

CA FINAL

RISK MANAGEMENT

NOV 2020

PAPER ANALYSIS

CASE STUDY 4

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The Risk Management paper of CA Final Nov 2020 Exam was considered to be a challenging paper by most students who appeared for the Exam. It was challenging in the sense that people could not find the answers from the mapping sheet in the ICAI Study Mat. It was challenging in the sense that most of the questions were applicative wherein:

- you know where the Risk Register topic is in the study mat, but you have to write something else
- you know where RCSA is in study mat, but you have to write about the **application** of RCSA in that particular case study
- you know what is strategic risk—you can pretty much find it in the study mat, but you have to talk about the **key drivers** of strategic risk.

So, it was applicative-applicative-applicative all through out. Even the MCQs were more-or-less related to the case study and not to be found from the institute's mat. All case studies required use of the exam taker's brain & judgement rather than just reproducing content from the mat. My question to you is--- isn't that what case studies actually mean and should be like???

So, people were obviously surprised because they could not find the arbitrage opportunity that was there in the previous RM papers to date.

Was it different for other elective papers?

No, even the other elective paper have the same status. But RM is in the limelight more because most people are doing RM these days and they have heard stories of people enjoying arbitrage in the past. As students of the RM paper, you will understand and acknowledge that markets are efficient and arbitrage itself leads to wiping out of the available opportunity. You, as budding CA's with RM as your elective (or specialization) have to now upgrade your levels. You got to understand that ICAI's study mat and mapping-sheet are now matters of the past and just a hoax now forth. These wouldn't help you on standalone basis now—that's guaranteed. What's required of you now is that whatever topic you are doing-- along with in-depth knowledge of it, you got to keep an open mind about its concept—use your brain, general understanding & common sense involved in the topic--- be it regarding Risk Based Internal Audit, be it risk and control matrix (RCM), risk management strategies, reputation risk, governance risk, enterprise risk management, risk maturity of an organization or any other concept.

So this paper is causing a sea- change in the way in which Risk Management paper shall be set in future.

I have carried out a deep analysis of each & every Case Study-- provided multiple answers wherever there was a scope of ambiguity. It's a subjective paper and the answers are based on my judgement and are not provided by ICAI. As always, confusion arises (and will arise) when ICAI comes out with their suggested answers.

When they do, please look at them in detail and remember that ICAI's answers are supposed to be given more importance (even if it defies logic) than the answers that I have reproduced below.

Note:

- ✓ **For Jan 21 exam, I will be sharing a number of insights in the coming days.**
- ✓ **Also, I have already announced fresh batches in both English and Hindi for RM to begin from 4th Jan Live at Home on the Ulearn Portal. These are obviously for the May 21 exams and beyond.**

STAY TUNED ON SSEI QFORUM
FOR ANALYSIS OF CASE
STUDIES 5

CA FINAL RISK MANAGEMENT

NOV 20 PAPER ANALYSIS

Case Study 4: Famous Textiles Limited (FTL)

Synopsis

- FTL manufacturing and selling export varieties of Textile home furnishings.
- High growth rate of revenue but falling GP and EBIT – auditor pointed out that such decline in profits may be due to faulty processes in the operations
- Appointment of RM specialist Ms Meena –

Meena's Analysis

- Company uses Monit App to record movement of Goods with respect to vendors and suppliers.
- Several process bottlenecks in operations.
- Service providers not provided with proper specifications.
- Lack of Co-ordination of various departments
- Excess production resulting in substantial losses
- A peculiar incident where Rs.20,000 cheque issued but Rs.2,00,000 paid by Bank – later rectified.
- Virus attack on Computer Systems.

Meena's Suggestions

- Prepare RM checklists as per ISO 31000
- Avail of a term loan and WC loan
- Use RCSA
- Use CRA
- Appoint Internal Auditors
- Regular meetings between managements and departmental heads

MULTIPLE CHOICE QUESTIONS

4.1. D is correct.

This is a direct question from page 5.17 – various quantitative tools are given – infact, 6 tools are given –

- Corruption Perception Index
- Democracy Index
- Freedom in the World
- Gini Coefficient
- Global peace Index
- Human Development Index.

There is no such term called Event Driven Index

Sanjay Sir's comment :

For this type of question, we need so called "Mapping Sheet". However, you'll hardly find this level (I mean low level) in more than 20% of the Paper. What preparation does it require? – Obviously nothing!! You have the mapping sheet – open the book and go into the particular page. No teaching required over here – YouTubers are sufficient.

In fact in SFM as well as FSCM, there is a particular type of Hedge Fund Strategy known as "Event Driven Strategies" where, the fund manager specializes in generating Alpha from major corporate events such as M&A. Average performance would have been excellent.

4.2. D is correct.

The additional task assigned by the management to Meena is that of assessing the post loss Risk management. This means once an organization suffers a loss, the loss is supposed to be identified, quantified, reported and corrective actions are to be taken as detailed in Page 9.28 to 9.32 of the ICAI Study mat.

What is the purpose of assessing RM at the post loss stage?

Obviously it is to review the available RM procedures – are they operating efficiently and effectively?

Sanjay Sir's comment :

The question is difficult – requires judgement. Average performance would have been poor.

4.3. C is correct

Option A talks about taking Photostat Copies of all the cheques – this wouldn't help because even the photocopy will reveal the amount of Rs.20,000.

Option B talks about printout of bank statements – this wouldn't help as there are thousands of entries in a bank statement muddled together and if human eye was capable of straightaway finding out which one is erroneous or additional or missing – BRS would never be required.

Option D talks about verifying the voucher. This wouldn't help as the voucher is of Rs.20,000 and payment is of Rs.20,000. So, our accounting is correct – Bank has committed a mistake. You need BRS.

Sanjay Sir's comment :

This question is based on common sense. Average Performance would have been good.

4.4. B is correct.

Option A i.e. Employing an updated packet filter of Firewall with strict employee access control privileges in all the computers – this will only protect our systems from Internet Based Virus. Virus attack can still take place from the use of USB device, Hard-disk, etc.

Option C and D are ruled out by common sense.

Sanjay Sir's comment :

This is a beautiful question – Hats off to ICAI!! Average performance would have been Average.

4.5. D is correct

It is a straightforward question from Page 3.8 – ISO 31000 - a clear gift!

Sanjay Sir's comment :

No Comments!! Jai Ho Mapping Sheet!!!

Average Performance would have been excellent.

DESCRIPTIVE QUESTIONS

4.6. Sample RCSA Entry

RCSA Register

- **Process** : Outsourcing Management Process
- **Sub-Process** : Calendaring/Designing/Printing or Stitching
- **Inherent Risk Description** : Risk of service provides failing to meet the deadlines in time schedule.
- **Probability Rating** : High (9 out of 10) due to several bottlenecks in process, wrong item/designs sent / lack of coordination.
- **Impact Rating** : Intermediate (7 out of 10) grading due to loss of revenue/delay in order execution/ Stretched use of working capital.
- **Risk Type** : **Financial Risk** due to delay in order completion stretched working capital.
- **Control Description**: Establishing strict monitoring mechanism within the "monit" app to identify any delay in time schedule by a vendor or prompt basis & alert management at the earliest. It would allow elimination of vendors who repeatedly miss deadlines.
- **Control Type** : Exception Triggers
- **Control Owners** : Operation Managers/Vendor Manager
- **Control Test Steps** : Use sampling to indentify existing over-due time schedules and upcoming deadlines.
- **Test Result** : High number of missed deadlines
- **Residual Risk Rating** : High since test result are poor

4.7. Altman Z score is given by :

$$Z\text{-Score} = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 1.0X_5$$

Where:

- $X_1 = \text{working capital} / \text{total assets} = 1/21$
- $X_2 = \text{retained earnings} / \text{total assets} = 1/21$
- $X_3 = \text{earnings before interest and tax} / \text{total assets} = 2/21$
- $X_4 = \text{market value of equity} / \text{total liabilities} = 2/6$
- $X_5 = \text{sales} / \text{total assets} = 150/21$

Therefore, we get $Z = 7.78$

Sanjay Sir's comment :

This is a direct question from page 6.26. I had also revised the same in my audio podcasts. You require real calibre to get it wrong. Average performance would have been excellent.

4.8. Importance of Risk management.

Governance functions include planning and budgeting, performance measurement, assurance and auditing, procurement, hiring, assessing staff as well as control over all day-to-day operations. The management of an organization, enabled by its governance arrangements, can be described as “coordinated activities to direct and control an organization”. Risk management is defined as “coordinated activities to direct and control an organization with regard to risk”. The parallels between these two statements demonstrate how closely risk management and governance are linked.

Risk Management is one of the important pillars of Governance and arguably the only tool to deal with business uncertainty. Risk Management is used most successfully by Fortune 500 and other large companies to sustain and grow their businesses. Risk management is recognised as an integral component of good management and governance. It is an iterative process consisting of steps, which, when undertaken in sequence, enable continual improvement in decision making.

Risk management is the term applied to a logical and systematic method of establishing the context, identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process in a way that will enable organisations to minimise losses and maximize opportunities.

Risk management is as much about identifying opportunities as avoiding or mitigating losses.

Risk consequences can be fatal to any business. The expenditure of fixing damage and/or the loss of valued assets or even customers to competition after a catastrophe can have a significant impact on the bottom line of a business. By identifying and managing risks entities are able to actively protect value from any potential catastrophes and save valuable time and money. A risk management plan and system is there to do more than identify risk, a good system should also quantify the risk, predict the impact, and put procedures in place to mitigate the risk, or even eliminate it to the extent possible.

The benefits of risk management plan

What are the benefits of a risk management plan?

- Saving valuable resources: time, income, assets, people and property can be saved if fewer claims occur
- Creating a safe and secure environment for staff, visitors, and customers
- Reducing legal liability and increasing the stability of your operations
- Protecting people and assets from harm
- Protecting the environment
- Reducing your threat of possible litigation
- Defining your insurance needs to save on unnecessary premiums

The absence of effective risk management participation at the Board level encourages herd mentality and the acceptance of status quo. Effectively defining and managing risks that matter is a key element for survival and sustained growth. It empowers the Boards to build business resilience and the maturity to manage risk priorities. This ultimately results in greater predictability of performance and higher value creation for shareholders. A holistic risk management framework would empower Boards to:

- Identify top threats to entity and asset protection measures.
- Link risks to more efficient capital allocations and business strategy.
- Develop a common language in the organisation for problem solving.
- Effectively respond to an evolving business environment.

It is wise to learn from history and risk scenarios than experience business catastrophe. Boards may be better prepared by reviewing the risk profit & loss statement along with the financial profit & loss statement to determine the health of their entities.

Insurance and risk management systems

Purchasing the appropriate insurance coverage for the business is an important element of the risk management plan, but it's not enough by itself. Organisation must have policies and procedures in place to reduce risks to

ensure your assets, reputation, financial security and operations can continue without interruption.

Insurance companies may view an organization more favourably if there is a stable risk management plan in place to minimize the impact of potential claims. It could even help in qualifying for reduced insurance premiums.

Risk management is an essential business activity for enterprises of all sizes. Enterprises that manage risks effectively will thrive and produce high quality products or services.

Sanjay Sir's comment :

No Comments !! – I am embarrassed on behalf of ICAI, but obviously happy for students. Average performance would have been excellent.