RSK2601
EXAM PACK

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MAY/JUNE 2016

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ENTERPRISE RISK MANAGEMENT

SECTION B: ESSAY QUESTIONS

ANSWER ALL QUESTIONS IN THE SPACES PROVIDED

QUESTION1-INTRODUCTION TO ENTERPRISE RISK MANAGEMENT (14MARKS)

Mrs Jacobs has just been appointed as the new CEO of CALL 4U Ltd.She approaches you as the risk manager to gain a better understanding of the implementation of enterprise risk management (ERM) within the company

Compile a report addressed to Mrs Jacobs in which you explain the elements of an ERM structure

I) Corporate governance (board oversight)

-Corporate governance refers to a framework of rules and practices by which a board of directors ensures Accountability, fairness and transparency in a company's relationship with all its stakeholders (financiers, customers, management, employees, government and the community.

-The corporate governance framework consists of the following:

.Explicit and implicit contracts between the company's and the stakeholders for the distribution of responsibilities, rights and rewards

.Procedures for reconciling the conflicting interests of stake holders in accordance with their duties, privileges and roles

.Procedures for proper supervision, control and information flows to serve as a system of checks and balances

ii) Internal controls

-It refers to the process that is effected by a company's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

-Reliability of financial reporting

-Compliance with applicable laws and regulations

-Effectiveness and efficiency of operations

iii) Implementation

-Implementation of risk can be resourced internally or externally. The parameters of any planned actions have to be communicated, mapped and agreed so that time factor, resources, costs, inputs and deliverables are understood.

IV) Risk Management Framework

-Risk management framework is a conceptual structure that is used to address the risks that are faced by an organisation.

-The purpose of the risk management framework is to assist an organisation in integrating risk management into its management process so that it becomes a routine activity. The frame work consists of the following five steps:

A) Mandate and commitment-Risk management must come from the top down in an organisation. (Organisation Management)

B) Design framework-Understanding the organisation and its context, establishing the risk management policy, embedding risk management in all of the organisations practices

C) Implement framework-Timing of implementation of framework should be planned and training sessions is required

D) Monitor Framework-Periodically review internal and external stakeholders whether the risk management framework, plan, policy and process require amendments

E) Improve Framework-Based on the results of the monitor process, decision should be made on whether the risk management framework step should be amended

5) Risk management policy

-A Risk management policy sets out how the risks, which have been identified by the risk assessment procedure, will be managed and controlled. The risk management policy assigns responsibility for performing key tasks, establishes accountability with appropriate managers, defines boundaries, limits and formalises reporting structures.

6) Risk management Process
-It essentially applies management policies, procedures and practices to a set of activities that are intended to establish the context, communicate and

consult with stakeholders and identify, analyse, evaluate, treat, monitor and review the risk. All the processes are repeated throughout the organisation up to the implementation of the risk response actions

7) Sources of Risks

-A risk source is where risk originates and the risk source has the intrinsic potential to give rise to a risk.

QUESTION 2- ENTERPRISE RISK MANAGEMENT PROCESS (10MARKS)

2.1) briefly explain the following six (6) process activities which need to take place in the risk evaluation stage (6)

BASIC CONCEPTS OF PROBABILITY

-It refers to the basic principles of probability, which can be used by a business to measure expected outcomes of mutually exclusive and non mutually exclusive events

SENSITIVITY ANALYSIS

-It is a method that can be used by a business to assess how sensitive the project outcomes are to changes in business. The method uses one variable and examines the effect of that specific variable on the project.

SCENARIO ANALYSIS

-It is a useful decision making method that focuses on the consequences of events that would have been ignored by the business because it was regarded as an event that has never happened or is unlikely to happen

SIMULATION

-It refers to a method that is used to analyse financial or time models, where the variables may be uncertain for example costs, duration, opportunities or risks.

-It can be used when a business has statical software or commercially available spread sheets

MONTE CARLO SIMULATION

-It is a method used by a business to evaluate the effect of uncertainty on a planned activity in a range of situations and uses or relies on the numbers to sample from a probability distributions.

LATIN HYPERCUBE SAMPLING

-It refers to a sampling method that is used to recreate the probability distributions that are specified by distribution functions accurately and is a more modern technology method.

2

2.2) Distinguish between key risk indicators and key performance indicators. Use examples to elucidate your answer (4 Marks)

KEY RISK INDICATORS (KRIs)

-It refers to captured information that makes a provision of useful views of underlying risk profiles at various levels to assist decision makers within a business.

-The following are seen as types of key risk indicators:

Inherent or exposure risk indicators

.Control risk indicators

.Composite indicators

.Model risk factors

.KEY PERFOMANCE INDICATORS (KPIs)

-It refers to high levels snapshots of the health and performance of a business based on specific predefined measures for example statistical information on the business

-The following are seen as key performance indicators such as GAAP or legal regulatory requirements:

.Profitability per business unit or product

.Exception reporting

.Employee performance such assets under management or profit per customer

.Competitiveness such as market share
.Cost management such as return on assets on IT or new delivering channel monitoring

.Credit management such as time to settlement or credit exposure

QUESTION 3-EXTERNAL INFLUENCES : MACRO FACTORS(6 MARKS)

3.1)Identify four(4) sources of risks embraced within economic risk (2 Marks)

-Fall in demand

-Government policies

-Movement in house prices

-Exchange Rates

-Inflation

3.2 Argue the importance of implementing economic risk management (4 MARKS)

-It provides an understanding of the impact of inflation and interest rates on demand

-Improves the knowledge of where the government is planning public spending

-Provides and understanding of how the short-term behaviour of Gross Domestic Product will have an impact on employment, prices and standard of living

-Promotes rigorous market research before entering new markets in both the domestic and international markets

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QUESTION B: ESSAY QUESTIONS

ANSWEE ALL QUESTIONS IN THE SPACES PROVIDED

QUESTION 1

1.1-increase in the likelihood of a business realising its objectives

-Build confidence in stakeholders and investment community

-Align risk appetite and strategy

-improve organisational resilience

-enhance corporate governance

-minimises operational surprises and losses

-optimise allocation of resources

-identify and manage cross enterprise risks

-link growth, risk and return

1.2 Corporate governance (board oversight)

-Corporate governance is the framework of rules and practices by which a board of directors ensures accountability, fairness and transparency in a company's relationship with all its

Stakeholders (financiers, customers, management, employees, government and the community

Corporate governance framework consists of the following:

-Explicit and implicit contracts between the company and the stakeholders for the distribution of roles and responsibilities, rights and rewards

-procedures for reconciling conflicting interests of stakeholders in accordance with their duties, privileges and roles

-Procedures for proper supervision, control and information flows to serve as a system of checks and balances

QUESTION 2:-ENTERPRISE RISK MANAGENT PROCESS (12MARKS)

RISK CHECKLISTS
-It is used to list all the risks that were identified on the previous project with in the business

GAP ANALYSIS

--It can be used to identify the main risk that are linked to a certain activity or project of the business

RISK TAXONOMY

-It refers to a structured checklist to breakdown the risks and opportunities into manageable components

PEST ANALYSIS

-The business can conduct this analysis in a workshop or brainstorming session. The business can also use the PEST analysis method in the identification stage to identify the risk exposure of the business to its external environment

SWOT ANALYSIS

-A swot analysis is a very easy and untestable method for a business to identify the risks and opportunities in the business

RISK QUESTIONNAIRE

-A Risk questionnaire is used when the business needs to establish the concerns and risks that arise in a business project/activity through various stages. The completion of a questionnaire will show how the business employees respond to the risk

2.2RISK APPETITE

-Risk appetite is referred to as risk attitude, tolerance, preference or capacity. A business risk appetite can vary according to its

objectives, culture, environment, perceived financial exposure to certain risks and risk attitudes(risk neutral, seeking and averse).It is very important for a business to determine its risk appetite/tolerance and inform its senior managers about the business risk culture

2.3 Monitoring is the collection of information on risks for later use. The monitoring process most identify the successes achieved in the planned responses to the risks and opportunities and be able to identify the changes in the business environment, which might lead to new emerging risks.

-The monitoring and review process implemented by the business can improve business knowledge on the lessons learned to improve the future of the enterprise risk management process

QUESTION 3 INTERNAI INFLUENCES: MICRO FACTORS

3.1-Monitoring predicted changes in interest rates

-The preparation of a cash budget plan to diminish the likelihood of threat of liquidity risk

-Securing credit insurance to cover non-payment of goods and services

-Carrying out comprehensive due diligence on counterparties whose default could seriously harm the business

-Carrying out a robust assessment of planned investments, using tried and tested techniques

-the development of a robust financial systems and internal controls

3.2 Ethical Risks refers to the exposure to events which may result in criminal prosecution, civil lawsuits or erosion of reputation

EXAMPLES OF ETHICAL RISK

-Bribery

-False accounting reporting

-child; labour

-money laundering and invasion of privacy

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SECTION A : MULTIPLE CHOICE QUESTIONS (40 MARKS)

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ENTERPRISE RISK MANAGEMENT

SECTION B: ESSAY QUESTIONS

ANSWER ALL QUESTIONS IN THE SPACES PROVIDED

QUESTION1 –ENTERPRISE RISK MANAGEMENT IN CONTEXT (10 MARKS)

MS Maria has just been appointed as the new CEO of Local Supermarket Ltd .She approaches you as the risk manager to gain a better understanding of the implementation of the risk management in the company

Briefly describe risk management and the seven (7) stages in the risk management process to Ms Mari Trevor to give her a better understanding of the implementation of risk management in Local Supermarket Ltd

STAGE 1(ESTABLISHING THE CONTEXT)

-it forms the foundation for all the stages of the ERM process. Establishing the context deals with the business as whole as well as the business activities, processes and projects. This stage is used to acquire accurate data and information about the whole business.

STAGE 2(RISK IDENTIFICATION)

-It is a crucial step in the ERM process. It is important to be able to identify the risks in the business and understand how they fit into the overall business context. Through risk identification, the business will be able to identify the key risks and risk events associated with the business. The business will constantly change and grow as well as the risks associated with the business. The business will need to identify risks on a constant basis and identify the opportunities that may arise in order to enhance its objectives as well as risks that may reduce the likelihood of the business achieving its objectives.

STAGE 3: RISK ANALYSIS

-This stage provide information on the likelihood of risks and opportunities occurring and the impact of them to aid in the decision making process. The risk analysis process will assess all the risk identified in the risk register.

STAGE 4: RISK EVALUATION

-This stage will evaluate the results obtained in the risk analysis stage. It focuses on both the risk exposure and opportunity that may arise from a business activity. All the information gathered in the risk analysis process is integrated into the risk evaluation process.

-The risk evaluation stage evaluates the financial impact (loss or gain) of a risk in a business in numerical terms.

-It is essential as it assists the business to understand the combined effect of a group of risks and opportunities. Risk evaluation is the only option available to the business for assessing the organisations exposure to risks and opportunities and it must be implemented properly

STAGE 5: RISK TREATMENT

-The risk treatment stage will assist the business to design a specific action plan and produce strategic responses to address the risk and opportunities identified in the business to secure business objectives. This stage is vital in the risk management process because the risk strategy responses and action plans must be prepared and implemented effectively into the business

STAGE 6: MONITORING AND REVIEW

-The monitoring and review stage is a key stage in the ERM Process. It may become necessary for a business to review all the previous stages in the risk management process because new information became available or circumstances changed in the business. The monitoring and review stage must be carried out in order to increase the success of the implementation of an entire ERM process.

STAGE 7: COMMUNICATION AND CONSULTATION

-The risk communication and consultation stage will be used across all other ERM process stages. It is essential for a business to understand how effectively the process outputs of each stage is communicated and understood by decision makers. Risk communication and consultation form a link with all the other stages in the ERM process. The business risk management process must be effectively communicated to all levels of employees in the business.

-This step is vitally important because every employee may be involved in an activity that might have a direct impact on the Erm process and if the employee does not understand the risk management culture in which the business functions it can have disastrous consequences

-All stages are interrelated and must be implemented effectively and communicated in the business so as to manage risks and opportunities

QUESTION2-ENTERPRISE RISK MANAGEMENT PROCESS
(14 MARKS)

2.1 Identify and describe four (4) process activities for risk analysis which can be used by a business in the ERM analysis stage
(8MARKS)

CASUAL ANALYSIS

It is used to identify the causes of any risk. it is important for the business to learn from the past events so as to implement risk management measures for future events

DECISION ANALYSIS AND INFLUENCE DIAGRAMS

-Decision analysis is used to structure decisions, uncertain/chance events and values of outcomes.

-The Influence diagram can be used to assist in the development and understanding of risks and the actions to be taken in the decision making process.

PARETO ANALYSIS

-Pareto analysis is used to identify those risks that will have a dramatic impact on business projects/activities and objectives

CAPITAL ASSET PRICING MODEL (CAPM) ANALYSIS

This model is used to determine the expected return of an asset in relation to its risk or profile

2.2. Identify and distinguish between the three (3) main attitudes towards risk (6MARKS)

RISK NEUTRAL
-The attitude towards risk that requires no changes in the risk/reward balance return for an increase in risk.

RISK AVERSE

-The attitude towards risk that requires an increase in return for an increase in the risk

RISK SEEKING

-The attitude towards risk where by a decreased return would be accepted for an increase in risk

QUESTION 3-INTERNAL INFLUENCES: MICRO FACTORS
(6MARKS)

Define and explain the importance of operational risk

-Operational risk is the exposure of an enterprise to losses resulting from people, processes, systems and external events.

-It is present in all organisations and can affect a firms solvency, fair treatment of its clients and the incidence of financial crime

IMPORTANCE OF OPERATIONAL RISKS

-Minimises day –to-day losses

-Improving ability to achieve business objectives

-Providing a more robust enterprise risk management system

MAY/JUNE 2015

SECTION A: MULTIPLE CHOICE QUESTIONS (40 MARKS)

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SECTION B: ESSAY QUESTIONS

ANSWER ALL THE QUESTIONS IN THE SPACES PROVIDED

QUESTION1-CORPORATE GOVERNANCE
(10MARKS)

Mr Simon Nkosi has just been appointed as the new CEO of CALL 4 U LTD. He approaches you as the risk mange to gain a better understanding of the implementation of corporate governance within the company. Compile and highlight the impact of corporate governance on a business.

Corporate governance adds value to an enterprise in the following manner:

EMPLOYING ASSETS EFFICIENTLY

-Effective corporate governance promotes the efficient use of resources within a firm and the economy at large.

-It should make it possible to replace managers who do not put scarce resources to efficient use or who are incompetent in what they do

-When an efficient governance system is in place, debt, equity and capital flow to enterprises that are capable of investing those resources efficiently in order to produce goods and services

ATTRACTING LOWERCOST OF CAPITAL

-Effective governance helps enterprises to attract lower cost of capital by improving the confidence of domestic and international investors and by assuring them that the assets are used in the form agreed upon, whether investment is in the form of equity or debt. This appositive impact on both debt and equity. For enterprises to succeed in competitive markets, corporate managers must innovate relentlessly and efficiently and constantly evolve new strategies to meet changing circumstances

MEETING SOCIAL OBLIGATIONS: COMPLYING WITH LAWS AND REGULATIONS

-To succeed in the long term, enterprises must comply with laws, regulations and expectations of the societies in which they operate. Most corporations take their corporate citizens seriously. They contribute to civil societies needs while some are opportunistic and have no regard for social or environmental issues. Good corporate governance is essential to ensure adherence to legislation as well as corporate social responsibility principles.

OVERALL PERFOMANCE

-If corporate governance is effective, it gives managers a holistic view of the organisation and holds mangers and the board accountable for the management of corporate assets. Such accountability contributes to the efficient use of resources, attraction of lower-cost capital and an increase in the responsiveness of the enterprise society and will therefore lead to an improvement of corporate performance. Effective corporate governance may not guarantee improved corporate performance at the individual firm level, but it should increase the likelihood of managers focusing on improving the performance of enterprises and their being replaced when they fail to do so.

QUESTION 2: ERM PROCESS
(12MARKS)

2.1 Identify and discuss the three (3) process activities which need to take place in the monitoring and review stage to ensure it is managed proactively (3MARKS)

EXECUTING

-All actions planned in the risk treatment stage to respond to risks and opportunities must be effectively implemented

MONITORING

-Monitoring involves the collection of information on the risks for later use. The monitoring process must identify the successes achieved in the planned responses to the risks and opportunities and be able to identify the changes in the business environment, which might lead to new emerging risks.

CONTROLLING

-The controlling process is based on the information gathered in the monitoring process to form decision making. It means the business must understand who needs what information for what purpose and when.

-controls must be a principle of the economy
2.2 Briefly explain the following three process mechanisms in the risk evaluation stage (6 MARKS)

PROBABILITY TREES

-A Probability tree is a method used by a business to ensure that all possible outcomes of a risk event have been taken into account

EXPECTED MONETARY VALUE (EMV)

-It involves the decision outcome of an event that can have more than one out comes

-The theory requires that probabilities and outcomes be determined

DECISION TREE

-A decision tree is used to illustrate problems graphically. A decision tree consists of different decision nodes, with interconnected branches, which represent the different alternatives for a particular decision

QUESTION3; INTERNAL INFLUENCES: MICRO FACTORS

Identify and define the three (3) main risk components of credit risk (3MARKS)

DEFAULT RISK

-It refers to the probability of an event of default

EXPOSURE RISK

-It relates to the uncertainty surrounding the payment of future amounts

RECOVERY RISK

-Relets to the uncertainty over the likely recovery

QUESTION 4-EXTERNAL INFLUENCES: MACRO FACTORS

(5 MARKS)

Define the term environmental sustainability and identify 94) environmental risk for a business

Environmental sustainability is the maintenance of the factors and practices that contribute to the quality of the environment on a long-term basis
ENVIRONMENTAL RISKS

-Pollution of land, water, air

-Increased regulation and higher operational costs

-prosecution arising from lack of observance of rules set by a regulatory body

-Reputational risk from adverse publicity as a result of pollution events, resulting in a reduced customer base

-Destruction of facilities or loss of manufacturing as a result of severe weather conditions

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SECTION B; ESSAY QUESTIONS

MAY/JUNE 2014

ENTERPRISE RISK MANAGEMENT IN CONTEXT (10MARKS)

ENTERPRISE RISK MANAGEMENT FRAMEWORK

-The risk management framework is a basic conceptual structure used to address the risks they faced by a business organisation. The purpose of the risk management framework is to assist an organisation in integrating risk into its management process so that it becomes a routine activity. The framework consists of the following 5 steps that is

.Mandate and commitment

.Design framework

.Implement framework

.Monitor framework

.Improve framework

RISK MANAGEMENT POLICY

-A Risk management policy sets out how the risks which have been identified by the risk assessment procedure will be managed and controlled. The risk management policy assigns responsibility for performing key tasks, establishes accountability with appropriate nagers , defines boundaries and limits and formalises reporting structures. The policy should address specific responsibilities to the board, internal audit, external audit, the risk committee, the corporate governance committee, the central risk function, employees and third party contractors in implementing risk management

RISK MANAGEMENT PROCESSES

-A Risk management process is the one that systematically applies management policies, procedures and practices to asset of activities intended to establish the context, communicate and consult with stakeholders and to identify, analyse, evaluate, treat, monitor and review the risk
-All processes are repeated through the organisation up to the implementation of the risk response actions.

QUESTION 2-ENTERPRISE RISK MANAGEMENT PROCESS
(14MARKS)

2.1 RISK REDUCTION

-Risk reduction can also be referred to as the treatment or mitigation. Risk reduction can be seen as risk diversification (reduction of risks by distribution) for example, where a business invests in multiple stocks to reduce risk and the impact of the risk

-Two approaches to reduce risk can be followed namely:

-reducing the likelihood of a risk occurring

-limiting the loss should the risk materialise

RISK REMOVAL

-Risk removal can also be referred to as the avoidance, elimination, exclusion and termination. Risk removal is used to eliminate a risk when a negative outcome/impact or high-risk exposure is anticipated. For example doing business with a political uncertain country may be too risky to make the opportunity worthwhile (a potential for loss has been eliminated)

RISKTRANSFER OR RISK ASSIGNMENT

-Risk transfer is a strategy used to transfer risk to another entity, business or organisation. Businesses can use contracts and financial agreements to transfer risk to a third party. Transferring a risk does not reduce its likely severity, it just moves it to another entity. In some instances risk transfer can increase the impact of the risk, as the party the risk is transferred is unaware that it is required to absorb it. The most common method of risk transfer is insurance. For example the financial consequences of a loss is transferred to an insurance company

RISK RETENTION

-Risk retention is also referred to as acceptance, absorption or tolerance. A business may be forced in a position to accept the risk as an alternative method, for example risk removal, reduction, and transfer are not available or it may be more economical for a business to accept the risk. When following a risk retention strategy the options available, timing and the ability to absorb the risk must be considered

2.2 KEY RISK INDICATORS (KRIs)

-Key Risk indicators refers to captured information that provides useful views of the underlying risk profiles at various levels to assist decision makers within a business. The following are seen as KRI types

-Inherent or exposure risk indicators

--Control risk indicators

-Composite indicators

-Model risk indicators

KEY PERFOMANCE INDICATORS

-Key Performance indicators refers to high levels snapshots of the health and performance of a business based on specific predefined measures for example statistical information on the business. The following are seen as Key Performance Types

-Exception reporting

-Competitiveness such as market share

-Cost management, such as return on assets (ROA) on IT or new delivering channel monitoring

-Credit management, such as time to settlement or credit exposure

-Profitability per business unit/ product/customer

3 –lack of risk maturity model

-lack of change process to introduce discipline

-no definition of roles and responsibilities

-lack of risk management awareness training programme to build core competencies

-lack of alignment between the business strategy, business model, and the risk management objectives

-lack of integration of risk management activities into day to day activities of project managers

-no clear demonstration of how risk management adds value and contributes to project performance

-Lack of clearly defined and disseminated risk management objectives