



Fiscal First Aid Quick Reference

Investigate Risk Management

By Sofia Anastopolous, Vice President, Client Service, Chandler Asset Management; Kent Austin, Finance Director, City of University Park, Texas; and Bob Eiche, Director of Finance, Boulder, Colorado

Introduction

Revisiting a government's risk management practices can be an effective fiscal first aid tactic. Risk is the probability that a threat or vulnerability will cause harm or damage to the government. Risk and dealing with risk can be a significant source of expenditure, not the least of which is preventative actions and insurance premiums, on the one hand, and claims settlement and recovery/rebuild expenditures, on the other. Getting a solid understanding of a government's risk, risk tolerance, and risk management program can help avoid preventable expenses and contain the consequences of those risks.

A solid understanding of the potential risks can help protect the government's property, services, reputation, financial resources, and employees. Not only does this ensure the continuity of government operations, but it also minimizes resulting expenses and helps avoid financial turmoil.

Steps to Take

The following steps should be part of a government's investigation of its risk management practices:

I. Gain an understanding of the situation

- A. **Identify risk.** Risk identification should identify exposure in each of the following areas:
 1. **Physical environment.** Potential natural disasters, man-made disasters, infrastructure failures.
 2. **Legal environment.** Laws and legal precedents.
 3. **Operational environment.** Day-to-day activities, services provided, workforce demographics
 4. **Political environment.** Legislative activities; elections
 5. **Social environment and the socio-economic composition of the community.**
 6. **Economic environment.** Market trends and interest rates.
 7. **Internal environment.** The attitude of individuals toward risk, and their risk tolerance.
- B. **Evaluate risk.** The frequency and severity of claims should be monitored and modifications made as needed. Risk evaluation reports often include the number of open claims, the amount paid out, and the amount reserved.



Fiscal First Aid Quick Reference

Investigate Risk Management

- II. **Treat Risk.** After identifying and evaluating risk exposures, the next step is to decide how to best treat or deal with the exposures. A well-rounded combination of preventative and control measures, risk transfer, and risk retention constitutes an effective fiscal first aid tactic.
- A. **Prevent or control risk.** Safety training, workshops, and inspections are common loss control measures.
 - B. **Avoid or mitigate risk.** Examples include improving safety practices as one way to reduce workers' compensation, or wellness programs to help reduce benefit costs or workers' compensation claims.
 - C. **Eliminate risk.** Governments decide not to provide specific services if the risk management costs are excessive. Stop activities that have a high cost of risk (whether in claims or insurance premiums) and stop offering services that require costly risk reduction expenditures (e.g., water parks or toboggan slides for a park district).
 - D. **Transfer risk.** There are two basic types of risk transfer.
 - 1. Financial risk transfer might involve using an insurance company or risk managements pools. As a fiscal first aid technique, the government may reexamine its insurance provider and consider rebidding. The criteria for procuring insurance should involve quality of service, scope of service, breadth of coverage (level of deductibles), financial stability of the insurer, and cost.
 - 2. The government might transfer risk to contractors more aggressively by assigning them a greater portion of the liability for services performed.
 - E. **Risk retention.** When a government retains risk, it assumes financial responsibility for some losses. Paying a higher deductible is a form of risk retention that can lower the government's premiums.

Self-insurance is another form of risk retention, and it is important to fully understand how much risk the government can bear in this area. Determining the amount that should be kept in the self-insurance account or fund is extremely important. If too much is kept in the account, it ties up resources the entity could use for other purposes. If the amount is not enough, departments or funds can be exposed to unexpected contributions at inopportune times. A best practice is to use an actuarial study to determine the appropriate balance.

Evaluating Success

Strive for the following benefits:

- Reduced injuries and accidents can produce both short and long-term benefits, such as reduced claims and reduced overtime (for shift coverage), including the reduction of the workers' compensation modifier. Aggressive management of



Fiscal First Aid Quick Reference

Investigate Risk Management

- claims, both internal and external, through investigation challenge, negotiation, and mitigation can reduce future claims and reduce payments for current claims.
- Improving risk management can provide the opportunity to have employees positively involved in combating fiscal stress by creating a safer work environment. Employees can be engaged through training, safety committees, and rewards for reduced incidents.
 - Strategies like reexamining insurance coverage or risk retention can reduce insurance premiums.
 - Reduce actual losses through more systematic inspections and training.
 - Create a “good risk culture,” in which people will do the right things even when risk policies and controls are not in place.
 - Adequate funding of outstanding liabilities (reserves).
 - Adequate insurance coverage to address property, liability, and workers’ compensation exposures. A large loss could cause havoc in financially distressed organization if the risk is not properly covered.

References

- GFOA Best Practice: *Creating a Comprehensive Risk Management Program* (2009)
- GFOA Best Practice: *Business Preparedness and Continuity Guidelines* (2005 and 2008)
- *Elected Officials Guide: Risk Management*, GFOA, 2001
- *Enterprise Risk Management-Integrated Framework*, The Committee of Sponsoring Organizations of the Treadway Commission, September 2004 (<http://www.coso.org/>).
- Association of Government Risk Pools (AGRiP) (<http://www.agrip.org/homepage/>).
- Public Risk Management Association (PRIMA) (<http://www.primacentral.org/>).