor for operational risk is …

1) system risk **Answer: 1**
2) interest rate increases
3) political risk
4) customer default

Explanation
Operational risk is the exposure of an enterprise to losses resulting from internal failures of people, processes and systems.

Question 12
Corporate governance is defined in its narrowest sense as ...

1) an informal system of accountability of the board of directors to shareholders
2) an informal and formal relationship between the corporate sector and its stakeholders

3) a formal system of accountability of the board of directors to stakeholders.
4) a formal system of accountability of the board of directors to shareholders. **Answer: 4**

Explanation
Corporate governance is defined in its narrowest sense as a formal system of accountability of the board of directors to shareholders.

Question 13
Which of the following are characteristics of good corporate governance?

a) Discipline
b) Fairness
c) Transparency
d) Social responsibility

Choose the **correct** combination:
1) a,b,c,d **Answer: 1**
2) a,b,c
3) b,d
4) b,c

Explanation
Corporate governance is made up of seven basic characteristics, namely: discipline, transparency, independence, accountability, responsibility, fairness and social responsibility.

Question 14
Traditional risk management is characterised by .... approach.
1) an integrative
2) a proactive
3) a functional **Answer: 3**
4) an inclusive

Explanation
Traditional risk management is characterised by a functional approach. Enterprise risk management is characterised by a comprehensive, inclusive, proactive and integrative approach to risk management.

Question 15
The need for a more integrated and holistic view of risk management is emphasised by the ….
1) decreased value of tangible assets
2) decreased value of intangible assets
3) decreased concentration of risk
4) increasingly demanding investors and regulators **Answer: 4**

Explanation
The need for a more integrated and holistic view of risk management is emphasized by the **increasingly** demanding investors and regulators, an **increased** value of **intangible** assets and **increased** concentration of risk.

Question 16
Alternative risk transfer techniques (ART) …

1) developed from a need for a less sophisticated approach to risk financing
2) do not apply to large catastrophic risks
3) involve the transfer of risk to capital markets **Answer: 3**
4) exclude derivative instruments

Explanation
ART involves the transfer of large catastrophic risks to capital markets. It developed from a need for a more sophisticated approach to risk financing and it applies particularly to large catastrophic risks. Derivative instruments are examples of ART.

Question 17
In assessing risk it is important to consider the following:

a) top risks currently faced by the enterprise.
b) the risks attached to intangible assets crucial to value creation.
c) the root causes of the identified risk.
d) an oversight structure.

Choose the **correct** combination

1) a,b,c,d.
2) a,b,c. **Answer: 2**
3) a,b,d.
4) b,c,d

Question 18
Which one of the following might be a barrier to the successful implementation of Enterprise Risk Management (ERM)?

1) Technology
2) Risk reporting structures
3) Organisational culture **Answer: 3**
4) Proper yardsticks

Explanation
Organisational culture may be a barrier to the successful implementation of ERM. Other barriers include improper yardsticks. Technology and risk reporting structures can enhance the application of ERM.

Question 19
A properly designed risk framework for formulating a common language for an enterprise serves the following purposes:

a) Prioritizing and collecting of information.
b) Categorising risks.
c) Formulation of a common language.
d) Identification and prioritising risk exposures.

Choose the **correct** combination.

1) a,b,c,d **Answer: 1**
2) a,b,c

3) a,c,d.
4) b,c,d

Question 20
…. objectives relate to the effectiveness and efficiency of an organisation's operations which reflect the business it is in, as well as the industry and economic environments in which it operates.
1) Compliance
2) Strategic
3) Reporting
4) Operational **Answer: 4**

Explanation

Operational objectives relate to the effectiveness and efficiency of an organisation's operations which reflect the business it is in, as well as the industry and economic environments in which it operates.
Compliance objectives have to do with the enterprise's compliance with relevant laws and regulations.
Strategic objectives serve as yardsticks for tracking the enterprise's performance in the long term.
Reporting objectives involve the reliability of internal and external reporting of both financial and non-financial goals of the enterprise.

Question 1
Swot analysis ….
1) is normally applied with assistance of insurance intermediaries
2) is a graphic representation of any form of flow within and to the enterprise
3) are primarily used to identify event risks
4) serves to identify risks in the internal and external enterprise environment **Answer: 4**

Explanation
Swot analysis serves to identify risks in the **internal** and **external** enterprise environment.

Question 2
Where there is little information available on a risk exposure the following measure can be used to evaluate the frequency of potential losses:
1) Maximum possible loss
2) National trends
3) "As-if" analysis
4) "Pareto" rule **Answer: 4**

Explanation
The "pareto" rule can be used to evaluate the frequency of potential losses where there is little information available on a risk exposure.

Question 3
Frequent losses of low priced stationery items can ideally be funded through ….
1) insurance
2) reserve funds
3) cash flow **Answer: 3**
4) captives

Explanation
Frequent losses of low priced stationery items can ideally be funded through cash flow.

Question 4
Indicate the **correct** statement.

1) Insured gross profit in terms of business interruption refers to net profit plus standing charges. **Answer: 1**
2) Rent is normally not covered under business interruption events.
3) Increased costs to regain sales after a loss event are not covered in terms of business interruption insurance.
4) Leasing charges are classified as variable costs in terms of business interruption events.

Explanation
The insured gross profit is defined as either revenue less variable expenses or net profits plus standing charges.

Question 5
Which of the following fire losses would you regard as the most serious?

1) R5 million which occurs every ten years **Answer: 1**
2) R3 million which occurs every seven years
3) R1 million which occurs every three years
4) R5 million which occurs every seventeen years

Explanation
1/10 x R5million = R0.5 million (has the highest normal loss expected).

Question 6
Which of the following is considered a traditional risk control measure?

1) Fault tree analysis
2) Quality assurance systems **Answer: 2**
3) Hazard and operational studies
4) Failure mode analysis

Explanation
Quality assurance systems are considered a traditional risk control measure.
Fault tree analysis, failure mode analysis, and hazard and operational studies are scientifically proven techniques of risk identification.

Question 7
Which of the following statements is **incorrect**?

1) Hedging limits profits.
2) A short position entails the buying and keeping of an asset. **Answer: 2**
3) The long buyer expects the price of the asset to rise.
4) A long position entails the buying and keeping of an asset.

Explanation
Incorrect. A long position entails the buying and keeping of an asset.

Question 8
A six-month call option is written on a commodity at a strike price of R68,00. The premium of the option is R0,25. The market price of the commodity at the time the option was written was R65,85. Three months after the option was written, the market price of the commodity had risen to R69,75.

Based on the above information, the buyer of the option will ...

1) walk away from the option and lose the premium of R0,25
2) walk away from the option and buy the commodity at a lower price on the market
3) exercise the option and make a profit of R0,75
4) exercise the option and make a profit of R1,50 **Answer: 4**

Explanation
Strike price: (X) = R68
Premium: (p) = R0.25
Breakeven price: (B) = R68.00 + R0.25 = R68.25
Market price: (S) = R69.75

If three months later the market price is higher than the breakeven price, the buyer of the option will exercise the option at R68,25 and make a profit of R1,50. (i.e. R69.75 - R68.25).

Answer questions 9 and 10 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 that the following information applies:

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

The treasurer wants to hedge the next rollover by buying a forward rate agreement (FRA) at 16,50%.

Question 9
In order to lock in a discount rate of 16,50% ….

1) the bank will have to pay R2 465,75 to Company A.
2) Company A will have to pay R2 465,75 to the bank **Answer: 2**
3) the bank will have to pay R4 685 to Company A.
4) Company A will have to pay R4 685 to the bank.

Explanation

Calculation of questions 9 and 10:

The spot rate on 4 July is lower than the FRA rate. The rand value of the difference is:

16.50% - 15.50% = 1%

$$= \frac{1\ x\ 90\ x\ R1000\ 000}{365\ x\ 100}$$

= R2 465,75
Therefore, the company will have to pay R2 465.75 to the bank.

Question 10
The cost of rollover of the BA for the company will be ….

1) R40 684,93 **Answer: 1**
2) R38 219,18
3) R35 506,85
4) R 3 452,05

Calculation

Cost of the transaction is:

$$= \frac{15{,}5\ x\ 90\ x\ R1000\ 000}{365\ x\ 100} = \text{R38 219.18}$$

Cost of the rollover for Compant A is:

Cost of transaction:	R38 219.18
Plus Rand value of difference in rates:	R 2 465.75
	R40 684.93

Question 11
Indicate the **correct** statement.

1) Futures contracts are traded on a formal exchange. **Answer: 1**
2) Futures contracts tend to be more expensive than forward contracts.
3) Forward contracts are more liquid than futures contracts.
4) Forward contracts entail lower credit risk than futures contracts.

Explanation
Futures contracts are traded on a formal exchange and tend to be less expensive than forward contracts. Forward contracts are less liquid than futures contracts and entail higher credit risk than futures contracts.

Question 12
Suppose borrower A can obtain R2 million for ten years at a floating rate of prime plus 0,80% but that he has to pay a fixed rate of 20% on a debenture for the same term. Borrower B, can borrow floating funds at the prime rate and fixed rate funds at 16%. Borrower A and B agree to enter into a swap agreement in which Borrower A agrees to pay an additional 3% interest premium to Borrower B.

With regard to the aforementioned scenario, indicate the **correct** statement.

1) The effective cost of the floating funds of Borrower B is reduced by 2,2%.**Answer: 1**
2) The total interest cost of Borrower A will be 16% on the total amount of R2 million.

3) Both borrowers gain 1% by entering to the swap agreement.
4) Borrower B gains 3% by entering to the swap agreement.

Explanation
The terms produce a total interest cost of 19% to borrower A (16% plus 3%) on the total amount of R2 million. (His cost on fixed funds would otherwise have been 20%). Borrower B benefits because his effective cost on the floating rate funds is reduced by 2.2% (prime plus 0.80 which he has to pay to A, less the 3% additional premium which he receives from borrower A).

Question 13
Indicate the **correct** statement.
1) Interest rate collars specify both a rate cap and rate floor around a contracted loan rate. **Answer: 1**
2) An investor of funds seeking protection from falling interest rates will typically buy a Forward Rate Agreement (FRA).
3) Interest rate caps protect both the lender and borrower against interest rate fluctuations.
4) An investor of funds seeking protection from rising interest rates will typically sell a FRA.

Explanation
Interest rate collars specify both a rate cap and rate floor around a contracted loan rate.

Question 14
Indicate the **correct** statement.
1) Aggregation methods provide a qualitative means to transfer, avoid and securitise risk.
2) Aggregation is a way to summarise an extremely simple set of rules.
3) Risks of which the mutual relationships are not known are pooled in order to manage them better.
4) Aggregation of multiple risks improves reporting and capital allocation. **Answer: 4**

Explanation
Aggregation of multiple risks **improves reporting and capital allocation.**

Question 15
Which of the following are enablers of the continuous improvement philosophy?
a) Benchmarking of performance to identify best practices
b) Interactive communications and sharing of knowledge
c) Integrating the enterprise's risk language and risk management process into its employee learning programme
d) Identifying new or changing risks

Choose the **correct** combination:
1) a,b,c,d.
2) a,b,c. **Answer: 2**
3) a,c,d.
4) b,c,d.

Explanation

Enablers of the continuous improvement philosophy include benchmarking of performance to identify best practices, interactive communications and sharing of knowledge and integrating the enterprise's risk language and risk management process into its employee learning programme

Question 16
Hurdle rates are used to .....

1) measure performance, taking into account the risks inherent in a portfolio.
2) strengthen the links between performance, accountability and estblished risk thresholds.
3) screen capital projects when using discounted cashflow techniques. **Answer: 3**
4) facilitate the allocation of capital based on risk

Explanation
Hurdle rates are used to screen capital projects when using discounted cash flow techniques.
At-risk frameworks measure performance, taking into account the risks inherent in a portfolio, strengthen the links between performance, accountability and established risk thresholds, and facilitate the allocation of capital based on risk.

Question 17
... is an attempt to provide a single number which summarises the total risk in a portfolio of financial assets.

1) Cashflow at risk
2) Earnings at risk
3) Value at risk **Answer: 3**
4) Risk adjusted return

Explanation
Value at Risk (VaR) is an attempt to provide a single number which summarises the total risk in a portfolio of financial assets.

Question 18
Reporting on the risk profile, business performance and risk implications usually forms part of the … risk report.

1) daily
2) monthly **Answer: 2**
3) quarterly
4) annual

Explanation
Reporting on the risk profile, business performance and risk implications usually form part of the **monthly** risk report.

Question 19
Monitoring processes are generally applied to accomplish the following:

a) determine changes in an enterprises risk profile.
b) identify emerging risks
c) evaluate risk management performance
d) measure the adequacy of risk control measures

Choose the **correct** combination:

1) a,b,c.
2) b,c,d.
3) a,c,d.
4) a,b,c,d. **Answer: 4**

Explanation
Monitoring processes are generally applied to determine changes in an enterprises risk profile, identify emerging risks, evaluate risk management performance and measure the adequacy of risk control measures.

Question 20
The following performance standards are generally applied by organisations to measure risk management performance:

a) budgets
b) schedules
c) hurdle rates
d) "At risk" frameworks

Choose the **correct** combination.
1) a,b,c,d
2) a,b,c
3) c,d
4) a,b **Answer: 4**

Explanation

Budgets and schedules performance standards generally applied by organisations to measure risk management performance

Question 1 (10)
1.1 Discuss the two basic properties of probabilities. 4

Answer
- The number of successes cannot be more the number of possible outcomes. Therefore maximum value of P = 1
- The number of successes cannot be a negative value. Therefore minimum value of P = 0

1.2 Distinguish between **fundamental** and **particular risks**. Give examples of each and motivate why it is necessary to distinguish between these two types of risk. (6)

Answer
Fundamental risks arise from losses that are impersonal in origin and consequence and originate in the economic, political or social interdependency of society. They may also arise from purely physical occurrences such as drought conditions occurring in Southern Africa. √√√

Particular risks are losses that have their origin in discrete events which have an essentially personal cause. Such risks would, would for example, be fire damage to a building or the explosion of a pressure tank. √√√

Question 2 (10)
Discuss the components of a typical risk management process, and illustrate the integration of the components by means of a diagram.

Answer

- **Identifying the risk** can be regarded as the first step of the risk management process. (1)
- **Risk evaluation** is the next step of the risk management process after risk identification. The aim is to assess and measure the identified risks that will enable managers to manage it to the best of their ability. (1)
- **Risk control** is the third step of a risk management process. Having identified and evaluated the risks, it is necessary to take action in order to eliminate the risk or minimise the effect if the risk event occurs. (1)
- **Risk financing** can be regarded as the final step of the risk management process. It entails contemplating the financial implications of the adverse effects of a risk and determining the financial implications of minimising the risk. (1)

Question 3 (10)
A risk manager is instructed to determine the impact of a possible fire on the organisation. Discuss any five of the methods that might assist the risk manager in determining the **severity** of such a possible loss for the organisation.

Answer

a) **Maximum possible lossv –** maximum possible loss that can occur from a single event under unfavourable conditions.v
b) **Normal loss expectancyv –** maximum possible loss that can occur from a single event when all control measures operate as expected.v
c) **As-if analysisv** – analysis of the past claims history of the organisation. It includes:
    a. Actual datav
    b. Projected datav
d) **Accumulationv –** the extent to which various risks could accumulate into a large loss as a result of the operation of a single event.v
e) **Asset value**v
f) **f.** Business interruption
g) **g.** Insured gross profit
h) **h.** Standing charges

PART B

Question 1
Which one of the following is a benefit of effective risk and opportunity management?

1) Improved profit certainty
2) Increased shareholder value
3) Increased stakeholder confidence **Correct option 3**
4) Lower economic returns

Explanation
Improved **cost** certainty, **sustainable** shareholder value, increased stakeholder confidence and **higher** economic returns are all benefits of effective risk and opportunity management.

Question 2

The board's role should be to steer the corporation towards corporate governance policies that support …

1) long-term sustainable growth in shareholder value **Correct option 1**
2) short-term sustainable growth in shareholder value

3) short-term sustainable growth in stakeholder value
4) long-term sustainable growth in stakeholder value

Explanation
The board's role should be to steer the corporation towards corporate governance policies that support long-term sustainable growth in shareholder value.

Question 3

Which one of the following statements is not considered a benefit of Enterprise Risk Management (ERM)?

1) Minimise operational surprises and losses.
2) Enhance corporate governance.
3) Comply with relevant legal and regulatory requirements.
4) Align return appetite and strategy. **Correct option 4**

Explanation
Benefits of Enterprise Risk Management (ERM) include minimisation of operational surprises and losses, enhancing corporate governance, complying with relevant legal and regulatory requirements and aligning **risk** appetite and strategy**. The determination of the risk appetite of a business is vital in the ERM process because it shows how much risk the business is willing to take on.**

Question 4

The King II report moved away from the … bottom-line principle to a … bottom-line principle.

1) double - triple
2) single - triple **Correct option 2**
3) single - double
4) double - single

Explanation
The King II report moved away from the **single** bottom-line principle to a **triple** bottom-line principle.

Question 5

As of June 2010, companies listed on the JSE are expected to comply with …

1) King I
2) King II
3) King III **Correct option 3**
4) King IV

Explanation
As of June 2010, companies listed on the JSE are expected to comply with **King III**.

Question 6

King III applies to …

a) All listed companies on the JSE
b) Banks
c) Financial institutions
d) Insurance institutions

Choose the correct option.

1) a, b, c, d
2) a, b, c
3) a, b, d **Correct option 3**
4) a, b

Explanation

King III applies to all listed companies on the JSE, banks, financial and insurance institutions.

Question 7

In financial ratio analysis, efficiency ratios …

1) measures the degree of success of the management in achieving their primary purpose of creating wealth for their owners
2) are also known as activity ratios **correct option 2**
3) examine the relationship between liquid resources held and creditors due for payment in the near future
4) assess the returns and performance of shares held in a particular business

Explanation

In financial ratio analysis, efficiency ratios are also known as activity ratios.

Question 8

A GAP analysis …

1) is used to list all the risks that were identified on previous projects within the business
2) is a list that categorises each risk into a type of area
3) can be used to identify the main risks linked to a certain activity or project of the business **Correct option 3**
4) is a structured checklist to breakdown the risks and opportunities into manageable components

Explanation

A **GAP analysis** can be used to identify the main risks linked to a certain activity or project of the business. A **risk checklist** is used to list all the risks that were identified on previous projects within the business.
A **risk prompt list** is a list that categorises each risk into a type or area.
Risk taxonomy is a structured checklist to breakdown the risks and opportunities into manageable components.

Question 9

Pareto analysis is used to …

1) identify those risks that will have a dramatic impact on business projects/activities and objectives **Correct option 1**

2) determine the expected return of an asset in relation to its risk or risk profile
3) structure decisions, uncertain events and values of outcomes
4) identify the causes of any risk

Explanation

Pareto analysis is used to identify those risks that will have a dramatic impact on business projects/activities and objectives.
The **CAPM model** is used to determine the expected return of an asset in relation to its risk or risk profile.
Decision analysis is used to structure decisions, uncertain events and values of outcomes.
Casual analysis is used to identify the causes of any risk.

Question 10

The attitude towards risk that requires an increase in the return for an increase in the risk is known as risk …

1) neutral
2) seeking
3) averse **Correct option 3**
4) impartial

Explanation

The attitude towards risk that requires an increase in the return for an increase in the risk is known as risk **averse**.

Question 11

The … is a method used by a business to evaluate the effect of uncertainty on a planned activity in a range of situations and uses random numbers to sample from a probability distribution.

1) scenario analysis
2) simulation
3) Monte Carlo Simulation **Correct option 3**
4) latin hypercube sampling

Explanation

The **Monte Carlo simulation** is a method used by a business to evaluate the effect of uncertainty on a planned activity in a range of situations and uses random numbers to sample from a probability distribution.

Question 12

The … is used to re-create the probability distributions specified by distribution functions accurately.

1) scenario analysis
2) simulation
3) Monte Carlo Simulation
4) latin hypercube sampling **Correct option 4**

Explanation

The **Latin Hypercube sampling** is used to re-create the probability distributions specified by distribution functions accurately.

Question 13

Which of the following are inputs for the risk treatment process?

a) Risk register
b) Industry betas
c) Description of the business risk appetite
d) Risk response actions

Choose the correct option.

1) a, d
2) a, b, d
3) a, b, c **Correct option 3**
4) a, b, c, d

Explanation

Inputs for the risk treatment process include the risk register, industry betas and description of the business risk appetite. The outputs for the risk treatment process will be the risk response (i.e. remove, reduce or transfer) actions.

Question 14

Which one of the following is a process **output** in the risk analysis process?

1) risk identification
2) risk recording
3) risk register **Correct option 3**
4) profit and loss account assessment

Explanation

Risk identification is done in the second stage of the risk management process. Risk is identified and recorded during this stage. Risk recording is a process input in the risk analysis process. The risk register is a process **output** of the risk identification and risk analysis process. One of the tools (process inputs) used to identify risk is the analysis/assessment of the profit and loss account.

Question 15

Risk appetite can defined as...

1) a reduction of risks by distribution
2) the amount of risk a business is prepared to tolerate at any point in time **Correct option 2**
3) the elimination of a risk when a negative outcome or high-risk exposure is anticipated
4) the strategy used to transfer a risk to another entity, business or organisation

Explanation

Risk appetite can defined as the amount of risk a business is prepared to tolerate at any point in time.

Use the following information to answers Questions 16 and 17.

Afrika Company's total current assets, total current liabilities, and inventory for each of the past 4 years are as follows:

Item	2009	2010	2011	2012
Total Current Assets	R 16 950	R 21 900	R 22 500	R 27 000
Total Current Liabilities	R9 000	R 12 600	R 12 600	R 17 400
Inventory	R 6 000	R 6 900	R 6 900	R 7 200

Question 16

The firm's current ratio for the year ended 2011 is ...

1) 1.24
2) 0.56
3) 1.79 **Correct option 3**
4) 3.26

Explanation

The firm's current ratio for the year ended 2011 is 1.79.
Calculation of current ratio: Current Assets / Current Liabilities
= R 22 500 / R 12 600
= 1.7857 ≈ 1.79

Question 17

The firm's quick ratio for the year ended 2012 is...

1) 1.55
2) 1.14 **correct option 2**
3) 2.42
4) 1.79

Explanation

Calculation of quick ratio (acid test ratio): (Current Assets – Inventory) / Current Liabilities
= (R 27 000 – R 7 200) / R17 400
= R 19 800 / R17 400
= 1.137 ≈ 1.14

Question 18

Effective corporate governance…

1) promotes the inefficient use of resources
2) attracts higher cost of capital
3) retards overall performance
4) ensures adherence to legislation **Correct option 4**

Explanation
Effective corporate governance promotes the efficient use of resources, attracts lower cost of capital, enhances overall performance and ensures adherence to legislation (laws and regulations).

Question 19
Key Risk Indicators must be …

1) linked to a loss
2) qualitative
3) quantitative **Correct option 3**
4) indicated by means of probability distributions

Explanation
Key Risk Indicators must be **quantitative**.

Question 20

Mr. A Lucky has been appointed as the risk manager for A-Z clothing Ltd. Mr. A Lucky must implement a risk management process for the business. Which of the following risk management stages should Mr. A Lucky implement?

a) establish the context, monitor and review
b) risk identification, risk analysis and risk evaluation
c) design and improve the process
d) risk treatment, communication and consultation

Choose the correct option.

1) a, d
2) a, b, d **Correct option 2**
3) a, b, c
4) a, b, c, d

Explanation
The **stages** in the risk management process include establishing the context, monitor and review, risk identification, risk analysis, risk evaluation, risk treatment, communication and consultation. The design and improve process is an **ongoing** process which takes place at commencement and throughout the risk management process.

PART C

Question 1
The risk that a counterparty to a contract will not live up to its contractual obligations is known as:

1) Liquidity risk
2) Credit risk
3) Counterparty risk **Correct option 3**
4) Default risk

Explanation
Counterparty risk is the risk that a counterparty to a contract will not live up to its contractual obligations.

Question 2

The uncertainty linked to the recovery of outstanding amounts due is known as:

1) Recovery risk **Correct option 1**
2) Exposure risk
3) Default risk
4) Credit risk

Explanation
Recovery risk is the uncertainty linked to the recovery of outstanding amounts due.

Question 3

Which one of the following is not a benefit of operational risk management?

1) Improving ability to achieve business objectives.
2) Maximising day-to-day profits. **Correct option 2**
3) Providing management the opportunity to focus on revenue generating activities.
4) Minimising day-to-day losses.

Explanation
Benefits of operational risk management include improving ability to achieve business objectives, minimising day-to-day losses and providing management the opportunity to focus on revenue generating activities.

Question 4
Information technology consists of the following:

1) E-commerce using the internet
2) Network Systems
3) Intranets **Correct option 3**
4) Broadband

Explanation
Information technology consists of Intranets and **communications** technology consists of broadband, network systems and E-commerce using the internet.

Question 5
The determination of the probability and impact of the identified risks and opportunities is referred to as risk …

1) identification
2) analysis
3) evaluation **Correct option 3**
4) review

Explanation
The determination of the probability and impact of the identified risks and opportunities is referred to as risk **analysis**.

Question 6

The sources of risk embraced under economic risk include the following:

a) Fall in demand
b) Government policies
c) Exchange Rates
d) Fall in Supply

Choose the correct option.

1) a, b, c, d
2) b, c, d
3) a, b, d
4) a, b, c **Correct option 4**

Explanation

The sources of risk embraced under economic risk include fall in demand (a shift in the aggregate demand curve), government policies (including interest rates and trade protectionism) and exchange rates.

Question 7

Macro-economic policy is influenced by government through the …

a) Fiscal policy
b) Econometric policy
c) Monetary policy
d) Competing theories

Choose the correct option.

1) a, b, c, d
2) a, c, d **correct option 2**
3) a, b, d
4) None of the above.

Explanation

Macro-economic policy is influenced by government through the fiscal policy, monetary policy and competing theories.

Question 8

Which one of the following factors influences the aggregate supply curve?

1) Consumer spending
2) Increased investment in education **Correct option 2**
3) Government spending
4) Exports and imports

Explanation

Increased investment in education is a factor that affects aggregate supply.

Consumer spending, government spending, exports and imports are factors that affect aggregate demand.

Question 9

Which of the following is an example of a political risk factor for the South African government?

1) Fiscal policy **Correct option 1**
2) Monetary policy
3) Monetary-economic policy
4) Inflation policy

Explanation

Political risk is defined as "the uncertainty that stems, in whole or in part, from the exercise of power by government actors and the actions of non-government groups". The political environment of overseas countries will always have an impact on the threats and opportunities of a business wanting to expand business overseas for example the tax regime (fiscal policy) may change, contract risk events, pressure groups, terrorism and blackmail. All of these factors can impact on the political risk a country or business can face.

Question 10

"The exposure to a potential loss arising from diminishing sales or margins as a result of changes in market conditions, outside of the control of the business" is known as…

1) interest rate risk
2) environmental risk
3) market risk **Correct option 3**
4) social risk

Explanation

"The exposure to a potential loss arising from diminishing sales or margins as a result of market conditions, outside of the control of the business" is known as **market risk**.

Question 11

Which one of the following methods is used to calculate Value-at-risk?

1) Monte Carlo **Correct option 1**
2) Pest Analysis
3) Economic value added
4) Economic simulations

Explanation

The **Monte Carlo** method is used to calculate Value-at-risk.

Question 12

Graham Capital is in the process of obtaining a loan from XWX Bank. Which of the following factors must Graham Capital take into consideration?

a) Interest rate at commencement of the loan
b) Interest rate at the end term of the loan
c) Duration of payment
d) Nature of the interest rate

Choose the correct option.

1) All of the above.
2) a, b, c
3) a, c, d **Correct option 3**
4) None of the above.

Explanation

When a company borrows money, it needs to know the interest rate at the commencement of the borrowing, the nature of the interest rate (fixed or variable), the duration of the payment and the basis of interest rate determination.

Question 13

Expropriation of corporate assets without prompt and adequate compensation is an example of…

1) economic risk
2) political risk **Correct option 2**
3) legal risk
4) cultural risk

Explanation

Expropriation of corporate assets without prompt and adequate compensation is an example of political risk. This example can also be seen as a macropolitical risk.

Question 14

A country's ability or intention to meet its financial obligations determines it's…

1) economic risk **Correct option 1**
2) financial risk
3) political risk
4) country risk

Explanation

A country's ability or intention to meet its financial obligations determines its **economic risk**. The fiscal and monetary policy of the government determines it financial obligations which can have an influence on economic risk.

Question 15

Which one of the following statements is correct?

1) Current ratio is the relationship between non-current assets and non-current liabilities.
2) The current ratio is more conservative than the quick ratio.
3) The current ratio excludes inventory.
4) A higher quick ratio means a better liquid current position. **Correct option 4**

Explanation
The correct statement is “A higher quick ratio means a better liquid current position”.
Current ratio is the relationship between **current** assets and **current** liabilities. The **quick** ratio is more conservative than the current ratio. The **quick** ratio excludes inventory.

Question 16
In implementing operational risk management in a business, external events which can occur outside of the business must be taken into consideration. These events may require a business to have response strategies in the form of:

1) change and knowledge management
2) project and knowledge management
3) change management and business contingency plans **Correct option 3**
4) project management and business contingency plans

Explanation
In implementing operation risk management in a business, external events which can occur outside of the business must be taken into consideration. These events may require a business to have response strategies in the form of **change management and business contingency plans**.

Question 17
Control technology can be defined as…

1) the collection, storage and processing of information by electronic means
2) specific computer-based production control systems **correct option 2**
3) network systems in which computers are linked to one another over a network
4) IT governance to manage the risks and constraints of IT

Explanation
Control technology can be defined as **specific computer-based production control systems.**

Question 18
Which one of the following is seen as a common challenge for businesses in implementing project risk management?

1) Lack of a risk maturity model. **Correct option 1**
2) Clear definition of roles.
3) Lack of responsibility assignment matrix.
4) Lack of team structure.

Explanation
A common challenge for businesses in implementing project risk management is a lack of risk maturity model.

Question 19

Which of the following risks are seen as internal micro influences to a business?

1) Project, market and legal risks
2) Economic, political and environmental risks
3) Social, ethical, health and safety risks
4) Ethical, project and technological risks **Correct option 4**

Explanation
Ethical, project and technological risks is seen as internal micro influences to a business.

Question 20
Credit insurance …

1) eliminates uncertainty over the likely recovery of outstanding amounts due
2) mitigates action for credit risk to protect a business against bad debt **Correct option 2**
3) prevents that a customer may default on its payment
4) relates to an uncertainty surrounding the payment of future amounts

Explanation
Credit insurance **mitigates action for credit risk to protect a business against bad debt.**

Question 1
Enterprise Risk Management (ERM) may be defined as ….

1) Being a reactive and responsibility system to events as they unfold.
2) A 'tick-box' process ensuring legislation is complied with.
3) A systematic process embedded in a company's system of internal control to support the fulfilling of the company's objectives. **Correct option 3**
4) A system aimed at satisfying stock exchange requirements.

Explanation
Enterprise Risk Management (ERM) may be defined as **a systematic process embedded in a company's system of internal control to support fulfilling the company's objectives.**

Question 2
What do boards essentially seek from an ERM system?

1) The avoidance of unpleasant surprises and loses.
2) Robust procedures.
3) Integration of risk management, audit and governance. **Correct option 3**
4) Competent risk management teams.

Explanation

Boards essentially seek **integration of risk management, audit and governance** from an ERM system.

Question 3

Which of the following are benefits of ERM?

a) Building confidence with stakeholders and the investment community.
b) Align risk appetite and strategy.
c) Link growth, risk and return.
d) Seize opportunities.

Choose the correct combinations:

1) a,c
2) b,c
3) a,b,c
4) all of the above **Correct option 4**

Explanation

The following are benefits of ERM:

- build confidence with stakeholders and the investment community
- Align risk appetite and strategy.
- Link growth, risk and return
- Seize opportunities.

Question 4

In terms of the King III Code of governance principles …..

1) Internal audit should be integrated with the risk management process.
2) Risk management is separable from the company's strategic business processes.
3) Risk management should be performed on an ongoing basis. **Correct option 3**
4) Compliance should not form part of the risk management process.

Explanation

In terms of the King III Code of governance principles **risk management should be performed on an ongoing basis,** internal audit should provide **independent** assurance on the risk management process, risk management is **in**separable from the company's strategic business processes and compliance **should** form part of the risk management process.

Question 5

According to King III ….

a) A minimum of three executive directors should be appointed to the board.
b) A financial director must be appointed to the board for listed companies as from 2009.
c) The memorandum of incorporation of the company should allow the board to remove any director from the board.
d) Non-executive directors could receive share options based on prior approval.

Choose the correct combination:

1) a,b
2) b,c **Correct option 2**
3) a,b,d
4) all of the above.

Explanation

According to King III **a financial director must be appointed to the board for listed companies as from 2009, the memorandum of incorporation of the company should allow the board to remove any director from the board,** a minimum of **two** executive directors should be appointed to the board and non-executive directors **should not** receive share options.

Question 6

The risk management process forms part of the risk management ….

1) Scenario
2) Taxonomy
3) Framework **Correct option 3**
4) Templates

Explanation

The risk management process forms part of the risk management **framework**.

Question 7

During the context stage of a risk study, the ERM team for ZK Furniture elects to examine ZK Furniture's financial ratios to understand the business's financial health before moving onto the risk identification stage. This will enable them to ….

1) Open the dialogue with the finance department and the internal auditors in ZK Furniture.
2) Assess whether ZK Furniture's records are regularly updated.
3) Provides a quick and relatively simple way to examine the financial position and performance of ZK Furniture. **Correct option 3**
4) Satisfy/reflect recommended ERM practices for this stage of the risk process in ZK Furniture.

Explanation

During the context stage of a risk study, the ERM team for ZK Furniture elects to examine ZK Furniture's financial ratios to understand the business's financial health before moving onto the risk identification stage. This will enable them to **provide a quick and relatively simple way to examine the financial position and performance of ZK Furniture.**

Question 8

Brainstorming is a technique which is primarily used in the ….stage of the risk management process.

1) Identification **Correct option 1**
2) Analysis
3) Evaluation
4) Monitoring and review

Explanation

Brainstorming is a technique which is primarily used in the **identification** stage of the risk management process.

Question 9

Scenario analysis can be used ….

1) To identify risks by using case scenarios (best to worst scenarios) to consider possible future developments. **Correct option 1**

2) For technological forecasting by expert scenarios.
3) To record ideas in a scenario for clarification and evaluation.
4) In an interview to view situation from a different perspective.

Explanation

Scenario analysis can be used **to identify risks by using case scenarios (best to worst scenarios) to consider possible future developments.**

Question 10

Which of the following is a typical output of the Risk Analysis stage?

1) Industry betas
2) Human Resource Plan
3) Risk Register **Correct option 3**
4) Profit and Loss account

Explanation

The **risk register** is a typical output of the Risk Analysis stage. Industry betas and the profit and loss account are typical inputs of the Risk Analysis stage.

Question 11

The attitude that requires an increase in return for an increase in risk is termed risk ….

1) Neutral
2) Seeking
3) Pursuing
4) Averse **Correct option 4**

Explanation

The attitude that requires an increase in return for an increase in risk is termed **risk averse** while the attitude towards risk that requires no changes in the risk/reward balance return for an increase in risk is termed **risk neutral**. The attitude towards risk whereby a decreased return would be accepted for an increase in risk is termed **risk seeking**.

Question 12

Sensitivity analysis is a useful technique to ….

1) Evaluate the effect of uncertainty on a planned activity in a range of situations.
2) Focus on the consequences of the combinations of events.
3) Examine how sensitive the project outcomes are to changes in the business. **Correct option 3**
4) Analyse financial models where variables may be uncertain.

Explanation

Sensitivity analysis is a useful technique to **examine how sensitive the project outcomes are to changes in the business.**

Question 13

Risk retention is used ….

1) When a business accepts the risk. **Correct option 1**
2) To transfer the risk to another business.
3) In the reduction of risks by distribution.
4) To eliminate a risk when a negative outcome is anticipated.

Explanation

Risk retention is used **when a business accepts the risk.**

Question 14

The monitoring and review stage ….

1) Occurs infrequently
2) Is a continuous process **Correct option 2**
3) Is implemented prior to the annual report
4) Is implemented to satisfy audit requirements

Explanation

The monitoring and review stage **is a continuous process.** It may become necessary for a business to review all the previous stages in the risk management process because new information became available or circumstances changed in the business.

Question 15

According to King III an independent non-executive director ……

a) Is not a member of the immediate family of an individual who is employed by the company in an executive capacity
b) Is not a representative of a shareholder who has the ability to significantly influence management
c) Is not a professional advisor to the company other than in a director capacity
d) Does not receive remuneration contingent upon the performance of the company

Choose the correct combination:

1) a,b
2) c,d
3) a,b,c
4) all of the above **Correct option 4**

Explanation

According to King III an independent non-executive director is someone who is **not** a member of the immediate family of an individual who is employed by the company in an executive capacity, a representative of a shareholder who has the ability to significantly influence management, or a professional advisor to the company other than in a director capacity and does not receive remuneration contingent upon the performance of the company.

Question 1

The risk of exposure of an enterprise to adverse events that erode profitability and in extreme situations, bring about business collapse is ….

1) Financial risk **Correct option 1**
2) Economic risk
3) Strategic risk
4) Market risk

Explanation

The risk of the exposure of an enterprise to adverse events that erode profitability and in extreme situations, bring about business collapse is **financial risk**.

Question 2

Operational risk ….

a) Is the exposure of an enterprise to losses resulting from people, processes, systems and external events
b) Is present in all organizations
c) Does not affect a firm's solvency
d) Can affect the fair treatment of a firm's clients

Choose the correct combination:

1) a,b
2) a,b,c
3) a,b,d **Correct option 3**
4) all of the above

Explanation

Operational risk is the exposure of an enterprise to losses resulting from people, processes, systems and external events, is present in all organisations, can affect the fair treatment of a firm's clients and **can** affect a firm's solvency.

Question 3

Communication technology tools include ….

1) Operational research
2) Broadband **Correct option 2**

3) Information assets
4) telematics

Explanation

Communication technology tools include **broadband**. Information technology tools include information assets and telematics.

Question 4

Risk ….as part of the Project Risk Management process entails the listing of risks that may affect the project as well as establishing its characteristics.

1) Identification **Correct option 1**
2) Analysis
3) Evaluation
4) Monitoring and review

Explanation

Risk **identification** as part of the Project Risk Management process entails the listing of risks that may affect the project as well as establishing its characteristics.

Question 5

Currency risk is concerned with …..

1) Not having a cash surplus to respond to sudden or unexpected liquidity problems
2) A lack of familiarity with the history of changes in the exchange rate of different currencies
3) Inability in the short term to obtain cash in desired currency
4) Fluctuations in exchange rates which affect cash flows from overseas investments **Correct option 4**

Explanation

Currency risk is concerned with **fluctuations in exchange rates which affects cash flows from overseas investments.**

Question 6

Which one of the following is a political risk factor a South African business may face when conducting business overseas?

1) Unexpected changes in tax rules in a foreign country. **Correct option 1**
2) Foreign exchange changes
3) Systemic risk
4) Changes in South African monetary policy

Explanation

Unexpected changes in tax rules in a foreign country are considered a political risk factor for a South African business conducting business overseas.

Question 7

Legal risk is defines as the …..

1) Uncertainty that stems from the exercise of power by government actors.
2) Society's impact on a business performance over which the business have no ability to control.
3) Influence of national macroeconomics through manipulation of consumer spending.
4) Risk arising from violations of laws, rules, prescribed policies and ethical standards. **Correct option 4**

Explanation

Legal risk is defined as the **risk arising from violations of laws, rules, prescribed policies and ethical standards.**

Question 8

Which of the following factors may influence social risk within a business?

a) Education
b) Crime
c) Health
d) Stress levels

Choose the correct combination:

1) a,b
2) a,b,c
3) a,b,d
4) all of the above **Correct option 4**

Explanation

Education, crime, health and stress levels may influence social risk within a business.

Question 9

Ethical risk refers to ….

1) Moral rules and regulations governing the business world.
2) Exposure to events, which may result in criminal prosecution **Correct option 2**
3) The breach of environmental legislation
4) The care a person should take before entering into an agreement with another party

Explanation

Ethical risk refers to **exposure to events, which may result in criminal prosecution.**

Question 10

Which of the following will be seen as positive indicators after implementing a health and safety risk management system?

a) Active health monitoring programmes (initial and ongoing).
b) A publicly stated health and safety management system to monitor performance.
c) A reward scheme which is designed to ensure that safety performance is rewarded.
d) Display of the health and safety policy in a prominent location.

Choose the correct combination:

1) a,b
2) a,b,c
3) a,b,d **Correct option 3**
4) all of the above

Explanation

The following will be seen as positive indicators after implementing a health and safety risk management system:

- Active health monitoring programmes (initial and ongoing).
- A publicly stated health and safety management system to monitor performance.
- Display of the health and safety policy in a prominent location.

Essay questions:
The following represents an extract of the risk and balance sheet management statement of Nedbank Group Limited. Read through the extract and answer **Question 1** below.

Risk and balance sheet management

Nedbank Group has a strong risk culture and follows worldclass enterprisewide risk management, which aligns strategy, policies, people, processes, technology and business intelligence in order to evaluate, manage and optimise the opportunities, threats and uncertainties the group may face in its ongoing efforts to maximise sustainable shareholder value.

BACKGROUND TO RISK AND BALANCE SHEET MANAGEMENT IN NEDBANK

Enterprisewide Risk Management (ERM) integrates risk, finance and balance sheet management across the group's risk universe, including business units and operating divisions, geographical locations and legal entities.

Against this backdrop, all risks – including those associated with sustainability – are managed according to a 'three lines of defence' governance model. It is Nedbank Group's view that a strong risk governance process is the foundation for successful risk management and balance sheet management, which is why this model represents the core of the business's Enterprisewide Risk Management Framework (ERMF). The ERMF places emphasis on accountability, responsibility, independence, reporting, communications and transparency, and comprises 17 key risk categories

that are managed, monitored, measured and reported on by the first, second and third line-of-defence functions across the group.

Question 1

1.1 In the extract, Nedbank Group's risk and balance sheet management statement is referring to the King Code of Governance Principles 2009 (King III). Discuss the principles listed in the risk and balance sheet management statement of Nedbank Group? **(7)**

Answer

Any seven of the following principles could have been identified from the risk and balance sheet management statement of Nedbank Group:

Principle:	Definition and explanation based on the King Code of Governance Principles for SA 2009
Communications	Effective communication with stakeholders is essential for building and maintaining their trust and confidence. Communication to stakeholders should be in clear and understandable language**.√**
Independence	Independence is the absence of undue influence and bias which can be affected by the intensity of the relationship between the director and the company. **√**
Responsibility	The state or position of having control or authority and being accountable for ones actions and decisions. **√**
Reporting	Integrated reporting and disclosure. The company needs a holistic and integrated representation of the company's performance in terms of both its finance and its sustainability.**√**
Sustainability	Sustainability of a company means conducting operations in a manner that meets existing needs without compromising the ability of future generations to meet their needs. It means having regard to the impact that the business operations have on economic life of the community in which it operates. Sustainability includes environmental, social and governance issues. **√**
Transparency	Easy to understand or recognise; obvious; candid; open; frank. √
Accountability	Being responsible and able to justify and explain decisions and actions. √
Responsible leadership	The board should provide effective leadership based on an ethical foundation. The board should ensure that all deliberations, decisions and actions are based on the four values underpinning good governance and ensure that each director adheres to the duties of a director. √
Risk based internal audit	Internal audit should be risk-based and every year the internal auditors should furnish an assessment to the board generally on the system of internal controls and to the audit committee specifically on the effectiveness of internal financial controls. **√**

Compliance	Companies must comply with all applicable laws. The board should delegate to management the implementation of an effective compliance framework and processes. Compliance risk should form an integral part of the companies risk management processes. Compliance should be an ethical imperative. **√**

1.2 Identify any six (6) additional governance of risk principles adressed in the King III report not specifically listed by Nedbank Group. **(6)**

Answer

Any six of the following additional governance of risk principles addressed in the King III report can be discussed:

- Management should be responsible for the risk management process. Management is accountable to the board for designing, implementing and monitoring the process of risk management and integrating it into the day-to-day activities of the company. **√**
- The board should be responsible for the process of risk management. **√**
- All staff should practise risk management. **√**
- The board should approve the company's chosen risk philosophy. **√**
- The board should adopt a documented risk management plan. **√**
- The board may delegate the responsibility of risk management to a dedicated risk committee. **√**
- Risk assessment should be performed on an on-going basis. **√**
- Risk identification should be directed in the context of the company's purpose. **√**
- The board should approve key risk indicators for each risk, as well as tolerance levels. **√**
- The board should ensure that key risks are quantified and are responded to appropriately. **√**
- Internal audit should provide independent assurance on the risk management process. **√**
- The board should report on the effectiveness of risk management. **√**
- The board should ensure that the company's reputational risk is protected. **√**
- The board should determine the extent to which risks relating to sustainability are addressed and reported on. **√**
- The board should ensure that information technology (IT) is aligned with business objectives and sustainability. **√**
- The board should consider the risk of the unknown as part of the qualitative and quantitative risk assessment process. **√**
- Compliance should form part of the risk management process. **√**

Question 2

Mr. Peter Khumalo has just been appointed as the new CEO of Local Coal Mining Ltd. He approaches you as the risk manager to gain a better understanding of the implementation of risk management in the company.

Briefly describe the difference between an enterprise risk management framework, policy and process to Mr. Peter Khumalo to give him a better understanding of the implementation of risk management in Local Coal Mining Ltd. **(10)**

Answer

The risk management framework is a basic conceptual structure used to address the risks faced by an organisation. The purpose of the risk management framework is to assist an organisation in integrating risk management into its management process so that it becomes a routine activity**√**. The framework is composed of the following five steps:

- Mandate and commitment: Risk management must come from the top down in an organisation (organisations management).**√**
- Design framework: Understanding the organisation and its context, establishing the risk management policy, determining accountability for risk management, embedding risk management in all of the organisation's practices/processes etc. **√**
- Implement framework: Timing of implementation of framework should be planned and training sessions is required. **√**
- Monitor framework: Periodically review with internal and external stakeholders whether the risk management framework, policy, plan and process require amendments. **√**
- Improve framework: Based on the results of the monitor process, decisions should be made on whether the risk management framework step should be amended. **√**

Risk management policy

A risk management policy sets out how the risks, which have been identified by the risk assessment procedure, will be managed and controlled**√**. The risk management policy assigns responsibility for performing key tasks, establishes accountability with the appropriate managers, defines boundaries and limits and formalises reporting structures**√**. The policy should address specific responsibilities of the board, internal audit, external audit, the risk committee, the corporate governance committee, the central risk function, employees and third party contractors in implementing risk management**√**.

A policy statement defines a general commitment, direction or intention. A policy on risk management expresses an organisation's commitment to risk management and clarifies its general direction or intention. The policy should state its purpose, objectives, scope, related and supporting policies, and its degree of confidentiality, frequency of review and date of last update.

Risk management process

According to International Risk Standard, ISO 31000 (2009), a risk management process is one that systematically applies management policies, procedures, and practices to a set of activities intended to establish the context, communicate and consult with stakeholders, and identify, analyse, evaluate, treat, monitor, and review risk**√**.

According to Chapman the process can be broken down into 7 stages: **context, identification, analysis, evaluation, treatment, monitoring/review and communication and consultation√**. All the processes are repeated through the organisation up to the implementation of the risk response actions**√**.

Question 3

3.1 Identify and describe four (4) risk response strategies which can be used by a business in the enterprise risk management treatment stage. **(8)**

Answer

The following risk response strategies can be used by a business in the risk treatment stage:

Risk reduction√
Risk reduction can also be referred to as treatment or mitigation. Risk reduction can be seen as risk diversification (reduction of risks by distribution) for example, where a business invests in multiple stocks to reduce risk and the impact of the risk√. Two approaches to reduce risk can be followed namely:

- *reducing the likelihood of a risk occurring, and;*
- *Limiting the loss should the risk materialise.*

Methods used to reduce the likelihood of occurrence or impact of risk by a business is protection, controls, maintenance and risk spreading.

Risk removal*√*
Risk removal can also be referred to as avoidance, elimination, exclusion and termination. Risk removal is used to eliminate a risk when a negative outcome/impact or high-risk exposure is anticipated*√*. For example, doing business with a political uncertain country may be too risky to make the opportunity worthwhile (a potential for loss has been eliminated). When a business wants to remove risk, factors such as opportunity, business objectives and costs involved must be considered. All three of these concepts must be taken into regard. For example, when a business decides not to introduce a new product or terminating the production of an existing product and ceasing operations that have been carried out in the past.

Risk reassignment or transfer*√*
Risk reassignment is the strategy used to transfer risk to another entity, business or organisation. Businesses can use contracts and financial agreements to transfer risk to a third party*√*. Transferring a risk does not reduce its likely severity; it just removes it to another party. In some cases risk transfer can increase the impact of the risk, as the party to whom the risk is transferred is unaware that it is required to absorb it. The most common method of risk transfer is insurance. For example the financial consequences of the loss is transferred to the insurance company. When a business transfers risk the business must consider the objectives of the parties, ability to manage the risk, risk context and cost effectiveness of the transfer.

Risk retention√
Risk retention is also referred to as acceptance, absorption or tolerance. A business may be forced in a position to accept the risk as an alternative method√, for example risk removal, reduction and transfer are not available; or it may be more economical to the business to accept the risk. When following risk retention strategy the options available, timing and the ability to absorb the risk must be considered.

3.2 Distinguish between key risk indicators (KRI) and key performance indicators (KPI) and give two examples of each of the types of KRIs and KPIs. **(6)**

Answer

A business must clearly distinguish between key risk indicators (KRI) and key performance indicators (KPI).

Key Risk Indicators

KRI's refer to captured information that provides useful views of underlying risk profiles at various levels to assist decision makers within a business√. The following are seen as KRI types:

Any two types can be mentioned:

- Inherent or exposure risk indicators.√
- Control risk indicators.√
- Composite indicators.√
- Model risk factors.√

Key Performance Indicators

KPI's refer to high level snapshots of the health and performance of a business based on specific predefined measures for example, statistical information on the business√. The following are seen as KPI types:

Any two types can be mentioned:

- Statutory KPI's, such as GAAP or legal regulatory requirements.√
- Profitability per business unit/product/customer.√
- Exception reporting.√
- Employee performance, such as assets under management or profit per customer.√
- Competitiveness, such as market share.√
- Cost management, such as return on assets (ROA) on IT or new delivering channel monitoring.√
- Credit management, such as time to settlement or credit exposure.√

Question 4

Identify and describe eight (8) common challenges faced by businesses in implementing project risk management. **(8)**

Any eight of the following common challenges in implementing PRM can be mentioned:

- Lack of clearly defined and disseminated risk management objectives.√
- Lack of senior executive and project director commitment and support.√
- Lack of a risk maturity model.√
- Lack of a change process to introduce the discipline.√
- No common risk language (terms and definitions). √
- Lack of articulation of the project sponsor's risk appetite.√
- No definition of roles and responsibilities.√
- Lack of risk management awareness training to build core competencies.√
- Lack of integration of risk management with other project disciplines.√
- Resistance of project personnel to spend time on risk management.√
- Risk owners not automatically taking responsibility for assigned risks.√
- No clear demonstration of how risk management adds value and contributes to project performance.√
- Overcomplicated implementation from an unclear risk policy, strategy, framework, plan and procedure.√

- Lack of alignment between the business strategy, business model and risk management objectives.√
- Lack of the integration of risk management activities into the day-to-day activities of project managers.√

Question 1 (10 marks)
Assume the following hypothetical distribution of possible losses due to a fire at two separate premises of an organisation.

PREMISES A

OUTCOME	AMOUNT OF LOSS	PROBABILITY OF OUTCOME
A	R10 000	0,8
B	R15 000	0,2

PREMISES B

OUTCOME	AMOUNT OF LOSS	PROBABILITY OF OUTCOME
A	R10 000	0,50
B	R15 000	0,50

Evaluate the riskiness of the two premises. Show all calculations.

PREMISES A

OUTCOME	AMOUNT OF LOSS	PROBABILITY OF OUTCOME	EXPECTED VALUE (R)	DEVIATION	SQUARED DEVIATION
A	R10 000	0.80	8 000	-1 000	1 000 000
B	R15 000	0.20	3 000	4 000	16 000 000
			11 000		17 000 000

Variance = R17 000 000/2 = R8500000

Standard deviation = √8500000
= R2915.47595
= R 2915.48

Coefficient of variation = Standard deviation /Expected value
= R2915.48/R11000
= 0.2650

PREMISES B

OUTCOME	AMOUNT OF LOSS	PROBABILITY OF OUTCOME	EXPECTED VALUE (R)	DEVIATION	SQUARED DEVIATION
A	R10 000	0.50	5 000	-2 500	6 250 000
B	R15 000	0.50	7 500	2 500	6 250 000
			12 500		12 500 000

Variance = R12 500 000/2 = R6250000

Standard deviation = √6250000
= R2500

Coefficient of variation = Standard deviation /Expected value
= R2500/R12500
= 0.2

CV of Premises A = 0.2650 and that of Premises B is 0.2
Premises A is more risky than Premises B because the coefficient of variation is higher than that of B.
High risk, high returns for A

Question 2 (10 marks)
Risk evaluation is probably one of the most difficult steps of a risk management process. It is therefore, important to use the correct methodology. Briefly provide your understanding of the following concepts relating to risk evaluation:
a) Maximum possible loss (3)

Answer
a). **Maximum possible loss –** maximum possible loss that can occur from a single event under unfavourable conditions. Unfavourable conditions imply that risk control measures did not operate as planned and that the loss was therefore not controlled.

Example:
The MPL of a building is equal to the total replacement cost of, say, R10 million. In case of fire it is assumed that the entire building will be destroyed. The assumption is that the risk control measures such as a sprinkler system will not function properly. The entire building will therefore be destroyed in the event of a fire

b) Normal loss expectancy (3)

Answer

b). **Normal loss expectancy –** maximum loss that can occur from a single event when all control measures operate as expected.
Example, the normal loss expectancy of a building valued at R10 million is, say, only R2 million because we assume here that the risk control measures will function properly and that the fire will be extinguished before the entire building is destroyed.

c) "As if" analysis (4)

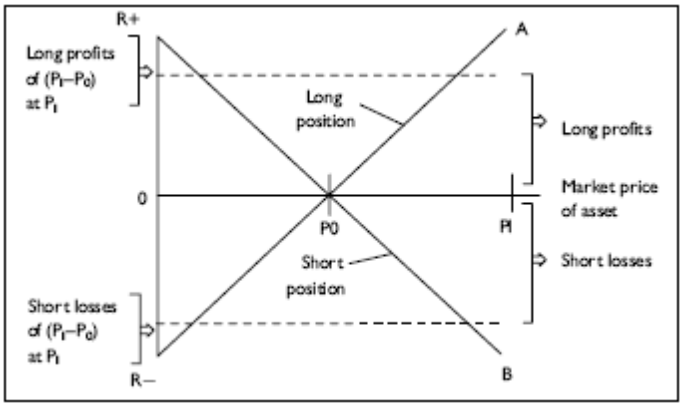
Answer

c. **As-if analysis** – analysis of the past claims history of the organisation. Such an analysis can be carried out on one of two bases:

- Actual data - The claims or losses incurred are evaluated without applying any inflationary adjustment.
- Projected data - The actual claims history is adjusted for inflationary trends as well as changes in the "scale of risk" before the "as if" analysis is carried out.

Question 3 (10 marks)
3.1 You are the risk manager for South African Airways (SAA). You expect the price of oil to increase over the next year and decide to make use of futures contracts to hedge this risk. **Graphically illustrate** the concept of a **perfect hedge** for purposes of managing the risk of an increase in the price of oil. (5)

Answer
The perfect hedge



3.2 Explain how organisational charts may be used by a risk manager to identify risks.(5)

Answer

- Assess the extent to which control is centralised or decentralised.
- Assess the degree of **autonomy** given to managers at different levels of **authority**.
- Indicate how different sections of the organisation are accountable for any losses they incur
- Identification of key personnel, the loss of whose services may adversely affect operations
- Indicates reporting structures

Question 1

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

The five steps/tasks from which to launch an ERM strategy are:

- Establishing an oversight structure✓ ✓
- Defining a common language and framework✓ ✓
- Targeting risks and processes✓ ✓
- Developing overall goals, objectives and processes✓ ✓
- Assessing risk management capabilities✓ ✓

Question 2

2.1 Briefly explain what an interest rate swap is and list at least any four purposes (uses) of interest rate swaps. (6)

An interest rate swap is a transaction in which two unrelated borrowers independently borrow two principal amounts for the same period ✓ from different lenders, one paying a fixed rate and the other a floating rate. ✓ Interest rate swaps may be used for the following purposes:

- to hedge or modify an existing asset or liability ✓
- to adjust or sculpt an existing cash flow into a desired structure ✓
- to improve the cosmetics of a transaction ✓
- to access the market artificially✓

2.2 Briefly explain the difference between interest rate caps and collars. (4)

Interest rate caps limit how far a loan can be adjusted upwards by the lender if interest rates increase✓. The lender agrees to impose a rate cap in return for a fee to compensate partially for the fact that interest rates may rise above the caps✓.

Interest rate collars place a maximum and a minimum around a contracted loan rate✓. The borrower is protected against interest rates rising too high, while the lender is protected against rates falling too low✓.

Question 3

3. A participant in the market obtains an option to buy an asset at a strike price of R100. The cost (premium) of the option amounts to R2,50. The market price at the time the option is written is R95,50. Two months after the option is written the market price of the asset increases to R110.

3.1 Graphically illustrate the position of the option at a market price of R110. (6)

3.2 Explain the profit/loss position of the buyer of the option if the option is:

- Exercised (2)

If the buyer of the option **exercises** – He or she will make a profit of R7.50✓ because she/he will be buying the commodity at a price that is lower than that offered by the market.✓

- Not exercised (2)

If buyer of the option does not **exercise**, – she/he will make a loss of R7.50✓ because the market price of the commodity is higher than the strike price.✓
Breakeven price = 100 + 2.50 = 102.50
Profit = 110 - 102.50 = 7.50

Question 4

Explain the impact that corporate governance has on the business areas of enterprises.(8)

Corporate governance has an impact on the following business areas of an enterprise:

- the efficient employment of assets ✓✓
- the attraction of lower cost capital ✓✓
- meeting social obligations by complying with laws and regulations ✓✓
- overall performance ✓✓

Question 5

Discuss the impact that the Companies Act 61 of 1973 has on corporate governance in South Africa. Include the shortcomings of the Act in your discussion. (10)

The Companies Act 61 of 1973 covers a number of corporate governance aspects, which include:

- the roles, responsibilities, accountability, qualifications and disqualifications of the directors ✓✓

- the liability of directors and shareholders if a company acts unlawfully or in bad faith ✓✓
- specification that the enterprise may not supply the directors, the holding company or subsidiaries with loans ✓✓
- placement of limitations on the allocation of share capital to directors ✓✓
- stipulation that directors' shareholding in an enterprise must be declared ✓✓ (6 marks for any three discussed)

A number of shortcomings can be identified in the Companies Act, namely:

- It does not address the accountability and responsibility of the enterprise towards stakeholders. ✓
- It only makes provision for financial reporting and not for environmental and social matters. ✓
- It does not regulate non-audit matters such as consulting with auditors. ✓
- It is difficult to monitor the dealings of the board despite extensive corporate governance legislation. ✓

Question 6

6.1 Discuss the relevance of the King II Report on corporate governance for investors in companies. (4)

Investors are willing to pay a premium to companies with proper corporate governance measures for the following reasons:

- There is a belief that the company will perform better over the long term, resulting in higher share prices. ✓✓
- It is a measure of reducing risk by either reducing it or coping better with adverse events. ✓✓
- It is a trend from which no one wishes to be excluded. ✓✓

(4 marks for any 2 discussed)

6.2 List the characteristics of good corporate governance as identified by the King II Report. (8)

Characteristics of good corporate governance:

- discipline √
- responsibility √
- transparency√
- fairness√
- independence√
- social responsibility√
- accountability√

Question 1

The main objective of the first stage (establishing the context) of Enterprise Risk Management (ERM) is to …

1) identify risks.
2) provide a judgement of the likelihood of the risks.
3) discover timely and accurate data. **Answer is 3**

4) establish risk management process.

Question 2
Which of the following are process inputs for stage 1: establishing the context?

a) Statements of the business goals against which success will be measured.
b) A management tool used to describe workflow diagrams and supporting text.
c) The Audit committee which is responsible for monitoring the integrity and completeness of a company's financial statements.
d) A "map" of the intended implementation of risk management to support a project or a business activity.
e) Business analysis which is the group of findings arrived at from conducting the activities.

Choose the correct combination:

1) a, b and c only
2) a, b and d only
3) a, b, c and d only **Answer is 3**
4) all of the above

Question 3
Four of the common process mechanisms (enablers) in establishing the context are financial analysis ratios, risk management process diagnostic, SWOT analysis and PEST analysis. PEST analysis is used to analyse the …

1) profitability of a business;
2) market environment in which the business operate; **Answer is 2**
3) strengths and weaknesses; and
4) micro environment over which a business has control.

Question 4
Process activities in establishing the context include …

a) understanding of the industry within which the business is operating and competitive forces within that industry;
b) establishing business processes to improve performance and competitive position;
c) identifying resources and explore how they are used for competitive advantage; and
d) understanding the regulatory framework within which the business operates.

Choose the correct combination:

1) a and c only
2) a, b and d only
3) c and d only
4) all of the above **Answer is 4**

Question 5
Which of the following industry analysis techniques may be used to obtain an understanding of the context of a business?

a) The impact of potential entrants, suppliers, buyers and the threat of competition from substitutes.
b) The life cycle of the industry.
c) Intensity or rivalry of competition.
d) Scenario analysis.

Choose the correct combination:

1) a only
2) a, b and c only **Answer is 2**
3) c and d only
4) all of the above

Question 6

The primary goal of the risk identification process is to identify both the risks and the … to the business.

1) threats.
2) strengths.
3) opportunities. **Answer is 3**
4) weaknesses.

Question 7

The risk evaluation process consists of various process activities. The … is used to impose a series of "What if" questions.

1) basic concepts of probability.
2) scenario analysis.
3) Monte Carlo Simulation.
4) sensitivity analysis. **Answer is 4**

Question 8

In relation to CAPM analysis, market risk is measured by its beta. A share with a beta of 0.5 tends to move up or down by the same percentage point as the equity market.
Indicate if the above statement is true or false:

1) True
2) False. **Answer is 2**

Explanation

Beta measures the risk of a share compared to the rest of the financial market, in other words Beta of a share measure the behaviour of that share price relative to the market and therefore a share with a Beta of 0.5 tends to react half a percentage points less than the market. In another example a share with a Beta of 1 moves exactly the same as the market.

Question 9

Investment appraisal technique is one of the series of mechanisms available to evaluate. Which of the following technique/s (if used) would accept a project where the return on investment is greater than the cost of capital?

a) Required rate of return.
b) Net present value.
c) Internal Rate of Return.
d) Pareto analysis.

Choose the correct option:

1) a and b only
2) b and c only
3) c only **Answer is 3**
4) all of the above

Question 10
Which of the following are risk response strategies?

a) The strategy adopted to move a risk onto another entity, business or organisation.
b) The strategy adopted to understate the level of risk exposure.
c) The strategy adopted to accept, absorb or tolerate risk.
d) The strategy adopted to eliminate risk altogether.

Choose the correct combination:

1) v. a and b
2) vi. a,b, and c
3) vii. a, c, and d **Answer is 3**
4) viii. all of the above

Question 11
Which of the following unfavourable financial risk events can erode profitability of a business or at worse collapse a business?

a) Poor investment decision.
b) Loss of key customer.
c) Political instability.
d) Unfavourable changes in the market.
e) Bad debts.

Choose the correct combination:

1) a and e only
2) a, b, c and d only
3) a, b, d and e **Answer is 3**
4) all of the above

Question 12
Derivatives are financial instruments that derive its value from the derivative market.
Indicate if the above statement is true or false:

1) True
2) **False Answer is 2**

Explanation
A derivative is a financial security/instrument whose performance depends on the price movement of the underlying asset, such as shares, interest rates, commodities or currency. In other words it derives its value from the value of the underlying asset.

Question 13
In the context of risk management the main purpose of derivatives is to…

1) speculate.
2) manage/hedge financial risk **Answer is 2**
3) improve return on investment.
4) comply with regulation.

Question 14
Which of the following risk exposures can be covered by derivatives?

a) Equities.

b) Bonds.
c) Agricultural commodities (e.g. maize).
d) Foreign currency.
e) Oil price.

Choose the correct combination:
1) a, b and c only
2) b, c and d only
3) a, b, d and e only
4) all of the above **Answer is 4**

Question 15
The risk of a borrower defaulting on its debt obligation is an example of which of the following sources of risk?
1) Currency risk.
2) Liquidity risk.
3) Credit risk **Answer is 3**
4) Foreign investment risk.

Question 16
Technology risk is defined as …
1) events that would lead to insufficient, inappropriate or mismanagement of resources.
2) events that would lead to insufficient, inappropriate or mismanagement of investment in technology. **Answer is 2**
3) being clear about both risks and opportunities associated with new technology, outsourcing, integrating legacy IT systems.
4) insisting that risk management is embedded in the management structure so that the business is able to respond quickly to changes in risk profiles.

Question 17
The benefits of technology risk management include …
a) continuous review of development in technology;
b) improving the quality of information;
c) helping businesses to streamline and modernise their process and their organisation; and
d) promoting a proactive approach to managing technology projects.

Choose the correct combination:
1) a, b and c only
2) a and b only
3) a, b and d only
4) all of the above **Answer is 4**

Question 18

… is all about boards exercising a set of responsibilities and practices with the view to providing strategic direction, ensuring the IT objectives are achieved.
1) E-commerce governance
2) Governance
3) Software technology governance
4) Business IT governance **Answer is 4**

Question 19
There are a number of common risks in the investment process for IT projects, namely:

a) Insufficient project definition.
b) Insufficient input from IT specialists.
c) Lack of stakeholder involvement.
d) People risk.

Choose the correct combination:

1) a, b and c only **Answer is 1**
2) a and b only
3) a, b and d only
4) all of the above

Question 20
… is a key evaluation method for proposed IT projects.

1) Net Present Value
2) Internal Rate of Return
3) ROI **Answer is 3**
4) Internal Rate of Return

Question 21
Which of the following statement/s best describe ERM

a) ERM is about protecting and enhancing share value of the business to satisfy the primary business objective of shareholder wealth maximisation
b) ERM is about understanding the interdependencies between the risks, how the materialization of a risk in one area may increase the impact of risks in another business
c) ERM practice is segmented and carried out in "silos"
d) ERM ensures that risks are managed in a coordinated and integrated way across an entire business

Choose the correct combination:

1) a and b only
2) a, b and c only
3) a, b, and d only **Answer is 3**
4) all of the above

Question 22
Enterprise Risk Management is a…….view of risk both from operational and strategic perspective

1) Narrow
2) Technical
3) Balanced
4) Comprehensive **Answer is 4**
5) Biased

Question 23
What are the key obstacles to making risk management integral with overall business strategy at an organisation?

a) Competition with other priorities

b) Fear of creating a risk-averse and bureaucratic culture
c) Directors consider risk management a task for line management, not the board
d) Poor awareness among staff inhibiting implementation
e) The board does not understand or appreciate the principles and benefits of enterprise risk management

Choose the correct combination:
1) a and b only
2) a, b, c and d only
3) a, d and e only
4) all of the above (external source – BHF conference presentation) **Answer is 4**

Question 24
The main objectives of ERM are to ensure that businesses:

a) Eliminate existing risks altogether
b) Do not take risks at all
c) Understand that risk is inescapable in business activity
d) Understand that taking risk and managing it is the essence of business survival and growth
e) Understand that risk management is about controlling risk as far as possible to enable a business to maximize its opportunities

Please choose the correct combination
1) a, b and c
2) a, c and d only
3) c, d, and e only **Answer is 3**
4) all of the above

Question 25
Which of the following are the benefits of ERM?

a) Businesses accept risk as part of wealth creation and preservation and they expect returns commensurate with risk
b) ERM strengthens governance through challenging potential excessive risk taking
c) Effective ERM process helps businesses to by-pass legal and regulatory requirements it has to comply with in order to save time and costs
d) The very process of identifying risks can stimulate thinking and generate opportunities as well as threats
e) ERM supports businesses to enhance their capability to identify potential risks events, asses risks and establish appropriate responses

1) a and b only
2) b, c, d and e only
3) a, b, d and e only **Answer is 3**
4) all of the above

Question 26
Which of the following statements best describes corporate governance?
a) Corporate governance is the system by which companies are directed and controlled.
b) Good corporate governance ensures accountability on the part of the board of directors to investors.

c) The purpose of corporate governance is to ensure the board of directors have an oversight of business operations and facilitate effective, entrepreneurial and prudent management that can deliver the long-term success.
d) Corporate governance places responsibility on the board for ensuring that appropriate systems and policies for risk management are in place.

Please choose the correct combination

1) a and b only
2) a, b and c only
3) b, c, and d only
4) all of the above **Answer is 4**

Question 27

Which of the following are the benefits of corporate governance?

a) Improves confidence of domestic and international investors and therefore attracting capital at lower cost.
b) Corporate government ensures efficient use of company resources.
c) Good corporate governance is essential to ensure adherence to legislation as well as corporate social responsibility
d) Effective corporate governance may improve overall performance

Please choose the correct combination

1) a and b only
2) a, b and c only
3) b, c, and d only
4) all of the above **Answer is 4**

Question 28

The following are key features of King III Report on Governance compared to King I and II reports:

a) Companies listed on the JSE do not have to comply with King III
b) Economic life of the community
c) Reporting on social, transformation, safety, ethics, health and environmental management policies and practices
d) Triple bottom line approach

Please choose the correct combination

1) a and b only
2) b and c only **Answer is 2**
3) b, c, and d only
4) all of the above

Question 29

What is the board's primary responsibility regarding risk management?

a) To manage risk as an integral part of day-to-day board-level planning and decision making
b) To be proactive in determining the organisation's level of appetite for risk
c) To spot emerging risks and develop strategies to prepare for them
d) To respond to risks as they arise

Please choose the correct combination

1) a and b only
2) a, b and c only

3) b, c, and d only
4) all of the above **Answer is 4**

Question 30

Which of the following are the principles in King III?

a) All staff should practice risk management
b) The board should approve key risk indicators for each risk, as well as tolerance levels
c) Internal audit should provide independent assurance on the risk management process
d) Companies have to report on the nature and extent of commitment to social, transformation, ethical, safety, health and environmental management policies and practices

1) a and b only
2) b, c and d only
3) a, b, and c only **Answer is 3**
4) all of the above

Question 31

Operational risk is the risk of loss resulting from inadequate or failed internal process, systems and … or from external events.

1) technology.
2) strategy
3) people **Answer is 3**
4) resources

Question 32

Operational risk management affords a business benefits by …

a) providing a more robust enterprise risk management system,
b) improving the ability to achieve its business benefits,
c) maximising day-to-day losses, and
d) improving financial planning and management, which sits at the heart of corporate governance.

Choose the correct combination:

1) a, b and c only
2) a and b only **Answer is 2**
3) a, b and d only
4) all of the above

Question 33

Failing to modify a successful strategy over time to reflect changes in the business environment is a form of operational risk.

Indicate if the above statement is true or false:

1) False
2) True **Answer is 2**

Question 34

When a business experiences poor staff retention, leading to disruption is an example of …

1) system risk.
2) people risk. **Answer is 2**
3) strategy risk.
4) loyalty risk.

Question 35
. … risk is defined as the failure of …due to their poor design, complexity or non-performance, giving rise to operational risk losses.

1) Operational; processes
2) People; processes and systems
3) Processes and systems; processes **Answer is 3**
4) Technological, data processes

Question 1
Which one of the following is a benefit of effective risk and opportunity management?
1) Improved profit certainty
2) Increased shareholder value
3) Increased stakeholder confidence **Correct option 3**
4) Lower economic returns

Explanation
Improved **cost** certainty, **sustainable** shareholder value, increased stakeholder confidence and **higher** economic returns are all benefits of effective risk and opportunity management.

Question 2
The board's role should be to steer the corporation towards corporate governance policies that support …
1) long-term sustainable growth in shareholder value **Correct option 1**
2) short-term sustainable growth in shareholder value
3) short-term sustainable growth in stakeholder value
4) long-term sustainable growth in stakeholder value

Explanation
The board's role should be to steer the corporation towards corporate governance policies that support long-term sustainable growth in shareholder value.

Question 3
Which one of the following statements is not considered a benefit of Enterprise Risk Management (ERM)?
1) Minimise operational surprises and losses.
2) Enhance corporate governance.
3) Comply with relevant legal and regulatory requirements.
4) Align return appetite and strategy. **Correct option 4**

Explanation
Benefits of Enterprise Risk Management (ERM) include minimisation of operational surprises and losses, enhancing corporate governance, complying with relevant legal and regulatory requirements and aligning **risk** appetite and strategy**. The determination of the risk appetite of a business is vital in the ERM process because it shows how much risk the business is willing to take on.**

Question 4
The King II report moved away from the … bottom-line principle to a … bottom-line principle.

1) double - triple
2) single - triple **Correct option 2**
3) single - double
4) double – single

Explanation
The King II report moved away from the **single** bottom-line principle to a **triple** bottom-line principle.

Question 5
As of June 2010, companies listed on the JSE are expected to comply with …

1) King I
2) King II
3) King III **Correct option 3**
4) King IV

Explanation
As of June 2010, companies listed on the JSE are expected to comply with **King III**.

Question 6
King III applies to …

a) All listed companies on the JSE
b) Banks
c) Financial institutions
d) Insurance institutions

Choose the correct option.

1) a, b, c, d
2) a, b, c
3) a, b, d **Correct option 3**
4) a, b

Explanation
King III applies to all listed companies on the JSE, banks, financial and insurance institutions.

Question 7
In financial ratio analysis, efficiency ratios …

1) measures the degree of success of the management in achieving their primary purpose of creating wealth for their owners
2) are also known as activity ratios **correct option 2**
3) examine the relationship between liquid resources held and creditors due for payment in the near future
4) assess the returns and performance of shares held in a particular business

Explanation
In financial ratio analysis, efficiency ratios are also known as activity ratios.

Question 8
A GAP analysis …

1) is used to list all the risks that were identified on previous projects within the business
2) is a list that categorises each risk into a type of area
3) can be used to identify the main risks linked to a certain activity or project of the business **Correct option 3**
4) is a structured checklist to breakdown the risks and opportunities into manageable components

Explanation
A **GAP analysis** can be used to identify the main risks linked to a certain activity or project of the business. A **risk checklist** is used to list all the risks that were identified on previous projects within the business.
A **risk prompt list** is a list that categorises each risk into a type or area.
Risk taxonomy is a structured checklist to breakdown the risks and opportunities into manageable components.

Question 9
Pareto analysis is used to …
1) identify those risks that will have a dramatic impact on business projects/activities and objectives **Correct option 1**
2) determine the expected return of an asset in relation to its risk or risk profile
3) structure decisions, uncertain events and values of outcomes
4) identify the causes of any risk

Explanation
Pareto analysis is used to identify those risks that will have a dramatic impact on business projects/activities and objectives.
The **CAPM model** is used to determine the expected return of an asset in relation to its risk or risk profile.
Decision analysis is used to structure decisions, uncertain events and values of outcomes.
Casual analysis is used to identify the causes of any risk.

Question 10
The attitude towards risk that requires an increase in the return for an increase in the risk is known as risk …
1) neutral
2) seeking
3) averse **Correct option 3**
4) impartial

Explanation
The attitude towards risk that requires an increase in the return for an increase in the risk is known as risk **averse**.

Question 11
The … is a method used by a business to evaluate the effect of uncertainty on a planned activity in a range of situations and uses random numbers to sample from a probability distribution.
1) scenario analysis
2) simulation
3) Monte Carlo Simulation **Correct option 3**
4) latin hypercube sampling

Explanation
The **Monte Carlo simulation** is a method used by a business to evaluate the effect of uncertainty on a planned activity in a range of situations and uses random numbers to sample from a probability distribution.

Question 12
The … is used to re-create the probability distributions specified by distribution functions accurately.

1) scenario analysis
2) simulation
3) Monte Carlo Simulation
4) latin hypercube sampling **Correct option 4**

Explanation
The **Latin Hypercube sampling** is used to re-create the probability distributions specified by distribution functions accurately.

Question 13
Which of the following are inputs for the risk treatment process?

a) Risk register
b) Industry betas
c) Description of the business risk appetite
d) Risk response actions

Choose the correct option.

1) a, d
2) a, b, d
3) a, b, c **Correct option 3**
4) a, b, c, d

Explanation
Inputs for the risk treatment process include the risk register, industry betas and description of the business risk appetite. The outputs for the risk treatment process will be the risk response (i.e. remove, reduce or transfer) actions.

Question 14
"Which one of the following is a process **output** in the risk analysis process?"

1) risk identification
2) risk recording
3) risk register **Correct option 3**
4) profit and loss account assessment

Explanation
Risk identification is done in the second stage of the risk management process. Risk is identified and recorded during this stage. Risk recording is a process input in the risk analysis process. The risk register is a process **output** of the risk identification and risk analysis process. One of the tools (process inputs) used to identify risk is the analysis/assessment of the profit and loss account.

Question 15
Risk appetite can defined as ...

1) a reduction of risks by distribution
2) the amount of risk a business is prepared to tolerate at any point in time **Correct option 2**

3) the elimination of a risk when a negative outcome or high-risk exposure is anticipated
4) the strategy used to transfer a risk to another entity, business or organisation

Explanation
Risk appetite can defined as the amount of risk a business is prepared to tolerate at any point in time.

Use the following information to answers Questions 16 and 17.
Afrika Company's total current assets, total current liabilities, and inventory for each of the past 4 years are as follows:

Item	2009	2010	2011	2012
Total current assets	R16 950	R21 900	R22 500	R27 000
Total current liabilities	R9 000	R12 600	R12 600	R17 400
Inventory	R6 000	R6 900	R6 900	R7 200

Question 16
The firm's current ratio for the year ended 2011 is ...
1) 1.24
2) 0.56
3) 1.79 **Correct option 3**
4) 3.26

Explanation
The firm's current ratio for the year ended 2011 is 1.79.
Calculation of current ratio: Current Assets / Current Liabilities
= R 22 500 / R 12 600
= 1.7857 ≈ 1.79

Question 17
The firm's quick ratio for the year ended 2012 is...
1) 1.55
2) 1.14 **correct option 2**
3) 2.42
4) 1.79

Explanation
The firm's quick ratio for the year ended 2012 is 1.14.
Calculation of quick ratio (acid test ratio): (Current Assets – Inventory) / Current Liabilities
= (R 27 000 – R 7 200) / R17 400
= R 19 800 / R17 400
= 1.137 ≈ 1.14

Question 18
Effective corporate governance…
1) promotes the inefficient use of resources
2) attracts higher cost of capital
3) retards overall performance
4) ensures adherence to legislation **Correct option 4**

Explanation
Effective corporate governance promotes the efficient use of resources, attracts lower cost of capital, enhances overall performance and ensures adherence to legislation (laws and regulations).

Question 19
Key Risk Indicators must be …

1. linked to a loss
2. qualitative
3. quantitative **Correct option 3**
4. indicated by means of probability distributions

Explanation
Key Risk Indicators must be **quantitative**.

Question 20
Mr. A Lucky has been appointed as the risk manager for A-Z clothing Ltd. Mr. A Lucky must implement a risk management process for the business. Which of the following risk management stages should Mr. A Lucky implement?
a) establish the context, monitor and review
b) risk identification, risk analysis and risk evaluation
c) design and improve the process
d) risk treatment, communication and consultation

Choose the correct option.
1) a, d
2) a, b, d **Correct option 2**
3) a, b, c
4) a, b, c, d

Explanation
The **stages** in the risk management process include establishing the context, monitor and review, risk identification, risk analysis, risk evaluation, risk treatment, communication and consultation. The design and improve process is an **ongoing** process which takes place at commencement and throughout the risk management process.

Question 1
The risk that a counterparty to a contract will not live up to its contractual obligations is known as:
1) Liquidity risk
2) Credit risk
3) Counterparty risk **Correct option 3**
4) Default risk

Explanation
Counterparty risk is the risk that a counterparty to a contract will not live up to its contractual obligations.

Question 2
The uncertainty linked to the recovery of outstanding amounts due is known as:
1) Recovery risk **Correct option 1**
2) Exposure risk

3) Default risk
4) Credit risk

Explanation
Recovery risk is the uncertainty linked to the recovery of outstanding amounts due.

Question 3
Which one of the following is not a benefit of operational risk management?
1) Improving ability to achieve business objectives.
2) Maximising day-to-day profits. **Correct option 2**
3) Providing management the opportunity to focus on revenue generating activities.
4) Minimising day-to-day losses.

Explanation
Benefits of operational risk management include improving ability to achieve business objectives, minimising day-to-day losses and providing management the opportunity to focus on revenue generating activities.

Question 4
Information technology consists of the following:
1) E-commerce using the internet
2) Network Systems
3) Intranets **Correct option 3**
4) Broadband

Explanation
Information technology consists of Intranets and **communications** technology consists of broadband, network systems and E-commerce using the internet.

Question 5
The determination of the probability and impact of the identified risks and opportunities is referred to as risk …
1) identification
2) analysis
3) evaluation **Correct option 3**
4) review

Explanation
The determination of the probability and impact of the identified risks and opportunities is referred to as risk **analysis**

Question 6
The sources of risk embraced under economic risk include the following:
a) Fall in demand
b) Government policies
c) Exchange Rates
d) Fall in Supply

Choose the correct option.
1) a, b, c, d

2) b, c, d
3) a, b, d
4) a, b, c **Correct option 4**

Explanation
The sources of risk embraced under economic risk include fall in demand (a shift in the aggregate demand curve), government policies (including interest rates and trade protectionism) and exchange rates.

Question 7
Macro-economic policy is influenced by government through the …
a) Fiscal policy
b) Econometric policy
c) Monetary policy
d) Competing theories

Choose the correct option.

1) a, b, c, d
2) a, c, d **correct option 2**
3) a, b, d
4) None of the above.

Explanation
Macro-economic policy is influenced by government through the fiscal policy, monetary policy and competing theories.

Question 8
Which one of the following factors influences the aggregate supply curve?
1) Consumer spending
2) Increased investment in education **Correct option 2**
3) Government spending
4) Exports and imports

Explanation
Increased investment in education is a factor that affects aggregate supply.
Consumer spending, government spending, exports and imports are factors that affect aggregate demand.

Question 9
Which of the following is an example of a political risk factor for the South African government?
1) Fiscal policy **Correct option 1**
2) Monetary policy
3) Monetary-economic policy
4) Inflation policy

Explanation
Political risk is defined as “the uncertainty that stems, in whole or in part, from the exercise of power by government actors and the actions of non-government groups”. The political environment of overseas countries will always have an impact on the threats and opportunities of a business wanting to expand business overseas for example the tax regime (fiscal policy) may change, contract

risk events, pressure groups, terrorism and blackmail. All of these factors can impact on the political risk a country or business can face.

Question 10
"The exposure to a potential loss arising from diminishing sales or margins as a result of changes in market conditions, outside of the control of the business" is known as…

1) interest rate risk
2) environmental risk
3) market risk **Correct option 3**
4) social risk

Explanation
"The exposure to a potential loss arising from diminishing sales or margins as a result of market conditions, outside of the control of the business" is known as **market risk**. Refer to TL501 for an explanation on the other risks.

Question 11
Which one of the following methods is used to calculate Value-at-risk?

1) Monte Carlo **Correct option 1**
2) Pest Analysis
3) Economic value added
4) Economic simulations

Explanation
The **Monte Carlo** method is used to calculate Value-at-risk.

Question 12
Graham Capital is in the process of obtaining a loan from XWX Bank. Which of the following factors must Graham Capital take into consideration?

a) Interest rate at commencement of the loan
b) Interest rate at the end term of the loan
c) Duration of payment
d) Nature of the interest rate

Choose the correct option.

1) All of the above.
2) a, b, c
3) a, c, d **Correct option 3**
4) None of the above.

Explanation
When a company borrows money, it needs to know the interest rate at the commencement of the borrowing, the nature of the interest rate (fixed or variable), the duration of the payment and the basis of interest rate determination.

Question 13
Expropriation of corporate assets without prompt and adequate compensation is an example of…

1) economic risk
2) political risk **Correct option 2**
3) legal risk
4) cultural risk

Explanation
Expropriation of corporate assets without prompt and adequate compensation is an example of political risk. This example can also be seen as a macropolitical risk.

Question 14
A country's ability or intention to meet its financial obligations determines it's…

1) economic risk **Correct option 1**
2) financial risk
3) political risk
4) country risk

Explanation
A country's ability or intention to meet its financial obligations determines its **economic risk**. The fiscal and monetary policy of the government determines it financial obligations which can have an influence on economic risk.

Question 15
Which one of the following statements is correct?

1) Current ratio is the relationship between non-current assets and non-current liabilities.
2) The current ratio is more conservative than the quick ratio.
3) The current ratio excludes inventory.
4) A higher quick ratio means a better liquid current position. **Correct option 4**

Explanation
The correct statement is "A higher quick ratio means a better liquid current position".
Current ratio is the relationship between **current** assets and **current** liabilities. The **quick** ratio is more conservative than the current ratio. The **quick** ratio excludes inventory.

Question 16
In implementing operational risk management in a business, external events which can occur outside of the business must be taken into consideration. These events may require a business to have response strategies in the form of:

1) change and knowledge management
2) project and knowledge management
3) change management and business contingency plans **Correct option 3**
4) project management and business contingency plans

Explanation
In implementing operation risk management in a business, external events which can occur outside of the business must be taken into consideration. These events may require a business to have response strategies in the form of **change management and business contingency plans**.

Question 17
Control technology can be defined as…

1) the collection, storage and processing of information by electronic means
2) specific computer-based production control systems **correct option 2**
3) network systems in which computers are linked to one another over a network
4) IT governance to manage the risks and constraints of IT

Explanation
Control technology can be defined as **specific computer-based production control systems.**

Question 18
Which one of the following is seen as a common challenge for businesses in implementing project risk management?

1) Lack of a risk maturity model. **Correct option 1**
2) Clear definition of roles.
3) Lack of responsibility assignment matrix.
4) Lack of team structure.

Explanation
A common challenge for businesses in implementing project risk management is a lack of risk maturity model.

Question 19
Which of the following risks are seen as internal micro influences to a business?
1) Project, market and legal risks
2) Economic, political and environmental risks
3) Social, ethical, health and safety risks
4) Ethical, project and technological risks **Correct option 4**

Explanation
Ethical, project and technological risks is seen as internal micro influences to a business.

Question 20
Credit insurance …
1) eliminates uncertainty over the likely recovery of outstanding amounts due
2) mitigates action for credit risk to protect a business against bad debt **Correct option 2**
3) prevents that a customer may default on its payment
4) relates to an uncertainty surrounding the payment of future amounts

Explanation
Credit insurance **mitigates action for credit risk to protect a business against bad debt.**

Statement of compliance
Vodacom is committed to the highest standards of business integrity, ethics and professionalism. The Board recognises the need to conduct the business in accordance with the principles of the King Code of Corporate Practices and Conduct ('King III'). These principles include discipline, independence, responsibility, fairness, social responsibility, transparency and the accountability of directors to all stakeholders. A number of these principles are entrenched in the Group's internal controls and policy procedures governing corporate conduct. The Board is satisfied that every effort has been made in the financial year to 31 March 2013 to comply in all material aspects with King III. Where we do not comply, this is stated and explained.

Question 1

1.1 In the extract, Vodacom's statement of compliance is referring to the principles of the King Code of Corporate Practices and Conduct (King III). Discuss the **principles** listed in the compliance statement of Vodacom? **(7)**

Answer

Principle:	**Definition based on the King Code of Governance Principles for SA 2009**
Discipline	Each company should demonstrate its commitment to its code of ethics by constantly enforcing appropriate discipline. √
Independence	Independence is the absence of undue influence and bias which can be affected by the intensity of the relationship between the director and the company. √
Responsibility	The state or position of having control or authority and being accountable for ones actions and decisions. √
Fairness	Free from discrimination or dishonesty and in conformity with rules and standards. √
Social responsibility	Is an important and critical component of the broader notion of corporate citizenship. √ One is a good corporate citizen, inter alia, by being socially responsible. Corporate responsibility is the responsibility of the company for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour that: contributes to sustainable development, including health and the welfare of society; takes into account the legitimate interests and expectations of stakeholders; is in compliance with applicable law and consistent with international norms of behaviour; and is integrated throughout the company and practiced in its relationships. Activities include products, services and processes. Relationships refer to a company's activities within its sphere of influences.
Transparency	Easy to understand or recognise; obvious; candid; open; frank. √
Accountability of directors to all stakeholders	Being responsible and able to justify and explain decisions and actions. √

1.2 Identify any three (3) **additional principles** included in the King III report not specifically listed by Vodacom. **(3)**

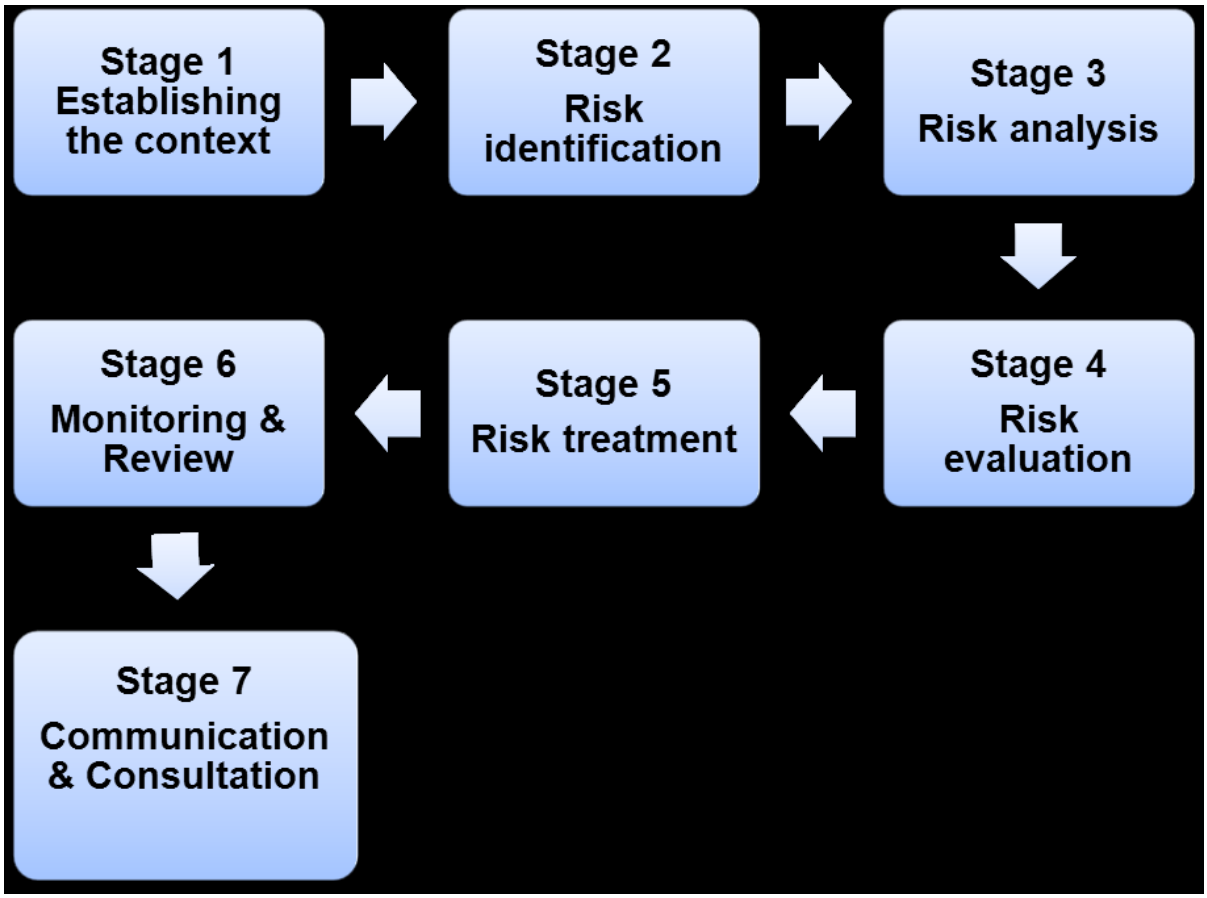
Answer

Any three of the following additional principles included in the King III report can be discussed:

- Management should be responsible for the risk management process. Management is accountable to the board for designing, implementing and monitoring the process of risk management and integrating it into the day-to-day activities of the company.
- All staff should practise risk management.
- The board should be responsible for the process of risk management.
- The board should approve the company's chosen risk philosophy.
- The board should adopt a documented risk management plan.
- The board may delegate the responsibility of risk management to a dedicated risk committee.
- Risk assessment should be performed on an on-going basis.
- The board should approve key risk indicators for each risk, as well as tolerance levels.
- Risk identification should be directed in the context of the company's purpose.
- The board should ensure that key risks are quantified and are responded to appropriately.
- Internal audit should provide independent assurance on the risk management process.
- The board should report on the effectiveness of risk management.
- The board should ensure that the company's reputational risk is protected.
- The board should determine the extent to which risks relating to sustainability are addressed and reported on.
- The board should ensure that information technology (IT) is aligned with business objectives and sustainability.
- The board should consider the risk of the unknown as part of the qualitative and quantitative risk assessment process.
- Compliance should form part of the risk management process.

Question 2
With reference to the seven (7) **stages** in the enterprise risk management (ERM) process explain how a business might design and implement an ERM approach to risk. **(15)**

Answer



Stage 1 of the ERM process is establishing the context. It forms the foundation for all the other stages in the ERM process. **√** Establishing the context deals with the business as a whole as well as the business activities, processes and projects. **√** This stage is used to acquire accurate data and information about the whole business. **√**

Stage 2: Risk identification is a crucial step in the ERM process. It is important to be able to identify the risks in the business and understand how they fit into the overall business context. **√** Through risk identification, the business will be able to identify the key risks and risk events associated with the business. **√** The business will constantly change and grow as well as the risks associated with the business. The business will need to identify risks on a constant basis and identify the opportunities that may arise in order to enhance its objectives as well as risks that may reduce the likelihood of the business achieving its objectives. **√**

Stage 3: Risk Analysis. The risk analysis stage will provide information on the likelihood of risks and opportunities occurring **√** and the impact of them to aid in the decision making process. **√** The risk analysis process will assess all the risks identified in the risk register. **√**

Stage 4: Risk Evaluation. The risk evaluation stage will evaluate the results obtained in the risk analysis stage. Stage 4 will focus on both the risk exposure and opportunity that may arise from a

business activity. All the information gathered in the risk analysis process is integrated into the risk evaluation process. **√** The risk evaluation stage will evaluate the financial impact (loss or gain) of a risk in a business in numerical terms. The risk evaluation stage is essential as it assists the business to understand the combined effect of a group of risks and opportunities. This stage will assist the business in its decision making process. **√** Risk evaluation is the only option available to the business for assessing the organisation's exposure to risks and opportunities and it must be implemented properly. **√**

Stage 5: Risk Treatment. The risk treatment stage will assist the business to design a specific action plan **√** and produce strategic responses to address the risks and opportunities identified in the business to secure business objectives. **√** This stage is vital in the risk management process because the risk strategy responses and action plan must be prepared and implemented effectively into the business. **√**

Stage 6: Monitoring and Review. The risk monitoring and review stage is a key stage in the ERM process.**√** It may become necessary for a business to review all the previous stages in the risk management process because new information became available or circumstances changed in the business. **√** The monitoring and review stage must be carried out in order to increase the success of the implementation of the entire ERM process. **√**

Stage 7: Communication and consultation. The risk communication and consultation stage will be used across all the other ERM process stages. **√** It is essential for a business to understand how effectively the process outputs of each stage is communicated and understood by decision makers. Risk communication and consultation form a link with all the other stages in the ERM process. The business risk management process must be effectively communicated to all levels of employees in the business. **√** This step is vitally important because every employee may be involved in an activity that might have a direct impact on the ERM process and if the employee does not understand the risk management culture in which the business functions it can have disastrous consequences. **√**

All the stages are interrelated and must be implemented effectively and communicated in the business to manage its risks and opportunities. **√**

Question 3 3.1
Argue the **value of good corporate governance** to business enterprises. (Hint: refer to the four business areas corporate governance might impact on). **(10)**

Answer
Corporate governance adds value to an enterprise in the following manner:

Employing assets efficiently
Effective corporate governance promotes the efficient use of resources within a firm and the economy at large. √ When an efficient corporate governance system is in place, debt, equity and capital flow to enterprises that are capable of investing these resources efficiently in order to produce goods and services that are most in demand and have the highest rate of return. √ In this regard, effective governance helps to grow and protect scarce resources and to ensure that societal needs are met. Effective governance should make it possible to replace managers who do not put scarce resources to efficient use or who are incompetent in what they do. **√**

Attracting lower-cost capital
Effective corporate governance helps enterprises to attract lower-cost capital by improving the confidence of domestic and international investors and by assuring them that the assets

are used in the form agreed upon, whether the investment is in the form of debt or equity. √ This has a positive impact on both debt and equity. For enterprises to succeed in competitive markets, corporate managers must innovate relentlessly and efficiently, and constantly evolve new strategies to meet changing circumstances. √

Meeting social obligations: complying with laws and regulations
To succeed in the long term, enterprises must comply with the laws, regulations and expectations of the societies in which they operate. Most corporations take their corporate citizenship seriously. √ They contribute to civil societies' needs while some are opportunistic and have no regard for social or environmental issues. Good corporate governance is essential to ensure adherence to legislation as well as corporate social responsibility principles. √

Overall performance
If corporate governance is effective, it gives managers a holistic view of the organisation and holds managers and the board accountable for the management of corporate assets. √ Such accountability contributes to the efficient use of resources, attraction of lower-cost capital and an increase in the responsiveness of the enterprise to society, and will therefore lead to the improvement of corporate performance. √ Effective corporate governance may not guarantee improved corporate performance at the individual firm level, but it should increase the likelihood of managers focusing on improving the performance of enterprises and of their being replaced when they fail to do so. √

3.2 Define operational risk and briefly explain each of the **main underlying risk factors** comprising operational risk management. **(10)**

Answer
Operational risk is defined as "the potential for loss due to failures of people, processes, and technology and external dependencies". **√** The main underlying risk factors comprising operational risk include the following:

- Business risk – includes adverse changes to a firm's market, customers or products, changes to the economic and political environments in which the firm operates and strategic risk which a firm faces if business plans, supporting systems and the implementation of these plans adversely affect the firm. √
- Crime risk including potential theft, fraud and computer hacking. √
- Disaster risk such as fires, floods and other natural disasters. √
- Information technology risk, including unauthorised access and disclosure, and data corruption.√
- Legal risk including loss arising from legal action against it and from inadequate, incomplete or otherwise unsound legal documentation and practices. √
- Regulatory risk relating to the lack of observance of rules set by a regulatory body. √
- Reputational risk from negative publicity about its business practices or internal controls. √
- Systems risk loss as a result of failure caused by the breakdown of business procedures, processes or systems and controls. √