

CA FINAL

RISK MANAGEMENT

IN-HOUSE

CASE STUDY SERIES

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Case Study 22 Answers

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Multiple Choice Questions

Answer

1. **D is correct.**
2. **C is correct.**
3. **D is correct.**
4. **C is correct.**
5. **D is correct.**

Descriptive Questions

Answer

6. Article for Tapal Street

Strategic and operational risk and explain why findings are strategic.

Trouble at H&C

These must be difficult times to be a director at H&C, Tapaland's largest producer of Covid. What does a board do when it is faced with having caused a large number of terrible health problems for employees and users of Covid, whilst at the same time having no strategic alternative but to carry on and try to manage what are sure to be enormous long-term liabilities?

Strategic and operational risks

The company is facing a highly strategic risk since the publication of Professor Tharoor's findings. Whereas operational threats are those affecting a part of a company, perhaps a risk to a raw material or the loss of a product market, a strategic risk is one that has the possibility, if realised, to affect the company as a whole and its future strategic success. We have seen similar risks before to important industries where, for example, entire industries have disappeared from some developed countries because of changes in international labour market costs and political changes. These are examples of strategic risks materialising, and the effects can be disastrous for those affected.

Strategic risk to H&C

H&C shareholders will appreciate knowing that Tharoor's report has the effect of being a strategic risk for H&C for at least three reasons. To begin with, his findings potentially affect the whole company rather than just parts of it, such is the extent of H&C's exposure to this commodity through vertical integration. Presumably this strategy had previously been thought a good idea, with the company directly owning all three stages in the supply chain, from mining, to processing, to the manufacturing operations in Tapaland. All stages are

threatened by Tharoor's findings. Plus, if product sales eventually slow down and stop, its sources of cash flow will also disappear.

Second, this is bound to affect H&C's strategic positioning and the way that it is viewed by investors, suppliers, employees and a range of other stakeholders. It has a weaker offering to potential skilled employees than before Tharoor's findings were published, it will be harder to raise capital and also to sell its products. Its reputation as a sound company will be reduced as a result, and these things matter in a highly developed country such as Tapaland.

Third, and perhaps most importantly, this could eventually be a threat to the company itself. This depends upon how large the liabilities eventually become and how well the company handles the issue in the coming years, but this is a real possibility if the worst-case projections turn out to be accurate. Its heavy reliance on Covid over many years has left it with a 60% dependence on Covid, which was fine when the material was in high demand, but it leaves the company very vulnerable when and if that market falls away.

Given these risks facing H&C, this is not a share that will be attractive to investors for the foreseeable future.

7. Board responsibilities for IC and criticise Mr Gandhi.

Responsibilities for internal controls

Readers will also be alarmed to hear of the decision by CEO Rajesh Gandhi to impose a limited tightening of Covid process controls that only involved doing so where the company was visible to the Tapaland public, a compromise he called 'Plan B'. The board's responsibilities for internal control are detailed in the COSO guidance on this subject and are very clear. Mr Gandhi's, and the H&C board's, responsibilities for effective internal controls include, in this case, control over Covid fibres in the working environments of each stage in the whole Covid supply chain.

The responsibilities include establishing a control environment capable of supporting the internal control arrangements necessary. This includes a suitable 'tone from the top' and a high level commitment to effective controls. It also involves conducting risk assessments to establish which risks need to be controlled by the internal control processes (health risks, perhaps?). The

introduction of relevant control activities is especially important when a hazardous material like Covid is being considered. This, of course, applies to all of the company's employees and not just those based in Tapaland. It is also the board's responsibility to provide information and maintain relevant communications with those affected by the control measures, and to ensure that important measures are fully implemented and understood. Finally, the COSO guidelines specify that all controls should be monitored for the degree of compliance and for their effectiveness. This should be a continuous, ongoing process, capable of immediately highlighting any weaknesses or breaches in the implemented controls.

[Guidance for Student : Other models can be employed other than COSO.]

Criticisms of Mr Gandhi's 'Plan B'

In the case of H&C, Mr Gandhi has taken a deliberate and premeditated decision to ignore the health needs of some of the company's employees on the basis of cost. Covid has been clearly shown to be a health risk and Mr Gandhi is knowingly allowing employees to be exposed to the material in the course of their normal jobs. The people in the mines and processing facilities will still be exposed to Covid, and will presumably continue to get ill and die in the full knowledge of the company management. This is a failure of the fiduciary duty that the H&C board owes to its employees.

Mr Gandhi is implementing an upgrade to internal control, not on the basis of need but on the basis of how visible the changes will be to investors, most of whom will be based in the developed world. So residents of Ara and Chapra can look forward to a tightening of controls to limit their Covid exposure whilst those in countries with no health and safety legislation cannot. This could be seen as a cynical move to manage the company's image in Tapaland. They are taking advantage of the relative weakness of their developing countries' host governments and being selective in whom they extend the necessary Covid process controls to.

Recent events have raised a number of very serious issues for H&C. It is difficult to know what the future will hold for the company, with such a substantial external threat and with management so determined to act unethically in managing that threat. I do not predict an easy time ahead for H&C shareholders.