Overview for Questions #1-4 of 88

Question ID: 1626127

TOPIC: FINANCIAL STATEMENT ANALYSIS

THE TOTAL POINT VALUE FOR THIS QUESTION SET IS 12 POINTS

Ali Saminder, CFA, has recently been hired by JJK Holdings, Inc. (JJK), a U.S.-based financial services holding company. JJK has global operations in commercial and investment banking alongside a significant wealth management division, JJK BMD. Saminder is currently on a six-month rotation working in the risk management division of JJK. She is seeking to become familiar with JJK's approach to risk management and the maintenance of an adequate capital base.

Saminder has reviewed an internal document outlining JJK's approach to meeting regulatory requirements and has made a note of two fundamental rules that she believes are used to help analyze capital adequacy.

Rule 1:	When assessing the tier 1 capital ratio, assets should be weighted according to their risk, with riskier assets assigned a lower value than risk-free assets such as cash.
Rule 2:	Off-balance-sheet assets should be excluded from the asset base of the bank when assessing capital adequacy.

The document provided to Saminder outlines JJK's approach to calculating regulatory capital. Extracts from the document are shown in Exhibit 1.

Exhibit 1: Internal Memo—Regulatory Capital Calculation (extracts)

- Tier 1 capital is defined in accordance with global regulatory standards and is appropriately adjusted for intangible and deferred tax assets resulting from losses carried forward.
- Other tier 1 capital consists of irredeemable non-cumulative preferred stock with a fixed divided of 4.3%.
- Consistent with local regulatory standards, Tier 2 capital is comprised of $18,047m of subordinated debt maturing in five years, and a convertible bond issue convertible only at maturity at the end of 20X9 (convertible into common stock).
- JJK Holding has a target tier 1 ratio of 15% and total capital ratio of 20%.
- 20X8 year-end figures are forecast as follows:

	20X8 ($m)
Regulatory capital	
Common equity tier 1 capital	87,390
Additional tier 1 capital	16,401
Tier 2 capital	25,447
Total assets	510,948
Risk-weighted assets	601,312

Saminder notes that the convertible bond is due for conversion in 20X9. She intends to recalculate the 20X8 tier 1 ratio as if the bonds had been converted already.

Saminder has also reviewed an internal memo outlining some key trends over the last three years that were labeled 'Possible concerns?' by a previous employee. However, it was not clear from the document which trends if any were actual cause for concern. The trends included in the documents are shown in **Exhibit 2: Internal Memo—Three-Year Trends**.

Exhibit 2: Internal Memo—Three-Year Trends

	20X5 $m	20X6 $m	20X7 $m
Assets under management[1]	139,398	118,957	108,086
Net outflows[2]	100,483	112,482	196,429
High quality liquid assets	111,432	127,352	198,393
Available stable funding	376,092	376,653	388,624
Required stable funding	327,043	301,275	303,182

[1] Represents client assets managed by JJK BMD Trusts

[2] 30-day liquidity needs in a stress scenario

Which of Saminder's fundamental rules is *most likely* to be accurate?

A) Only rule 1 is accurate.
B) Only rule 2 is accurate.
C) Neither rule is accurate.

Question #2 of 88

Question ID: 1560270

Using the forecasted data and explicit targets given in **Exhibit 1: Internal Memo—Regulatory Capital Calculation (extracts)**, Saminder is *most likely* to conclude that JJK Holdings would:

A) meet its targeted tier 1 ratio and total capital ratio.
B) meet its targeted tier 1 ratio but not its targeted total capital ratio.
C) fail to meet either target.

Question #3 of 88

Question ID: 1560271

How are tier 1 capital and total capital *most likely* to change when Saminder makes her stated adjustment for the convertible bonds?

A) Common equity tier 1 capital and total capital will both remain unchanged.
B) Tier 1 capital will increase and tier 2 capital will decrease.
C) Other tier 1 capital will decrease and total capital will remain unchanged.

Question #4 of 88

Question ID: 1626128

Using the data in **Exhibit 2: Internal Memo—Three-Year Trends**, which of the following statements is *most* accurate?

A) The number of days JJK can withstand a stress-level-volume of cash outflows decreased by three days from 20X5 to 20X7.
B) The liquidity coverage ratio decreased in each of the two years.
C) The trend in net stable funding ratio indicates an increase from 20X5 to 20X7 in highly liquid funding available, compared to the level of funding required.

Overview for Questions #5-8 of 88

Question ID: 1630309

TOPIC: FINANCIAL STATEMENT ANALYSIS

THE TOTAL POINT VALUE FOR THIS QUESTION SET IS 12 POINTS

Roleo is a large U.S. multinational with subsidiaries around the world and prepares its financial statements in accordance with the U.S. GAAP. Among these subsidiaries is Simlair Industries. Alex Dudda, CFA, is one of the equity analysts following Roleo. Roleo has a defined benefit pension plan for its employees.

In preparing his research report, Dudda makes the following observations in the working documents:

Defined Benefit Pension Plans

Dudda noted that the assumed higher expected rate of return on plan assets reduces reported pension expense but does not affect the PBO, and thus increases the plan's funded status.

Employee Share Option Scheme

Roleo also has an employee share option scheme. Just as there is a cost to Roleo for its defined benefit scheme, the cost of Roleo's share option scheme will be charged as an expense to the income statement and hence reduce retained earnings and equity even if there is no cash outlay.

Question #5 of 88

Question ID: 1560264

Assume the country where Simlair is operating has been experiencing 30% annual inflation over the past three years and that Simlair has a net monetary liability position. Which of the following best describes the effect on Roleo's consolidated financial statements?

A) A gain is recognized in the income statement.
B) A loss is recognized in the income statement.
C) A gain is recognized as a direct adjustment to the balance sheet.