

CF02

Operations Of Financial Institutions

11 MAY 1999

1. Time allowed : Three (3) hours
2. Total number of questions : Five (5) questions on 3 pages
3. Number of questions to be answered : Four (4) questions
Part A: Compulsory question [40 marks]
Part B: Three (3) questions [20 marks each]
4. Show details of working, where appropriate. Silent, non-programmable calculators may be used.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.

PART A**COMPULSORY QUESTION**

1. (a) Bank Negara Malaysia is the central bank of Malaysia. Briefly describe its **four** functions as the central bank. [8]
- (b) In bills of exchange, what are the **three** conditions that must be met for an instrument to be negotiable? [8]
- (c) Bank Negara Malaysia has pegged the Malaysian Ringgit (MYR) at 3.7998/8000 to the US dollar (USD). The Euro is trading at USD1.1635/38.
Calculate the Euro bid and offer rates in MYR terms (i.e. 1 Euro = ? MYR). [7]
- (d) Explain the following:
- (i) a red clause letter of credit [4]
- (ii) a revolving letter of credit [5]
- (e) Whenever there is an alteration to a cheque, the drawer must indicate his agreement to the alteration by signing against the alteration.
What are the alterations to a cheque that are deemed as material alterations? [8]
- (Total:40 marks)

PART B**ANSWER THREE (3) QUESTIONS ONLY**

2. (a) What are the **five** Cs in credit evaluation? Describe the factors that are considered in assessing each of the "C"s. [10]
- (b) One of your bank customers, Smart Kids Tuition Centre, submits its financial statements to you for your annual credit review exercise.
Based on these financial statements on the next page, calculate the following financial ratios:
- (i) Net profit margin [2]
- (ii) Current ratio [2]
- (iii) Quick/Acid test ratio [2]
- (iv) Times interest covered [2]
- (v) Total assets turnover [2]

SMART KIDS TUITION CENTRE
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 1998

	RM
Tuition fees collected	250,000
<i>Less</i> : Tutors' salaries	125,000
Rental	24,000
Electricity and water	6,000
Depreciation	25,000
Interest	18,000
Total expenses	198,000
Net profit for the year	52,000

SMART KIDS TUITION CENTRE
BALANCE SHEET AS AT 31 DECEMBER 1998

	RM
Current assets:	
Bank	32,000
Rental and utilities deposits	20,000
Fixed deposits at bank	50,000
Stock – books and stationery	10,000
Tuition fees receivable	25,000
Total current assets	137,000
Fixed assets:	
Tables and chairs	75,000
Van	45,000
Air-conditioners	30,000
Total fixed assets	150,000
TOTAL ASSETS	287,000
Current liabilities:	
Rental payable	2,000
Tutors' salaries	14,000
Bank loan payable within 12 months	15,000
Total current liabilities	31,000
Long-term liability:	
Bank loan	85,000
TOTAL LIABILITIES	116,000
	171,000
Represented by:	
Capital account	
Balance b/f	119,000
Profit for the year	52,000
	171,000

(Total:20 marks)

3. (a) (i) What are the main characteristics of factoring? [4]
- (ii) Briefly describe the factoring process. [6]
- (b) Briefly describe how leasing works. [10]

(Total:20 marks)

4. Encik Zakaria, who is a valued customer of your bank, wants to expand his business by selling his products overseas. He has come to seek your advice on documentary credits.

Explain to him what are the advantages of documentary credits to

(a) the exporter, and [12]

(b) the importer. [8]

(Total:20 marks)

5. (a) Describe the **six** principles which bankers must observe as custodian of public funds. [12]

(b) State **four** advantages of credit cards. [8]

(Total:20 marks)

OUTLINE ANSWERS

PART A

Question 1

- (a) **Generally, this question was reasonably answered.**
- (b) **Many of the candidates “misread” the question and gave answers pertaining to the characteristics of cheques.**
- (c) **This question was poorly answered and many candidates did not show their workings.**
- (d) **This question was generally well answered.**
- (e) **Again, many candidates “misread” the question. The question was on “what are deemed as material alterations” but the answers given were on “discrepancies” e.g. words and figures differ, signature differs, etc.**

- (a) Functions of Bank Negara Malaysia (BNM)
- (i) Issues and manages the ringgit
 - (ii) Acts as Government’s banker and advisor
 - (iii) Regulates the liquidity
 - (iv) Acts as banker to banks
- (b) The three conditions are:
- (i) Transfer of title by mere delivery or by endorsement.
 - (ii) Holder of the instrument can acquire absolute legal title by taking the instrument:
 - in good faith
 - for value
 - without notice of defect in title
 - (iii) The transferee gains full title and can sue in his own name.
- (c)
- | | | | <u>BID</u> | | <u>OFFER</u> |
|---|------|---|-------------------|--|-----------------|
| 1 | USD | = | RM3.7998 | | 3.8000 |
| 1 | EURO | = | USD1.1635 | | 1.1638 |
| 1 | EURO | = | RM3.7998 x 1.1635 | | 3.8000 x 1.1638 |
| | | = | RM4.4211 | | 4.4224 |
- Euro1 = MYR4.4211 (bid) 4.4224 (offer)
- (d)
- (i) A letter of credit (LC) with a unique clause that authorises the advising/negotiating bank to make an advance to the beneficiary before the presentation of documents. This is to enable the beneficiary to source for materials to fulfil the order. The clause is inserted at the request of the applicant of the LC.
 - (ii) An LC that handles the shipments of goods on a continuing basis over a specific time period. It may revolve around:
 - **Time** i.e., a fixed sum is available until that sum is exhausted e.g. RM100,000 a month for six months.
 - **Amount** i.e., a revolving sum of money, constantly renewable during a specified period of time e.g. RM100,000 revolving for a period of six months. The credit will be reinstated to RM100,000 each time until the end of the six months.
- (e) Material alterations
- (i) Date
 - (ii) Amount in words
 - (iii) Crossing
 - (iv) Alterations from order to bearer
 - (v) Payee’s name

Question 2

- (a) **A large percentage of candidates were able to give the 5Cs but failed to elaborate on the factors considered in assessing each of the “C”s.**
- (b) **This question which required financial ratio calculations was well-answered.**

- (a) The 5Cs in credit evaluation are:
- (i) Character - honest, responsible, industrious, acumen, reasonable, humble, correct attitude
 - (ii) Capacity - ability to repay, qualifications, experience, aggressiveness, judgement
 - (iii) Capital - amount of borrower’s own money
 - (iv) Conditions - government policy, economic conditions
 - (v) Collateral - security charged/pledged should be adequate and easily disposed
- (b) (i) Net profit margin = $\frac{52,000}{250,000} = 20.8\%$
- (ii) Current ratio = $\frac{137,000}{31,000} = 4.42$
- (iii) Quick ratio/acid test = $\frac{127,000}{31,000} = 4.10$
- (iv) Times interest covered = $\frac{70,000}{18,000} = 3.89$
- (v) Total asset turnover = $\frac{250,000}{287,000} = 0.87$

Question 3

This was clearly the most unpopular question among the candidates and the few candidates who attempted this question fared poorly.

- (a) (i) The main characteristics of factoring are:
- Outright purchase of accounts receivable;
 - Risk of non-payment is assumed by the factor;
 - Seller informs buyers of the factoring arrangement; and
 - Buyer pays direct to the factor.
- (ii) There are three parties in a factoring agreement, i.e.:
- The financial institution;
 - The supplier; and
 - The purchaser of the goods.
- The factoring process:
- The factor approves certain purchasers of the suppliers.
 - When the supplier sells to the approved purchasers, the supplier will inform the purchaser that he should make payment to the factor.
 - The factor will collect payment and remit it to the supplier. If the purchaser defaults, the factor will make payment to the supplier.
- (b) (i) Lessee identifies the equipment he wants.

- (ii) He obtains the price from the supplier.
- (iii) He applies to lessor to finance the purchase.
- (iv) Lessor assesses the creditworthiness of lessee.
- (v) If agreeable, lessor will finance the purchase.
- (vi) Lessee has the exclusive use of the equipment.
- (vii) Lessee pays the lessor periodic rentals for a specified period.

Question 4

Answers to this question showed a poor understanding of documentary credits. Many candidates were unable to distinguish between “exporters” and “importers”.

The advantages of documentary credits to:

(a) **Exporter**

- Does not have to worry about the credit standing of his buyer.
- If he doubts the credit standing of the issuing bank, he can ask for the Letter of Credit (LC) to be confirmed by a local bank.
- An irrevocable LC cannot be cancelled/amended without his consent.
- Does not have to worry about the customs' requirement of his buyer's country.
- He can use LC as security to enable him to source for the goods ordered.
- If the buyer issues a transferable LC, he can transfer part/all of the LC to his supplier.
- In the case of a sight LC, he can get payment almost immediately. In the case of a deferred LC, he will receive payment on maturity date.

(b) **Importer**

- Payment will only be made by the bank, if all the terms of the LC are complied with.
- He can stipulate the latest time when the goods must be sent to him.
- If he requires the goods on a regular basis, he can establish a revolving LC.
- If he requires financing, he can arrange for a deferred LC or he can arrange for his banker to finance him.

Question 5

This question was generally well-attempted.

(a) The **six** principles are:

- (i) To avoid conflict of interest;
- (ii) To avoid misuse of position;
- (iii) To prevent misuse of information;
- (iv) To ensure completeness and accuracy of records;
- (v) To ensure confidentiality of communication and transaction between the financial institution and the customer; and
- (vi) To ensure fairness and equitable treatment of all customers.

(b) Advantages of credit cards:

- Provide means of obtaining credit.
- Interest free credit for 1 to 4 weeks.
- Easier to use than cheques.
- Able to withdraw cash at ATM.