STRATHMORE BUSINESS SCHOOL

BACHELOR OF FINANCIAL SERVICES

SPECIAL EXAMINATION

BFS 4101: FINANCIAL RISK MANAGEMENT

DATE: Monday, 11th May 2026 **TIME:** 14:00 – 16:00

Instructions

1. This examination consists of **FIVE** questions.
2. Answer **QUESTION ONE** and **ANY OTHER TWO** questions.

QUESTION ONE (30 MARKS)

The following sales information is given for Widgets Ltd (Sh.000).

2023		2024												2025	
Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb
200	150	140	150	160	170	200	230	250	200	180	160	150	130	120	120

There are no cash sales. The assumption is that 10% of sales will be paid for in the month of sales, 80% will be paid one month after sale and the final 10% will pay their bills two months after the sale. The cost of raw material is 20% of sales. The raw material for each month's production will be ordered the month before (i.e. the raw material for January's production is ordered in December). Monthly sales of finished products are made the previous month (i.e. the sale of finished products in February is manufactured in January). Purchases of raw material are paid for in the month after purchase. The following expenses are also incurred and paid for during the incurred:

a. Sales and marketing expenses 10% of sales
b. Production expenses 85% of sales
c. General expenses Sh. 10,000 per month.
   An interim dividend of Sh.40,000 is paid in May. A final dividend of Sh.60,000 is paid in December. Interest on loans amounts to Sh. 20,000 annually and is paid at the end of each quarter.

Required:

i. Calculate Widget Ltd's net cash flow for the year ended 31 December 2024. **(10 marks)**
ii. Comment on the liquidity position of the company and suggest any action management can take to address liquidity challenges if any. **(5 marks)**

iii. Discuss **FIVE** techniques that are applicable to exchange rate and interest rate risk management. **(10 marks)**

iv. Highlight the role of the following in risk management:

(a) The board of directors **(2.5 marks)**

(b) The Chief Risk Officer **(2.5 Marks)**

QUESTION TWO (15 MARKS)

Basel Committee on Banking Supervision (BCBS) provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide.

Required:

a) Differentiate the requirements of Basel I, II and III? **(5 marks)**

b) A risk register for a financial institution serves as a central database for identifying, assessing, and managing risks across complex operations. In highly regulated sectors, it is a critical tool for maintaining regulatory compliance and ensuring long-term financial stability. Describe **FIVE** contents of a Risk Register that would be relevant to a banking institution **(10 marks)**

QUESTION THREE (15 MARKS)

a. The Financial Sector Stability 2024 report highlighted that Kenya's financial system remained sound and stable but faced elevated operational risks, primarily driven by cybersecurity threats, technological adoption, fraud, and governance weaknesses.

Required:

Discuss **FIVE** specific interventions taken by various financial Institutions in Kenya to address the concerns. **(10 marks)**

b) State **FIVE** key processes of risk management **(5 marks)**

QUESTION FOUR (15 MARKS)

i. Explain **THREE** primary components of credit risk evaluation **(3 marks)**

ii. A commercial bank has issued a KES 2,000,000 term loan to a manufacturing company. The bank's internal risk models have assigned the following parameters for the next 12 months: Probability of Default (PD)**:** 1.5%, Loss Given Default (LGD)**:** 40%, Exposure at Default: KES 1,800,000.

Required:

a) Calculate the Expected Loss (EL) for this loan over the next year. **(4 marks)**

b) If the bank's recovery rate suddenly drops to 30% due to a market downturn, what is the new LGD, and how does it impact the EL **(5 marks)**

iii. Discuss **THREE** limitations of using beta as a risk measure for investment decisions **(3 marks)**

QUESTION FIVE (15 MARKS)

Every organization faces a unique set of risks based upon its industry, financial condition, regulatory environment, culture, and a host of other factors. Consequently, an entity's risk management program must be tailored to the specifics of the organization for the program to be effective. Nevertheless, an established risk management framework can be very helpful in providing guidance and structure in developing such a program.

Required:

i. Discuss the two widely used Risk Management Frameworks **(3 marks)**

ii. Highlight any **FOUR** areas of convergence between the two Risk Management Frameworks as identified in i above **(8 marks)**

iii. Illustrate with an example the distinction between residual and inherent risks within the insurance industry. **(4 marks)**