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Risk Management

Cima P3

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QUESTION NO: 1

The long-term prospects for interest rates in the UK and the USA are 2% and 6% per annum respectively.

The GBP/USD spot rate is currently GBP/USD1.71.

Using interest rate parity theory what GBP/USD spot rate would you expect to see in six months' time?

- A. GBP/USD = 1.74
- B. GBP/USD = 1.78
- C. GBP/USD = 1.65
- D. GBP/USD = 1.67

ANSWER: A

QUESTION NO: 2

Which of the following actions would breach CIMA's Code of Ethics for Professional Accountants?

- A. An accountant has been asked to evaluate an investment opportunity that is open for a very short time. The accountant has recommended rejecting the opportunity without doing any evaluation because he was too busy to study the proposal properly.
- B. An accountant has been asked to select a new supplier and has decided to recommend a supplier based in country A because that will give the accountant an excuse to visit a family member who lives there.
- C. An accountant has been asked to confirm that a complex financial instrument that has been recommended by the bank is suitable for the company. The accountant does not understand the instrument but has confirmed its suitability because senior management wishes to use it.
- D. An accountant has been asked to compile a list of all contacts at the company's bank so that they can be included in the mailing list for the calendar and coffee mug that are distributed as business gifts by the company in December of every year.
- E. An accountant has been asked to identify the two least profitable factories so that they can be closed down with the loss of all jobs. All of the company's factories are located in areas of high unemployment.

ANSWER: A B C

QUESTION NO: 3

D is a large oil refinery.

The managers have identified four risks shown in the risk map below:

Which of the risk mitigations listed below would be the best for dealing with the two risks classified as medium likelihood and high impact?

- A. Accept
- B. Reduce
- C. Transfer
- D. Avoid

ANSWER: C

QUESTION NO: 4

Division A of X plc produced the following results in the last financial year.

Net profit \$200,000 Gross capital employed \$1,000,000

For evaluation purposes all divisional assets are valued at original cost.

The division is considering a project that has a positive NPV will increase annual net profit by \$15,000 but will require average inventory levels to increase by \$50,000 and non-current assets to increase by \$50,000.

X plc imposes a 16% capital charge on its divisions. Given these circumstances will the evaluation criteria of return on investment (ROI) and residual income (RI) motivate division A managers to accept the project?

- A. ROI Yes RI Yes
- B. ROI Yes RI No
- C. ROI No RI Yes
- D. ROI No RI No

ANSWER: D

QUESTION NO: 5 - (DRAG DROP)

H sells machinery and also associated services such as advice and repairs. H's industry is going through considerable transformation.

Classify each of the examples of information available to H's management as strategic operational or of having little value.

Strategic	Operational	Little value
Details of all service calls processed over the past two years.		
Details of forecast data for 3 years per product line.		
Details of sales figures and forecasts for regional areas for both the previous 3 years and the next 4 years.		
Details of market research data carried out 4 years ago.		
Details of qualifications held by staff.		
Details of customer base evolution over the past 3 years.		

ANSWER:

Operational
Strategic
Strategic
Little value
Operational
Strategic

QUESTION NO: 6

Which of the following statements best explains why a corporate treasury department should be established as a cost centre rather than a profit centre?

- A. The Treasury Department should not be encouraged to speculate.
- B. The Treasurer should not have a great deal of responsibility.
- C. There is no way for the Treasury Department to generate revenue.
- D. The Treasurer has the ability to manipulate the Department's reported profit.

ANSWER: A

QUESTION NO: 7

Company M has lost 25% of its revenue in the last three months due to bad debts. One of the receivables written off was from a long standing customer and the other three were from new customers. The management accountant has warned the sales team that the company cannot survive any more substantial bad debts.

Which of the following internal controls should be put in place to try and prevent further bad debts?

- A. A credit check should be carried out on each new customer.
- B. Credit limits should be set for all customers. However if the credit limit will cost a sale then sales staff can override this limit.
- C. Two sales staff must authorise new customers and sign a form stating that they have done so.
- D. An aged analysis of customer balances must be reviewed every month.
- E. As soon as a customer payment is overdue they should not be allowed to purchase more until their balance has been reduced.

ANSWER: A D E

QUESTION NO: 8

In relation to the use of the adjusted present value (APV) technique which of the following statements are correct?

- A. To apply APV the proportions of debt and equity in the capital structure must be known.
- B. To apply APV the actual amounts of debt and equity in the capital structure must be known.
- C. The interest tax shield on the project's debt must be known or at least estimated.
- D. The weighted average cost of capital - net present value technique and the APV technique will if applied correctly give the same answer.

ANSWER: C D

QUESTION NO: 9

Why do businesses take risks?

Select the TWO correct answers.

- A. Risk taking can give the impression that senior management roles are very dynamic.
- B. Risk taking can assist businesses to gain an advantage on their competitors.
- C. Risk taking allows businesses to save time by not having to find out all the facts before they embark on new projects.
- D. Risk taking provides businesses with opportunities to make better returns.
- E. Risk taking allows for multiple random outcomes some of which may be worth chasing.

ANSWER: B D

QUESTION NO: 10 - (DRAG DROP)

V buys vegetables and fruit from three farms located in a different part of V's country and sells them to large supermarket chains.

A recent newspaper magazine had an article on these farms showing that the farms employ illegal immigrants whose status was used by the factory's owners to force them to work for low wages and in unpleasant conditions. They are forced to live in small overcrowded caravans with no running water. They are also given meals which are cold and poor quality. These farms are located in a developed country with strong labour laws.

Classify each of the following statements as true or false.

True	False
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V's share price is likely to fall as a result of this article.

V is entitled to blame the Government of the farms' host country for failing to supervise conditions properly.

V's only responsibility is to its shareholders and those who are employed directly by the company.

It will be difficult for V to restore its reputation.

V should investigate the conditions at all of the other farms that it uses.

ANSWER:

True
False
False
True
True

QUESTION NO: 11

The interest rate on EUR deposits is 7%. The interest rate on GBP deposits is 5%. The spot rate is EUR/GBP0.8500. What is the one year forward rate predicted to be assuming interest rate parity holds true?

A. 0.8662

- B. 0.8341
- C. 0.7500
- D. 0.9633

ANSWER: B

QUESTION NO: 12

K plc is a large listed company in the retail industry. It has recently appointed T as a non-executive director. T has never had any previous involvement with K plc but is well known to K's Chief Executive P because T is the Managing Director of K plc's largest supplier.

K has recently expanded into Asia. Doubts about the wisdom of the move have been expressed in the financial press with some journalists commenting that it has exposed K plc to higher degrees of risk than previously. The move had been approved by the Risk Committee which consists of four Non-Executive Directors (NEDs) all of whom have significant experience in business.

K plc does not have a Nominations Committee. Nominations to the Board are usually proposed by P and generally agreed by the other directors.

In relation to the above scenario which of the following comments is valid?

- A. K plc is in line with best practice as it only has NEDs on its Risk Committee.
- B. There is no possible conflict of interest in relation to T's position as a NED and as Managing Director of a supplier company since in both roles he would clearly want K plc to prosper.
- C. The Risk Committee should have rejected the proposal to enter the Asian market merely because it exposed K to greater risk than the other markets in which it operates.
- D. The absence of a Nominations Committee exposes K plc to the risk that the Chief Executive may have unfettered power.

ANSWER: D

QUESTION NO: 13

YHJ is considering an investment in a project that will cost \$20 million. Annual fixed costs will be \$12 million per year excluding depreciation. Annual sales are forecast at 5 million units with a contribution per unit of \$8. After five years the equipment will be worn out and YHJ will have to spend \$50 million on disposal costs. The discount rate is 10%.

Calculate the sensitivity of the net present value of this project to a 20% increase in the disposal costs.

- A. 11%
- B. 13%
- C. 31%
- D. 20%

ANSWER: A

QUESTION NO: 14

Which of the following statements are correct?

- A. It is always possible to remove all risks when undertaking large projects.
- B. If a project has high risks it should always be accepted as the rewards will always be high.
- C. If a project has low risks it will usually have relatively low returns.
- D. Risk can always be transferred to someone else.
- E. Risk should be carefully considered when evaluating possible future projects.

ANSWER: C E

QUESTION NO: 15

TYU is a retailer selling televisions. The company is financed wholly by equity.

Why might TYU be exposed to interest rate risk?

- A. Customers' disposable income may change.
- B. TYU's competitors may have variable rate borrowings.
- C. TYU's suppliers may have borrowings.
- D. TYU's cost of capital will vary with interest rates.
- E. TYU's competitors may have fixed rate borrowings.

ANSWER: A B C