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MAIN EXAMINATION

JANUARY – APRIL 2014 TRIMESTER

FACULTY OF COMMERCE

DEPARTMENT OF ACCOUNTING AND FINANCE

REGULAR PROGRAMME

CBF 311: INTRODUCTION TO BANKING AND FINANCIAL SERVICES

Date: APRIL 2014	**Duration: 2 Hours**
INSTRUCTIONS: Answer Question ONE and ANY OTHER TWO Questions	

Q1. a) One major characteristic of commercial books which distinguishes them from other financial intermediaries is their ability to 'create' demand deposits.

i) Discuss how banks are able to create demand deposits. **(4 marks)**

ii) Supposing XYZ's Bank customer deposits Ksh. 10,000 into his account and the reserve requirement is 15%. Calculate the maximum total deposit expansion possible, noting to give any assumptions made. **(5 marks)**

b) Explain why a pension scheme is an intermediary financial institution. **(3 marks)**

c) Discuss why in lending on major commercial properties permanent or long term lenders such as life insurance companies and pension funds do not provide the interim funds used during the construction period. **(4 marks)**

d) A wheat farmer borrows Ksh. 3,000,000 to be rapid in 3 equal installments at the end of each of the next 3 years from the Agricultural Finance Corporation. The institution is charging subsidized interest at a rate of 6% (per annum) on reducing balances.

Using the expression:

$$DF_a = \sum_{t=1}^{n} \frac{1}{(1+k)^t} = \frac{1-\left[1(1+k)^n\right]}{k}$$

Where DF_a = Discount factor
k = interest charged
n = number of periods

i) Calculate the discount factors for each of the 3 years. **(3 marks)**

ii) Given that

PV of annuity = Pmt (DFa)
PV = Present Value
P_{mt} = Payment amount for each period

Calculate the amount of money the farmer must pay at the end of each year. **(1 mark)**

iii) Prepare an amortization schedule for the 3 year period indicating the interest and principal portion of the loan repayment. **(10 marks)**

Q2. a) Consider the following transaction:

Frankie purchases from Goldsmith, a jeweler, a diamond bracelet and pays with a cheque for Ksh. 1.5 million representing payment in full to the order of Goldsmith. However upon returning to his home, Frankie discovers that Goldsmith has fraudulently substituted a plastic replica for the genuine diamond bracelet that Frankie had inspected and had intended to buy. Frankie naturally immediately contacts his bank and places a stop payment on the cheque. In the meantime Goldsmith purchases some gold rings from Silverstone another jeweler in town by endorsing and delivering Frankie's cheque to him. Silverstone deposits the cheque to his bank account. The cheque is dishonoured by Frankie's bank and is returned to Silverstone. When Silverstone discovers that Goldsmith has closed shop and left the country, he brings suit against Frankie to recover his Ksh. 1.5 million. Analyze the chances of Silverstone's suit succeeding. **(10 marks)**

b) Discuss the factors which led to the rapid growth of savings and credit cooperative societies in this country and the current challenges facing them. **(10 marks)**

Q3. a) Discuss the term "special crossing" on a cheque. **(4 marks)**

b) Discuss why a letter of credit (LC) is critical in the facilitation of international trade. **(10 marks)**

c) Explain how property casualty insurance underwriting risks come about. **(6 marks)**

Q4. a) Under the Central Bank of Kenya Prudential Guidelines, explain how provisioning for bad and doubtful debts is carried out. **(4 marks)**

b) i) Discuss the attributes of a good security (collateral). **(10 marks)**

ii) Briefly discuss major strengths and weaknesses of 3 securities commonly used by banks in this country. **(6 marks)**

END