CA FINAL

RISK MANAGEMENT

IN-HOUSE

CASE STUDY SERIES

-By Sanjay Saraf Sir

Case Study 22 Questions

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Case Study

H&C is a long established listed company based in Tapaland, a highly developed and relatively prosperous country. For the past 60 years, H&C has been Tapaland's largest importer and processor of a product named Covid, a compound used in a wide variety of building materials, protective fabrics and automotive applications. Covid is a material much valued for its heat resistance, strength and adaptability, but perhaps most of all because it is flexible and also totally fireproof. It is this last property that led to the growth of Covid use and made H&C a historically successful company and a major exporter.

Covid is mined in some of the poorest developing countries where large local communities depend heavily on Covid mining for their incomes. The incomes from the mining activities are used to support community development, including education, sanitation and health facilities in those developing countries. The Covid is then processed in dedicated Covid facilities near to the mining communities, supporting many more jobs. It is then exported to Tapaland for final manufacture into finished products and distribution.

Each stage of the supply chain for Covid is dedicated only to Covid and cannot be adapted to other materials. In Tapaland, H&C is the major employer in several medium-sized towns. In Ara, for example, H&C employs 45% of the workforce and in Chapra, H&C employs 3,000 people and also supports a number of local causes including a children's nursery, an amateur football club and a number of adult education classes. In total, the company employs 15,000 people in Tapaland and another 30,000 people in the various parts of the supply chain (mining and processing) in developing countries. Unlike in Tapaland, where health and safety regulations are strong, there are no such regulations in most of the developing countries in which H&C operates.

Recently, some independent academic research discovered that Covid was very harmful to human health, particularly in the processing stages, causing a wide range of fatal respiratory diseases, including some that remain inactive in the body for many decades. Doctors had suspected for a while that Covid was the cause of a number of conditions that H&C employees and those working with the material had died from, but it was only when Professor Suresh Tharoor discovered how Covid actually attacked the body that the link was known for certain. The discovery caused a great deal of distress at H&C, and also in the industries which used Covid.

The company was faced with a very difficult situation. Given that 60% of H&C's business was concerned with Covid, Professor Tharoor's findings could not be ignored. Although demand for Covid remained unaffected by Tharoor's findings in the short to medium term, the company had to consider a new legal risk from a stream of potential litigation actions against the company from employees who worked in environments containing high levels of Covid fibre, and workers in industries which used Covid in their own processes.

In order to gain some understanding of the potential value of future compensation losses, H&C took legal advice and produced two sets of figures, both describing the present value of cumulative future compensation payments through litigation against the company. These forecasts were based on financial modelling using another product of which the company was aware, which had also been found to be hazardous to health.

	In 5 years Tapa (M)	**In 15 years Tapa (M)**	**In 25 years Tapa (M)**	**In 35 years Tapa (M)**
Best case	5	30	150	400
Worst case	20	80	350	1,000

The finance director (FD), Radha Kapoor, informed the H&C board that the company could not survive if the worst-case scenario was realised. She said that the actual outcome depended upon the proportion of people affected, the period that the illness lay undetected in the body, the control measures which were put in place to reduce the exposure of employees and users to Covid, and society's perception of Covid as a material. She estimated that losses at least the size of the best case scenario were very likely to occur and would cause a manageable but highly damaging level of losses.

The worst case scenario was far less likely but would make it impossible for the company to survive. Although profitable, H&C had been highly geared for several years and it was thought unlikely that its banks would lend it any further funds. Radha Kapoor explained that this would limit the company's options when dealing with the risk. She also said that the company had little by way of retained earnings.

Chief executive officer, Rajesh Gandhi, commissioned a study to see whether the health risk to H&C workers could be managed with extra internal controls relating to safety measures to eliminate or reduce exposure to Covid dust. The confidential report said that it would be very difficult to manage Covid dust in the three stages of the supply chain unless the facilities were redesigned and rebuilt completely, and unless independent breathing apparatus was issued to all people coming into contact with Covid at any stage. FD Radha Kapoor calculated that a full refit of all of the company's mines, processing and manufacturing plants (which Mr Gandhi called 'Plan A') was simply not affordable given the current market price of Covid and the current costs of production. Rajesh Gandhi then proposed the idea of a partial refit of the Ara and Chapra plants because, being in Tapaland, they were more visible to investors and most other stakeholders.

Mr Gandhi reasoned that this partial refit (which he called 'Plan B') would enable the company to claim it was making progress on improving internal controls relating to safety measures whilst managing current costs and 'waiting to see' how the market for Covid fared in the longer term. Under Plan B, no changes would be made to limit exposure to Covid in the company's operations in developing countries.

Radha Kapoor, a qualified accountant, was trusted by shareholders because of her performance in the role of FD over several years. Because she would be believed by shareholders, Mr Gandhi offered to substantially increase her share options if she would report only the 'best case' scenario to shareholders and report 'Plan B' as evidence of the company's social responsibility. She accepted Mr Gandhi's offer and reported to shareholders as he had suggested. She also said that the company was aware of Professor Tharoor's research but argued that the findings were not conclusive and also not considered a serious risk to H&C's future success.

Eventually, through speaking to an anonymous company source, a financial journalist discovered the whole story and felt that the public, and H&C's shareholders in particular, would want to know about the events and the decisions that had been taken in H&C. He decided to write an article for his magazine, Tapal Street, on what he had discovered.

Multiple Choice Questions

(2 ò 5 = 10 Marks)

1. Which of the following is does not give rise to significant deficiencies that can impact the reputation, existence and continuity of the organization?

A. Boards have incomplete understanding of the risks faced by the company

B. Boards receive information that is short-term

C. Unauthorized related party transactions

D. Risk managed on an enterprise basis and adjusted to corporate strategy

2. As per SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, which of the following risk management disclosures is not mandatory for listed entities in India.

A. The listed entity shall lay down procedures to inform members of board of directors about risk assessment and minimization procedures

B. The board of directors shall be responsible for framing, implementing and monitoring the risk management plan for the listed entity

C. Under disclosures in Annual Reports applicable to all listed entities including banks : Management Discussion and Analysis - discussion on the matters within the limits set by the listed entity‘s competitive position.

D. Under minimum information to be placed before the Board on a quarterly basis- Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material.

3. The Board of Directors

A. discusses all risk strategies on both an aggregated basis and by type of risk

B. reviews the audits of internal controls over the risk governance framework established by management to confirm that they operate as intended

C. are actively involved in key decision-making processes from a risk perspective (e.g., the review of the business strategy/strategic planning, new product approvals, stress testing, recovery and resolution planning, mergers and acquisitions, funding and liquidity management planning) and can challenge management’s decisions and recommendations

D. sets the tone from the top, and seeks to effectively inculcate an appropriate risk culture throughout the firm

4. The majority of the cases reported so far under cyber security refer to ……………., alone, whereas cyber security for ………………. sectors is equally important.

A. Financial institutions; Education Sector

B. Infrastructure Sector; Financial Institutions

C. Financial Institutions; Infrastructure

D. Infrastructure Sector; Edu-tech sector

5. Enterprise risk governance framework incorporates:

A. The Risk Appetite Framework (RAF)

B. The Risk Appetite Statement (RAS)

C. The Risk Limits

D. All of the above

Descriptive Questions

Writing as the journalist who discovered the story, draft a short article for the magazine Tapal Street. You may assume the magazine has an educated readership. Your article should achieve the following:

6. Distinguish between strategic and operational risk and explain why Professor Tharoor's findings are a strategic risk to H&C;

(7 Marks)

7. Discuss the board's responsibilities for internal control in H&C and criticise Mr Gandhi's decision to choose Plan B.

(8 Marks)