



UNIVERSITY
OF
JOHANNESBURG

Department of Finance and Investment Management

Performance and Risk Strategy

FNB18x7

LAST ASSESSMENT OPPORTUNITY 6 November 2015

Time: 3 hour 15 minutes (195 minutes)

Marks: 100

Assessor: Mr B Mogapi, UJ
Moderator: Mrs A Oosthuizen, UJ
Mr Kevin Thomas, UJ
External Moderator: Mrs L Ehlers, ACMA

INSTRUCTIONS:

- This is a closed book exam.
- This paper consists of 16 pages, including this page (page 15 and 16 consists of an answer sheet for the completion of Question 1).
- You are allowed 15 minutes reading time before the examination begins during which you should read the question paper and, if you wish, make annotations on the question paper. However, you will not be allowed, under any circumstances, to open the answer book and start writing or use your calculator during this reading time.
- Answer all questions.
- Start each question on a new page or new book as instructed.
- Silent, non-programmable calculators may be used.
- Please hand in the question paper together with your answer book.

Question	Aspect/Topic	Marks	Time
	Reading time	---	15 minutes
1	Objective Test (OT) Questions: Various Topics	25	45 minutes
2	Scenario: YJ Oil and Gas	50	90 minutes
2	Scenario: Beats Pty (Ltd)	25	45 minutes
TOTAL		100	195 minutes

Question 1**25 marks****Instructions for answering Objective Test (OT) Questions**

The answers to the OT questions should be recorded in your answer script.

The answers to the 25 questions in Question 1 should be recorded on the answer sheet provided. Write only the correct answer or letter you select next to each question number.

Each question is awarded ONE mark for the correct answer.

1. Which of the following would **not** normally be classified as a strategic risk?
 - A. The risk that a new product will fail to find a large enough market.
 - B. The risk of competitors moving their production to a different country and being able to cut costs.
 - C. The risk that a senior manager with lots of experience will be recruited by a competitor.
 - D. The risk of resource depletion meaning that new sources of raw material will have to be found.
2. Is the following statement TRUE / FALSE?

The level of reputation risk depends significantly on the level of other risks.
3. Complete the following sentence with the most appropriate word/phrase.

_____ can be defined as the nature and strengths of risk that an organisation is prepared to bear.
4. Select the correct option between brackets to make the statement valid or correct.

'Risk aversion' focuses on the i) (risk level / return level), while 'risk seeking' focuses on the ii) (risk level / return level).

Question 1 (Continued)

5. A systematic risk management process will reflect the following consecutive steps:

A. Identification, analysis, mapping and consolidation.
B. Analysis, identification, mapping and consolidation.
C. Identification, analysis, and mapping.
D. Mapping, analysis, identification and consolidation.

6. When mapping risks, the TARA framework is useful for describing the options for managing risks.

Match the appropriate TARA option in the table below to the correct position on the risk map provided (A, B, C, D).

Transfer	Accept	Reduce	Avoid
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		Severity	
		Low	High
Frequency	Low	A	B
	High	C	D

7. Complete the following sentence with the most appropriate word/phrase.

_____ is taking action that will offset an **exposure** to a risk by incurring a new risk in the opposite direction.

Question 1 (continued)**25 marks**

8. The features of a dual board include:

Select ALL that apply

- A. The board is made up of a mix of executive and non-executive directors.
- B. A board structure consisting of a supervisory board and management board.
- C. Decision making is generally slow.
- D. All directors have the right to participate in decision-making.
- E. The board lacks independence.

9. Complete the following statement with the most appropriate word or phrase.

A (n) _____ sets out the directors' analysis of the business, in order to provide to investors a historical and prospective analysis of the reporting entity 'through the eyes of management'.

- A. Statement of financial position.
- B. Information system.
- C. Business review.
- D. Integrated report.

10. Which Three of the following statements are true? Select **all** that apply.

- A. Strategic information is used to plan the objectives of the organisation, and to assess whether the objectives are being met in practice.
- B. Operational information is used to ensure that specific operational tasks are planned and carried out as intended and therefore include productivity measures such as output per hour.
- C. Tactical information is used when strategic decisions are implemented.
- D. Tactical information is used when decisions are made on how the resources of the business should be employed, to monitor how they are being, and have been, employed.

11. The technologies, applications and practices for collecting, integrating, analysing, and presenting business information, is known as:

- A. Big Data
- B. Business analytics
- C. Business intelligence
- D. Data warehousing
- E. Data mining

Question 1 (continued)

12. Which one of the following is not a benefit of control self-assessment?
- A. Supporting concepts such as TQM and benchmarking.
 - B. Providing comprehensive control documentation.
 - C. Providing absolute assurance of compliance with control requirements.
 - D. Highlighting areas of potential weakness.
13. Which one of the following will form part of the company's general business environment, but not necessarily its control environment?
- A. Culture.
 - B. Management approach to risk.
 - C. Political factors.
 - D. Organisational culture.
14. Which one of the following would not be considered good practice when preparing wages and salaries?
- A. Salaries are calculated automatically by a computer based on information held on the payroll files.
 - B. There is segregation of duties with respect to the calculation and payment of wages for casual workers.
 - C. Management regularly review the payroll summary.
 - D. For consistency, one person calculates and pays out wages for casual workers.
15. Which ONE of the following is not a function of the internal audit department?
- A. Checking that the company complies with the law, regulations and company policy.
 - B. Helping managers to manage more effectively.
 - C. Ensuring that statutory accounts give a true and fair view of the company's activities.
 - D. Identifying areas for improvement.
16. An auditor will consider the following to be reliable evidence:
- Select two statements that apply
- A. Audit evidence obtained from the entity's records, rather than from external to the entity.
 - B. Audit evidence obtained by inference, rather than directly by the auditor.
 - C. Audit evidence in the form of documents or written representations, rather than oral.
 - D. Original documents are obtained, rather than photocopies.
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Question 1 (continued)**25 marks**

17. The post implementation review of a new information system is carried out to ensure which of the following?

Select three statements that apply.

- A. The system is secure.
 - B. The system meets the needs of managers.
 - C. The system produces accurate information.
 - D. Time taken for the project.
 - E. Costs incurred on the project.
18. B's directors do not believe that they always get value for money from their investment in capital projects. Over the past decade the company has invested in 18 projects that have cost more than \$1m. They are considering introducing a system of post completion audit.

Which three of the following are true with regard to a post completion audit?

- A. Post completion audits could produce valuable insights.
 - B. Post completion audits will not prevent dysfunctional behaviour by project sponsors.
 - C. Project sponsors should be held liable for all negative findings from post completion audits.
 - D. Post completion audits cannot be conducted until the project has reached its end.
 - E. It may be difficult to introduce post completion audits.
 - F. Only those projects starting after the audit system was introduced should be audited.
19. The Board of Directors of company A has four Executive Directors: the Chief Executive, the Production Director, the Finance Director and the Commercial Director. In addition there is a Company Secretary and a Non-Executive Chairman. In accordance with company A's Articles of Association, the Non-Executive Chairman is drawn from one of the four subsidiaries. The Non-Executive Chairman is the sole representative of all four subsidiaries. The chairmanship changes every two years with each of the four subsidiaries taking turns to nominate the Chair.

Which three of the following statements are correct in relation to the Non-Executive Chairman?

- A. A's Chairman is in post for only two years, which does not permit time for a new Chairman to establish an agenda and then to see it through.
- B. It is an excellent strategy to allow one of the four subsidiaries to appoint the Non-Executive Chairman every two years as they are more independent than the Board of Directors.
- C. Appointing a new Non-executive Chairman every two years is a good strategy as the company needs to change direction frequently.
- D. It is a bad idea to allow the subsidiaries to appoint the Non-Executive Chairman every two years as each subsidiary will have its own agenda.
- E. Appointing a new Non-Executive Chairman every two years could lead to an inconsistent pursuit of different strategic directions with every change of chairmanship.

Question 1 (continued)**25 marks**

20. The Ministry of P is a government department running a service desk and project support on behalf of other government departments. The service desk queries can be quite simple, the project support ones generally more complex. It is very difficult to measure the Ministry's performance. The Ministry has therefore decided to introduce the balanced scorecard approach.

Identify **THREE** measures to include in the balanced scorecard.

- A. Introduce a target measure on the minimum number of incidents to be handled by each member of staff every month.
- B. Introduce target measures on time to close calls.
- C. Differentiate groups of queries into simple or complex and measure these separately.
- D. Introduce group target measures rather than individual ones.
- E. Introduce customer satisfaction measurements.

21. A plc needs to borrow £5 million for the purchase of new machinery. The directors expect the capital investment to provide annual cash flows of £800 000 net of taxation indefinitely.

At present the company is funded totally by equity. The discount rate it intends to apply is 13% net. The current annual gross rate of interest required by the market on corporate undated debt of similar risk is 9%. The after tax costs of issue will be £300 000. The marginal tax rate is 30%.

Calculate the adjusted net present value of the investment in £ million, give your answer in £ million, to two decimal places.

22. Which of the following statements are true of investment appraisal techniques?

Select two statements that apply.

- A. Either NPV or IRR (or AIRR) should be used to select projects.
- B. As a minimum, to be acceptable a project should have an NPV greater than zero or an IRR (or AIRR) greater than the discount rate.
- C. The NPV and IRR are equally useful for choosing between competing projects.
- D. Sometimes postponing the implementation of a project can increase its NPV.
- E. Payback is often a useful alternative to NPV or IRR.

Question 1 (continued)**25 marks**

23. C is based in the UK. The company manufactures computer systems for sports cars. C has just sold a test system with a value of US\$1 756 250 to M, a company based in the USA. M insisted on being invoiced in US\$. C agreed to this request in an attempt to generate goodwill with its new customer. Payment is due in 90 days.

The Management Accountant has taken advice on hedging the transaction risk and concluded that a forward contract is the best method available. Information relevant to this decision:

- Current spot rates £1 = US\$1.6000 - 1.6050
- There is a three month discount forward of 2.3 cents – 2.5 cents
- The actual spot rate 90 days later was £1 US\$1.6585 -1.6635.

- A. £21 685
B. £24 998
C. £55 763
D. £59 289
24. A UK company expects to receive a payment of B\$14million. B\$ is the currency in country B. Today's exchange rate between B\$ and pound is B\$1 = 1.75/£.

The daily volatility of the pound/dollar exchange rate is 0.5% and the standard normal value (Z) associated with the one-tail 95% confidence level is 1.645. Calculate, to the nearest whole £, the 1-day 95% VaR.

25. Buying and selling in more than one market to make a risk-free profit is called
- A. Speculation.
B. Arbitrage.
C. Profit maximisation.
D. An efficient market.

Total for question 1 = 25 marks

QUESTION 2**[50 marks]**

You are provided with the unseen case material below. This unseen case material should be read in conjunction with the pre-seen material (including appendices) in answering the required for question one.

Introduction

YJ Ltd (YJ) is a UK based company which was formed in 2005 and listed on the Alternative Investment Market (AIM) in January 2007 with an initial public offering (IPO) of US\$60 million. Its main shareholders are 12 large institutional shareholders which together own 96% of the shares.

The principal activity of YJ is the exploration of, and production from oil and gas fields. The company's strategy is to explore, appraise and develop into production its licensed oil and gas fields both safely and responsibly. Value is created as YJ proceeds through the initial stages of exploration through to production.

Environmental risk assessment

The Priobskoye oil deposit in Russia (Project RRR) is amongst the 12 potential oil and gas fields currently being investigated by Milo Purdeen (director of explorations) and Jason Oldman (director of legal affairs). The Priobskoye deposit is situated in Western Siberia, Russia's largest oil production region. The Russian government published a project plan for the development of the Priobskoye oil field which is expected to produce 700 million tons of oil over a 70 year period. There are currently 600 wells on 31 pads on the site and the government is looking to award additional licences for test drilling of the deposits located under the floodplain of the Ob River. The Ob River is 5300 km in length and empties into the Arctic Ocean. It is the seventh largest river in the world and the gulf of the Obi River is the world's largest estuary. The river is used for irrigation, drinking water, hydroelectric energy and fishing (the river is home to more than 50 species of rare and economically valuable fish). The cities along the river include Novosibirsk, the third largest city in Russia with a population of 1.5 million people. The Russian government exercises strict control to prevent environmental damage from oil spillages in the Ob River and there have been no accidents to date.

Lee Wang, Director of Health, Safety and Environment believes that there is a high environmental risk associated with a potential drilling project at the Priobskoye oil deposit

QUESTION 2 (continued)

(Project RRR). Findings from a preliminary report prepared by scientists from his department have indicated the following:

Lee Wang is concerned that due to the ecological sensitivity of the Ob River's floodplains, an oil spillage flowing into the Arctic Circle may result in international headlines comparable to the Deepwater Horizon disaster in 2010. Based on these initial findings, Director Lee Wang believes that a full feasibility study in which the environmental risks associated with project RRR are assessed be conducted. He further suggested that a report with recommendations on how YJ should manage the environmental risks in this area be produced. However since YJ does not have the in-house expertise to conduct such a further study, Lee Wang recommended to the board that a special environmental risk assessment working group (ERAWG) consisting of industry experts and ecology specialists be appointed to assess the impact of an oil spill in the Ob. The board approved Lee Wang's recommendation notwithstanding objections from the newly appointed CEO Ullan Shah, who argued that such an exercise would be a waste of resources and valuable time since YJ has never had an accident.

The ERAWG was formed by Lee Wang under significant pressure from Ullan Shah who insisted that one of his connections Dr Deborah True, the former Russian minister of Environment and Development Co-operation, be appointed as the leader of the ERAWG. The ERAWG consisted of the following individuals:

- **Dr. Deborah True:** Dr. True received her PhD in 1975 from the University of Alaska. Before her appointment as minister of Environment and development co-operation, she led the ecological assessment team at the National Centre for Environmental assessment at the Russian Environmental Protection Agency (REPA).
- **Dr. David James:** Dr. James is an environmental scientist with the REPA's Environmental Response Team.
- **Dr. James Charters:** Dr. Charters is a research chemist in the Ecological Toxicology Research Branch at the REPA.

Due to the time pressure placed upon him by Ullan Shah, Lee Wang was not able to establish terms of reference for the ERAWG. During dinner to discuss the project, Dr True assured Ullan Shah that she would ensure that costs are kept to a minimum in accordance with his request:

QUESTION 2 (continued)**ERAWG: Findings**

The following is a summary of the main findings of the ERAWG:

Oil spill effects

The most dangerous season for an oil spill would be spring, an oil spill in this season would reach the Ob River and Ocean. Hydrocarbons within a water-oil emulsion would have a lethal effect on the rare and economically valuable fish.

Spill response

New technology has made spill containment more effective, although it is very expensive it has enhanced detecting, tracking, sensing and recovery in the event of an oil spill.

Required**PART A**

2.1 In light of the CEO's comment that a more thorough assessment of the risk of an oil spillage for Project RRR would be a waste of resources, *discuss* the factors which make a more thorough environmental risk assessment desirable. (10 Marks)

2.2 *Evaluate* the appointment and recommendations of the ERAWG. (15 Marks)

Sub-total for Question 2 Part A = 25 marks

PART B

- 2.3 *Explain* the ethical implications of the CEO Ulla Shah's request that Dr. True ensure that the fee charged for the work done by the ERAWG be kept low. (5 Marks)
- 2.4 *Discuss* the factors that increase the compliance risk for YJ. (8 Marks)
- 2.5 With reference to the information from the pre seen and unseen material, *Identify* four critical success factors for YJ and *discuss* one operational risk which may negatively impact each critical success factor. (12 Marks)

Sub-total for Question 2 Part B = 25 marks

Total for Question 2 = 50 marks

QUESTION 3**[25 marks]**

Beats Ltd ("Beats") is a long established manufacturer and distributor of electronic equipment, with a focus on headphones. The company has expanded rapidly over the last few years. The company's recent expansion has been largely due to having the rights to manufacture and distribute "Beats by Cray" headphones associated with the world renowned hip hop and RnB producer Crayton Jackson. With Mr Jackson's name behind Beat's headphones has boosted sales and led to significant expansion over the last few years. None of Beat's other headphones have matched the success of the Beats by Cray, nor seem likely to have similar long-term appeal.

Outsourcing to Asia

The board has decided to outsource the manufacture of all headphones to a manufacturer based in East Asia People's Republic. The directors believe that a competitive advantage can be gained as outsourcing will significantly reduce production costs, the saving will be passed on to consumers and thus stimulate demand. A service level agreement was reached with the manufacturer, however, a minimum service requirement for timely communication of production arrangements has been breached by the manufacturer as they have failed to produce a detailed production plan which was due a week ago.

Director's remuneration

Director's remuneration has been the subject of much controversy at Beats as the director's basic salaries have been increased significantly as a result of the unparalleled growth associated with the Beats by Cray deal. The directors also earn a performance bonus based on sales and profits from headphones launched in the last couple of years. The CEO contends that bonuses should be based on new products due to the intensity of competition in the headphones industry. The directors also receive generous fringe benefits including unlimited use of the company's private suites during events, luxury cars and all expenses paid holidays for their families. The company's policy is to enter into long term employment contracts with directors, in order to limit turnover at senior management level.

Amp project

The directors are considering a proposal to manufacture and launch a new range of Bluetooth earphones called Amp-phones. The product was designed for athletes who prefer to listen to music during training without the inconvenience of cables, which ripped the earphones out of their ears during intense workouts. The Amp-phones are wireless and stay out of the athletes range of motion, they include in-ear wings which keep them from shifting in the user's ears to keep a consistent amplified sound. The board would like to appraise the Amp project by computing its net present value. The Amp-phones will be manufactured locally and projections

from the marketing department suggest that they will stay relevant for the next five years after which they will be replaced by new technology. Immediate capital expenditure of R805 million at 1 July 2016 is required, projected cash flows over five years are as follows:

Year Ended	1 July 2016	30 June 2017	30 June 2018	30 June 2019	30 June 2020	30 June 2021	30 June 2022
Cash flows (R million)	-805	266.2	243.54	358.38	230.21	97.21	-38.34

Beats pays tax at 28% on its taxable profits twelve months after they arise. Beats currently has R8 250 million of equity and R2 750 million of debt in issue quoted at current market values. The current cost of its debt finance is 10.29%, which is 5.29% higher than the risk free rate, while the cost of equity is 8.5%. Beats wishes to raise the additional finance for this project through a new bond issue. The company's advisors do not believe that this will alter the company's bond rating. The new issue will incur transaction costs of 1% of the issue value at the date of issue.

Required

3.1 Discuss the extent to which the following creates risks for shareholders of Beats:

3.1.1 Remuneration and service contracts of directors. (8 Marks)

3.1.2 Outsourcing of manufacture to the East Asia People's Republic (6 Marks)

3.2 Advise the board of Beats on whether to proceed with project Amp by calculating the adjusted present value; also justify the use of this technique for project Amp. (11 Marks)

Total for Question 3 = 25 marks

Total = 100 marks

{End of assessment}

Question 1 Answer Sheet**PLEASE ENSURE THAT YOU PROVIDE YOUR NAME AND/OR STUDENT NUMBER.**

Student name: _____

Student number: _____

#	Answer
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