ACT
PAST PAPER

Diploma in Treasury Management (AMCT)

Unit 2: Risk management for treasury

March 2025

This is a past paper for Unit 2 of the Diploma in Treasury Management (AMCT)

Based on the syllabus assessed from 1 August 2022.

INTRODUCTION

This past paper has been produced by the Awarding Body at the Association of Corporate Treasurers (ACT) to assist students in their preparation for the Diploma in Treasury Management assessments. It is important to highlight that the answers provided in this paper are not exhaustive and that any other reasonable answers would be awarded marks where necessary in a marked assessment. It contains a past exam for the specified unit as well as past answers. Ideally, students should have completed the majority of their Diploma in Treasury Management studies for Unit 2 before attempting this past paper.

Students should allow themselves 180 minutes to complete the exam plus an additional 25 minutes reading time. They should then review their performance to identify areas of weakness on which to concentrate the remainder of their study time. Although the past exam in this guide is typical of a Diploma in Treasury Management assessment, it should be noted that it is not possible to test every single aspect of the syllabus in any one particular exam.

To prepare properly for the examination, students should make full use of the tuition options where available and read as widely as possible to ensure that the whole syllabus has been covered.

ASSESSMENT TECHNIQUE

This paper is a professional paper that as well as testing theory expects application to practice at a managerial level.

The best way to approach written assessments is to work methodically through the questions. You should not spend too much time on any one question if you are struggling to think of an adequate answer. Remember you can flag any question to come back to later should you want to continue your way through the exam.

When all of the questions have been answered, it is prudent to use any remaining time to go through each question again, carefully, to double-check that nothing has been missed. Altering just one response could make the difference between passing and failing.

Please ensure you show your workings within your answer when prompted as this means there are marks available for the workings out. You will be able to make rough workings on a piece of paper during the exam and on screen should you wish to, however these will not count towards your final mark.

ASSESSMENT INFORMATION AND TEST SPECIFICATION

The Diploma in Treasury Management assessments for Units 1 and 2 each have 4 written questions, of which you must answer 3, and will involve a pre-seen case study workbook that is released no later than two weeks prior to the assessment date. The papers will be split into sections A and B and can be made up of either one case study or two case studies; each unit exam is worth a total of 100 marks. For the purpose of this past paper the questions follow each case study.

Diploma in Treasury Management assessment test specification:

Section	Amount of questions	Marks available
Section A	1 case study based question	50
Section B	3 shorter case study based questions, of which candidates choose to only answer two	25 marks each
Total	**3**	**100**

Under exam conditions, **3 hours** (180 minutes) is allowed for the Diploma in Treasury Management assessments plus an additional 25 minutes reading time.

When you take your actual exam, you will be sitting online using your own PC/Laptop. You have access to an online scientific calculator, but for the purpose of this past paper, you may use a non-programmable scientific calculator.

In order for you to determine how well you have performed, sample mark schemes are provided after each question. Please note that these are mark schemes only and not model answers. They provide lists of points that are expected to be covered within answers, although the content of your answers must be much more detailed (satisfying the command word used in the question, for example 'analyse'). As with all mark schemes, the content is indicative only, i.e. the lists of points featured are not exhaustive. It is highly likely that there are other perspectives and, provided these are valid and supported fully, marks would be awarded for these in a live exam. There are also references to the relevant Learning Outcomes if you need to revisit the associated material.

SECTION A

1 long form question worth 50 marks based on a pre-seen case study. This question should test knowledge, analysis, application insight, evaluation and justification as appropriate to level descriptors. This is a professional paper and application to practice should be at 'management' level.

Total available for Section A: 50 marks

QUESTION 1: CASE STUDY

TechnoSolar AG (TSA) is a leading renewable energy company headquartered in Switzerland with subsidiaries in Canada, India and South Africa. It specialises in solar panel manufacturing and large-scale solar farm installations. TSA's products are primarily used by utility companies, industrial players and governments aiming to transition to clean energy sources. TSA is listed on major European stock exchanges and has consistently expanded into emerging markets.

TSA's core mission is to drive the adoption of sustainable energy solutions by making solar energy more affordable and accessible. Over the years, it has become a prominent player in the renewable energy market, known for high-efficiency solar panels that outperform many competitors. TSA has also built long-term partnerships with governments for clean energy projects as part of their national energy strategies.

In May 2024, TSA announced a multi-billion EUR project to build the world's largest floating solar farm off the coast of South Africa. This project is funded through a mix of retained earnings and external borrowing. TSA's goal was to reduce land use while maximising solar energy output through innovative floating technology. The project was set to be operational by 2026 and was expected to be transformational for TSA, as it could increase its revenues by 20% annually over the next decade. TSA invested heavily in R&D for this floating solar farm technology. However, the project is at risk after news broke in August 2024 of a delay in South Africa's national renewable energy incentives that could push the start date of the floating farm to 2030. This delay poses significant financial challenges for TSA, which had already allocated 50% of its capital expenditure towards this initiative.

Below is a snapshot of TSA's financials from its latest report:

EURm	2024	2023
Total revenue	1,544.64	1,485.52
Operating profit	313.20	252.72
Interest income	14.32	14.88
Interest expense	(86.56)	(91.36)
Profit for the year (after tax)	216.88	144.96
EBITDA	484.08	473.28

Non-current assets		
Investments in new development initiative	1,758.48	1,523.04
Plant, equipment, inventory	3,565.60	3,171.28
Securities and promissory note loans	173.04	170.40
Other non-current assets	452.64	414.48
Total non-current assets	5,949.76	5,279.20
Current assets		
Other current assets	177.36	210.96
Cash and cash equivalents	360.40	365.92
Total current assets	537.76	576.88
Total assets	6,487.52	5,856.08
Total equity	2,274.00	2,143.68
Non-current liabilities		
Loans and other borrowings	2,548.48	2,201.44
Trade accounts payable	17.52	19.20
Other non-current liabilities	951.36	816.64
Total non-current liabilities	3,517.36	3,037.28
Current liabilities		
Trade accounts payable	143.04	137.92
Loans and other borrowings	236.16	258.16
Other current liabilities	316.96	279.04
Total current liabilities	696.16	675.12
Total liabilities	4,213.52	3,712.40
Total equity and liabilities	6,487.52	5,856.08

TSA's capital structure consists primarily of equity (45%) and a combination of long-term loans (40%) and green bonds (15%). However, much of the company's available cash has been tied to the floating solar project, with total borrowings of EUR113.76m allocated to future capital expenditure in infrastructure and operating projects, leaving limited funds for other short-term needs.

By July 2024, TSA was 60% complete on the development of the floating farm technology. If the product launch is delayed, TSA will face several risks:

- market risk: the delay could result in missed opportunities in other countries where competitors might develop similar floating farms first.

- liquidity risk: TSA might struggle with its cash flow, especially if the revenue increase from the solar farm does not materialise on time.
- project risk: with such a large share of capital locked into this one project, a delay could jeopardise TSA's future pipeline of projects.
- political/regulatory risk: the project depends on South Africa's renewable energy incentive policies, and any policy change could affect TSA's long-term projections.

TSA's 2023 post-pandemic strategy aimed for a steady 6% revenue growth year-on-year, which with a 4.9% increase, was not achieved. However, much of TSA's planned capital expenditure for 2024, totalling EUR 450m, is locked into the floating solar farm, leading to cash flow management concerns.

At the balance sheet data (2024), there was a mix of borrowings consisting of project financing (21.5%), external bonds (4.8%), bilateral loans (43.1%) and promissory note loans (30.6%). Overall, financial liabilities have an average remaining term of 5.5 years. After accounting for interest rate hedging measures using interest rate swaps, the floating rate portion of gross debt was approximately 27%, and the fixed portion approximately 73%. Floating rate debt pays interest linked to Euro short-term rate (ESTR). TSA does not currently have a public credit rating.

TSA's debt agreements are tied to two key covenants:

1. Net-Debt-to-EBITDA ratio must remain below 4.5x
2. EBITDA-to-interest coverage ratio must stay above 6.0x.

Its liquidity is further impacted by the recent downturn in the global economy, leading to a tightening of credit markets. This has put TSA under pressure; it needs to not borrow more for the time being and complete the project without exceeding budget.

TSA is exploring possible mitigation strategies, such as diversifying its portfolio by investing in smaller, more immediate projects in other regions to maintain cash flow while awaiting further clarity on South Africa's renewable energy incentives.

TSA's funding profile is given in the table below. Financial liabilities are stated as undiscounted payments and include interest. Forward interest rates are derived from the current yield curve to determine interest payments on liabilities bearing interest at floating rates.

EURm	2024	2025	2026-30	2031-35	2036 and beyond
Loans and other borrowings	298.00	256.96	1317.60	895.60	215.16
Lease liabilities	26.40	18.48	72.48	22.44	7.44
Trade accounts payable	137.92	11.88	5.40	1.92	0.00
Other financial liabilities	28.32	0.00	0.00	0.00	0.00
Total	490.64	287.32	1395.48	919.96	222.60

QUESTION 1

a.	Evaluate the effectiveness of TSA's liquidity, funding and working capital management given its floating solar farm commitments. Within your answer you are also required to recommend and justify future actions to improve TSA's situation in these three areas.	25 marks
b.	Assess the key political and/or regulatory risks that might materially affect TSA's profitability.	6 marks
c.	Analyse the potential financial impact of the risks to which TSA is exposed, given the uncertainty over the floating solar farm project.	10 marks
d.	Recommend and justify potential solutions to mitigate the financial impacts you have analysed in (c).	9 marks
		Total: 50 marks

Mark scheme
Q1a

Working capital management:

- A negative working capital in 2024 and 2023 may indicate TSA is struggling in manging its working capital.

  Working Capital = (Total Current Assets - Total Current Liabilities)
  2024 Working Capital = 537.76 – 696.16= (158.4)
  2023 Working Capital =576.88 – 675.12 = (98.24)

  (Current Assets/ Current Liabilities)
  2024: 77% 2023: 85%

- The current ratio is less than 1 and it does not currently have any trade receivables on the balance sheet. This shows weak cash inflow. This is further worsened by the fact that significant portion of TSA funds are tied to its floating solar project.
- There is no detail available about its receivables which is an important component to manage the working capital & liquidity.
- There is no inventory detail on its balance sheet. TSA should look at potentially increasing the speed of conversion of inventories to cash to be able to improve its working capital.
- A significant amount of cashflow is tied to the floating project which has been delayed.

Liquidity management:

1 mark for each point identified. 0.5 Extra mark for calculation.

Max 12 points

1 mark for each recommendation max 13 points

Total marks: 25

- TSA has potential liquidity from EUR360.40m in cash and cash equivalents to meet short-term needs. This has slightly decreased but other current assets have decreased by 16%, making TSA less liquid for current year.
- There is EUR173.04m in securities and promissory notes, though these are likely to be less liquid to manage its current obligations.
- There is no mentioning of cashflow forecasting or monitoring of cash position to anticipate any gaps in managing the obligations due in near term.
- There is no Liquidity buffer (90-120 days).
- TSA is exposed to concentration risk due to its heavy investment in a single project.

Funding management

- TSA has breached its loan covenants.
- Net Debt to EBITDA ratio must remain below 4.5x however in 2024 it has reached to 5x.

Net debt	2,424.24	2,093.68
EBITDA	484.08	473.28
Net debt to EBITDA	5.00793	4.42377

- EBITDA-to-interest coverage ratio must stay above 6.0x however it has breached in both years.

EBITDA to interest exp		
EBITDA	484.08	473.28
Interest EXP	86.56	91.36
Ratio	5.59242	5.18039

- Based on a net debt of EUR 2,424.24m and a 4.5x covenant threshold, the company would need to increase its current EBITDA of EUR 484.08m by approximately 11.29% (EUR 54.64m) to meet the required level of EUR 538.72m (2,424.24/4.5)
- Currently bilateral loans (43.1%), promissory note loans (30.6%), project financing (21.5%) and bonds (4.8%). The large proportion of bilateral loans may indicate TSA is over-banked. No further information is given to know whether there is concentration risk or are loans from multiple lenders.
- Liability maturities are spread out, but the bulge in 2026-30 AND 2031-35 indicates that TSA planned that repayment would be funded by sales of the new product in the coming year which is now threatened. (EXTRA 1 mark).
- There is no information on currency breakdown, so it is not possible to see the steepness of the yield curve. Yields may have fallen since the debt was issued.

Future actions

Working capital & liquidity

- TSA must arrange working capital facility loan to manage any gaps. As the current ratio is below 1, the working capital loan will facilitate its current obligations.
- A detailed cashflow forecasting must be conducted to better plan and manage its cash position, identify any gaps and plan to manage the obligations efficiently.

- Create a liquidity buffer (90-120 days)
- Consider cash pooling across subsidiaries and establish Central Treasury model to optimise costs and reduce duplications.
- Improve the receivable collection by offering discounts for earlier payments.
- Consider the receivables factoring or even asset-based financing.
- Renegotiate longer payment terms with suppliers.
- Consider supply-chain financing.
- There is a need to temporarily reducing staff cost, hold dividend payments and other capex related expenditure specifically linked to the project to manage its working capital and liquidity needs.

Funding:

- TSA has breached its loan covenants. It is important to obtain a waiver for current year as well as renegotiate the covenants to remain complaint in the future considering the uncertainty, it is likely that TSA will breach the covenants in future as well.
- The borrowings comprise diverse source of funding from project financing (21.5%), external bonds (4.8%), bilateral loans (43.1%) and promissory note loans (30.6%). Given that the Company's main business revenue comes from solar farm projects, it is effective that it utilises project financing and green bonds as source of financing for more attractive terms and to better match the cashflow forecast of the projects.
  (1 mark extra for green bond as the case study is about renewable energy and ESG concept supports the green bond as a source of fund)
- TSA could raise other capital to compensate for reduced revenues. It is advisable to raise equity rather than debt to reduce gearing and covenant risks, extend the maturity profile of capital, and minimize the impact on Return on Equity and ownership dilution.
- TSA could extend borrowing maturities to match the duration of assets.
- Bulk of the loan repayments are between year 2026-2030. There is no detail of payments year wise. TSA must ensure even spread out of loan repayments. The payment terms should be planned/ negotiated in a way that no loan repayment date is in same month/single year. Given the delay, if required the loan term should be renegotiated with the tenor of the project.
- Continue with diversified funding sources, refinancing debt with more longer-term debt, and replacing debt with equity given the high gearing.
- Swapping more fixed rate debt to floating rate could reduce interest payments, however, it should only be considered if interest rates are forecasted to be falling (with further insights from forward rates), and TSA can accommodate the increased risks within budgets and covenants.
- A covenant breach could lead to a default event, triggering loan withdrawal, refinancing risk, and a liquidity crunch. It's unclear whether the credit facilities, particularly bilateral loans (43% of the portfolio), are committed or uncommitted. Since the projects are long-term, TSA should aim to secure committed loans to ensure funding availability throughout the project's duration.
- Given the expected delay in the project, TSA should approach its lenders to update about the project delay with an updated cashflow projections and renegotiate for a delay in the repayment profile to ease its pressure.
- TSA does not have a public rating. Obtaining a credit rating from reputable agency would give more investor base to TSA. It can diversify its capital sources

at better interest rate.

- TSA could consider borrowing in the local currencies of their operations to better match assets and earnings – no mention of currency breakdowns of revenues and/or expenses, and debt.

Syllabus refs: 2.2.1, 2.2.2, 2.2.3, 2.2.4,2.3.2, 2.3.4, 2.4.3, 2.4.1a

Q1b

Key political & regulatory risks

- Governmental policy on green energy – Considering TSA's primary customers are the government, the stance of governments on renewable energy and any change in its policy will have direct impact on TSA and its project. It also has the risk if the government pushes for other green energy technology such as wind and hydro, over solar, it will also affect TSA.
- Sovereign risk - the stability of the government and the consistency of the government action and policy. This is especially crucial as these projects are longer-term in nature and require a long of time and investment. Any changes in the government policy will result in uncertainty for TSA. It is especially clear to the South Africa's national renewable energy incentives that could push the start date of the floating farm to 2030.
- Infrastructure support - Given that TSA's expanding into the emerging markets, like India and South Africa, to enable the installation of the solar farm, it is also important for the countries to have the necessary infrastructure to support the installation process. It is important that the government support the development of their infrastructure which necessary for the successful development of solar farm.
- Sanctions, Tariffs, or trade war - This affects the cost of the raw materials that is needed for TSA to build the solar panels. if raw materials need to be imported in a country, and there are trade tariffs, this could increase the costs massively, further eroding the profit margins.
- Tax incentives or other financial support - this can be in form of any government incentives (tax incentives, financial support) or policy to encourage. The tax compliance in each country is different. Any added tax on clean energy or tariffs can affect the profitability for TSA. Likewise, there could be government policy to give subsidies rates to support green projects hence it can help TSA.
- There is not mention of price caps, hence, there could be risks if price caps are set, and then if they are not set at an accurate rate: TSA margins are squeezed by actual inflation and return on equity differing from the regulator's inflation estimates and that estimates used in future regulation are detrimental to TSA.
- ESG regulation is constantly evolving and is different between regions and countries. It is important to have a regulatory communication team and ensure ongoing dialogue with governments to avoid fines, etc.
- TSA has some green bonds. Green bonds require ESG reporting and if the regulatory bodies find that the ESG reporting standards are lacking quality, the company can be accused of greenwashing and exposed to reputational risks hence loosing access to subsidies.

1 mark for each valid point.

Total marks: 6

- Any changes to competing markets such as oil and gas regulation and sanctions will have a proxy impact on TSA. If oil and gas become cheaper then countries and consumers may respond by not investing in solar as much reducing TSA's revenue.
- There's an increased focus on supply chain risk and ensuring that suppliers are not using unethical practices for providing the necessary raw materials for green projects. TSA may face increased compliance costs through having to assess suppliers more regularly or may have to switch to more expensive suppliers with higher standards.
- Impeded maintenance of existing systems and development of new systems shows weakness in internal policies.
- A sudden reconfirmation of the policy may lead to a labour shortage and bottlenecks if staff cannot be adequately increased in a timely manner.

Syllabus refs: 2.1.1, 2.1.3, 2.1.4, 2.2.1, 2.2.4, 2.3.2, 2.4.4, 2.5.2

Q1c

Assess the potential financial impact of the risks to which TSA is exposed, given the uncertainty over the multi-billion-euro project to build the world's largest floating solar farm.

- Financial covenants have already breached. This can lead to further restrictions and monitoring by the lenders which can tighten the liquidity and financial position for TSA.
- Although the major portion of the loan is on fixed basis, the delay in project exposes TSA to interest rate risk. Whether the fixed rate is reset or 27% floating rate is reset during the project life, any adverse movement can increase the cost of the project due to interest expense.
- TSA operates in four different countries, it is exposed to forex risk with a larger portion locked in S.A. therefore, adverse movement in forex could reduce. This exposes TSA to transactional and translational risk.
- Higher depreciation of assets will reduce profits and EPS. There is also the major risk that assets will be written down if there is a postponement and as a result such assets become less valuable and obsolete. Higher impairment could devastate profits and gearing and trigger insolvency.
- Reduced revenues from reduced demand as consumers would have to wait on the news to determine which model to purchase.
- Delayed revenues from the projects: TSA has already made huge capex investment in the project while the cashflow from the investment is not expected before 2030. This delay will affect the financial covenants, which are already is already breached.
- TSA EBIDTA is below the required level which can trigger the cost of the loan if lenders are not comfortable with the delay of the project and covenant breach which will impact the ratios on continuous basis.
- The delayed revenue can also impact other TSA projects which could have been funded via solar farm revenue proceeds, hence impacting long-term strategic objectives.
- Increased costs of operation results in potential low revenue and margin for 2024.
- More regulation, both at local and national level could increase the cost of doing business.
- Divestment by investors constrains the performance of the share price.

1 mark for each valid point.

The focus should be financial impact.

Total marks: 10

- Increased rating agency and lender/investor scrutiny increases the cost of debt. Also makes refinancing harder. Falling share price makes equity finance harder and costlier. Potential negative impact on dividend policy if dividend is cut, although the case does not specify if dividend is expected and is paid.

- The delay can impact the demand of solar. Technology is rapidly evolving. By the time TSA completes its project and make renewable energy available, there is a risk that more advanced technology replaces solar concept hence reducing the demand among customer and ultimately impacting the revenues.

Syllabus refs: 2.1.3, 2.1.4, 2.2.1, 2.2.2, 2.2.3, 2.2.4, 2.2.5, 2.3.2, 2.3.3, 2.5.1

Q1d

Discuss the potential solutions to the financial issues.

- Focus on improving profitability and cash flow to stabilise the company's financial health.
- Diversify into other smaller projects globally. For instance, it could invest into shorter-term less risky projects which can generate cash flows earlier, thus reducing the reliance on solar project and reducing project concentration risk.
- Have a proactive communication with stakeholders, investors, debtors to explain the current financial situation, be transparent.
- Consider sale and lease back of some assets to generate liquidity.
- Consider cash pooling across subsidiaries and manage cash centrally.
- Promote the renewable energy, gain favourable terms for pricing, and guarantees prior to committing to the development.
- Borrowings allocated to future projects should be reconsidered.
- Strengthen the equity position by retaining earnings (limiting dividends or distributions).
- Conduct scenario analysis to understand the potential impact of different regulatory outcomes and prepare alternative strategies and contingency plans for minimising the influence of regulatory change.
- Establish dialogue with investors and lenders on their requirement.
- Address the breached covenants urgently by assessing the breach to understand the cause and develop a remediation plan.
- Consider obtaining regulatory risk insurance to cover potential financial losses due to regulatory changes.
- Explore alternative sources of financing, such as debt restructuring or government grants, to maintain liquidity.
- Cost reduction and efficiency measures: Make operations cost effective so that they do not create great impact on TSA finance.
- Ensure that contracts with suppliers, customers, and partners include clauses that protect against regulatory changes, such as force majeure or hardship clauses.

I mark for each valid point.

Total marks: 9

- To reduce some of the financial impacts, TSA must consider diversifying as much of its operations as possible. It should look to engage in other projects that could free up cash and generate revenues. TSA could look at expanding in those emerging markets.
- TSA could have clear and consistent dialogue with its stakeholders to ensure that a delay to its projects will not be adverse and that delays can occur. Communication will be key to try and offset the risk of a potential market backlash for TSA through declining share price and worsening of its credit.
- TSA should make sure its supply chain is very resilient and diversify its supplier base as much as possible to reduce the impact there. It could negotiate contracts with key suppliers to ensure any inflationary pressures are mitigated.
- If any damage to reputation arises due to the delay, TSA could look to engage in marketing and social media campaigns to increase its reputation and highlight its approach to climate change through making solar energy more affordable and accessible.
- For any FX risks, TSA should engage in a hedging strategy which may be to look at natural hedging or the use of derivatives. It could also look to restructure the cost base of its business and look to invoice for projects in EUR or borrow in local currency for the subs to use as a natural hedge against net assets.

This mark scheme is not exhaustive – all valid points within answers will be awarded marks.

Syllabus refs: 2.1.3, 2.1.4, 2.2.1, 2.2.2, 2.2.3, 2.2.4, 2.2.5, 2.3.2, 2.4.1a, 2.4.2b, 2.4.4, 2.5.1

Total: 50 marks

SECTION B – 50 MARKS

Answer TWO of the following THREE questions. (2 x 25 marks).

Questions test knowledge, analysis, application, insight, evaluation and justification as appropriate to level descriptors. This is a professional paper and application to practice should be at 'management' level. Candidates are expected to be able to synthesise knowledge from different elements of the syllabus rather than be tested on discrete areas.

Total available for Section B: 50 marks

QUESTION 2: CASE STUDY

GreenFields Organic Supply: leading the sustainable agriculture movement

Overview

GreenFields Organic Supply (GOS), based in New Zealand, focuses on sustainable agriculture with an emphasis on organic crop production. It operates in four main areas:

1. Cultivation: growing certified organic crops such as fruits and vegetables.
2. Sourcing: purchasing organic raw materials for other eco-conscious producers.
3. Processing: packaging fresh produce for retail and wholesale markets
4. Export and import: engaging in international trade to meet growing global demand for organic products.

Market reach

GOS has a strong presence in six key geographic markets, with revenue breakdowns as follows:

NZD m	**2023**	**2022**
Europe, excluding the United Kingdom	8,175.74	7,775.15
Australia	98.06	55.65
United Kingdom	5,311.74	5,494.58
United States	8,682.20	8,363.97
China	3,656.96	2,341.67
Rest of the world	14,669.96	11,254.50
Total	**40,594.64**	**35,285.51**

Financial summary

A summary of GOS's financial performance in 2022 and 2023 is shown in the following table.

NZDm	2023	2022
Revenue	40,594.50	35,285.40
Operating profit	**7,104.38**	**4,982.85**
Profit for the year	**5,499.90**	**3,595.95**
Selected information extracted from the income statement, net of tax		
Of which, FX adjustments of investments in subsidiaries	419.18	(1,129.73)
FX hedging instruments	(31.73)	(53.10)
Other items	(15.98)	424.13
Total other comprehensive income for the year	**371.48**	**(758.70)**
Total of profit for the year and other comprehensive income	**5,871.38**	**2,837.25**
EBITDA	**11,413.58**	**9,278.78**
Total intangible assets	**13,818.83**	**12,888.00**
Of which, goodwill	8,196.75	7,884.00
Brand	1,962.45	1,962.45
Other intangible assets	3,659.63	3,041.55
Property, plant and equipment (PPE)	4,799.93	3,813.53
Right-of-use assets	7,443.68	5,582.25
Deferred tax assets	1,254.38	1,416.15
Other financial assets	538.43	453.38
Total non-current assets	**27,855.25**	**24,153.31**
Inventories	3,967.20	3,617.10
Trade receivables	3,049.65	1,615.05
Derivative financial instruments	347.40	652.28
Cash	1,957.05	5,404.50
Other current assets	2,866.73	1,652.18
Total current assets	**12,188.03**	**12,941.11**
Total assets	**40,043.28**	**37,094.42**

Total equity	**15,614.57**	**13,715.77**
Loans and borrowings	11,843.21	3,834.45
Other non-current liabilities	954.68	1,370.93
Total non-current liabilities	**12,797.89**	**5,205.38**
Loans and borrowings	3,839.85	7,417.13
Derivative financial instruments	214.88	220.28
Trade payables	2,810.81	5,961.38
Other current liabilities	4,765.28	4,574.48
Total current liabilities	**11,630.82**	**18,173.27**
Total equity and liabilities	**40,043.28**	**37,094.42**

GOS primarily conducts its activities in currencies other than NZD, with revenue mainly generated in USD, GBP, CNY and EUR. A significant portion of its costs are related to raw materials purchased in USD, while all debt is denominated in NZD.

GOS has a clear risk policy stating that its strategy is to hedge foreign exchange risks associated with net cash flows in order to stabilise cash flows in foreign currencies and safeguard the profitability of each subsidiary by hedging back to their respective functional currencies. GOS does not hedge subsidiary net assets, subsidiary profits or cash flows in NZD at parent level, though GOS is currently reviewing its policy on hedging net assets. Foreign currency cash flows are hedged only at the subsidiary level. For 2024, 60% of foreign currency cash flows were hedged based on a rolling 12-month liquidity forecast. Hedging updates occur at the end of each month, with hedge ratios decreasing as maturity approaches, and cash flows are hedged from one to 12 months forward.

Target hedge ratios are as follows:

%	Minimum	Maximum
1 – 3 months ahead	70	100
4 - 6 months ahead	70	90
7 – 9 months ahead	50	70
10 – 12 months ahead	30	50

GOS employs various financial instruments to hedge foreign exchange risk solely at the subsidiary level. These instruments include currency swaps, forward contracts and options.

The table below shows the group-level impact of a 10% appreciation in the NZD exchange rate on net profit and changes in equity, after accounting for the effects of hedge accounting.

NZDm		2023		2022	
	(appreciation of NZD)	Profit (loss) before tax	Equity	Profit (loss) before tax	Equity

USD	10%	(193.50)	(265.50)	(155.25)	47.25
GBP	10%	(72.00)	(128.25)	56.25	(72.00)
EUR	10%	(243.00)	(204.75)	18.00	411.75
CNY	10%	(65.25)	(15.75)	78.75	47.25
TOTAL		**(573.75)**	**(614.25)**	**(2.25)**	**434.25**

Financial covenants:

- the leverage ratio (net debt/EBITDA) must not exceed 3.0x
- the interest coverage ratio (EBITDA/interest expense) must be at least 4.5x
- the minimum cash balance must be no less than NZD750m.
- the gross debt-to-equity ratio must not exceed 2.0x.

QUESTION 2

a.	Evaluate the effectiveness of GOS's foreign exchange risk management approach.	10 marks
b.	Recommend and justify THREE indicators that derivatives counterparties could use to monitor GOS's creditworthiness considering its foreign exchange risk management policy.	6 marks
c.	i. Assume 50% of debt is in USD. Calculate, showing your workings, the new gearing ratio for 2023 assuming a 10% NZD appreciation and that the effect of this appreciation is a net change of equity of minus NZD614.25m. ii. Considering that net assets at subsidiary level are denominated in multiple currencies, discuss the issues that may arise for GOS due to having all debt in NZD for 2023. iii. Recommend and justify a hedging policy for GOS to mitigate the balance sheet risk of all debt being in NZD.	3 marks each part. 9 marks total
		Total: 25 marks

Mark Scheme
Q2a

• Transaction exposure: The company incurs significant cost in USD while debt is in NZD. • Translation exposure: The subsidiaries functional currencies (multiple) are different from the financial reporting currency (NZD) • The use of forwards, cross-currency swaps, and options is permitted, but the specific derivatives employed are not disclosed. • GOS retains the flexibility to take a view on FX rates by under-hedging if desired. • While these hedges protect against short-term price fluctuations, GOS remains exposed to longer-term price trends. Considering the impact of forex movement, 10% appreciation in NZD can result almost 25% impact on profit and loss generated in USD. A careful sensitivity analysis can help GOS to manage the forex movement exposure. • GOS adopts rolling hedges to manage foreign exchange (FX) risk up to 12 months into the future. • Balance sheet items are not hedged, which likely excludes the use of currency swaps. • Unhedged FX fluctuations could affect both revenues, margins, and covenants. • Unhedged translation of foreign currency profits, as well as assets and liabilities, can impact equity, leverage ratios, net worth, and earnings, which could, in turn, affect covenants and GOS's credit rating.	1 mark for each valid point **Total marks: 10**

- There appears to be no need for the flexibility offered by contingent payments, making options unnecessary although applying options instruments here is not outrightly wrong.
- Hedge ratios are higher for near-term cash flows, as they are easier to forecast.
- There is no reference to the use of natural hedges.
- GOS reports that the majority of its costs are in USD, which provides some offset; however, it may be prudent to consider generating costs in GBP, EUR, and CNY, given its sensitivity to these currencies.
- Assets and liabilities denominated in different currencies are not disclosed.
- With 99.8% of revenues generated abroad, GOS faces significant FX risk at the consolidated level if debt is denominated in NZD or if headquarters expenses in New Zealand are substantial.
- Revenues are diversified across EUR, GBP, and USD, rather than being concentrated in a single currency.
- Despite the hedges, residual FX risk remains: a 10% movement in USD could impact 2023 profits by -3.5%.
- The sensitivity analysis does not account for the probability of such movements; complementing it with a Value-at-Risk (VaR) analysis could be beneficial.
- The prevailing debt to equity ratio is 1x. which is a below the threshold limit. This suggests that GOS must have either paid back most of its debt or issue more equities although this is not stated in the case.

Syllabus refs: 2.1.3, 2.1.4, 2.2.1, 2.2.2, 2.2.3, 2.2.4, 2.2.5, 2.3.2, 2.3.4, 2.4.1a, 2.4.2a

Q2b

- Credit rating: This can be a public rating from an agency or an internal assessment from the counterparty.
- Lagging indicators: Ratings may not promptly reflect credit quality changes as they often trail behind actual developments.
- Press and industry reports: Look for mentions of GOS.
  Including sector reports and macro-economic analyses.
- Financial reports: Regularly review updated financial statements. Including Ratio Analysis (although this will be out of date if only published annually).
- Debt covenants: Early warning signs could be found in GOS's debt covenants if accessible, such as those on publicly traded debt.
- Market-related measures: These are more dynamic and current but can be influenced by market sentiment and may overreact, such as:
  - Credit spread over risk-free rates or swaps.
  - Credit default swap prices for GOS.
  - Increased volatility in GOS's share price relative to a benchmark.
  - General market volatility changes, like shifts in the VIX index, indicating overall credit condition deterioration.

Syllabus refs: 2.1.3, 2.1.4, 2.2.1, 2.2.2, 2.2.3, 2.2.4, 2.2.5, 2.3.2, 2.3.3, 2.4.3

1 mark for each indicator identified and explained.

Total marks: 6

Q2c

i. Assume 50% of debt is in USD. Calculate, showing your workings, the new gearing ratio for 2023 assuming a 10% NZD appreciation and that the effect of this appreciation is a net change of equity of minus NZD614.25m.

Step 1: Calculate current gearing ratio.

Gearing Ratio	**Debt/Equity**
	2023
Current Borrowing	3,839.85
Long term borrowings	11,843.21
Total debt	**15,683.06**
Equity	15,614.57
Gearing	1.004386288

Step 2: Assume 50% debt is in USD, value of debt.

Actual value of debt	Debt	15,683.06	
50% (a)	USD	7,057.38	(15,683.06/2) *.90
50% (b)	NZD	7,841.53	(15,683.06*.50)
New value of debt	Total	**14,898.91**	(a+b)

Step 3: Value of Equity (net change of equity of minus NZD614.25m)

Equity	15,614.57
less impact of 614.25	(614.25)
Value of Equity	**15,000.32**

Step 4: Gearing ratio after changes

Debt	14,898.91
Equity	15,000.32
Gearing Ratio	**0.99**

Impact of FX rate movements (e.g., NZD appreciation of 10%).

Impact on gearing: A 10% appreciation of the NZD results in a slight decrease in the debt-to-equity ratio from 1x to 0.99x, improving gearing.

****

3 marks for each sub-question (i, ii & iii)

Total marks: 9

ii. **Considering that net assets at subsidiary level are denominated in multiple currencies, discuss the issues that may arise for GOS due to having all debt in NZD for 2023.**

- Though gearing calculation was positive, it shows that negative FX movements can erode equity and increase the leverage ratio.
- If assets in foreign currencies depreciate in value relative to the NZD, the gearing ratios may appear worse, potentially affecting its credit rating or borrowing capacity.
- Holding assets and liabilities in different currencies exposes the risk of experiencing unfavourable interest rate movements in both currencies, leading to a double impact on profitability. For instance, if the NZD interest rate rises, debt becomes more expensive, while the depreciation of the NZD makes converting USD to NZD more costly.
- The translation of the balance sheet becomes more complex due to the use of different currencies, exposing GOS to translation risk that can impact their profitability.
- Economic conditions in the New Zealand region (e.g., interest rate changes) may not align with the regions where assets are located, exposing GOS to macroeconomic risks.
- With cash flows in foreign operations (USD, GBP, EUR, or CNY), and debt in NZD, movements in NZD and exchange rate fluctuations can create mismatches, have a fatal impact on foreign revenues and asset values, leading to higher costs when converting to NZD for debt repayments and servicing.

****

iii. **Recommend and justify a hedging policy for GOS to mitigate the balance sheet risk of all debt being in NZD**.

- Borrow in currencies that match the assets and cash flows (e.g., USD debt for USD-denominated assets and revenue) to reduces the risk of FX revaluation affecting the gearing ratio and stabilise the Debt-to-Equity ratio against currency fluctuations, particularly with exposures in USD, GBP, EUR, and CNY.
- Use **natural hedging** by matching the currency of debt with the currency of net assets of operations. This will reduce the need for financial derivatives and minimises FX exposure.
- GOS can use **forwards** to lock in exchange rates for future cash flows, thus reducing the risk of exchange rate movements affecting profitability. For example, to repay NZD-denominated debt with future USD or EUR cash flows, it could use FX forwards to lock in an exchange rate for converting USD or EUR to NZD at the time of repayment.
- **FX swaps** can be employed to manage liquidity and currency exposure, particularly for short-term debt obligations, by swapping one currency for another at predefined terms.
- **Refinancing the NZD**-denominated debt with debt issued in the local subsidiaries' currencies particularly United States and Europe to align the

GOS liabilities with its income and expenses, thereby reducing currency mismatch risk.

This mark scheme is not exhaustive – all valid points within answers will be awarded marks.

Syllabus refs: 2.1.3, 2.1.4, 2.2.1, 2.2.2, 2.2.3, 2.2.4, 2.2.5, 2.3.2, 2.3.3

QUESTION 3: CASE STUDY

Rotterdam Optical Labs (ROL), a family-run company with headquarters in the Netherlands, is engaged in the production of precision optical lens elements used in the manufacture of telescopes and microscopes. ROL's equity is privately held, with the majority controlled by descendants of the founder. While ROL has several long-standing relationships with banking partners, the company has no publicly traded debt. ROL has long been the leader in this specialised niche market, but it has struggled to expand beyond Europe, with the exception of several contracts with a few US-based companies. ROL is facing increased threats from Asian companies with quickly increasing technical know-how, access to greater liquidity and a much lower cost structure. ROL is also facing challenges in managing its treasury functions effectively. ROL operates in multiple countries, dealing with various currencies.

This is an extract of data from ROL's financials.

EURm	**2024**	**2023**
Revenue	196.35	178.50
Cost of goods sold (COGS)	(114.24)	(107.10)
Gross profit	82.11	71.40
Operating expenses	(49.98)	(42.84)
Operating income	32.13	28.56
Interest expense	(4.28)	(3.57)
Net income	27.85	24.99
Total assets	392.70	357.00
Total liabilities	160.65	142.80
Equity	232.05	214.20

Revenues are received in local currencies, but expenses are predominantly denominated in EUR. From 2023 to 2024, USD appreciated by 5% against the EUR, and JPY depreciated by 3% against the EUR. The foreign exchange (FX) rate changes resulted in a positive impact on revenue from the United States but negatively affected revenue from Asia.

The following table provides a breakdown of ROL's revenues by currency:

	2024	**2023**
EUR	58%	60%
USD	31%	27%
JPY	11%	13%

In the most recent quarter USD revenue was USD10m. Average 10-day historical volatility of the USD exchange rate is 2.5%.

Risk management

The market for optical products is affected by a number of factors such as inflation, interest rate, supply and demand of local economies depending on budgets for investment in large telescopes, and others. It is difficult to predict price movements with a reasonable level of accuracy. ROL's profitability depends on the demand for retail optical products and state spending. It has not engaged in any hedging activities regarding prices of input materials, including raw commodities such as aluminium, copper, steel and certain precious

metals used in the fabrication of these precision lenses and associated components. Volatility of these commodities is part of the business risk ROL is willing to take.

As a small, family-run company, ROL does not have a formal risk management framework and hedges neither currency risk nor commodity risk.

QUESTION 3

a.	Estimate the impact of the exchange rate fluctuations on ROL's revenues from 2023 to 2024. Recommend and justify strategies for ROL to manage its foreign exchange (FX) risks.	8 marks
b.	Calculate ROL's USD exposure using a 10-day VaR based on the last quarter's revenue. Use a 95% confidence level and assume a normal distribution. Discuss the benefits and drawbacks of using stress testing, scenario analysis and VaR to calculate risk exposure.	9 marks
c.	Discuss ROL's non-financial risks and the potential benefits for ROL of establishing a risk management framework.	8 marks
		Total: 25 marks

Mark Scheme
Q3a

- Total revenue changes can be broken down into "organic" and "FX-driven".
- USD revenues increased by a total of 26% (= (196.35*31%-178.5*27%)/ (178.5*27%)) of which 5% of the increase can be attributed to FX movements (12.67m EUR increase of which 2.41m EUR due to appreciation of USD)
- JPY revenues decreased by 6.9% (= (196.35*11%-178.5*13%)/ (178.5*13%)) of which 3% can be attributed to FX movements (1.61m EUR decrease of which 0.7m EUR due to Yen depreciation)
- Comprehensive long-term FX plan for ROL involves a holistic approach. This includes conducting regular currency risk assessments, incorporating FX risk into strategic planning, and aligning business operations with the company's risk appetite (and ultimately the risk appetite of its owners). Developing a global treasury function that actively manages FX exposures, leveraging technology for real-time data analysis, and continuously educating key stakeholders on FX risks will contribute to the company's resilience against currency volatility in the long run.
- For the USD and JPY exposure, ROL could consider using forward contracts to lock in exchange rates for future transactions. This would provide certainty in costs related to EUR-denominated expenses. Additionally, ROL might explore options contracts to hedge against adverse movements of the JPY and USD exchange rates. Diversifying currency holdings and considering natural hedges, where possible, can further enhance the effectiveness of hedging strategies.
- Forward contracts are cheaper and easier; options are more expensive upfront but allow for upside potential.

Total marks: 8

1 mark for each valid point

- Implementing a dynamic pricing strategy that considers currency fluctuations and the price elasticity of demand for ROL's goods could help offset cost increases and protect ROL's margin.
- Natural hedging is another strategy that can help ROL to minimise the forex exposure. This can be achieved by funding its business with loans denominated in USD and JPY to match off the receivables in USD and JPY as a form of economic hedges.
- Changing its cost structure by sourcing for its raw materials in the local currencies where it sells its goods to, e.g. USD and JPY to match off the revenue in these currencies.
- ROL must have accurate and reliable future forecasts of its exposure levels to effectively hedge against both currency and commodity risks.
- A thorough understanding of the raw commodities such as aluminium, copper, steel, and specific precious metals used in the fabrication of precision lenses and their components is essential for successful hedging strategies.

- **Syllabus refs:** 2.2.2, 2.3.1, 2.4.1, 2.4.2

Q3b

Calculate 10-day VaR assuming normal distribution and using a 95% confidence level:

- VaR = Revenue × Volatility × Z-Score
  USD 10m*0.025*1.645
  USD 0.411m or USD 411,250

Stress Testing:

- Stress testing evaluates the impact of extreme and unexpected events on a portfolio, helps identify vulnerabilities that may not be evident in normal market conditions.
- Provides insights into tail risk, helping understand potential losses in worst-case scenarios. Can be customised to simulate specific events or conditions relevant to the organisation's business environment.
- The scenarios chosen for stress testing are subjective and depend on the assumptions made. Stress tests can be complex, requiring detailed modelling and a deep understanding of the relationships between various factors. While stress testing provides qualitative insights, quantifying the precise impact of extreme events can be challenging.

Scenario Analysis:

- Flexibly allows for the creation of a range of likely and unlikely future scenarios, providing a comprehensive view of potential outcomes. It considers multiple variables and their interdependencies, offering a more holistic assessment of risk. Qualitative and Quantitative: Can be both qualitative and quantitative, allowing for a nuanced understanding of risks.

Total marks: 9

3 marks for calculation, then 2 marks for each complete point

- Like stress testing, scenario analysis involves assumptions, and precise quantification of outcomes may be difficult. Developing and running multiple scenarios can be resource-intensive, requiring significant time and effort. Results are highly sensitive to assumptions made.
- Scenario analysis includes one or two variables which is kept constant, and the overall financial impact is determined. For example, it could look at profit from the US for a 1% through to 10% move in EUR / USD either way. Scenario analysis is useful for determining the extent of risk the business is facing and providing a view on the impact of each scenario. However, it does not give any indication of the likelihood of each of the scenarios and in extreme incidences may not cover a real-life adverse event.

Value at Risk:

- Provides a quantitative measure of potential losses, offering a clear numerical representation of risk. Offers a standardised metric for comparing and managing risk across. VaR is widely used and understood.
- VaR assumes a normal distribution of returns, which may not hold true especially during extreme market conditions, leading to underestimation of tail risks. VaR provides information about potential losses but does not provide information on timing or the likelihood of when those losses might occur. VaR may not capture tail events effectively, and extreme events that fall outside the normal distribution may not be adequately accounted for.
- VaR benefits are that it gives quantitative outputs using inputs that are relatively standardised. VaR is widely used and understood, helping management understand and share in the results. However, VaR assumes a normal distribution applies which may not hold true and may not be true in extreme scenarios. This can lead to underestimating tail risks.
- In practice, a comprehensive risk management approach often involves using a combination of these measures to leverage their respective strengths and mitigate their weaknesses. No single method is fool proof, and a diversified risk management strategy is essential for effectively navigating complex and dynamic treasury environments.

- **Syllabus refs:** 2.2.1, 2.2.2, 2.3.1, 2.3.2, 2.3.3

Q3c

- **Operational risks:** which include damage to construction facilities, depreciation risk. Premature depreciation of equipment may be unpredictable.
- **Supply Chain risk**: disruption in supply chain could impact production.
- **Competitors risk**: Asia markets are increasing the competitiveness of the market but bringing cheaper products.

- **Political risks**: The increase in tariffs by US gov could impact the revenues stream from US.
- **Disruptive event**: like war, which could reduce the sourcing materials, impact the sales.
- **Reputational risk**: Partnering with companies that have compromised ethical values could jeopardize ROL's reputation.
- **Evolving technology:** There is a real risk of emerging competitors reverse-engineering ROL's intellectual property or by poaching key employees; this risk is increased if ROL is forced to outsource and/or relocate parts of its R&D or manufacturing construction process to reduce costs and be more competitive.
- **Regulatory risk**: It is mentioned that ROL operates in multiple countries, which will result in them facing regulatory risk, as they need to prove compliant to multiple different regional regulations.
- **Commodity risk**: ROL is affected by commodity risk, as the volatility in prices of their raw materials may result in lower profits.

1 mark for identifying non-financial risk.
Max 4 marks

Risk management framework (RMF)

- Non-financial risks need proper identification, assessment, evaluation and reporting in order to ensure ROL's risk appetite is being managed, help ROL prepare and mitigate the fallout from such risks, and meet the reporting expectations of shareholders, counterparties and other stakeholders as well as regulatory requirements.
- A robust risk management system allows a good risk management culture to form. For example, regulation of the manufacturing sector can be unpredictable and government regulations can change quickly. With a good risk management framework, ROL can decide whether to avoid (perhaps relocating the manufacturing operation), accept, or accept and reduce the risk (relocating only a portion of operations).
- Setting risk-based KPIs as part of employee goals can reduce agency problems by aligning employees and company objectives, and incentivising risk reducing behaviours.
- A proper risk management framework also allows quick and responsive introduction of new risk policy. This standardises procedure and allow more efficient risk reporting.
- Setting up a RMF means more credibility to ROL, improve investor relations, and ensure new risk policies are more effectively communicated to stakeholders.
- Enterprise management framework will help ROL to take holistic view of the risks and how they interact and can have material impact on its profitability. This way multiple risks are managed more efficiently.

1 mark for each benefit explained for risk management framework.
Max 4 marks

Total marks: 8.

This mark scheme is not exhaustive – all valid points within answers will be awarded marks.

Syllabus refs: 2.1.1, 2.1.2, 2.2.1, 2.3.1, 2.3.4, 2.4.4, 2.5.2

Total: 25 marks

QUESTION 4: CASE STUDY

Walter Events & Conferences (WEC) is an event management and conference business based in California. WEC believes it can strengthen its business by expanding its consulting and advisory services to large hotel groups.

Data extracted from WEC's annual report and financial statements:

USD '000	2024	2023
Revenue	63,265	52,696
Costs	(53,592)	(43,661)
Operating profit	9,673	9,036
Finance income	319	142
Finance expense	(273)	(252)
Profit before tax	9,719	8,926
Tax	(1,770)	(1,740)
Profit after tax	7,948	7,186

Revenue represents amounts receivable for professional services provided by WEC. Consideration accrues as activity on the project progresses. Amounts deemed to be recoverable on services in progress are recognised in unbilled revenue.

USD '000	2024	2023
Non-current assets		
Property, plant and equipment	1,329	1,279
Intangible assets and goodwill	6,534	2,032
Other assets	51	51
Total non-current assets	7,914	3,362
Current assets		
Trade receivables	20,696	17,380
Unbilled revenue: work in progress	8,080	7,866
Cash and cash equivalents	1,759	2,621
Other financial assets	260	0
Total current assets	30,796	27,868
Total assets	38,710	31,230

Corporate Governance

The corporate structure of WEC includes a five-member board of directors with extensive experience in the event management industry. Several members of management are also on the board: the chief executive officer (CEO), chief risk officer (CRO) and chief financial officer (CFO).

The composition of the board is as follows:

Role	Age	Year joined the board	Member of management
Chair	80	2006	X (CEO)
Vice Chair	77	2009	X (CRO)
Member	81	2004	
Member	74	2010	X (CFO)
Member	69	2005	

Risk management
The risk committee (RC) is led by the CRO. Risks are identified and recorded for quarterly evaluation by the RC. The RC assesses the gravity of the risk and determines appropriate action, such as avoidance, mitigation or toleration.

Credit risk
The nature of payment in the conference and event management industry means there is significant uncollected revenue each year. Management must make assumptions about future trends in demand and economies, as well as identify the impact of changes in the scope of work and the recoverability of work-in-progress and receivables balances.
WEC performs credit checks on clients to ensure there are no unacceptable concentrations of credit risk. Long-standing relationships with conference venues and hotel groups mean ageing accounts is not necessarily an indicator of increased risk.

The table below shows receivables not impaired and past due (i.e. overdue). WEC does not hold collateral against these amounts.

USD '000	**2024**	**2023**
Not past due	20,126	17,254
Past due 0-30 days	3,904	3,073
Past due 31-120 days	3,819	4,140
Past due greater than 120 days	6,909	4,635
	34,757	**29,102**

QUESTION 4

a.	You are a new member of the RC. Assess WEC's long-standing approach to managing its receivables, in relation to ageing accounts.	10 marks
b.	Evaluate WEC's disclosures on credit risk management and its approach to managing credit risk.	15 marks
		Total: 25 marks

Mark Scheme
Q4a

Overdue payments

- WEC's long-standing approach of length overdue not being an indicator of ability to collect full value on outstanding accounts receivable should be carefully examined based on past data and industry best practices. It must also evaluate the competitor's approach on receivable ageing to get industry approach.
- There seems to be an implication that WEC tolerates past due amounts because they are with clients who have long-standing relationships with WEC.

10 marks total, 1 mark

This policy should be clarified by WEC to ensure that no conflicts of interest arise such as related party transactions that may pose greater credit risk, and that this approach is supported by past data and industry best practices. • Accounts receivable days are high at 119.4 days. • Trade receivables and unbilled revenue comprise 74% of total assets. • There is mixed data over the past two years on this approach: amount past due by more than 120 days has been increasing YoY, but no receivables are more than one year past due; more historical data should be examined. • The amount of past due receivables should be considered along with the corresponding level of repeat business from each client to potential substantiate the value of tolerating overdue amounts for specific clients. • WEC has considerable discretion over revenue recognition, trade receivables, unbilled revenue, and impairment of receivables – this should be monitored closely by the risk committee to ensure appropriate risk management. • Apparently, it seems that existing customer base is concentrated which makes WEC revenue reliance dependent on those customers. Any delay in customer receipts will create liquidity issues to manage the working capital. • The board members have served a long term with WEC. It comprises of members with similar age group. Lack of diversity has also restricted any change in its approach towards improving its ageing account. • It is mentioned that WEC perform credit checks on clients to ensure there are no unacceptable concentration of credit risk, but does not provide quantification, and how to measure it.	for each complete point
Q4b	
Credit risk management • Credit risk for WEC seems limited to trade receivables and unbilled revenues. • There is no mention of credit risk on cash and cash equivalents but there is likely bank credit risk for wherever this cash or cash equivalents are held; counterparties to investments of bonds, commercial paper, money market funds, etc. represent further credit risk. • There seems to be no derivatives exposure, so no counterparty credit risk as a result. • It is not clear who is responsible for credit risk; the only risk body mentioned is the Risk Committee at Board level. • WEC conducts credit checks on clients. • Risk management seems to be through dealing with 'reputable' clients and diversification among clients. • There is no indication of the size of large exposures. • No data on credit risk exposure levels. • There is no explanation of WEC's policy for determining Impairment, Amounts charged for impairment are not reported.	**Total marks: 15** 1.5 marks for each complete point

- It may not be realistic that once a receivable becomes past due for 30 days credit risk does not worsen even if the past due period increases beyond that, as the company suggests.
- Amounts past due by more than 120 days are increasing, now USD 6.9m = 20% of past due receivables (2023: USD4.6m = 16%); This could be a sign that customers are hitting financial difficulties (This point is worth 2 marks).
- However, no trade receivables are reported to be due beyond one year, so it seems WEC is able to collect within the current reporting period; this point should be clarified by company policy as should be what the company would do if receivables do end up being more than one year past due.
- WEC could consider different terms of business and charge more or impose penalties if clients are late payers.
- WEC does not hold collateral against past due amounts so is exposed to losing the full amount owed.
- WEC could try to reduce exposure by asking clients to pay monthly to cover billing hours completed up to that point and/or offer discounts for early payments.
- WEC should implement mitigation techniques as per example:
- Provide only services clients with overdue invoices up to a certain amount limit.
- Regular checks on credit in overdue per client
- Ensure that only provide a new service to a recurrent customer when the earlier overdue receivables are partly or totally paid.
- Request guarantees or collateral when possible.
- Proactively engage with customers, to inform their situation and press them to sort out (but avoiding jeopardising the relationship)

This mark scheme is not exhaustive – all valid points within answers will be awarded marks.

Syllabus refs: 2.1.1, 2.1.3, 2.2.1, 2.2.4, 2.5.2, 2.5.3

Total: 25 marks

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