# PAPER – 6A: RISK MANAGEMENT

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 has an outdated computerized accounting system which does not lock out the changes made after the month end.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

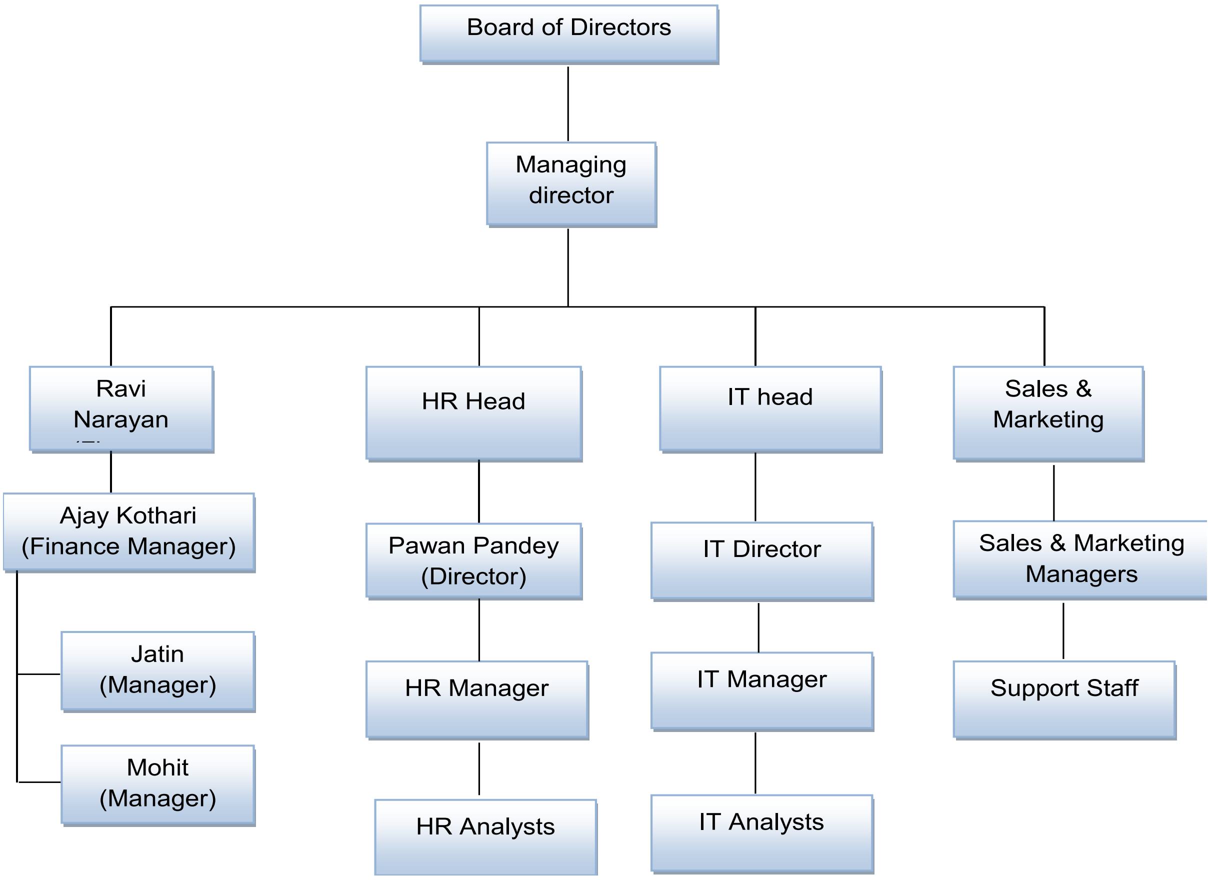
On the Human Resource front, to overcome the problem of retaining the sales employees, the company has recently hired Pawan as the HR director who is known for developing good HR policies to manage people effectively and motivate them to perform well.

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.

## A. 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)**

(iv) Course of action to be followed to treat these risks. **(5 Marks)**

(v) Matters on which Risk Governance Framework can define a policy statement. **(5 Marks)**

(vi) Risk Maturity Level and reasons for the same. **(5 Marks)**

**B. Multiple Choice Questions**

1. 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. 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

3. 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 it 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.

4. 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

5. 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

6. Technique involving acceleration of payments of hard currency and delaying payments of soft currency payables to hedge forex exposure is called

   (a) Netting

   (b) Managing Blocked Funds

   (c) Leading and Lagging

(d) None of these

7. Which of the following option gives the effect of it purchases into a floating rate of interest that is bounded on both high side and the low side?

   (a) Cap Option

   (b) Floor Option

   (c) Collar Option

   (d) Swaption

8. Which of the following exposure measures the effect of fluctuations in foreign exchange rate on the value of the firm?

   (a) Transaction Exposure

   (b) Translation Exposure

   (c) Economic Exposure

   (d) Industry Exposure

9. 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

10. Which of the following action is called hedging?

   (a) Protection of a profit already made from having undertaken a risky position

   (b) Making profit by accepting risk

   (c) Reducing or eliminating exposure to risk

   (d) None of these **(10 x 2 = 20 Marks)**