



CA FINAL
SUBJECT-
Elective Paper (Risk Management)

Test Code – FNJ 7365
(Date :)

(Marks - 100)

The question paper comprise five case study questions. The candidates are required to answer any four case study questions out of five.

CASE STUDY: 1

Good Morning Ltd. is a start-up company specializing in three-dimensional modelling and solutions. The brainchild behind the company is Mr. Good and Morning who formulated the idea of providing 3D solutions to mid engineering is and engineers.

Before the foundation of the company, the founders hired a consultant to study the feasibility of the project whether they could establish various branches in major cities across the country and, offer solutions throughout the country and also ex- to select' EU and US regions. The consultant after analysing all the aspects of a feasibility study including technical, economic and financial concluded that the project is feasible if the market is tapped within the next 18 months. He had employed various statistical techniques and tools in his detailed analysis.

For the purpose of formation of the company, the founders sold their idea and raised Rs. 20 crores by way of bank loan from Bank of London., Terms of the loan are as follows:

Loan Amount	–	Rs. 20 crores
Rate of Interest	–	11.25 percent
Tenure	–	10 Years

They provided a joint property as collateral Security for an equivalent amount. Further, they also pooled Rs. 10 crores from known sources, from a foreign country. In order to safe guard their investment in the company, the foreign investors wanted a report on;

- (i) RBI's guidelines on Credit Default Swap (CDS),
- (ii) How the Basel II norms were applied in the Indian banking sector and the risk management measures with regard to loans sanctioned by them,
- (iii) risk appetite of the management,
- (iv) how various risks are addressed by management,
- (v) forming of risk management committee by the company
- (vi) uncertainties existing in the industrial climate,
- (vii) periodic audits to be carried out and
- (viii) the BCP mechanism

Expected revenue of the company are as follows:

2020-21 - Rs. 18 crores

2021-22 - Rs. 27 crores

2022-23 - Rs. 32 crores

10% p.a. growth from thereafter.

Also, the founder were informed that the key to measure the success of the project is proper accounting. An ERP was implemented to record the financial transactions and several controls were put in place to prevent/detect any undesired events from occurring.

Recently Mr. Good learnt from a journal that organizations possessing details of EU citizens must comply with the stringent GDPR regulations. In case the organization need to comply with GDPR, there should be proper framework built in the organization.

Further they learnt that the companies Act 2013 requires a company's Board to develop and implement a proper risk management policy to identify those risks that cause a doubt on the going concern assumption of the company.

The company was keen to adopt sound Risk Governance Practices as well as the company grows. However, a major risk that the company faces is the technology that constantly changes.

The company has planned to provide solutions to customers located abroad as well. In that case, the company would be receiving the foreign currency.

The founders are worried about the volatility of the market and thus would like to cover their exposure by taking an appropriate position in the market.

Descriptive Questions

1.1 Based on the above scenario, answer the following questions:

- (a) Explain briefly the key features of Reserve Bank of India guidelines on CDS. **(6 Marks)**
- (b) Differentiate between Credit Insurance and Credit Default Swaps. **(6 Marks)**
- (c) Explain the methods of Estimating Probability of Credit Default. **(3 Marks)**

Multiple Choice Questions. Each Question carries 2 marks.

Choose the correct answer in the following Multiple Choice Questions

- 1.2 Before commencement of the project, various risks factors have to be considered for feasibility study. In a case where a project feasibility is based on a particular land acquisition and the cost of treating it in terms of legal fees is much higher, the appropriate recommendation the consultant would provide is to:
- (A) Terminate the Project
 - (B) Treat the Project
 - (C) Transfer the Project
 - (D) Continue the Project

- 1.3 The Delphi technique is a method which involves getting opinion on a process
- (A) From an Individual
 - (B) From Group of Individuals
 - (C) From Regulator
 - (D) None of the above
- 1.4 Which of the following is not an Internal risk ?
- (A) Economic factors as price fluctuations, changes in consumer preferences, inflation, etc.
 - (B) Technological factors unforeseen changes in the techniques of production or distribution resulting into technological obsolescence etc.
 - (C) Physical factors such as fire in the factory, damages to goods in transit, etc.
 - (D) Human factors as strikes and lock-outs by trade unions; negligence and dishonesty of an employee; accidents or deaths in the factory etc.
- 1.5 The concept of risk-based maintenance is an advanced form of :
- (A) Probability Centered Maintenance
 - (B) Risk Centered Maintenance
 - (C) Control Centered Maintenance
 - (D) Reliability Centered Maintenance
- 1.6 Operational risk is an overarching concept interrelated with
- (A) Several other types of risk, and can. be viewed in isolation.
 - (B) Several other types of risk, and can be viewed with no financial impact.
 - (C) Several other types of risk, and cannot be viewed in isolation
 - (D) None of the above

(2 x 5 = 10 Marks)

CASE STUDY: 2

ABC Ltd. is a Delhi based company. It was established in 2009 and deals in the manufacturing business of high-end electronics distributed through retail superstore. The company is currently going through a rapid growth phase. Its products are receiving good response from the market. The company is experiencing the challenges of retaining good sales employees and developing an efficient financial system. Ravi Narain is the CFO of the company.

ABC Ltd. has an outdated computerized accounting system which does not lock out the changes made after the month end.

ABC is looking to develop a more effective and efficient financial system and considering implementing an incentive plan for sales employees who are currently paid a flat salary.

ABC Ltd has a turnover of Rs. 800 crores in 2016-17 and was listed on Indian Stock exchange in 2014. Ajay and Pawan are the newly appointed directors of Finance and Human Resource divisions respectively.

Ajay is a street smart finance professional and he played a critical role in the areas of budgeting and forecasting, finance and asset management. He has a team of 25 people including Jatin and Mohit who directly reports to Ajay.

In spite of a limited salary, Ajay maintains a lavish style of living. Jatin maintains the journal entries according to Ajay's directions. One day HSBC bank notified Ravi Narain that Ajay's personal credit card balances were being paid off by ABC's account. Since, Ravi Narain was busy for Board Meeting confirmed that this might be reimbursement of his Travelling Expenses.

Jatin records the internet sales from the company's retail outlet as well as carries out following functions:

1. Reconciliation of accounts receivable sub-ledger to general ledger
2. Mailing checks to vendors
3. Coding and recording of checks received for deposit Ravi normally never reviews financial details as he trusts Ajay.

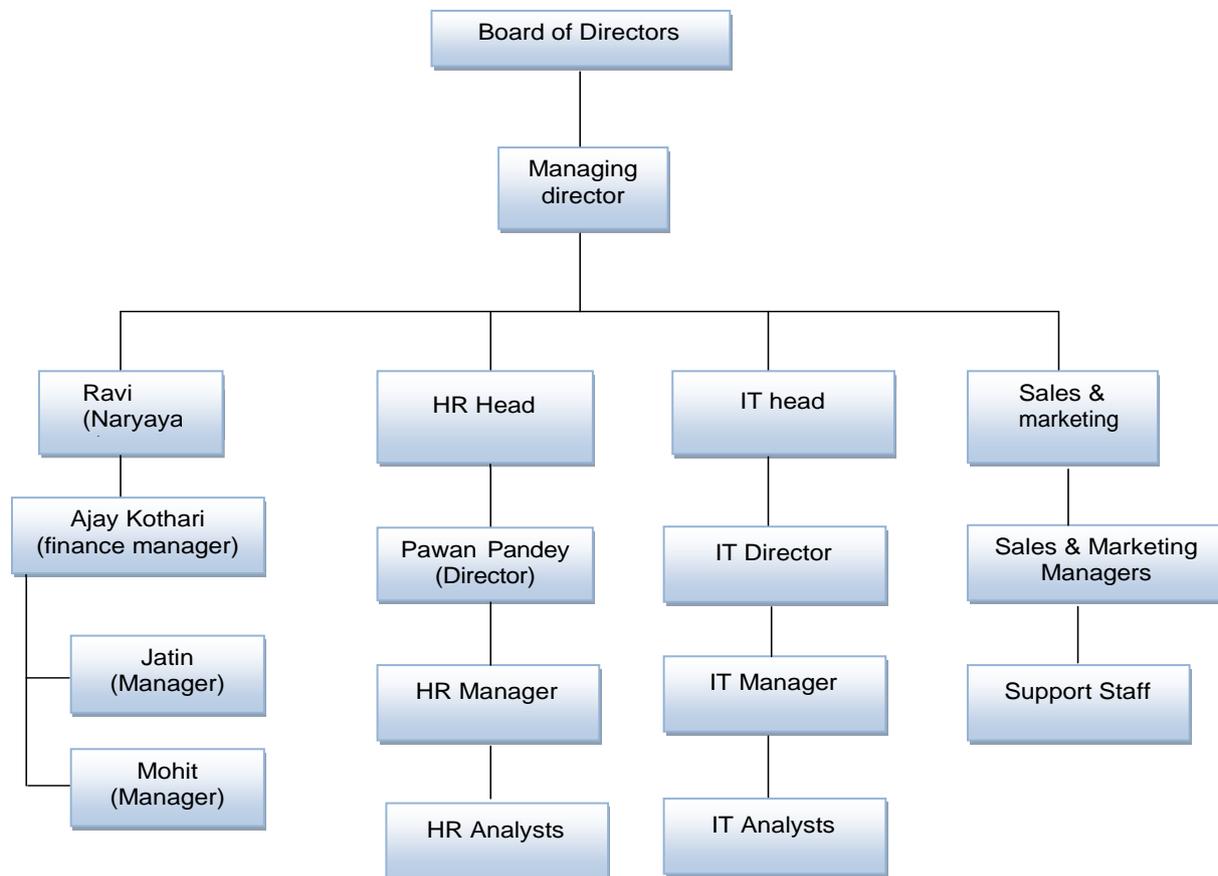
On the Human Resource front, to overcome the problem of retaining the sales employees, the company has recently hired Pawan as the HR director who is known for developing good HR policies to manage people effectively and motivate them to perform well.

Pawan advised the management to implement a compensation plan of base salary and bonus instead of fixed monthly salary. Sales incentive compensation is based on the performance of sales employees. The performance can be measured by looking at the revenue they generate for the employees. The management liked the proposal advised by Pawan and the compensation plan is finalized which was as follows.

Base Salary: 35,000/month

Commission: 5% of Sales exceeding 10,00,000/month + 5% extra commission on sales made over and above 20,00,000/-

Consequently, the present organization structure comes out as follows:



After passing some time, the Board of Directors started realizing that the company is facing liquidity crunch. Also, the introduction of new compensation plan resulted in unhealthy competition among employees.

Some employees were less willing to provide assistance to struggling co-workers and would prefer to improve their own productivity. It also promoted an environment of excessive risk – taken by the sales employees for pursuing short term profits.

The company has a system of identification of risk but only at the functional level and not for processes. Further these Risks are not communicated among various organization levels.

2.1 Questions

The Board of Directors approaches you and requests you to submit a report on the following aspects:

- (i) Identify the Risks that may be possible and their nature. **(5 Marks)**
- (ii) Scaling of these identified risks based on ICAI Guide on Risk Based Internal Audit. **(5 Marks)**
- (iii) Any three to four approaches to identify and assess the risk. **(5 Marks)**

Multiple Choice Questions

- 2.2 As per the.....risk has been defined as resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.

- (a) Basel II
 - (b) ICAI - SA 315
 - (c) CIMA
 - (d) None of these
- 2.3 Which of the following is not the classification of risk as stated by Enterprise Risk Management?
- (a) Knowledge risk
 - (b) Operational risk
 - (c) Financial risk
 - (d) Residual risk
- 2.4 Which of the following is not the benefit of the risk management plan?
- (a) Saving Valuable resources: time, income, assets, people and property can be saved if fewer claims occur.
 - (b) Creating a safe and secure environment for staff, visitors and customers
 - (c) Reducing legal liability and increasing the stability of your operations
 - (d) Provide an absolute assurance that risks will be mitigated.
- 2.5 In which of the following techniques to assess and evaluate risks, a panel of experts are appointed and each of them gives his/her opinion in a written and independent manner:
- (a) Judgment and intuition
 - (b) The Delphi approach
 - (c) Scoring
 - (d) Quantitative techniques
- 2.6 Which of the following is not the risk type that often overlaps or is caused by operational failure?
- (a) Regulatory Risk
 - (b) Financial Risk
 - (c) Credit Risk
 - (d) Legal Risk

(2 x 5 = 10 Marks)

CASE STUDY: 3

You have been recently appointed as Chief Risk Officer of a company which is in Steel Castings business. Name of the Company is ABC Electro Steel Castings Ltd. [in short, ABC].

You have been told that ABC is fully committed to strengthen its risk management capability on continuous basis in order to protect and enhance shareholder value. You have been told that the risk management framework ensures compliance with the requirements of amended Clause 49 of the Listing Agreement. The framework establishes risk management processes across all businesses and functions of the Company. These processes are periodically reviewed to ensure that the Management controls risks through properly defined framework.

You are also made aware that the Company has already undertaken an extensive Risk Management effort that includes introducing Risk Management Manual, compiling a comprehensive profile of the key risks to the Company, identifying key gaps in managing those risks and developing preliminary action plans to address those risks. This effort accomplishes the following goals:

- responds to the Board's need for enhanced risk information and improved mitigation plan;
- provides the ability to prioritize, manage and monitor the risk in the business; and
- formalizes the explicit requirements for assessing risks on an ongoing basis, including an effective internal control and management reporting system.

You are also given information that the Company uses raw materials to manufacture the steel castings. It is faced with the threat of pressure on margins on sales. To counter the threat, the Company has taken various steps which include backward integration which comprises coal mines and iron mines, and brownfield expansions, e.g. sinter plant, sponge iron plant, coke oven plant, power plant from waste head recovery. It also set up an R & D to expand its manufacturing capacities with a view to control costs.

You came to know that the Company is ISO-140001-2004 certified and is adhering strictly to the emission norms applicable for industry.

You are also told that with the thrust given by Government of India on water and water related projects and with the estimated growth in water requirement, the demand of DI Pipes is expected to grow substantially and the Company is confident of retaining its market share.

Labour relations have been excellent throughout the year in spite of number of unions. It is the result of such cordial and harmonious relations that not a single man-day has been lost in the last 8 years. The Company believes that labour relations will continue to remain excellent.

Descriptive Questions

3.1 Now, you have been asked to give a report to the Company's Management, which should contain the key risks affecting the Company. **(15 Marks)**

Multiple Choice Questions. Each Question carries 2 marks.

Choose the correct answer in the following Multiple Choice Questions

- 3.2 An excess payment made to a vendor, which is accounted correctly, would be categorized under which of the following risks?
- (A) Financial Reporting risk
 - (B) Legal risk
 - (C) Reputation risk
 - (D) Financial risk
- 3.3 In Information Technology General Controls, under change management, the risk of incorrect change is NOT mainly due to
- (A) Change being wrongly conceived by the user groups
 - (B) Change control audit trail not maintained
 - (C) Change is wrongly executed
 - (D) Change being carried out without approvals
- 3.4 Annual Report of the Board of Directors must include a statement indicating the development and implementation of a risk management policy for a company. This is mandated by
- (A) SEBI through 'Issue of Capital and Disclosure Requirements Regulations'
 - (B) Information Technology(Amendment) Act, 2008
 - (C) Companies Act, 2013
 - (D) Prevention of Money Laundering Act, 2002.
- 3.5 While taking a decision, the category risk profile bucket that would most likely to escape attention of the Management is
- (A) High Impact-Low Probability
 - (B) Low Impact-Low Probability
 - (C) High Impact-High Probability
 - (D) Low Impact-High Probability
- 3.6 Governance risks mean significant deficiencies that can impact the reputation, existence and continuity of the organization. Such deficiencies would NOT occur because of
- (A) Inappropriate practices adopted by the Board
 - (B) Inability of the Board to identify trivial risk facts that can impact business continuity
 - (C) Failure of the Board to direct and control the organization
 - (D) Collusion of management to override significant internal control mechanism causing financial losses

(2 x 5 = 10 Marks)

CASE STUDY: 4

ABC Co. Ltd. is a manufacturing company and is listed. It has 10000 workers and 1200 employees. The Company is subject to Ind AS 19 in respect of its employee benefits which include gratuity.

Ind AS 19 is an Accounting Standard applicable to companies which are required to measure and disclose the amount of accrued liability (Present Value of Benefit Obligation) in respect of employee benefits in statements of accounts.

As per the Accounting Standard, the accrued liability in respect of, employee benefits can be determined using actuarial principles. Accordingly, the Company engaged an actuary for the purposes of the Ind AS 19.

The Company is, liable to make payment of gratuity benefit to its employees as per Payment of Gratuity Act, 1972. As per the Act, the gratuity benefit is determined using a formula, which is $[15/26] \times$ monthly salary (which is relevant for gratuity calculation) \times number of completed years of service at the date of cessation of service of the employee. There are terms and conditions mentioned in the Act for payment of gratuity benefit, which the company is required to comply with the same.

The Company engaged Mr. X, a consultant actuary, to get the actuarial reports certified by Mr. X as per Ind AS 19 for the last two years.

After submission of the actuarial report by Mr. X, in the third year, Auditors (who were recently appointed by the Board) observed that Mr. X does not hold any certificate of fellowship issued by the Indian Actuarial professional body. They pointed out and qualified the Accounts in their Auditors' Report. They also observed that the Mr. X's reports were accepted during last two years.

Since the Management is worried over GRC (Governance, Risk and Compliance), the CRO (Chief Risk Officer) was asked to address the issue pointed out by the Auditors and submit a report to the Company giving details of the risks and how they can be mitigated.

Descriptive Questions

4.1 Now, you are recently appointed as the CRO and you are asked to draft the Report to be submitted to the Board, and the Report should include:

- (a) What is the type of risk the Company is subjected to?
- (b) What is the impact of the risk on the Company's performance?

(15 Marks)

Multiple Choice Questions. Each Question carries 2 marks.

Choose the correct answer in the following Multiple Choice Questions

4.2 A FICO score of 750 means:

- (A) 1% of chance of default
- (B) 2% of chance of default
- (C) 8% of chance of default
- (D) 61% of chance of default

- 4.3 Automated controls are dependent on a:
- (A) Manual check
 - (B) Predefined system check
 - (C) Predetermined check
 - (D) None of the above
- 4.4 The following is the Section of the Companies Act, 2013 that instructs that the Audit Committee shall review the risk management procedures implemented by the Management:
- (A) 177
 - (B) 134
 - (C) 315
 - (D) None of the above
- 4.5 The following aspect does not indicate the risk maturity of an organization:
- (A) Business objectives are defined and communicated across the organization.
 - (B) Risk appetite is defined and communicated across the organization.
 - (C) Control environment is strong including tone from the top.
 - (D) None of the above
- 4.6 Brexit impact scenario has the following associated principal risk:
- (A) Brand, Reputation and Trust
 - (B) Data Security and Data Privacy
 - (C) Political, Regulatory and Compliance.
 - (D) None of the above

(2 x 5 = 10 Marks)

CASE STUDY: 5

Ms. X is new to operational risk management. While analysing the risks of an established airline based on the Risk Grading /Rating model, she identified the following risks:

- (1) Stagnant business growth resulting from competition from other airlines.
- (2) Aggressive fleet expansion, which may lead to over-capacities. There are about 170 aircrafts under order, which could also result in massive financial commitments. A comprehensive feasibility study has been shared by the Company, justifying the expansion strategy.
- (3) Safety standards resulting in crash/disastrous hijacking.
- (4) Volatile oil prices. There is a risk of failure to address adequately the challenges of fluctuating oil prices. Whilst it is usually rising oil prices that hurt airlines, during 2008, several airlines suffered significant hedging losses as the hedging strategies went awry, when oil prices plummeted from \$147 p/b in July 2008 to \$35-40 p/b level.

Descriptive Questions

5.1 Please, help Ms. X to classify the above risks, by giving a report to her.

(15 Marks)

Multiple Choice Questions. Each Question carries 2 marks.

Choose the correct answer in the following Multiple Choice Questions

5.2 One of the principles of Basel Committee on Banking Supervision Principles for sound stress testing practices and supervision is:

- (A) Stress testing should form an integral part of the overall governance and risk management culture of the bank.
- (B) Stress testing should be done in case of mergers or take overs only.
- (C) Stress testing should be done at the direction of Reserve Bank of India only.
- (D) None of the above

5.3 Gini coefficient is an index to measure a country's:

- (A) level of corruption.
- (B) inequality in income distribution.
- (C) level of crimes, violence, military expenditure.
- (D) None of the above

5.4 The following one is a financial risk:

- (A) The cash flow of an issuer will not be adequate to meet its financial obligation.
- (B) A fisherman starting a sea voyage on fishing expedition.
- (C) An infant climbing on a window pane.
- (D) A student writing the examination.

5.5 If a long term instrument is rated as "B", this means that instrument carries:

- (A) Highest Safety
- (B) High Risk
- (C) Very High Risk
- (D) None of the above

5.6 As per the RBI's framework, SMA (Special Mention Account) with sub category 1 (SMA-I) denotes:

- (A) Principal or interest payment overdue between 31-60 days.
- (B) Principal or interest payment overdue between 61-180 days.
- (C) Principal or interest payment not overdue for more than 30 days.
- (D) None of the above

(2 x 5 = 10 Marks)