

ELECTIVE PAPER 6A: RISK MANAGEMENT

SUGGESTED SOLUTION

Case study 2

Note: Please note these solutions are for guidance purpose only.

(A)

To: The Board

From: ABC, Risk Consultant

Date: 6th April 2018

Subject: Risk Management

Our Report on the various issues raised is as follows:

(i) **The possible Risks and their nature are as follows:**

- **Financial risk** - These risks are associated with the financial assets, structure and transactions of the particular industry. In other words, these risks are related specifically to the processes, techniques and instruments utilised to manage the finances of the enterprise, as well as those processes involved in sustaining effective financial relationships with customers and third parties.
- **Operational Risk** - These risks are associated with the on-going, day-to-day operations of the enterprise. In other words, these risks associated with the operations of an organization. It is the risk of loss resulting from failure of people employed in the organization, internal process, systems or external factors acting upon it to the detriment of the organization. It includes Legal Risk and excludes strategic and Reputational Risks as they are not quantifiable.

(ii) **Scaling of Risk as identified above:**

- **Measurement of the likelihood of risk**

Financial Risk – Likely (score 4)

Operational Risk – Likely (score 4)

- **Risk Consequences**

Financial Risk – Major

Operational Risk – Major

(iii) **Four approaches are suggested to identify and assess the risk as below:**

- **Analysis of processes** – Under this technique, material or significant business processes are flow chartered. This will facilitate identification of process level operational risks. An approach that helps improves the performance of business activities by analysing current processes and making decisions on new improvements.
- **Brainstorming** – Under brainstorming a group of employees put forward their ideas or sensation of risk. The employees estimate the risk based on their past experience or intuition involves a focused group of managers working together to identify potential risks, concerns, root causes, failure modes, hazards, opportunities and criteria for decisions and/or options for treatment. Brainstorming should

stimulate and encourage free-flowing conversation amongst a group of knowledgeable and focussed people with a fair/objective outlook. The group should not be biased or critical. It is one of the best and most popular ways to identify both risks and key controls and is the basis for most successful risk workshops.

- **Questionnaires & Interviews** - Focused on detecting the concerns of staff with respect to the risks or threats that they perceive in their operating environment. During a Structured interview, interviewees are asked through a set of prepared questions to encourage the interviewee to present their own perspective and thus identify risks. Structured interviews are frequently used during consultation with key stakeholders when designing the risk management framework. Structured interviews are good to assess risk appetite and tolerance when developing risk appetite statements. A specialist in risk prepares interviews with various management level members of the company in order to elicit the concerns.
- **Checklists** are information aids to reduce the likelihood of failures from potential hazards, risks or controls that have been developed usually from past experience, either as a result of a previous risk assessment or as a result of past failures or incidents or history or industry learning. Auditors often prepare checklists of key controls to aid in their assessment of control effectiveness and the internal control environment. Checklists are good guiding tools; however, can lead to herd mentality and risk managers can miss out on fresh risk thinking and the big picture.

Note: Students can also mention any four techniques other than above.

(iv) Suggested course of action to reduce/ manage risk i.e. risk treatment is as follows:

- Strengthening of Internal Controls System
- Setting up limits for the sanction of amounts.
- Setting up operational risk management department.

Note: Students can also mention other course of action based on their work experience.

(v) The Risk Management (Governance) Framework should define a policy statement on the following matters:-

- (i) Determining when to review the Risk Management Framework (RMF) and the frequency for undertaking the review.
- (ii) Deciding who is responsible for the review. The RMF is generally reviewed by the Audit Committee or a team of Directors. Once in few years the RMF can be reviewed with external facilitation. This would provide fresh insights and benchmarking information to the Board.
- (iii) Selecting the scope and method for a review. The scope and boundary of the RMF review can be clearly set out along with the most suited method for review.
- (iv) Manner of circulation of results.

(vi) The risk maturity level of the company is "Risk Aware". The reason is that the risks are identified within functions and not across processes. Also, risks are not communicated across the enterprise. It is basically a scattered silo based approach to risk management.

B. Answers to Multiple Choice Questions

1. (b)
2. (d)
3. (d)

4. (b)
5. (c)
6. (c)
7. (c)
8. (c)
9. (a)
10. (c)