

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

Time Allowed – 4 Hours

Maximum Marks – 100

CASE STUDY: 1

TW Ceramics Limited was incorporated under the Indian Companies Act, 2013 to manufacture fine bone china table ware like dinner sets, tea sets, mugs etc. as Export Oriented Unit. The Company was promoted by a big industrial house having diverse interests in various areas ranging from power production and distribution, heavy engineering, hospitality etc. It was a first time venture for the group who had no prior experience in such area. The group is well established and enjoys tremendous brand image not only in India but all over the world. Each Company under the Group is headed by professional managers at key levels and Board of Directors consists of well known persons with years of experience in their field. MIS systems were robust and helped in periodical review and decision making. All Group Companies were governed by a consolidated Company under governing council headed by very well known professionals.

Exhibit - 1

TW Ceramics Limited was a subsidiary Company of one of the Group Company and majority of the shares were held by the holding Company. The company decided to establish its facility in Export Promotion Zone in close proximity to port to facilitate easy export of products. Besides this, all inputs are allowed to be procured duty free subject to fulfilment of export volume equal to 75% of production.

Exhibit - 2

TW Ceramics Limited decided to seek financial and technical collaboration from well known brands located abroad since local units did not have the requisite technical expertise and quality required to meet global standards. Idea of going in for financial collaboration together with technical collaboration was to ensure interest of the foreign collaborator in the project. Accordingly, holding company (Promoter of TW Ceramics Limited) held 70% of the equity shares thus retaining controlling interest and balance 30% was allotted to the foreign entity after obtaining necessary approvals. Brands which enjoyed global reputation for tableware are Wedgewood and Royaldowton based in UK and Noritaki based in Japan. Products of these Companies are of Premium quality and commanded high price in global markets and hold close to 70% of global market among themselves.

After due diligence and discussions collaboration agreement was executed between Wedgewood and the Holding Company on behalf of TW Ceramics Limited. As per the agreement, holding Company will execute the project using its resources and manpower with technical input from Wedgewood. Among other things agreement provided for-

- ◆ Experts in erecting and commissioning facility to manufacture products for global markets will be stationed in the factory and they will be responsible for ensuring inspection of equipment imported including plant and machinery, advice on equipment selection, erection, lay out as per international standards.
- ◆ Commissioning of the unit and ensuring quality in production by stationing their technical and production person.
- ◆ Training of local managers in production, quality and technical aspects at their facility in UK.
- ◆ Initial assistance in Marketing of the product in overseas markets till local people can take over.

- ◆ All expenses in connection with deployment of expats will be the responsibility of TW Ceramics Limited.
- ◆ Wedgewood will also provide all drawings and technical support for the project for which they will be paid technical fee.
- ◆ In addition, they will assist in procurement of imported China clay till local sourcing is done.
- ◆ Commission of 5% will be paid on products sold through Wedgewood.
- ◆ All other aspects including Commercial. Local procurement, finance, legal, import export matters and all clearances required will be the sole responsibility of TW Ceramics Limited who will execute the project by deploying its manpower.
- ◆ Total project cost was pegged at ₹150 cr including all investments, project expenses and margin for working capital.

Exhibit - 3

Execution of project was undertaken by Managers deputed from Holding Company and required man power in critical areas was appointed locally. Despite the backing of Group with manpower and money, the project suffered delays on all fronts and cost overrun was inevitable. The technical team deputed by Wedgewood was found wanting in areas of expertise and it was evident that they did not possess the knowledge or skills required. Added to this the local team did not have any knowledge about the industry or the product and relied heavily on the expats.

In anticipation of production commencing, management recruited the core team and manpower. This was not a wrong move since the company wanted its people to be ready on all aspects of managing the operations and also get required training to man production, procurement, quality and other aspects since these cannot be learnt on the job.

The required technical training at the factory of Wedgewood did not take place despite repeated requests. Since project was already delayed and had to be commissioned to meet norms of Export Processing Zone, production was started by local team under the guidance of expat manager who had joined the company as per agreement. It was decided that the technical team will undergo required training under him. Further delay in commissioning the project would have meant losing all the benefits including duty saved on imported equipment with attendant consequences. Ultimately, by the time project started operations cost overrun was 30% over and above the estimate of ₹150 cr. Initial funding was done as follows-

		Rupees in Cr.	Rupees in Cr.
Equity	- 70% Holding Company	35.00	
	- 30% Foreign Collaborator	<u>15.00</u>	50.00
Term loan			<u>100.00</u>
		Total	<u>150.00</u>

Cost overrun on the project meant that holding Company was required to bring in more money since the ultimate project cost came to ₹195 cr and Bank was sceptical in funding and demanded more to be brought by the promoter whose resources were strained due to funding and meeting interest obligations on the loan already availed.

Exhibit - 4

Wedgewood went back on its commitment on initial marketing citing quality issues to market the products in overseas markets. This meant that TW Ceramics were required to look for marketing and sales support

from day one which was not anticipated. Group had its own marketing arm which looked after export markets for various products manufactured by the group. They were roped in to do the marketing of the product. They did not possess required knowledge about the new product which spelt more problems for TW Ceramics Limited. TW Ceramics were forced to obtain special permission from Commissioner Under 25% window to sell the product locally. This permission came with riders and. Added to this the first lot of export of one million mugs were rejected by the consignee due to wrong pasting of decal and damages amounting to One million dollar was slapped on the Company.

Top Management of the group did not want things to drift anymore and stepped in to stem the rot. They decided to undertake a thorough investigation into the happenings and fix responsibility before deciding on further course of action since the reputation of the Group was at stake.

Descriptive Questions

Board of Directors appoints your firm to help them and come up with a policy framework to assess the risk and manage it.

1.1 Analysis of potential risk associated with the project. **(8 Marks)**

1.2 Suggest a risk management framework. **(7 Marks)**

Multiple Choice Questions

Choose the correct answer from the following.

1.3 Units located in Export Processing Zone are allowed to

- (a) procure all input including Capital Goods free of duty.
- (b) procure duty free covers both imports and domestic procurement.
- (c) sell 25% of output in domestic market.
- (d) All of the above.

1.4 Nonadherence to terms of agreement can result in

- (a) cost escalation and delay in commissioning of the project.
- (b) reputational risk.
- (c) losing all benefits.
- (d) All the above.

1.5 Assessing Risks associated with projects involves

- (a) carrying out proper due diligence
- (b) assessing all risks associated with the project.
- (c) assessing technical capability of the collaborator
- (d) assessing the reputation and standing of the collaborator.

1.6 Nonadherence to risk management practice results in

- (a) exposing the project to all risks associated with the project.
- (b) failure of the project.
- (c) time delay and cost overrun
- (d) exposing the Company to Financial and operational Risk.

1.7 Risk Management System includes

- (a) establishing a sound risk assessment process.
- (b) constituting Risk Management Committee.
- (c) employing Chief Risk Assessment Officer.
- (d) All the above

(2 x 5 = 10 Marks)

CASE STUDY: 2

World Resorts Limited operates 5* deluxe property under brand name- Golden Palms with 150 rooms of different categories ranging from Standard to Presidential Suites spread over 15 acres of land and surrounded by complete greenery all round. Tariff varies depending on the category of Rooms. Resort also has a 24 hour coffee shop besides speciality restaurants serving choice food from across regions including Indian/ Chinese/ Italian fare etc.; besides this, it has 7 banqueting facilities ranging from Board Room to halls capable of accommodating 1000 guests at a time. Besides this, the property boasts of one of the largest swimming pools in Asia, open air dining options besides the pool area, facilities for various games, well laid badminton court, excellent SPA offering wellness treatment, health club and a well-appointed bar selling choice spirits. The property is in operation for close to 15 years and brand is well known

Being located away from the City, it is essentially a resort catering to corporate clients who conduct workshops for their staff lasting for one to three days and day out for their staff. Resort is also preferred wedding destination thanks to the huge space it offers. Resort derives its business on regular basis through these events. Besides this Outdoor catering is done for large events including International cricket matches and exhibitions. Resort is preferred for outdoor catering for exhibitions due to locational advantage since International Exhibition Centre is just 3 kms away from the resort. Resort also runs Membership loyalty program for which tie up has been done with an outside agency. Members who enrol for the program enjoy benefits and privileges by paying a fixed fee. Marketing activity has been outsourced to an outside agency that has the responsibility to bring in the business related to rooms and banqueting as well as corporate events like day outs/ Sunday brunch etc. for the entire property. The agency is also responsible for collection of dues from customers. Agency is paid commission on sales effected based on statements submitted each month duly vetted by Finance as well as Front Office manager and F & B manager. Marketing of SPA is not in the scope of agency and business is generated through in house guests and word of mouth. Resort has also tied up with on line portals for generating business for rooms mainly to cater to leisure travellers.

Despite boasting of location and facilities, business has not been encouraging and constantly falls short of budget. Being a resort property, located over vast area, maintenance and upkeep is a challenge. Besides this, frequent breakdowns of equipment due to ageing results in heavy repair and maintenance cost on regular basis. Apart from this there are other issues which are-

- High fixed cost which means Breakeven can be achieved only if occupancy levels are constant at 70%
- Dependence on outsourced marketing activity means continued business is at the mercy of the agency who have other tie up similar to this. Besides this, they constantly complain about the poor up keep and attribute low business to this.
- Choice of wrong agency to run the Loyalty Program who did not market the program properly meant loss of business and wrong choice of members. Membership was sold to all and sundry without verifying their back ground. Membership norms included clearly defined benefits. Agency flouted this by promising benefits beyond the norms. Added to this the Agency did not remit the amount due to

the Resort collected from Members citing some issue or the other. At the same time, they issued cards to Members and authorised them to avail the benefits under the program. Agreement required the agency to share details of Members enrolled on weekly basis with amount collected which they did not comply with properly. This resulted in loss to the Resort and Members who paid the Membership Fee could not be allowed to utilise the benefits since resort did not receive its share of fee leading to bad publicity by prospective members who were made to suffer for no fault of theirs.

- It was found that resort did not have a proper system to monitor the program including number of members, money due and collected, monitoring of utilisation of benefits member wise etc. which posed further challenges.
- Frequent breakdowns meant disruption in service to guests.
- Due to lack of business, much needed expenditure on equipment including replacement was not carried out since management was not willing to commit further infusion of funds from their side.
- Man power in hospitality industry is a challenge with trained manpower difficult to get. This is more so in resort properties which are located away from main city.
- On line agencies who were an added facility to get additional business did not bring in the desired business despite huge potential to market the property as a weekend getaway.
- Resort had given the responsibility of managing its website including comments/ enquiries etc; to an outside agency. This agency did not keep up its commitment fully even though it should be said to their credit that they did what best they could. The fact that the agency was located in a different city did not help matters.
- Due to poor follow up on collections by the marketing agency, realisations were delayed leading to cash flow problems. This resulted in delay in payments to vendors who increased the price of supplies to cover their cost. This meant increase in procurement cost and frequent disruption in supplies.
- Head of departments who were responsible for running the operations could not live up to the challenge and frequent resignations among them added to the problem.
- Added to this resort had to deal with legacy issues arising out of erstwhile owners from the property was acquired. This put pressure on the resources.
- Certain suggestions given to reduce cost and improve operational efficiency like conversion of diesel fired boiler into LPG along with use of improved technology in gas consumption was not implemented. This could have saved the property around 3 million a year in cost.
- Resort also did not have the practice of preparing event wise Profit & Loss Account. Thus, the profit or loss of a particular event could not be ascertained to take informed decision.
- Management accepted all business brought in by Marketing Agency irrespective of its viability.
- Union activity among staff was another destabilizing factor.
- Resort had received Duty Credit Scrip under Serve from India Scheme towards free foreign exchange earned to the tune of 7 million out of forex earnings for three years. Resort could not utilise it properly with almost 50% of the scrip going unutilised. This could have saved the resort valuable duty amount and saved much needed cash.

Exhibit-1

State of hospitality industry

Hospitality Sector is seasonal in nature with months beginning from November to March being busy season followed by a lull period between April to June when business is low and main business is from room occupancy and Food and Beverage sales. Post June the business begins to pick up with an uptick in conference and other events. Hotels need to accordingly plan and use the lean period to carry out all the maintenance and refurbishing required. This is also the time to revisit all the customers and renew contracts as well as conclude business for the year. In addition, competition is a major factor to be taken care of since there are quite a number of 5* hotels including leading brands vying for business. They offer equally attractive facility in terms of rooms/ amenities and banqueting facilities besides locational advantage. Hotels typically get their business from Rooms which in turn ensures business in terms of usage of dining facility, laundry, SPA, Health club etc; In addition F & B sales bring in the additional revenue together with banqueting. Addition of large scale rooms in the city means reduced occupancy levels and reduction in rates since numbers of travellers do not go up proportionately. Important thing to remember in Hotel Industry is concept of inventory that can be held and sold does not exist. If a room does not get sold on a given day, it is business lost for ever.

Exhibit-2

Political environment

This plays a very important role in shaping the business of the hotel and resorts including business and leisure travellers. Uncertainty in political situations, calamities, internal disturbance all contribute to the business uncertainty. Countries routinely issue advisories relating to travel to a particular country based on their assessment of the situation like the one issued by other nations on avoiding travel to India due to the happenings all round due to passage of Citizenship Bill or advisory issued by the Indian Government relating to travel to Iraq. This will mean last minute cancellation of business already concluded resulting in heavy loss.

Exhibit-3

Financial Implications

Hotel Industry, by nature is capital intensive with cost of construction of a good hotel with rooms and amenities varying from as little as ₹10 cr to ₹ 400 cr depending on the category of the property. For example a good 5* hotel with facilities like 3 restaurants, banqueting facilities, health club, swimming pool, shopping area etc. as mandated by Ministry of Tourism for classification purpose requires an investment close to ₹ 150 cr for standalone property. If the property is built in collaboration with leading hotel chain, cost goes up considerably since the hotel needs to meet the standards of the chain including number of rooms and facilities offered. Besides there needs to be payment to the chain towards technical knowhow coupled with management fee on regular basis putting further pressure on finance. Added to this gestation period of hotel industry is long ranging from 5 to 7 years before hotel can hope to make decent profit. Promoters need to have the capacity to withstand this. They should be for long term in the business.

Similarly, in order to have sustained and continued revenue, it is imperative to ensure decent rates on rooms as well as banquets and F & B. Marketing is the key and attempts to sell at any rate just to fill up the facility will not work. Here role of outsourced agency needs to be carefully weighed since they have no interest except to earn their commission and will be dealing with several properties at the same time. Marketing through on line portals has its own pitfalls. Thanks to easy choice available to customer, he picks and chooses the least available rate for booking of room and portals vie with one another to offer discounted rates just to stay in business.

Availability of funds is a big challenge for hotel industry since banks do not lend money easily and insist on high margin from the promoters.

Exhibit-4

Internal Control Systems

In the background of what we have seen above, it is absolutely essential that a hotel has sound operating system like Standard Operating Procedure (SOP) for each area and controls. These SOP's must be constantly reviewed and updated regularly. Regular review of operations including daily review, weekly review of certain areas, monthly review are the need of the hour backed by robust audit mechanism. Systems to monitor each activity like food cost, banqueting, procurement etc; need to be in place so that variance can be analysed and corrective measures initiated where needed.

Descriptive Questions

Management approaches you and requests you to submit detailed report covering the following areas as well as suggestions for rectifying the situation.

2.1 Various risks that the resort is exposed to and consequence thereof. **(5 Marks)**

2.2 Rate the above identified risks and potential of these risks to cause damage to the business.

(5 Marks)

2.3 Action plan to treat the risks including monitoring mechanism. **(5 Marks)**

Multiple Choice Questions

Choose the most appropriate answer from the given options:

2.4 System of controls in the hotel industry helps in

- (a) identifying weak areas as well as risks that require constant monitoring.
- (b) improving the operational efficiency of the hotel.
- (c) reorienting the process.
- (d) All of the above.

2.5 Standard Operating Procedure is a set of

- (a) documents that guides operation of the hotel.
- (b) procedures listing dos and don'ts.
- (c) documents laying down policies and procedure to be followed in operation of the hotel.
- (d) documents that lay down controls to be instituted.

2.6 Financial control in the hotel industry helps in

- (a) identifying financial risks involved in operations as well as investments.
- (b) ensuring better financial management.
- (c) ensuring steady cash flow to run the operations.
- (d) covering whole spectrum of the hotel enabling optimum use of resources.

2.7 Food and beverage costing including event costing helps to

- (a) monitor cost on constant basis

- (b) pinpoint the cost overruns in food consumption and device ways to reduce the cost.
- (c) continuous monitoring food cost including event cost helps in better management of events ensuring decent margin.
- (d) reduces procurement cost thereby helping in reducing food cost.

2.8 Risk based Internal Audit is effective in

- (a) pointing out the deficiencies in operations.
- (b) identifying various risks beforehand and helps in remedying the situation.
- (c) better monitoring of the system including review of SOP's thereby leading to better efficiency in operation.
- (d) All of the above

CASE STUDY: 3

A company in the financial services sector has been fined by the Regulator for various breaches of relevant regulations owing to which they suffered Reputation Loss and Credibility among customers and the public. There is a possibility that some of the Directors and Officers may be penalised and could be sued by the shareholders for losses suffered and wrongs committed. The Board and the Top Management of the company were quite worried about this turn of events as breach of Corporate Governance norms and non-compliance of laws and regulations were not expected to happen in the company.

You have been appointed as the new Chief Risk Officer to review and ensure best practices in Corporate Governance particularly in the areas of compliance, disclosures, consumer protection, management of frauds and financial crime and ethical conduct in the organisation. It is a well understood fact that in the financial services sector, Regulators are active and regulatory risk is one of the major risks faced by companies in this sector. You are also aware that there have been many scandals and collapses in the financial sector world-wide and you share the concern of the Board that it is important to set benchmarks for governance in the company.

Keeping in mind that disclosures are information that is meant for shareholders, consumers who have bought products from the company and for other stakeholders such as employees, agents, other intermediaries and those in the ecosystem of the company, you are asked to reshape the disclosure policy of the company in tune with regulations and best practices.

Consumer protection is increasingly being focused on by Regulators. Consumer Forums, Courts and other bodies raise their voices against customer service deficiencies and penalise companies. They are shamed when such information is circulated in the media. The CRO is asked to ensure that conduct risk is better managed by a cultural change in the organisation.

Fraud and financial crime are on the rise and these can be happening with the connivance of or wholly by employees and even at senior management levels. Cyber-crimes, frauds and losses are becoming common place and there is a need to ensure that systems are security proofed and employees are made aware of the risks. This can be further risk proofed by raising the ethical standards and putting place necessary controls to ensure that the conduct of everyone in the institution is ethical and upright.

You have been asked to advise the Board and draft suitable policies for upgrading corporate governance practices and risk management. To bring about cultural change in areas that is dependent on management and employee conduct. To create a culture that is customer oriented and strongly against violations of regulations. To discourage opaque practices that give rise to arbitrary decisions at operational levels as these work against customers, reputation and bottom line of the company.

Based on such a background and considering the OECD guidelines on corporate Governance, please answer the following questions.

Multiple Choice Questions

Choose the most appropriate answer from the given options:

- 3.1** Corporate Governance risk is intended to identify deficiencies that can damage the following important existential aspects of the company.

Point out the wrong answer.

- (a) Reputation.
- (b) Existence.
- (c) Sales growth.
- (d) Continuity.

- 3.2** A holistic risk management framework would empower the Board to Point out the wrong answer.

- (a) identify top threats to the entity and asset protection measures.
- (b) link risks to more efficient capital allocations and business strategy.
- (c) develop a common language in the organisation for problem solving.
- (d) look back strategy made to ensure that best practices are continued.

- 3.3** Stress Tests are important for Banks and are an important aspect for Board/Corporate Governance oversight. Choose the right reason for conducting Stress Tests from the options given below.

- (a) To deal with natural and manmade asset and disaster risks.
- (b) To manage optimally business and portfolio downside movement.
- (c) To manage political and country risks.
- (d) To prevent fraud risks, malpractices and financial crimes.

- 3.4** 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.

- 3.5** Normally every Board of a company should have a Risk Committee. Among other things the following are the duties of this Committee except one, which?

- (a) Risk Committee discusses every matter in the agenda of the Board prior to the Board Meeting.
- (b) Is required to review and approve the company's risk policies at least annually.
- (c) Discusses all the risk strategies on both aggregate basis and by types of risks.
- (d) Oversees that management has in place robust processes to ensure adherence to the risk policies approved by the Board.

(2 x 5 = 10 Marks)

Descriptive Questions

- 3.6 Explain Corporate Governance referring to OECD guidelines and explain how the Board can shield against Corporate Governance Risks. **(4 Marks)**
- 3.7 What is the type of risk management that is to be initiated by the Board/Management so as to prevent frauds and financial crimes? **(3 Marks)**
- 3.8 How can Credit Risk Management be upgraded to ensure that risk of default is kept to the minimum. **(8 Marks)**

CASE STUDY: 4

M/s. Modern Realty Developers is a partnership concern situated in Chennai. The current project of the firm is construction of 20 luxury apartments in the outskirts of Chennai. Each apartment is identical and the ultimate selling price of each apartment is ₹ 2.50 crores. The project had commenced in April, 2018 and the project completion is scheduled to be completed in September, 2019. Two apartments remained unbooked. A term loan was taken for ₹ 12 crores in April 2018 with no moratorium period.

Key figures:

Item	Projected	Actual
Project Completion	60%	45%
Collections from Customers	₹ 27 Crores	₹ 25 Crores
Term Loan payable to bank	12 installments	10 installments
Payments outstanding towards supply of materials	₹ 2 Crores	₹ 3 Crores
Salaries and Wages payable	Nil	25 lakhs
Outstanding statutory payments	Nil	50 Lakhs

Other issues faced:

- ◆ Workers hired were not adequately skilled.
- ◆ Scarcity of the Raw Material-river sand. Compelled to use substitute- M-Sand.
- ◆ Increase in price of construction materials by 10% over the estimated price.
- ◆ Acute water scarcity in Chennai.
- ◆ Accidents occurred. Workers and the site supervisors did not follow the safety regulations. The construction industry today favours low-cost housing aimed at the middle-class section of people. This is due to the availability of concessions in the form of reduced interest rates, interest subsidy and tax benefits. The workers at the construction site faced dust and pollution problems. The neighbours around the site were complaining about the increasing dust levels.

It was suggested that the workers use protective face masks and spray water to the buildings under construction. Data variables about the (i) dust control measures and (ii) dust levels were collected and correlation between the above two variables was calculated for further analysis.

When preparing the cement mortar, it was decided to use 1 part of cement and 6 parts of sand. Drawing samples from 20 places, where cement mortar was applied, it was found that at 3 places such ratio was not maintained. The management contemplated to provide training in (i) handling the equipment, (ii) work culture, (iii) safety programs.

Funds were earmarked for payment of income-tax. The same was utilized to purchase cement and bricks. Hence the payment of income-tax could not be made on the due date.

The firm received a notice from the bank asking for repayment of the outstanding dues immediately failing which, the bank would take precautionary steps to make the firm to prepay the loan.

Multiple Choice Questions

Choose the most appropriate answer from the given options:

- 4.1** Instance of non-payment of income-tax on the due date would be most likely to show that
- (a) the risk appetite of the firm is lower than its risk capacity.
 - (b) the firm has taken an internal risk.
 - (c) the firm has considered it as a residual risk.
 - (d) the risk appetite of the firm is higher than its risk capacity.
- 4.2** Which of the following is MOST likely the reason that prompted the bank to issue such a notice?
- (a) The bank felt that it is facing Risk Exposure.
 - (b) The bank felt that it is facing Default Risk.
 - (c) The bank felt that it is facing Recovery Risk.
 - (d) The bank felt that it is facing Guarantee Risk.
- 4.3** The proposed action of the management to provide training and safety programs would fall under
- (a) Risk Alternatives.
 - (b) Insurance Alternatives.
 - (c) Operational Alternatives.
 - (d) Strategic Alternatives.
- 4.4** Risk culture requires.....
- (a) continuous efforts of communication
 - (b) building corporate memory
 - (c) shaping the right risk actions
 - (d) All of these
- 4.5** If the tolerable limit for exception was 6% in the case of cement mortar sampling, the most likely conclusion would be that
- (a) the control risk is high.
 - (b) the detection risk is high.
 - (c) the control risk is low.
 - (d) the detection risk is low.
- (2 x 5 = 10 Marks)**

Descriptive Questions

- 4.6** Briefly explain the types of risks faced by the firm. **(6 Marks)**
- 4.7** Prepare a sample risk register on dust and pollution risk faced in the activities of the firm. **(5 Marks)**
- 4.8** Briefly explain the benefits of 'Improved risk measurement and Management' to the management. **(4 Marks)**

CASE STUDY: 5

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.

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

- 5.1 Discuss the SWOT analysis of Sunshine Ltd. (5 Marks)
- 5.2 Briefly explain the political risk to be encountered by Sunshine Ltd. (3 Marks)
- 5.3 Elucidate the types of exposures risks to be encountered by the company. (3 Marks)

5.4 Discuss the efficacy of the Internal Financial Control System of Sunshine Ltd.

(4 Marks)

Multiple Choice Questions

Choose the most appropriate answer from the given options:

5.5 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

5.6 More risk in a project can be incorporated by decreasing

- (a) estimated future cash inflows from the project
- (b) initial investment in the project
- (c) required rate of return of the project
- (d) internal rate of return of the project

5.7 Which of the following risk will not affect foreign exchange rate?

- (a) Investment Risk
- (b) Inflation Risk
- (c) Interest Rate Risk
- (d) Sovereign Risk

5.8 The purpose of Financial Swap is to reduce

- (a) Interest Rate Risk
- (b) Exchange Rate Risk
- (c) Credit Risk
- (d) Both (a) and (b)

5.9 In case if principal or interest payment overdue between 61-180 days then as per RBI's framework for Revisiting Distressed Assets in Economy they are classified in category of

- (a) SMA – 0
- (b) SMA – 1
- (c) SMA – 2
- (d) SMA – 3

(2 x 5 = 10 Marks)

Exhibit 1

Domestic ratings agency ICRA said that the appreciation in the rupee is aggravating the troubles of the Indian IT sector, which is already hit by a change in the market landscape and compressing revenue growth.

It said the industry is already reeling under pressures like uncertain macroeconomic environment, lower deal sizes in digital technologies, cloud adoption and high competitive intensity.

The agency said despite a 8.1 per cent growth in USD revenue, IT players have registered a growth of only three per cent in the second quarter of the current fiscal, due to the rupee appreciation of four per cent during the quarter.

Due to the difficulties on the currency front, the agency said the \$160-billion industry will be able to notch a mid-to-high single digit growth till FY20.

On margins, it said the industry should brace for an impact on margins as price led competition is likely to intensify and will negatively impact the spreads.

"IT Services players profitability also remains sensitive to rupee depreciation vis-a-vis major currencies such as USD, GBP and Euro and the same too will have an impact," it said.

Its vice president Gaurav Jain said future growth will be supported by higher spend on digital technologies, continued cost benefit offered through outsourcing model and market share gains for the Indian IT sector.

"While companies have increased spending on digital technologies and awarding new contracts, the overall IT budgets have moderated leading to lower incremental spends," he said.

He, however, warned that an increase in the global IT market, which moved up to 67 per cent in 2016 from 60 per cent in 2012, will be limited as Indian IT Services companies, which are in the midst of re-orienting their business models focusing more on higher-end services such as IT consulting and digital, are lagging behind the competition.

"We expect large Indian IT companies to grab a higher share of the digital services space over the next three years," he said.

From a vertical standpoint, manufacturing is outperforming with a 5.8 per cent growth but the largest revenue contributor of banking and financial services has shown a muted trend over the last few quarters on macroeconomic conditions including factors like Brexit.

Over the next decade, the agency expects consolidation in the sector due to the margin pressures.

The rating agency, however, said that despite the pressures on growth and profitability, credit profile for the sector will remain stable.

(Extract from Economic Times)

Exhibit 2

The U.S. government is toughening up the process for renewing a popular foreign work visa.

This week, U.S. Citizenship and Immigration Services advised its officers to "apply the same level of scrutiny" to extension requests for the H-1B visa, among other sought after visas.

In other words, officers are instructed to review requests for renewal as thoroughly as they would initial visa applications.

The H-1B is a common visa pathway for high-skilled foreigners to work at companies in the U.S. It's valid for three years, and can be renewed for another three years. It's a program that's particularly near and dear to the tech community, with many talented engineers vying for one of the program's 85,000 visas each year.

The directive rescinds the previous guidance, which gave "deference" to previously approved visas "as long as the key elements were unchanged and there was no evidence of a material error or fraud related to the prior determination."

"This updated guidance provides clear direction to help advance policies that protect the interests of U.S. workers," said new USCIS Director L. Francis Cissna, who was sworn in this month. President Donald Trump announced his intent to nominate Cissna last spring.

In April, Trump directed federal agencies to implement a "Buy American, Hire American" strategy, which included proposing new rules and guidance for preventing fraud and abuse of work visas. The H-1B program, in particular, is one that President Trump has eyed for reform, criticizing abusers of the program who use the visa to replace American workers.

Other visas impacted by the new guidance include L-1, for intracompany transfers, TN for Canadian and Mexican citizens, and O-1, for those with "extraordinary abilities."

Some say the new policy will be unnecessarily burdensome and is aimed at limiting foreign workers.

Betsy Lawrence, the director of government relations for the American Immigration Lawyers Association, told CNN Tech that the previous guidance made it efficient to review cases. Even then, USCIS had the authority to question prior decisions and request additional information in reviewing extensions.

"We are going to much greater scrutiny of these cases, and thus delays, even when the underlying facts have not changed," Lawrence told CNNMoney.

Immigration attorney Chris Wright of The Wright Law Firm told CNNMoney that it fits a broader pattern: "It seems clear that USCIS have been instructed to push back wherever they can..." he said, noting that "the prevailing attitude seems to be, 'How might we be able to deny this petition?'"

(<http://money.cnn.com/2017/10/25/technology/business/h1b-visa-renewal-uscis/index.html>)

Exhibit 3

Effect on IT sector due to Brexit

The Indian IT sector, faced with multiple challenges, is already bracing itself for a tough ride with US tightening its visa norms. Brexit only adds to the growing uncertainty in the business environment for the IT companies. Of the \$108-billion of the IT industry's estimated exports in 2015-16, 17 per cent was to the UK and about 11.4 per cent to other nations within the EU. For large Indian IT companies, over a fourth of their revenues come from Europe, in particular from the UK.

Currency has always been a wild card for the IT sector. Wild swings in the pound vis-à-vis dollar and the rupee, will also impact revenues and profits for Indian IT companies. The British pound revenues make for 10-15 per cent of the overall revenues in the case of TCS, Tech Mahindra and Wipro. For Infosys, GBP revenue makes for 6.7 per cent of the overall revenue.

With pound depreciating sharply over the past year, dollar revenues of Indian IT companies have been under pressure. The pound has also depreciated over 20 per cent against the rupee. This can reduce cost arbitrage for companies outsourcing to the UK.

(Extract from Hindu Business Line)