

FINANCIAL MANAGEMENT FOR GEORGIA LOCAL UNITS OF ADMINISTRATION

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NATURE AND PURPOSE

Risk management is the process of managing a local unit of administration's (LUA) activities to minimize the adverse affects of accidental losses. In other words, risk management is the process of identifying and controlling risks of all kinds. Effective risk management is essential for LUAs, especially as third party insurance premiums continue to rise or are not available to certain LUAs.

Risk management normally is concerned with potential losses arising from the following:

- Torts
- Theft of, damage to, or destruction of assets
- Business interruption
- Errors and omissions
- Injuries to employees
- Acts of God

The two primary elements of risk management are risk control and risk financing. Risk control techniques are used to minimize the accidental losses that strike an LUA. Risk financing techniques are used to obtain resources to restore the economic damages resulting from those losses.

Because the topic is so broad, this chapter is not intended to be all-encompassing about risk management. This chapter provides an overview of risk management as it applies to LUAs with particular emphasis on risk financing. Risk control is reviewed briefly also. Finally this chapter includes an overview of the risk management pool available through the Georgia School Board Association (GSBA).

IDENTIFYING THE TYPES OF RISKS

Generally there are four basic types of risks that an LUA should identify. Loss can occur as a result of:

- **Damage to property (e.g., schools, buses)**
- **Loss of property (e.g., money, equipment)**
- **Loss of revenue or increased costs because of damage to or loss of property (e.g., a river floods a school food service lunchroom and meals cannot be served)**
- **Liability to others as a result of injury to persons or property (e.g., a teachers falls down slippery steps in a school building)**

Damage to Property

Accidental loss or damage can occur with both real and personal property. Real property can include school buildings, bus garages, athletic stadiums and boilers. Personal property can include motorized equipment such as buses or maintenance trucks, desks, chairs, computers and tools. Loss may result from carelessness, natural causes, faulty equipment or fire.

Loss of Property

Cash is a primary target for loss, either from dishonest employees or the general public. Burglary, robbery and embezzlement are examples. In addition, various types of equipment may be stolen.

Loss of Revenue or Increased Costs

This element is not as common in LUAs since most LUA activities are not revenue generating, other than the school lunchrooms and athletic stadiums. If these facilities are damaged or destroyed, there could be a significant loss of income.

Liability to Others

Normally, this type of liability is likely to have the most serious loss exposure. Unfortunately, school violence can cause harm or injury to LUA employees. There seems to be numerous workers compensation claims in LUAs. A private citizen or business may claim a loss due to actions by the LUA. These losses can arise from wrongful acts (i.e., known as torts) or from contractual liabilities. For example, wrongful acts can occur as a result of:

- Harmful actions of LUA employees or school board members (e.g., auto accidents, libel and unintentional discrimination,
- Faulty public facilities (e.g., broken bleachers, cracked concrete steps),
- Faulty products provided to the students or public (e.g., serving spoiled food in a school lunchroom).

METHODS TO IDENTIFY RISKS

There are four principal approaches to identify risks:

- Analyzing selected documents
- Inspecting premises and operations
- Using risk recovery questionnaires
- Analyzing operational flow charts

Analyzing Selected Documents

Though it is not feasible to review all LUA documents, some of the more important documents should be reviewed to determine potential risks. These records might include personnel policies, contracts and leases and operating policy and procedures manuals.

Inspecting Premises and Operations

A physical inspection of all LUA premises is a "must" to reveal risks. Property inspections need to be conducted periodically. School building principals and custodians can assist with this task. Fire marshals and boiler inspectors normally conduct regular inspections.

Using Risk Recovery Questionnaires

A risk recovery questionnaire is a listing of major types of possible losses. This questionnaire should be used in conjunction with the other three alternatives included here. The questionnaire could include:

- **The relative severity of possible risks**
- **General information including the locations of buildings and land**
- **Information about the financial management procedures and records used**
- **A detailed description of each building and its contents (i.e., is there an adequate capital asset inventory?)**
- **A description of each vehicle**
- **Plate glass exposures**
- **Elevators in operations**
- **A boiler and machinery analysis**
- **A section on crime risks (e.g., internal controls), safety measures, and fidelity schedules**
- **Claims and loss analysis records for the past few years**
- **Transportation and employee benefit schedules**

Analyzing Operational Flow Charts

The last alternative is less common than the three previously discussed. If an LUA has developed flow charts for its various operations (e.g., an accounting policy and procedures handbook), these flow charts can be reviewed to identify any potential risks in the LUA processes.

CONTROLLING RISKS

When controlling risks, an LUA should decide if the risk can be:

- **Eliminated entirely**
- **Reduced to an insignificant cost**
- **Assumed partially or in total by the LUA**
- **Transferred to insurers through risk assumption agreements**

First the risk should be evaluated to determine the potential frequency and severity. The frequency of risk is as it relates to the number of losses. Severity of loss refers to the cost or size of losses.

Obviously, the highly severe risks should be emphasized. The LUA needs to consider whether the risk can be eliminated entirely by changing methods or equipment or by ceasing performance of a particular service. If elimination is not an option, an effort should be made to reduce the risk so that it becomes insignificant. For example, a surety bond might be obtained for an amount that statistically reduces the potential amount of theft to an amount that is insignificant.

If risks are not severe but are highly frequent, they may be assumed (i.e. an amount set aside in the budget) since they are predictable and the total amount of loss will be fairly certain. A risk which does not occur very often and results only in a small loss also can be assumed. However, the infrequent type of loss which can be very severe should be transferred by buying insurance or through risk assumption agreements. This transfer is needed because such risks are impossible to predict with accuracy but can cause severe economic loss.

RISK ASSUMPTION

As indicated above, an LUA should not want to assume a great risk without proper financing. LUAs need to understand which risks they are assuming. Unexpected assumptions might include a situation where property insurance policies are written on an actual cash value basis which is current replacement cost less depreciation. In other words, the LUA would be assuming the risk for the amount of depreciation on the asset. In addition, understanding coinsurance clauses and identifying risks is an important part of risk assumption.

Planned assumptions are those risks which the LUA knows it is taking on. One extreme is to insure everything and another extreme is not to insure anything. Obviously, neither of

these extremes is practical. A balance between these two extremes is desirable. The key advantage to assuming rather than insuring a risk is that planned assumption is more economical. Careful attention must be given to the amount of risk that may be assumed compared to the size of premium to insure the risk.

RISK TRANSFER

Transferring risk is the last step in controlling risk. Transferring may be done by use of pooling, hold harmless agreements or third party insurance.

Pooling

Pooling risk provides an alternative to traditional insurance programs for treatment of property, liability and workers' compensation risks. It eliminates duplication of effort and inefficiency that drives up costs. It also expands coverage, promotes stability and focuses attention on risk improvement and accident prevention. The Georgia School Boards Association Risk Management Fund (GSBA RMF) offers this type of coverage.

Established under O.C.G.A. 20-2-2002, the GSBA RMF is an interlocal risk management agency that allows members to do the following - .

- (1) Pool its general liability risks in whole or in part with those of other boards of education.
- (2) Pool its motor vehicle liability risks in whole or in part with those of other boards of education.
- (3) Pool its property damage risks in whole or in part with those of other boards of education; or
- (4) Jointly purchase general liability, motor vehicle liability, or property damage insurance with other boards of education participating in and belonging to the interlocal risk management agency, the participating boards of education to be coinsured under a master policy or policies with the total premium apportioned among such participants."

Overview of Bylaws. By-laws set forth the governance structure of GSBA RMF and define the responsibilities of the Board of Trustees. The Board of Trustees must approve all applications for membership. Once approved, the LUA's initial contribution will be determined by the Board of Trustees in accordance with State law and regulations of the

Insurance Commissioner. Annually premiums are determined by the Board based on regulations of the Insurance Commissioner and premiums approved by the Insurance Commissioner. The Board may decide to pay dividends in the event of a surplus providing the stability of the GSBA RMF is not impaired. The fiscal year of the GSBA RMF is July 1 – June 30.

Membership in the GSBA RMF (the Fund) may be terminated for the following reasons –

- **Failure to timely meet its financial obligations to the Fund;**
- **Failure to comply with loss control and other recommendations of the Fund or its representatives or agents;**
- **Excessive losses; or**
- **Failure to discharge its obligations to the Fund as set forth in the bylaws,**

For more information visit www.gsba.com.

Hold Harmless Agreements

In some contracts, an LUA may transfer the risk to the other party by including a "hold harmless" agreement which indicates that the other party will hold the LUA harmless in certain situations. Obviously, if the other party cannot make financial restitution, the agreement is not very valuable. Many LUAs include insurance and "hold harmless" agreements in bid documents for school construction documents. In addition, these requirements could be included in service contracts such as food service, maintenance, transportation and any other circumstance where an LUA hires an outside service contractor.

"Hold harmless" agreements should be reviewed by the LUA's legal counsel.

Purchasing Insurance

The most common form of transferring risk is that of purchasing insurance from a third party. In purchasing insurance, LUAs need to have the following:

A clear plan for how much and what types of insurance to buy.

- **Professional advice**
- **Understanding of the principal methods of placing insurance and the advantages and disadvantages of each.**

- **Knowledge of the various criteria for evaluating the performance of insurance companies**
- **Knowledge of types of insurance policies available**
- **Proper recording and filing of purchased insurance policies**

Unfortunately or fortunately, depending upon perception, there is a variety of insurance coverage available to LUAs including:

- **Property**
- **General liability**
- **Errors and omissions**
- **Workers compensation**
- **Student athletic**
- **Student professional**
- **Boiler & machinery**
- **Automobile**
- **Environmental impairment**

Unless the LUA official is knowledgeable in risk management, acquiring professional advice is recommended strongly.

SUMMARY

- 1. Risk management is the process of managing a local unit of administration's (LUA) activities to minimize the adverse affects of accidental losses.**
- 2. The two primary elements of risk management are risk control and risk financing.**
- 3. There are four basic types of risks damage to property; loss of property (e.g., money, equipment), loss of revenue or increased costs because of damage to or loss of property, and liability to others as a result of injury to persons or property.**
- 4. There are four principal approaches to identify risks - analyzing selected documents, inspecting premises and operations, using risk recovery questionnaires, and analyzing operational flow charts**
- 5. When controlling risks, an LUA should decide if the risk can be eliminated entirely, reduced to an insignificant cost, assumed partially or in total by the LUA, or transferred to insurers through risk assumption agreements.**
- 6. An LUA should not want to assume a great risk without proper financing.**
- 7. Transferring risk may be done by use of pooling, hold harmless agreements or third party insurance.**