

MOCK TEST PAPER
FINAL (NEW) COURSE: GROUP – II
PAPER – 6A: RISK MANAGEMENT

CASE STUDY: 1

ABCD Ltd. is a diversified business group. The consolidated Balance Sheet, Statement of Profit & Loss and Cash Flow Statement of ABCD Ltd. prepared in analytical format are given below:

Customer Name: ABCD LTD.		INR (Rs.) Thousand	
		31-Mar-18	31-Mar-19
		12 months	12 months
BALANCE SHEET			
CORE ASSETS			
TOTAL FIXED ASSETS (A)		222,301	214,666
TOTAL CURRENT ASSETS (B)		763,428	679,539
TOTAL CURRENT LIABILITIES (C)		395,337	382,908
OPERATING CAPITAL EMPLOYED (A) + (B) – (C)		590,392	511,297
TOTAL NON-CORE/NON CURRENT ASSETS (D)		71,621	70,838
OVERALL CAPITAL EMPLOYED (A) + (B) - (C) + (D)		662,013	582,135
CAPITAL STRUCTURE			
Equity Share Capital (Rs. 10 each share)		222,248	222,248
Profit and Loss Account		98,278	61,549
Other Reserves		35,080	36,303
Less: Intangibles		-12,112	-9,620
TANGIBLE NET WORTH (E)		343,494	310,480
Minorities		53,422	62,929
Provisions/Other Long Term Liabilities		61,790	56,445
OTHERS (F)		115,212	119,374
EXTERNAL FINANCE (G)			
Bank O/D and Short Term Loans		203,307	152,281
OVERALL CAPITAL EMPLOYED (E) + (F) + (G)		662,013	582,135
Contingent Liabilities		101,000	131,977
Capital Commitments		52,500	50,000
PROFIT AND LOSS ACCOUNT			
Sales		1,446,791	1,469,762
Less: Cost of Goods Sold		-1,117,664	-1,132,857
GROSS PROFIT		329,127	336,905
Less: Distribution and Selling costs		- 156,049	- 160,370
Administration Costs		-114,623	-106,887

OPERATING PROFIT	58,455	69,648
Share of Profit of Associate Companies	2,030	10,059
Other Income	24,819	13,703
PROFIT BEFORE INTEREST AND TAX	85,304	93,410
Less: Interest Expense	-7,619	-4,777
PROFIT BEFORE TAX	77,685	88,633
Less: Taxation Charge	-6,500	-6,500
PROFIT AFTER TAX	71,185	82,133
Minorities	-11,976	-16,583
PROFIT AVAILABLE FOR APPROPRIATION	59,209	65,550

Additional Information [All amounts in Rs. 000s] :

Turnover comprises: Equipment and Automotive: 28680, Consumer Products: 71400,

Industrial Products: 29800 and Office Equipment: 17100.

Largest inventory item was trading inventory and finished goods, which towards 2019-end, decreased to 19100 (22200 as at 31st March, 2018).

Similarly, the figures of Trade Debtors and Creditors was as follows:

	31-Mar-18	31-Mar-19
Trade Debtors	366246	308547
Trade Creditors	217121	230476

Sales growth of year 2019 is almost in line with the previous years.

Opening Operating Capital for the financial year 2018-19 was 611,000.

Currently the share of ABCD Ltd. is quoted in market at Rs. 80.70 per share.

Descriptive Questions

1.1 Suppose ABCD approaches to a Bank for a consortium loan to finance a big project and you as a risk consultant has been requested by the bank to give your opinion covering the following measures:

- Quantum of Liquid Assets in relation to the size of the company.
- Profitability of the company reflecting the company's age and earning power.
- Operating Efficiency apart from tax and leveraging factors.
- Market dimensions that can show up security price fluctuations as a possible red flag.
- Total Asset Turnover.

(15 Marks)

Multiple Choice Questions

Choose the most appropriate answer from the given options:

1.2 An excess payment made to a vendor, which is accounted correctly, would be categorized under which of the following risks?

- Financial Reporting risk
- Legal risk
- Reputation risk

(D) Financial risk

1.3 In respect of an organization, **Reputation risk** means

(A) Risk of possible financial loss to the organization.

(B) Risk of a failure which may lead to violation of the regulatory requirements that the organization is supposed to comply with.

(C) Risk of the organization's reputation in public view which is a key concern in engaged media and social media.

(D) None of the above.

1.4 Which one is an external factor in respect of risks for an insurance company?

(A) Financial position

(B) Machine failure

(C) Staff Morale

(D) Earthquake

1.5 If Risk rating is 5, then the risk is called

(A) Severe

(B) High

(C) Moderate

(D) Low

1.6 RAROC is

(A) Return on capital adjusted for inflation.

(B) Risk-based profitability measurement framework.

(C) Return on gilts

(D) None of the above

(2 x 5 = 10 Marks)

CASE STUDY: 2

About one and half year back Ms. X was appointed as Chief Risk Officer of an Airline Company. Though she was naïve to risk management professional knowledge and skills but at the time of her interview she presented some documents in support of her claim that she is as expert of Risk Management. Around one month the Risk Committee asked her to provide a report on various risks the company is exposed to and their bucketing according to their impacts. Accordingly, about 15 days before Ms. X furnished a report to the Committee. The next the HR Head of the company contacted the Head of Committee stating that from some source they came to know that Ms. X is very naïve to Risk Management profession and documents presented at the time of interview are forged one. Somehow Ms. X came to know about the same findings by HR about her. After that neither she is coming to the office or she is picking up the phone.

You a recently qualified Chartered Accountant have recently have joined the company in Finance Department has been called up by the CFO and have been requested to look into the report submitted by Ms. X to confirm whether it is OK to present before the Board of Director for their discussion at the meeting scheduled to be held at the earliest.

The report submitted by Ms. X is as follows:

To: Board of Directors

From: Ms. X

Date: -----

Subject: Grading/ Bucketing of Various Risks

The company is facing some of the under-mentioned Operational Risks which and the grading/ bucketing of these identified operational risks is in italics.

- (1) Stagnant business growth due to Covid 19 and competition from other airlines.

This risk is bucked in the category of 'Low Probability – Low Impact'.

- (2) Aggressive fleet expansion leading to over-capacities. 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.

This risk is bucked in the category of 'Low Probability – High Impact'.

- (3) Safety Standards resulting in Crash/ disastrous hijacking

This risk can be classified as 'High Impact – High Probability'

- (4) Volatile Oil Prices. 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.

This risk can be categorized as 'High Impact – Low Probability'

Descriptive Questions

- 2.1 You are required to comment whether Report is in order or not. Further you are also required to revise the same Report on the lines of your suggestions. **(15 Marks)**

Multiple Choice Questions

Choose the most appropriate answer from the given options:

- 2.2 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

- 2.3 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

- 2.4 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.

2.5 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

2.6 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 61-90 days.
- (C) Principal or interest payment not overdue for more than 30 days.
- (D) None of the above

(2 x 5 = 10 Marks)

CASE STUDY: 3

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 $[15/26] \times \text{monthly salary (which is relevant for gratuity calculation)} \times \text{number of completed years of service at the date of cessation of service of the employee}$. 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

3.1 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

Choose the most appropriate answer from the given options:

3.2 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

3.3 Automated controls are dependent on a:

- (A) Manual check
- (B) Predefined system check
- (C) Predetermined check
- (D) None of the above

3.4 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

3.5 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

3.6 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: 4

Sunshine Ltd. is a software company specialized in the software development for their clients. In last decade it has earned a good name and fame. For example, a super critical boiler in a thermal power plant takes 10-12 days to be fine-tuned or synchronized. It means system is shut for power generation and lead to loss of millions of dollars. Sunshine Ltd. came up with a solution that cuts the time taken to synchronize a boiler from 10-12 days to 3-4 days through the use of software and services of IT Professionals. The main strength of Sunshine is the IT professional they employed with it.

Additionally company has started using Machine Learning and Artificial Intelligence.

It captured data through sensors on the boilers, use the algorithm built in house to check nearly 240 parameters and over 10,000 combinations to tune the boiler.

It also helped a global heating, ventilation and air conditioning firm to bring down the time taken to design an AC solution in a building or office from 9 days to just 2 hours now.

However, traditional outsourcing business of Sunshine Ltd is dying a slow death as clients cutting their budgets on such services and shifting their focus on newer areas such as digital and cloud.

Three-fourth of the revenue of Sunshine Ltd is from traditional services. However, half of its revenue still comes from fixed price projects which allow it the flexibility to determine the resources it deploys and use software tools to deliver services. Now, the aim is to increase that goal by reducing the dependency on people and more on software led services which coincide with its goal of IT Modernization.

Sunshine Ltd. derives a major portion of its revenues from customers discretionary spending which is linked to their business outlook. Its major revenues are from UK, USA and other European countries.

Some draft legislations in USA have been made to restrict the availability of work visas. Such protectionist policies threaten the prospect of global mobility of people which may also affect the work of TCS as distributed software development requires free movement of people.

Appreciation of the rupee against any major currency results in the revenue denominated in that currency to appear lesser in reported terms. Then, there may be different exchange rate when sale took place and when invoice is collected.

The Internal Financial Control System

The internal Financial Control System of Sunshine Ltd. has been laid down as below:

- ◆ Recording and providing reliable financial and operation information.
- ◆ Safeguarding assets.
- ◆ Ensuring compliance with corporate policies.
- ◆ Well defined delegation of power.
- ◆ Efficient ERP system.
- ◆ Internal audit by one of the big audit firm.
- ◆ Periodic audit by specialized third party consultants.
- ◆ Audit Committee found internal financial control adequate.

Descriptive Questions

4.1 Advise Sunshine Ltd. the various aspects it should cover before outsourcing any business.

(5 Marks)

4.2 Briefly explain the main issues that can surface from technology risk from an Auditor's or Operational Risk Professional's perspective.

(10 Marks)

Multiple Choice Questions

Choose the most appropriate answer from the given options:

4.3 Risk Adjusted Discount Rate Method is based on the concept that

- (A) investors demand higher returns from more risky projects
- (B) investors demand lower returns from more risky projects
- (C) investors demand higher returns from less risky projects
- (D) None of these

- 4.4 A project has a cost of capital of 10% and a payback period of 2 years with annual cash inflows commencing from year end 2 to 4 of Rs. 60 crore. The initial investment outlay at the beginning of year 1 shall be
- (A) Rs. 67.80 crore
 - (B) Rs. 74.58 crore
 - (C) Rs. 60.00 crore
 - (D) Rs. 95.07 crore
- 4.5 Which of the following risk will not affect foreign exchange rate?
- (A) Investment Risk
 - (B) Inflation Risk
 - (C) Interest Rate Risk
 - (D) Sovereign Risk
- 4.6. The purpose of Financial Swap is to reduce
- (A) Interest Rate Risk
 - (B) Exchange Rate Risk
 - (C) Credit Risk
 - (D) Both (a) and (b)
- 4.7 Credit risk mitigation in Banks is a key concern of the Board. It can include the following except one. Point out which answer is inappropriate?
- (A) Norms of lending are tightened.
 - (B) Credit insurance.
 - (C) Making Covenants with the borrowers.
 - (D) Verification of assets.

(2 x 5 = 10 Marks)

CASE STUDY: 5

ABC Limited, a listed company, announced the appointment of AG as the company's first lead independent director. Despite opposition by few shareholders, the management offered justifications for the new structure to be more independent and investor friendly. Investors liked the idea and the announcement brought positive sentiments to the falling stock prices which increased to Rs. 75.10, the next day of the announcement. It proved that investors were optimistic about the future of the company and expected better financial results. AG was actually appointed and responsible to response to the present state of affairs of the company. The company had been actually witnessing and struggling in the months to address certain corporate governance challenges. Proxy advisory firm, XYZ, raised alarms and questioned executive compensation package in the years of falling performance. A small shareholder filed a law suit against Board of Directors misuse of corporate funds.

RG, the present Chairman and CEO, was working with the company since last sixteen years and was a close family friend of promoters. His leadership style being democratic was liked and praised by everyone. He was often found meeting people at all levels within the organisation and called for trying new things. His philosophy diminished conflicts and tensions in pursuit of goal setting and achieving. He believes that as long as dividend is paid to shareholders and earnings per share increases, the market values the stock. In the last AGM, he said "The recent decline in financial performance is taken as a publicity stunt by few self interested groups. The company is on its way towards bright future ahead".

The Income Statement Summary of ABC Limited for last three years:

Particulars	Year 2017	Year 2018	Year 2019
Revenue (Rs. Crores)	13938	13696	13373
Expenses (Rs. Crores)	9608	9420	9119
Operating Income (Rs. Crores)	4330	4276	4254
Stock Price (Rs.)	65.64	61.00	58.4

Shareholding pattern at the end of Year 2019:

Type of Shareholder	Percentage Stake
Promoters	51.60
Mutual Funds	7.25
Domestic Financial Institutions and Banks	24.75
Foreign Institutional Investors	10.40
Corporate Bodies	4.60
Individuals	1.40
Total	100

Descriptive Questions

- 5.1 What should RG and other members of the BOD do? (5 Marks)
- 5.2 Suppose you are Statutory Auditor of ABC Ltd. and you want to carry out risk assessment of ABC Ltd. for financial reporting purpose then mention the circumstances in which risk can arise or changed.

(10 Marks)

Multiple Choice Questions

Choose the most appropriate answer from the given options:

- 5.3 Which of the following is called Governance Risk?
- (A) Risk of management override, deliberate acts of omission
 - (B) Ineffective and unethical management of a company by its executives and managerial levels
 - (C) Inability of management to meet its process related objectives
 - (D) Management interference in day-to-day operations.
- 5.4 Which of the following is not an index for Country Risk Analysis?
- (A) Democracy Index
 - (B) Global Peace Index
 - (C) Human Perception Index
 - (D) Gini Coefficient
- 5.5 is necessary to evaluate all types of risks impacting all categories of stakeholders and find solutions to pre-empt the threats before the risk occurs.
- (A) Stakeholder Risk Management
 - (B) Country Risk Management
 - (C) Shareholder Risk Management
 - (D) Enterprise Risk Management

- 5.6** OECD Guidelines for corporate governance does not include
- (A) Disclosures and Transparency
 - (B) Role of shareholders
 - (C) Responsibilities of the board
 - (D) Institutional investors, stock markets and other intermediaries
- 5.7** Opportunities under Risk and Opportunity Disclosure in the Annual Report would not include
- (A) Value realization of by-products by exploring new areas
 - (B) Creating differentiation through acceleration of new product development
 - (C) Securing raw material supplies
 - (D) Volatility in financial markets and fluctuations in exchange rates
- (2 x 5 = 10 Marks)**